Investor expectations from the Budget

It will be a litmus test for the government's reform credentials

Akash Prakash **January 21, 2020** Last Updated at 00:14 IST

On February 1, Finance Minister Nirmala Sitharaman will present in Parliament what will arguably be the most important Budget this government has formulated to date. Investors will go through the document and the Budget speech with a fine-tooth comb, looking for any indication on how the government will tackle the slowdown and the path forward. Investors are keen to see a coherent economic game plan.

There is consensus among global investors that the time has come for a serious push to improve the business climate. If we do not see major reform steps to boost the economy now, given the economic weakness and the majority this government enjoys, there is little chance anything significant will happen later. For investors, this Budget will be a litmus test for judging the reform credentials of the government.

A few things are clear. We will have a significant fiscal slippage. Most investors expect a revised fiscal deficit of 3.7-3.8 per cent of GDP, compared with the targeted 3.3 per cent. We have a slippage of 11 basis points, 3.3 per cent to 3.41 per cent, simply due to a lower nominal GDP. An additional 30 or 40 basis points of fiscal slippage over that will be acceptable to most, given the weakness in the economy and the need to maintain government spending in the absence of a revival in either consumption or exports.

Investors would like to see this fiscal space be used for capital expenditure. For the following year, though, they do expect efforts to get the fisc back on track, and a target of 3.3- 3.5 per cent of GDP for 2021 seems realistic. No one expects the 3 per cent fiscal target to be hit anytime soon.

Given the lack of space on the fiscal front and constraints on monetary policy, now is the time for genuine reforms. The finance minister would be well advised to go sector by sector and try to implement the policy changes needed to boost investment and exports, with the hope that consumption will follow. Here’s what investors are hoping for from the Budget.

For global investors, one important step would be the scrapping of the long-term capital gains (LTCG) tax on equities. LTCG tax has not yielded much revenue and administratively makes life complicated for global funds. Many of the truly long-term investors (the endowments, sovereign wealth and foundations) pay no tax in their home jurisdictions and consider India an outlier in levying capital gains taxes on them.

It would not be feasible to totally scrap capital gains taxes but at least long-term capital gains may be exempted. This would raise the expected post-tax returns of investing in Indian financial markets, and lower the cost of capital for companies. This move for equities can be easily funded

by marginally raising the securities transaction tax. This step, while not costing the fisc much, would boost risk appetite, encourage the financialisation of savings and send a positive signal to global capital providers.

Another step in the Budget must be to provide funding to implement a scrappage scheme for old vehicles. Any commercial vehicle over 15 years old must be scrapped, and incentives provided to do so. This will not cost the exchequer more than Rs 10,000-Rs 15,000 crore, but provide a huge boost for the auto industry. It will dramatically lower pollution and vastly improve fuel efficiency of the commercial fleet. This is a win- win for everyone.

Illustration: Ajay Mohanty

The auto industry is a big employer with a significant multiplier for the economy, but it is currently doing poorly. Cash for clunkers schemes have been implemented across the world, especially during the time of the financial crisis. They have been proven to work. There is no reason why India cannot go down this path. The only constraint is money. Whatever fiscal leeway is available must be used to implement schemes like this.

Another area where we should see government action is start-ups. We now have a robust start-up ecosystem, with money available across the maturity spectrum of companies. From angel rounds to series D, E and F, money is available. While the government has done a lot to encourage start-ups, clearly recognising their importance, more can be done. They should be allowed to carry forward losses for 15 years, rather than the eight years permitted today. The median start-up today will remain a private company for 12 years (US data), compared with six or seven years earlier. They will also most likely lose more money, for longer than in the past, before turning profitable. Extending their period of carry forward losses, improves their cash flows and net margins when

they finally turn the tide on profitability. A case can also be made to tax employee stock options on sales, rather than on exercise. This will make options more attractive for employees and ease their cash flow burden. A final point would be to exempt the start-ups from provisions of Article 42 of the companies Act, wherein under certain conditions, these start-ups can be considered as public companies.

Exports have been a big disappointment over the past few years. Till such time as domestic demand recovers, exports would be a good way to tap into global demand. Higher utilisation will eventually trigger an investment cycle. A comprehensive package of incentives and policies to improve export competitiveness must be announced.

For the telecom and power sectors, we need industry specific interventions. On telecom, the government has to find a middle path and provide some relief to the beleaguered industry from the whole adjusted gross revenue fiasco. We cannot have only two private players surviving.

On power, the state electricity boards (SEBs) remain bankrupt. The UDAY scheme has not worked. Why will anyone invest in a sector where your principal counterparty is bankrupt? The SEB debt to private power players has once again ballooned to Rs 46,000 crore.

When it comes to direct taxes, many expect that we will see significant cuts in rates. Realistically, the best we can hope, though, is some rationalisation in the exemptions, simplification and a marginal rebalancing of the slabs/ rates.

The disinvestment targets for 2020 will be missed but 2021 should be a big year as the Bharat Petroleum Corporation, Container Corporation of India and Air India transactions will get completed. The government must sell its stakes in Tata Communications and Hindustan Zinc, and other such residual holdings and monetise whatever is possible. In both these companies, the government is not involved in day to day management, why keep the stakes?

The government must also go through the list of public sector units and see where value can be captured. NMDC is an obvious example. Another example of potential value unlocking is Hemisphere Properties. The land is worth thousands of crores and there has to be a way to monetise its value, rather than wait years to develop the asset. The big one, however, will be the Life Insurance Corporation of India (LIC). This is probably the most valuable wholly-owned asset of the government. Given that LIC has done a reasonable job handling private sector competition, there is significant value. Will the government list LIC? It cannot be a strategic sale, but a listing and gradual sell-down of stake while maintaining control.

There are many other sector-specific things which can be announced in the Budget. Real estate and the NBFC space are other areas of focus. This Budget needs to revive confidence in the Indian economy, and convince investors and India Inc that the economy and reforms are once again a top priority for this government.

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