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FM Nirmala Sitharaman's second Budget a missed opportunity

The government has wasted the chance to firmly establish its reform credentials

Akash Prakash February 01, 2020 Last Updated at 22:04 IST

In a normal year, the Budget just presented by the finance minister (FM), would have been accepted by the markets without too much fuss. Some good, some bad, but on the whole largely reasonable. However, given the expectations for something more radical, something truly reformist, it has disappointed market participants. We don't see any big new ideas. We still do not have a sense of the economic vision and game plan of this government. Do they understand why the economy has slowed, and what needs to be done to get things back on track? How do we improve ease of business on the ground? What is there in the Budget that will actually get the economy back on its feet?

We see nothing for sectors in deep trouble. No scrappage scheme, nothing for exports, only minor extensions of existing schemes to help the non-banking financial companies (NBFCs) and real estate sectors. These schemes have not worked so far, why will that change? Nothing to encourage the banks to lend rather than park money with the Reserve Bank of India, or help clear the "non-affordable housing" inventory. Surprisingly there has been no allocation of incremental capital for the public sector banks. The shrinkage in credit is probably the biggest drag on the economy.No mention of the chaos in the telecom sector, and a resolution plan, or steps to improve the viability of the power distribution sector. Nothing was also mentioned about simplifying the goods and services tax (GST), harmonising and lowering rates. I know it is a subject for the GST council, but the FM could at least have acknowledged the pain being felt by the informal sector and the difficulties in implementation. Will corporate confidence really improve after this? Will someone sitting on the sidelines green-light a new capital intensive project post this Budget?

There are some good steps in the Budget. The simplification and lowering of personal taxes is the most the FM could have realistically done. That will give a Rs 40,000-crore stimulus to consumption. She has partly addressed the issue startups have on taxation of employee stock ownership plans (ESOPs) and initial losses. The decision to list LIC is significant, as it may be the most valuable company in India on the basis of the valuation of listed private peers.

Bond markets have been opened up further with corporate bond limits raised to 15 per cent, and some government paper opened up entirely to non-resident capital. The extension of the concessional 5 per cent withholding tax for interest payments on debt gives certainty till 2023. Decriminalisation of civil offenses in the Companies Act and other statutes is a big positive, as is the attempt to implement a dispute resolution mechanism for direct taxes and hopefully the new tax charter.

Thankfully there was no movement on estate duty or wealth tax, which would have killed animal spirits entirely.

The fiscal deficit was as per most investors' expectations at 3.8 per cent and 3.5 per cent, no real surprise there. The Budget arithmetic seems mostly reasonable. Gross tax revenues are assumed to grow by 12 per cent, not entirely unreasonable if you agree with the assumption of 10 per cent nominal GDP growth and on a very weak base, though one can question assuming 14 per cent growth in income taxes following the Rs 40,000-crore tax cut. The real question is the Rs 2.1 trillion disinvestment receipts assumed. Obviously this assumes that divestment of Bharat Petroleum Corporation Limited, Concor and Air India happen in 2021 along with a listing of LIC. I am not sure LIC will be ready to list within the next 12 months. The level of disclosure and preparation involved is considerable. Any delay here can blow a hole in the Budget arithmetic.

The government also seems to have budgeted Rs 1.33 trillion in telecom receipts for financial year 2020-21. With the government having granted a two-year extension of deferred spectrum payments, this number implies that the Budget is building in Rs 1.1 trillion in upfront 5G spectrum payments and Adjusted Gross Revenue dues — this looks unlikely.

On the expenditure side, subsidies seem to be underfunded, especially food and fertiliser, and the outlay for defence seems to have no growth at all. Net market borrowings seem to be up by 15 per cent at almost Rs 5.5 trillion and will put pressure on bond markets, hence the move to allow greater foreign participation.

Investors are very disappointed with the lack of repeal of the long-term capital gains tax. This was a step which would have boosted sentiment and attracted long-term capital at very little cost to the government. Instead they have repealed the dividend distribution tax, which will help cash-rich and highly-profitable companies, which frankly need no help.

The tax burden will effectively increase for large investors in the markets, those who receive the bulk of the dividends. For these investors, equities have gone from once being the most attractive investment avenue, with no tax on dividends and capital gains, to being the least preferred asset class, with taxes on all gains and dividends.

This was the chance for the government to firmly establish their reform credentials for the second term. Economy is weak, they have a majority, they seem to be listening to industry, however they have not been bold enough. The economy will recover, it is cyclically depressed, and will revert to the mean. Unfortunately, our policymakers do not seem to be using the weakness to push ahead on next-generation reforms. We seem to be helping those sectors and companies that are in no need of support, and continuing to ignore the weak areas of the economy. Investors will be disappointed.

The writer is at Amansa Capital. Views are personal