Sunday Business Standard
Volume VIII Number 16
NEW DELHI | 29 JUNE 2014

A Budget for investment

CHANDRAJIT BANERJEE

While preparing our economic outlook at the beginning of the year, we had outlined three risks to a recovery in growth. A key risk at that point was a fractured outcome in the general elections. A welcome development over the last month has been the formation of a new government with a decisive mandate. As Finance Minister Arun Jaitley presents his maiden Budget in July, the other two risks will still be relevant. These are the possibility of a weak monsoon and a rise in international crude oil prices. The Budget must be fiscally conservative, as the government must be prepared for each of these contingencies.

That would leave little room for the stimulus measures that would normally be called for when the economy has been underperforming. Instead, some tough decisions need to be taken that will move the economy towards a virtuous cycle of growth. For example, the recurring possibility of a shortfall in the monsoon should lead to a rethink on our agricultural policies. A number of bottlenecks in the production, marketing and trade of agricultural commodities have led to persistently high food inflation. While policy interventions have been made to enhance food security, they have been a deterrent to higher investment and growth in agriculture.

Public expenditure needs to be reallocated from subsidies to productivity-enhancing investments to boost agricultural production. The foodgrain management system needs to become more efficient and the APMC Acts need to be modified to give farmers more freedom to sell directly to private buyers. Much of the policy action will need to be at the state level but the Budget speech would provide a great opportunity to initiate these changes. Similarly, the issue of ballooning fuel subsidies needs to be fixed once and for all, so that the possibility of rising oil prices does not lead to panic about India's twin deficits. One method could be to cap the subsidy at a level beyond which price increases will be passed on to the consumer.

The Budget should invite investors to set up manufacturing facilities on a large scale. Measures to improve the investment climate alone may not be adequate

So what's in it for industry? Traditionally, industry seeks lower tax rates or higher duties at Budget time. However, in recent years, what has become extremely important for industry is the creation of a facilitative climate for investment. This has several aspects, such as streamlining the complex compliance processes in starting a business, rationalisation of labour laws and bringing stability in tax policies.

CII has made several suggestions, some of which I will highlight here. First, a Task Force should be set up on simplification of administrative procedures in order to improve India's rank in the World Bank's Ease of Doing Business. Maximum use of e-governance should be made and the mandate should be to improve India's rank to at least 50 from the current level of 134. Second, a flexible exit policy should be adopted on the lines of the Chapter 11 bankruptcy procedure prevalent in the US.

One area where complex regulations are hurting industry is with regard to labour. Both Central and state governments have the power to enact and implement labour laws. Consequently, there is a multiplicity of inspections, of maintenance of returns, records and notices under various labour legislations, leading to a heavy compliance burden. Further, industry is unable to deploy manpower flexibly because of rigid provisions related to downsizing, closure and engagement of contract labour. An announcement in the Budget to initiate a process of labour law reforms would be welcome.

Industry is also urgently calling for stability in tax policies. At a time when the economy is struggling to regain its growth momentum and investment sentiment is weak, frequent and retrospective changes in tax laws, which are ambiguous and open to wide interpretation, should be avoided. CII has strongly advocated an amendment of the Income Tax Act which would promulgate the reversal of retrospective amendment and make all taxation prospective. Similarly, early implementation of the goods and services tax would bring about uniformity in the indirect tax regime. This would bring enormous benefit to industry, which currently faces a multitude of taxes, adding to the already high cost of production.

The Budget should also make a strong pitch to invite investors to set up manufacturing facilities on a mass scale. Measures to improve the investment climate alone may not be adequate for urgently attracting investment. It may be necessary to create a shelf of specific proposals and invite foreign capital to set up facilities to cater to global demand. The government would need to set up product-specific and country-specific manufacturing zones for export to the home country. The Budget could also set aside some funds for the creation of a national-level export promotion agency for intensive marketing overseas and assistance to domestic exporters in market development and information dissemination.

All this will be possible only if the Budget is able to draw up a credible road map for fiscal consolidation. Subsidies, which now account for 2.3 per cent of GDP, must be brought under control. A 20 per cent rationalisation of subsidy expenditure could result in savings to the tune of ₹50,000 crore (or 0.4 per cent of GDP). At the same time, the government should bite the bullet and clear all dues of oil and fertiliser companies. The current buoyancy in the stock market should be utilised to disinvest public sector undertakings (PSUs) aggressively while assets of sick PSUs should be monetised systematically. The government's spending mix should be altered to increase the share of capital spending, which has fallen to a low of just 12 per cent.

Expectations are riding high on the new government's maiden Budget. What makes the current situation challenging is the prolonged period of high inflation which is preventing the RBI from moving towards a more accommodative monetary stance. A tough balancing act is required to foster fiscal discipline and at the same time rekindle the investment cycle.

The writer is director general of the Confederation of Indian Industry