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Indian Budget 2020-21: A Push for Growth

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Summary

The recent Indian budget proposals seem to be a conscious effort by the Narendra Modi government to move towards a greater investment-friendly economy. Apart from a large outlay for health and infrastructure, the privatisation of public sector banks and greater fiscal transparency have been some of the highlights. However, it is not clear if these measures are enough to bring back the confidence among investors and result in growth.

The interesting part of the recent Indian budget announced on 1 February 2021 is the conscious effort to move towards a greater investment-friendly economy. Repeatedly, during the long budget speech in Parliament, Finance Minister Nirmala Sitharaman stressed on the need to rekindle the animal spirit and make investments, and that it was necessary for the government to take on the role of being the facilitator rather than the driver for growth.

This ideological shift, for indeed it is a significant one, must be seen in a historical perspective. The early reform initiative of 1991, in the wake of a severe economic crisis, did not last very long, primarily because the Congress party did not have its heart in it. There was a next brief spell, between 1996 and 1998, when a coalition government instantiated several reform measures. This was followed by a genuine spell of wide-ranging reforms during the Atal Bihari Vajpayee era between 2000 and 2003 when there were several market friendly initiatives.

The United Progressive Alliance government that followed under Prime Minister Manmohan Singh reverted to the traditional Congress policies of welfare and welfare-support programmes. Hence, there was little in terms of economic reforms between 2004 and 2014.

The Narendra Modi government that came into power in 2014, anchored in a nationalistic Hindutva agenda, wary of economic and market liberalisation, also leaned towards the same welfare policies, with very little to show in terms of economic liberalisation. There was emphasis on cleaning up bank and corporate balance sheets but those efforts were patchy. During the last few years, growth has suffered. Since 2016, there has been a steady decline in gross domestic product growth, and the government has been tardy in recognising the distress signals. The economic distress caused by the COVID-19 pandemic, the loss of jobs, high levels of internal migration and the slow pace of recovery have acted as warning signs. Finally, politics is about economics and there is a realisation that unless there is growth, there will be pressure on the record of performance.

There are reports of a huge overhang of liquidity in the markets, of monetary easing leading to exuberance in the financial markets, of asset values of the rich going up even more rapidly than before – all signals that the politics of the economy is in a shaky situation. Therefore, there is a conscious shift towards greater opening up.

The most important initiatives come from fiscal expansion, with a very large outlay for health and infrastructure, including railways and roads. There is also an attempt to create a development finance institution to lend to infrastructure, recapitalize banks, and for the first time, a commitment to privatising public sector banks. This has not been announced ever before. Relaxations in funding for startups as well as in limited liability partnership rules are meant to help new businesses.

Two problems had loomed large as holy cows: foreign direct investment in insurance and the privatisation of public sector banks. These announcements are certainly a great step forward. This is also the first time that a finance minister has said that public sector banks will be privatised. There is a symbolic value in breaking past these barriers in our minds.
The budget speech makes progress towards defining the concept of infrastructure development: the government as the developer which gets an asset up and running, and then sells it to private operating companies. In the logjam of institutional difficulties faced by an infrastructure developer in India, state organisations are the ones best placed to build new assets, after which capital can be recycled by selling these off to private operating firms which have access to the wholesale securities markets.

From 2007 onwards, fiscal transparency of the union government had become an embarrassment. Starting last year, there has been major progress in cleaning up this situation. It is quite remarkable to see the food subsidy being brought on budget.
The question is whether these efforts are adequate. The reason that private investments has been lagging is mainly due to the structure of the business environment. There is still a concern over the way in which the Indian government prioritises sectors, which poses a business risk. There is also concern over the arbitrary power caused by myriad regulations over private business, and the problem of resolving hard economic tangles.

In spite of the various budget measures, it is not clear if the budget will bring back the confidence in growth and investment that the government is seeking.

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