

ISAS Brief

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Union Budget 2024: The NDA's First Budget in its Third Term



Vinod Rai

Summary

The National Democratic Alliance government presented the first budget of its third term in July 2024. The budget did not contain any major policy initiatives heralding the long-term policy direction of the government. However, it did reveal the intent to follow a path of fiscal consolidation, boost infrastructure and incentivise formal employment in the private sector. It has also proposed the digitisation of land records in the rural areas.

The <u>first budget</u> of the Narendra Modi 3.0 government made two significant announcements. The first was the government's resolve to continue on the path of fiscal consolidation and limit the fiscal deficit to 4.9 per cent in Fiscal Year (FY) 2025 as opposed to the 5.1 per cent indicated in the interim budget. A lower fiscal deficit will provide flexibility to the government to chart an appropriate fiscal course that builds in higher capital spending.

The other announcement was that the government would initiate and incentivise reforms to improve the productivity of all factors of production, thereby facilitating markets and sectors to become more efficient. As a part of these reforms, the government plans to digitise land records and maps to help urban local bodies. For rural land, the government plans to assign unique identification numbers and establish a new land registry that will be linked to a farmer registry to help credit flow. Rural land-related actions will include the assignment of a unique land parcel identification number or *Bhu-Aadhaar* for all land parcels, digitisation of cadastral maps, the survey of map sub-divisions as per current ownership, the establishment of land registry and linking it to the farmer's registry.

In its previous two terms, the National Democratic Alliance (NDA) government had laid considerable emphasis on the development of rural and urban infrastructure. Continuing with this policy, the budget has earmarked ₹11.1 trillion (S\$178 billion) for capital expenditure (3.4 per cent of gross domestic product). Added to this is a provision of ₹1.5 trillion (S\$24.1 billion) for long-term interest-free loans to state governments. The budget also proposes to promote private sector investment through viability gap funding and to work out a market-based financing network. The idea is to kick start a collaborative effort by incentivising private investment to build infrastructure. It however needs to be emphasised that though the infrastructure push looks appealing and brings immense opportunities, it is fraught with challenges of managing fiscal prudence, project completion with deadlines and environmental concerns in relation to the development work. The government has to prioritise budgetary allocation on sustainable urban development, water conservation and green energy infrastructure.

Further, with a view to shifting focus from speculative trading to long-term investment, the budget proposes to increase the rates of securities transaction tax on the sale of an option in

securities from 0.0625 per cent to 0.1 per cent of the option premium and on the <u>sale of</u> <u>futures in securities</u> from 0.0125 per cent to 0.02 per cent of the price at which such futures are traded. Derivatives were originally designed as hedging instruments to help investors minimise potential losses by entering into contracts such as futures and options. They were introduced to protect the farmers from crop losses and were later extended to stocks, currencies, and bonds. However, derivatives are now widely used as speculative tools globally. Investors aim to generate substantial profits with a relatively small capital investment compared to stocks. This lower initial investment in futures and options has attracted young investors to trading. A dramatic increase in derivative trading volumes, which surged from two per cent in 2018 to 41 per cent in 2023, had led to the regulators expressing concern that the surge in trading is leading to speculative behaviour that could be detrimental to individual investors and the broader economy; hence, the increase in taxation.

The budget has also proposed a decrease in the long-term capital gains tax (LTCG) to 12.5 per cent from the existing rate of 20 per cent and the removal of indexation on all financial and non-financial assets. The short-term capital gains tax (STCG) has been hiked to 20 per cent from 15 per cent on certain financial assets. Widening the gap between the STCG and LTCG rates appears to be to provide a clear incentive for longer-term holdings. The removal of indexation, which adjusts the purchase price of an investment for inflation has, however, sparked a debate as it may be neutral or <u>marginally beneficial for investments</u> with holding periods over 10 years.

The government has been cognisant that one of the issues impacting the general election in 2024 was the relatively high rate of unemployment in the country. It has thus announced major employment-linked incentive schemes to boost employment. The thrust on employment includes the following schemes:

- Providing direct benefit transfer of one month's salary, up to a limit of ₹15,000 (S\$244), in three instalments to first-time employees registered in the employee provident fund organisation (EPFO).
- ii. Job creation in the manufacturing sector. Incentives will be directly provided to employees and employers based on their EPFO contributions during the first four years of employment.
- iii. Providing internship opportunities in 500 top companies to 10 million youths in five years.

Meanwhile, external and internal agencies have reposed confidence in India's healthy economic outlook. The International Monetary Fund has revised India's growth forecast from 6.8 per cent to seven per cent for FY25. The stock markets, which may be displaying some froth, have shown sound fundamentals and robust earnings. There has also been an uptick in domestic participation in Indian stock markets. The burgeoning middle class, with increased earnings, is venturing to invest more in financial assets and is moving towards domestic institutional agencies such as mutual funds, thereby increasing the assets under management, leading to an increase in demand for scrips.

The industry and the common citizen have welcomed the budget as it has also provided a minor relief by increasing the standard deduction from ₹50,000 (S\$803) to ₹75,000 (S\$1,204) in the new tax regime and introducing a tax slab of 20 per cent (as against 30 per cent earlier) for those earning between ₹1.2 million (S\$19,270) and ₹1.5 million (S\$24,090). With the NDA government returning to power, markets anticipate continuity and consistency in economic policies. The budget has yet to come up for detailed discussion in parliament.

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Mr Vinod Rai is a Distinguished Visiting Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute in the National University of Singapore (NUS). He is a former Comptroller and Auditor General of India. He can be contacted at <u>isasvr@nus.edu.sg</u>. The author bears full responsibility for the facts cited and opinions expressed in this paper.