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Press Release

Union Budget 2021:

Growth priority but medium-term strategy on fiscal recovery is critical

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The pandemic has called for a paradigm shift in our thinking. It has shaped our world views, compelling us to reassess our idea of the budget. In fact, this budget could be viewed as a major pivotal point in the Indian economy.

There are two primary objectives before the government at this stage. – **reignite the growth engine in the economy while committing itself to a medium-term fiscal consolidation path**.

The growth impetus should incentivise demand in the near term and ensure its sustainability over the medium to long term. Four elements must be activated to build economic vibrancy over the long term. **(i) Give infrastructure a significant push through public and private investments (ii) Facilitate large-scale private and foreign investments across industrial, services and agricultural sector (iii) Incentivise private consumption in the near term without significant compromises on tax revenues (iv) Step up allocation in health and education sectors.**

FY2021 has been an exceptional year not only for the domestic but also the global economy. The global GDP print is estimated to have contracted by 3.5% in CY20 owing to the pandemic. India's GDP contracted by 23.9% in Q1FY21. There is a larger consensus among economists that the annual GDP for FY21 will decline by 7%-8%, one of the weakest performances among the developing nations. The government must play a critical role in pulling the economy out of the trough.

The pandemic is showing signs of being less virulent. Gradual progress in the vaccination programme is fuelling hope for a better future. A sustainable economic revival will need a policy catalyst. That's where this budget assumes a special relevance.

Accelerate National Infrastructure Pipeline (NIP) Programme

Lack of adequate infrastructure is a structural growth constraint which inhibits the economy's long-term growth potential. The government had announced a National Infrastructure Pipeline (NIP) programme through an aggregate investment of Rs 111 Lakh Cr over the period 2020-25. This is proposed to be jointly funded by the central, state governments as well as the private sector. Time is right for acceleration in the programme.

The outlay on capital expenditure has to be significantly increased by both the central and the state governments at the cost of non-productive revenue expenditure. The Centre should have a suitable incentive plans for the states to increase the share of capital expenditure for specific project categories.

While PPP programmes could do with a boost, access to long-term funds for private sector sponsored infrastructure projects, impacted by the IL&FS episode, needs to be enhanced.

Commercial banks can play a limited role in infrastructure sector funding and, therefore, the role of domestic financial institutions and long-term funds like pension and insurance funds become critical.

The government must activate a supportive policy framework to facilitate such funding. Also, it must ensure mitigation of systemic risks through appropriate risk-sharing mechanisms such as partial guarantees from highly-rated institutions.

Further, the National Investment and Infrastructure Fund (NIIF), which has successfully partnered with prominent global investors such as ADIA, PSP, CPPIB, Temasek, etc. and manages over US$4.4 billion of equity capital commitments, needs to scale up. Higher budgetary allocation towards the NIIF is the need of the hour.

Apart from the regular infrastructure segments, the government needs to prioritise farm infrastructure such as warehouses through PPP mechanisms.

Incentivise manufacturing sector

The government had introduced Production-Linked Incentive (PLI) scheme to incentivise domestic manufacturing. It is also bait for foreign manufacturers to move base to India. The scheme, with an allocation of Rs 1.97 lakh Cr, was aimed at generating employment. Not just that, the country could reduce dependence on imports from other nations under the Atmanirbhar Bharat programme.

Initially, the PLI scheme only covered mobile phones and allied equipment, pharmaceutical ingredients and medical devices. Later, in November 2020, it was extended to 10 more labour intensive sectors. The government must track its progress and modify it suitably to ensure fresh FDI in the manufacturing sector. Large-scale production units in select sectors will not only substitute imports but also support growth of export earnings.

Stimulate growth in private consumption

Private consumption remains a key growth driver. A pent-up demand is evident in segments such as PVs and 2Ws after the pandemic. For a sustainable growth in consumption, disposable incomes of the population clearly must rise over the medium term.

In the near term, moderate tax reliefs can be considered for the middle-income population. It is unlikely that the government will opt for any significant reduction in GST rates in the current budget given the fiscal headwinds. The scrappage policy should receive attention, for it can be a major driver of auto demand. The government has announced phasing out of 15 year-plus vehicles it owns. Without any further delay, the whole stock of existing vehicles should be subject to a scrappage policy through use of suitable incentives or even disincentives such as the green tax.

Investments in healthcare and education

The pandemic has made universal health care and adequate health infrastructure non-negotiable. While the government has made an effort to cover a large part of the population through PMJAY, adequate health care facilities are yet to be developed in semi urban and rural areas. This will need to be undertaken with high priority in partnership with the private sector and with suitable incentive mechanisms. While the fiscal expenditure on health is estimated to be less than 2.0% of GDP, it is significantly higher at 7%-8% of GDP for the developed nations.

Similarly, there is need to step up on investments in primary and higher education. Here the private sector can play a large role. Such enhanced investments in healthcare and education will not only involve deployment of innovative technology but also create many job opportunities.

While the government's spending list is huge, priority should be given to those that can have a multiplier effect on the economy. The economic slowdown, which preceded the severe Covid pandemic, has already led to a sharp deterioration in the central fiscal deficit beyond 3.5% in FY20. It is likely to be more than double in FY21. To mitigate external risks such as a sovereign rating downgrade, the government has to revert to fiscal discipline and commit to a medium-term fiscal consolidation plan. Ability to monetise various assets of the government and expedite the ongoing disinvestment programmes will need to be an important element in the fiscal strategy.

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