Union Budget 2021-22– Foreword

FOREWORD

On this 1st day of February 2021, post a year of unprecedented uncertainty, our Honorable Finance Minister, Ms. Nirmala Sitharaman presented India's first digital Union Budget for FY 21-22 under the 7th year of the BJP led NDA regime.

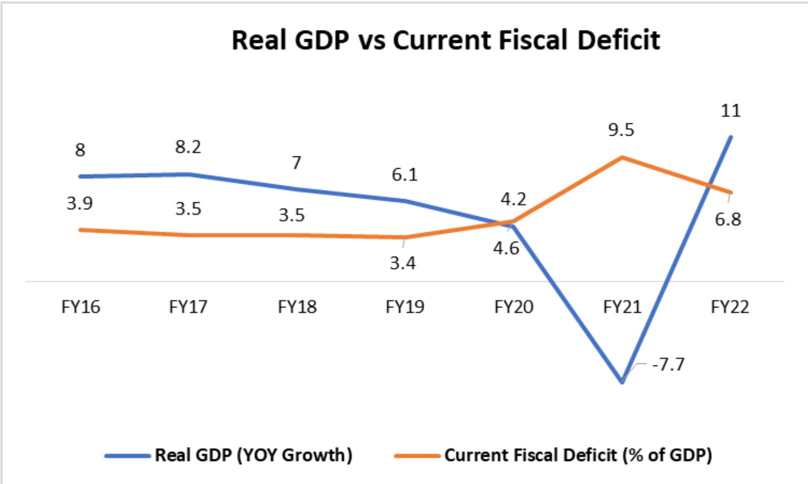
Since the last Union Budget presented on 1st February, 2020 for FY 20-21, there have been five 'mini budgets' presented by the Finance Minister to address the urgent need of stabilizing the Indian financial ecosystem post the Covid pandemic.

This budget is said to be in line with the five 'mini budgets' to achieve the larger objective of reviving the Indian economy post COVID, while not loosing sight of our targets for fiscal consolidation.

To give context to our budget snapshot, we thought it may be relevant to take a quick overview of some key historical economic variables which would help highlight critical areas of interest. After all, "you can't really know where you are going until you know where you have been".

Accordingly, we have identified a few indicators of historical economic performance that help reflect the economic scenario prior to this Union Budget:

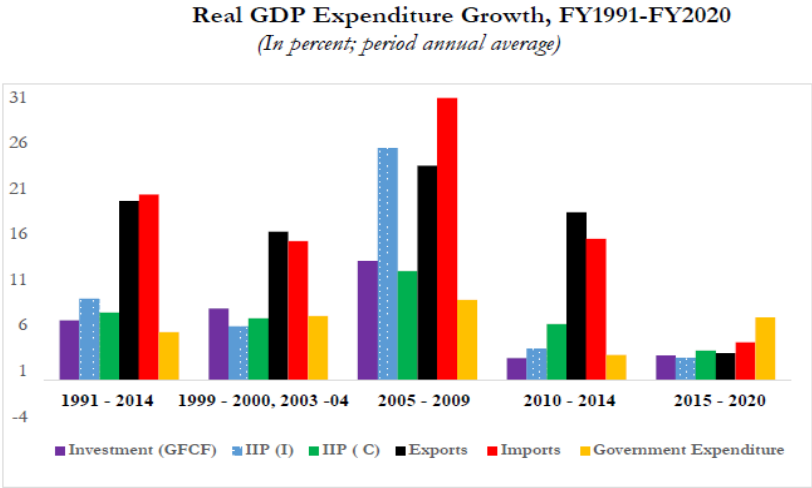
1. **GDP and Fiscal Deficit:**



Since 2016, India's Real GDP growth had slowly plateaued for numerous reasons including the intent of controlling inflation, and reduced spending by government to achieve fiscal consolidation towards their FRBM target of 3% by March 20-21. This slowdown is said to have been exacerbated by numerous bold structural reforms such as GST and Demonetization which however are expected to yield long term economic benefits for years to follow.

Source of Graph: Indiabudget.gov.in

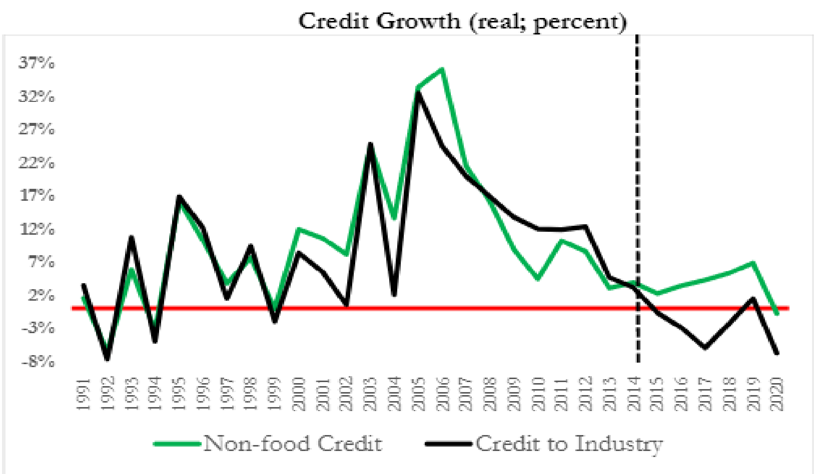
2. Real GDP Expenditure Growth[1]



As evident from the above data, there was an enormous boom in the first decade of the 21st century across investments, government expenditure and foreign trade. However, post the Global Financial Crisis of 2008-09, global trade, investments in capital formation, overall government expenditure, index of industrial production for capital goods and consumer goods, all showed a gradual decline and apparently haven't recovered since. These figures highlight the need to enhance such investments and spending by the government to further attract private investments and kick start the engines for long term sustainable growth.

3. Real Credit Growth[2]

With declining investments and sluggish economic growth, the banking and financial sector was facing its own challenges with accumulating stressed assets over the years creating a Twin Balance Sheet Problem. The graph below reflects this growing lack of confidence over the past decade restricting flow of credit. The Insolvency and Bankruptcy Code, 2016 was introduced to help such financial institutions find an exit, reduce the stress of NPAs, regain confidence and lend to worthy corporates fueling the economic value chain.



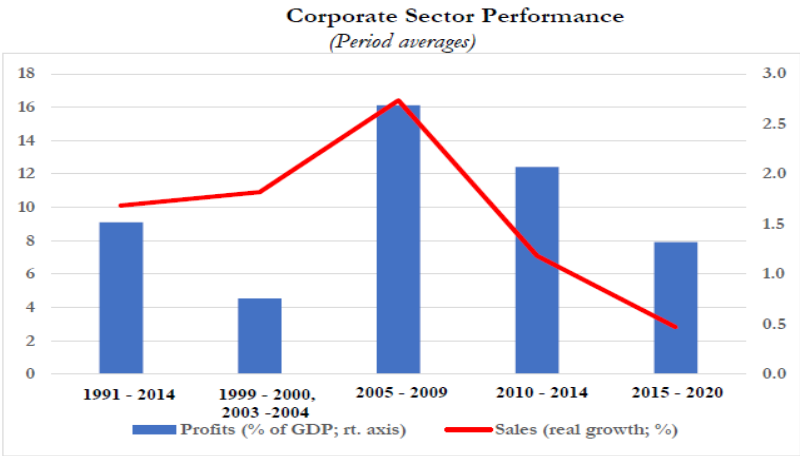
1 . Note: All indicators are averages of annual growth rates.

2 . Note: Data are for end-March of each year.

Source of Graphs: The Economy and Budget: Diagnosis and Suggestions by Arvind Subramanian and Josh Felman, January 2021

4. Corporate Sector Performance[3]

Similarly, following the declining investments and credit confidence, there was a decline recorded in growth of corporate sales and profits as a % of GDP. These reflect a reduced confidence within the private sector, which further curtailed investments, job creation, limited competition and correspondingly reflected in a plateauing GDP growth number as above.



There are various other relevant economic indicators, some of which are also recorded in the "Economic Survey Summary FY 20-21". However, the reason for highlighting the specific data above is our understanding that these fundamental issues and related aspects are driving government policies including those proposed under the Union Budget 2021-22 to help achieve the Governments key objectives including a Self-Reliant India ('Atmanirbhar Bharat'); Ease and Quality of Living; Ease of Doing Business to be a USD 5 trillion economy and achieve all this through Sustainable, Inclusive Growth.

Accordingly, over the past seven (7) years, the government has been introducing structural reforms across key areas and elements of the ecosystem to move forward on these outlined objectives. These reforms include Education & Skill Development; Healthcare; Infrastructure Development; Power Supply and Distribution; Banking among others. Such reforms have been supported by changes in softer areas including Digitization (such as Direct Benefit Transfers and Unique Identification Aadhaar Card); simplified and uniform Tax Regime (Goods and Service Tax), Judiciary and Dispute Resolution (Insolvency and Bankruptcy Code); Sustainable Development (FAME, Signatory to Paris Agreement); Land & Labor Reforms (Labor Codes) and Agricultural Reforms (Farms Bill).

With these historical facts, objectives and structural reforms in place, the honorable Finance Minister laid out the theme for this budget on the foundation of six (6) pillars, all of which are consistent with their historical principles – Health & Wellbeing; Physical & Financial Capital and Infrastructure; Inclusive Development for Aspirational India; Reinvigorating Human Capital; Innovation and R&D; Minimum Government, Maximum Governance.

With an estimated GDP of 7.7%, a Fiscal Deficit of 9.5% and a low Debt to GDP ratio of 91%, in FY 20-21, the Finance Minister has adopted a path of slow fiscal consolidation with a target of 4.5% in FY 25-26, increased borrowings of INR 12 lakh crore, enhanced allocation for Capital Expenditure, Privatization and Disinvestments at INR 1.75 lakh crore all targeting a Real GDP growth rate of 11 % and a fiscal deficit of 6.8% in FY 21-22.

3 . Notes: Data are from the CMIE's Prowess database. Only non-financial corporate sector firms are included. Data for 2019-20 are not included because reporting is patchy. Sales is calculated as annual nominal growth deflated by consumer price inflation. Profits after tax is expressed as share of nominal GDP.

Source of Graph: The Economy and Budget: Diagnosis and Suggestions by Arvind Subramanian and Josh Felman, January 2021

Addressing the need of the hour, budgeted spending on infrastructure has been substantially increased by 34.5% y-o-y for FY 21-22 along with allocation for reviving the stressed state power distribution companies, which will have an exponential impact on job creation, flow of credit and in turn much needed consumer spending **(Increased Gross Capital Formation)**.

The Proposed setting up of a Domestic Financial Institution, an Asset Reconstruction Company, Recapitalization of Banks and streamlining the functioning of IBC will all help strengthen the Banking system, regain confidence at banks with liquidity surplus estimated at over INR 5 lakh crores and permit flow of much needed credit. **(India - an economic superpower)**

Creating new opportunities for the young and aspirational India through higher education and up skilling to mobilize our youth up the value chain and support growth in manufacturing (under new PLI schemes) and services which constitutes over 50% of our GDP **(Inclusive Growth for an Aspirational India)**.

Further, allocations have been increased by 137% y-o-y towards enhancing healthcare (including INR 35,000 crores for Covid Vaccine), ensuring water supply, reducing pollution to enhance the Quality and Ease of Living across the nation **(Ease and Quality of Living)**.

Proposals to streamline compliances, remove GST Audit, overhaul dispute resolution, decriminalize breaches under LLP Act, widening scope of small company and One Person Company, liberalize foreign investments, enhanced digitization are all dovetailing into principles of Minimum Government, Maximum Governance **(Ease of Doing Business)**

Though there are no changes in the tax rates, there have been substantial amendments in Income Tax provisions including abolition of Settlement Commission, faceless ITAT, pro-investment changes attracting long term stable capital and other such changes following principles of clarity and consistency in the tax regime.

In Conclusion, as evident, this budget addresses historical issues despite testing times, in a consistent, clear, progressive, and collaborative manner with constructive allocation of capital prioritizing the immediate needs of our nation to unleash its true potential. This budget provides the necessary shot in the arm to boost economic recovery in the post pandemic era.

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