THE UNION BUDGET 2011-12

Economic Implications & Impact on Capital Market

Minoo R Shroff
Sunil S. Bhandare
Kanu H. Doshi
Bhargava Vatsaraj

FORUM
OF FREE ENTERPRISE

> *"Free Enterprise was born with man and shall survive as long as man survives".*
>
> \- A. D. **Shroff**
> Founder-President
> Forum of Free Enterprise

THE UNION BUDGET 2011-12

I

Will Containing Inflation be Illusive

Minoo R. Shroff*

During the British Regime, the Finance Secretaries used to describe the Union Budget as a "Gamble in the Monsoons". Agriculture then constituted over 50% of the GDP. Though currently its share has declined to around 16% it does provide employment to over 50% of the population and has direct and indirect impact on the lives of 70% of our population residing in rural areas. The monsoon still has a definite impact on the economy as witnessed in the recent past, having played havoc with prices of vegetables (especially onions), pulses and sugar. The Finance Minister has said he will seek the blessings of Lord Indra to attain high growth in agriculture next year.

The Budget basically is a photographic impression of the State of the economy at a particular point of time. It analyses the economic and fiscal developments during the preceding year and sets out projections for the short and medium term.

The author is an eminent economist, corporate advisor and President, Forum of Free Enterprise. *The text is based on the talk on the subject delivered at a public meeting arranged under the auspices of the Forum of Free Enterprise and other organizations on 1st March 2011 in Mumbai.*

The Economic Survey, which precedes the Budget, is a document which deserves study in greater depth. than the Budget proposals, which universally attracts attention of the lay public and corporates as it affects them directly and through the stock market.

The primary task of the Finance Minister in framing the Budget is to evaluate the critical issues facing the economy and shape the proposals in a manner that would give optimal thrust to growth within given resources, with due concern for social imperatives. In recent years our savings rate to 34-35% of GDP and the investment rate to 36137% of GDP, has been satisfactory for sustaining 9% annual growth. However, for financing $ 1000 billion infrastructure programme in the next Plan we require a much larger share of long-term finance which we are not able to attract with the current restrictions in place, notwithstanding some relaxation announced in the Budget.

The resort to giving larger subsidies distorts the market mechanism and retards efforts towards fiscal consolidation. Oil subsidies are a particular case in point. The outgo on subsidies for the coming year appears grossly understated in view of the surging oil prices. The Economic Survey rightly argues that all price increases should not be met by government interventions. Prices rise and fall in response to changing demand and supply scenarios.

Prices are signals to consumers and producers to alter their behaviour in response to exogenous changes in the economy. It is not advisable for Government to step in and flatten out all such price fluctuations. The proposed direct cash transfers is a very desirable alternative and should be implemented urgently, at least in case of fuel, cooking gas and fertilizers.

The current fiscal year has been a very difficult one particularly in view of the political gridlock which stalled working of Parliament and thus introduction of much forward looking legislation. Given this backdrop the Finance Minister has done a balanced but cautious job in framing the Budget. There have been no path-breaking initiatives to solve the various urgent problems staring the country and to which he himself has referred to at length in his Speech. It is, however, utopian to expect economic policy imperatives will only dictate tax policy, without political considerations. Politics invariably triumphs over sound economics. This is a Global phenomenon, more so in developing societies with democratically elected Governments.

INFLATION SCENARIO

Inflation has been hovering at an unacceptable level of an average 9% during the last fiscal year, with food inflation having surged to almost 20% at one stage. Though it has come down lately and the Wholesale Price Index has been predicted to decline to 7% by end March, consumer price index particularly food prices are not likely to come down substantially, despite an improved Rabi harvest. This is due to several factors:

a) Inadequate investment in agriculture in recent years; agricultural output having grown only at an average annual rate of 2% in the last five years;

b) Inclement weather and poor management of the food economy has aggravated the supply position. Besides we have miserably failed in anticipating weather conditions locally and the trend of rising prices globally; and

c) Rising incomes and consequent demand for superior foods particularly milk and protein products, the output of which has fallen way behind growing demand.

High inflation is no short-term problem and is likely to become more acute next year with volatile oil prices. According to the London Economist, Commodity Price Index, prices of all items have risen 49% in the last one year (in dollar terms) with food prices rising by 41%, metal prices by 37%, non-ferrous metals by 106% and crude oil by 25%.

Adverse weather conditions and reported shortages in output in various leading exporting countries, is bound to exercise upward pressure on food prices. A detailed survey of the impending world food crisis prepared by the Economist presents a grim picture of the imbalances that are developing between global supply and demand.

Some additional outlays are provided in the Budget for warehousing, cold storages and improving rural connectivity, but this will make a small dent in the problem. What is called for is a Second Green Revolution with much larger investments in irrigation and rural infrastructure, and improved connectivity to facilitate movements between states and regions, combined with creation of modern warehousing and cold storage facilities to reduce the enormous wastage currentlyentailed. It is, indeed, a tragedy that India, the largest producer of milk in the world, is now facing milk shortage the price of which has been escalating. According to Dr. M.S. Swaminathan (father of the Green Revolution) schemes for improving agriculture are plenty, but the implementation has been extremely poor. The focus has to be on "Outcomes" and not on "Outlays".

Rising commodity prices globally are now affecting the general price index in India more than in the recent past. Consequently, containing inflation at 5%, the year end target for 2010-11, is most unlikely.

FISCAL DEFICIT

The Finance Minister's assurance to reduce the fiscal

deficit is commendable. However, this is predicated on 9% GDP growth, buoyancy in revenues and lower rate of inflation. For undernoted reasons these assumptions sound optimistic.

1) The projected GDP growth rate of 9% is based on effective implementation of the ongoing infrastructure projects and implementation of long pending economic reforms. Recent press reports indicate that there is an acute shortage of coal threatening to destabilize new power projects in which investments of Rs.75,000 crores has already been made for generating 15,000 MWs of power. In case of roads, we have been able to meet just over 40% of the target of 20 KM per day. The current political climate is not also conducive to generate momentum on the reforms front at least in the short term.

2) The rate of inflation is likely to be much higher than the estimated 5%. This will dampen demand and impact GDP growth.

3) The central taxes/GDP ratio rose from 8.8% in 2000-2001 to 11.9% in 2007-2008 has declined to little over 10% currently despite the sharp rise in tax revenues. This must be stepped up to over 12% to reduce resort to borrowings to reduce the interest burden and thus make larger resources available to fund social performances.

4) Current account deficit around 3 to 3.5%of the GDP is acceptable in the short-term but the worrying factor is that it is largely funded by short-term FII flows which are very volatile as experienced in the past.

The growth rate in exports, which has been 30% in the current year is likely to decelerate as a result of fragile economic recovery in Europe and USA. Further, FDIs have

sharply declined in recent months and FIIs and NRI deposits have also shown a downward trend. The outgo on oil imports next year will be certainly larger. Consequently the current account balance will deteriorate.

India's foreign exchange reserves are currently around $.300 billion and have remained at this level for the last four years. However, as the foreign debt liabilities have been growing the position is not comfortable as it was in the earlier years leaving less room for manoeuvre.

TAX REFORMS/CORRUPTION

Goods and Service Tax can be the single best reform for combating corruption and raising resources. GST will attack black money in a big way, especially in the real estate sector which generates the maximum unaccounted wealth. Real estate transactions estimated at Rs.10 lakh crores annually can be brought under the indirect tax net once these become part of the formal economy, Income from these activities can be taxed separately.

The political significance of this can be gauged. The nexus between politics and slush money from real estate can be exposed. The Finance Ministry's task force which studied the upside of the GST reforms puts the potential value of transactions on which the Centre and States can collect such tax at over Rs.35 lac crores (45% of this year's GDP). Currently only 60% of this transaction value is probably taxed.

GST must be introduced by 1st April 2012, the revised date indicated by the Finance Minister. However, this will not happen unless there is active political engagement with and credible accommodation reached with the opposition parties which are not yet falling in line.

GOVERNANCE

Many leading citizens and even Government spokesmen have in recent months been expressing their deep concern at the growing governance and ethical deficits. Corruption has been with us since olden days, but it has now become a virus. What is most disturbing is that the tolerance to corruption in all walks of life has risen and generally people have come to accept that there is little they can do individually or even in small groups.

Thanks to the Right to Information Act, the aggressive media campaigns and the alertness of the higher judiciary, many blatant cases of misdemeanor and corruption have come to light. However, people are dismayed at the very feeble and delayed action that has followed such disclosures. The authorities have not displayed any serious intent or will to strike at the guilty.

One of the effective fiscal tools to stamp out corruption is the early introduction of GST referred to earlier.

The Economic Survey has summarized the malady pithily: - "For India to develop faster and do better as an economy, it is important to foster the culture of honesty and trust worthiness. We recognize that honesty, integrity and trust worthiness are not just good moral qualities in themselves but qualities that, when imbibed by a society, lead to economic progress and human development, people will have a tendency to acquire these qualities."

There is an old saying – "If Gold rusted what can IRON do."

The sublime realization of the imperative need to foster this culture must start from the very top. Currently the omen for this is not propitious.

II

The Prospective Roll-over Budget 2011-12 Economic Implications

Sunil Bhandare*

Managing the expectations is truly a hallmark of a veteran politician Finance Minister, and Mr. Pranab Mukherjee has achieved this task with remarkable elan and success. When chips are down – and that has been the situation for the past over six or eight months – some concerted positive action and words of comfort in the latest FM's budget speech and strategy seem to have spawned significant soothing effect. He has done well to build "feel good factors" and ward off a possible spread of despondent mood.

Not surprisingly, the immediate response of stock markets has been fairly enthusiastic and most spokespersons of business and industry have heaved a sigh of relief that nothing untoward has really happened. Albeit no historically path-breaking reforms agenda has been pushed forward either. Most of the proposed financial, fiscal and tax reforms have

**The author is former Economic Adviser, Tata Services Ltd., and presently Adviser, Economic & Government Policy, Tata Strategic Management Group. The text had originally appeared in "Monthly Economic Digest" (March 2011) published by Maharashtra Economic Development Council, Mumbai, and is reproduced with the latter's kind permission.*

already been in the pipeline for a prolonged period! Evidently, there is now a meaningful convergence of all such plethora of policy initiatives and developmental schemes. But searching for the USP of this budget would be in vain!

The real satisfaction comes from the perspective that the 2011-12 budget promises:

- high economic growth accompanied by continued process of fiscal consolidation;
- provision of some reliefs, within a limited fiscal space available, for personal income tax payers and refraining from phasing out the remaining part of fiscal stimulus initiated in 2008-09;
- taking forward the long-pending economic reforms agenda through various new economic legislations or amendments to the existing economic legislations;
- seeking to tackle "governance deficits", "infrastructure deficits" etc.;
- raising substantially the investment limits for FIIs in corporate bonds and allowing foreign investars to invest in equity schemes of registered mutual funds;
- pursuance of a medium-term goal of raising sharply the share of manufacturing sector in the structural composition of our economy – the National Manufacturing Policy, et *al*.

All these and many other similar initiatives are also being combined with sufficient augmentation of social sector programmes as part of inclusive development strategy.

Economic Backdrop to the Budget

However, the current state of India's key macro-economic parameters are doubtless worrisome. This is in sharp contrast to the situation prevailing around this time last year. The

economic recovery process then was still in the nascent stage. Yet, it was distinctively more promising and comfortable, with substantive positive sentiments about political stability and prospective growth and investment opportunities.

Unfortunately, domestic political scenario has been greatly marred by recurrence of scams as well as disruptive economic trends, especially the stubbornly high inflation accompanied by rapid deceleration of industrial growth in the last about five months (Sept-Dec 2010). Also, foreign investors' investment intentions (both FDI and FIIs) have gradually started waning and many of the mega projects promoted by domestic enterprises are bogged down for want of various clearances and financial closures. Surely, all such events have vitiated the overall economic climate and dampened the enthusiasm of virtually all the stakeholders.

In the global context too, there are continuing uncertainties about sustainability of ongoing economy recovery in many advanced countries. But even more worrisome are the recent events of popular protests and uprisings sweeping through the Middle East and North Africa and possibly spreading to other authoritarian regimes and consequential recent upsurge in crude oil prices as well as rising commodity prices (even the spectre of global food shortages is looming large!). All these factors have engendered the external vulnerabilities of many countries. So also of India!

Needless to emphasise, the FM in his speech, as is to be expected, has downplayed most of the negatives in the economic scenario, while sounding overwhelmingly eloquent about the positives. But it would be foolhardy not to decipher the underlying message of our economic scorecard unveiled in the Economic Survey of 2010-11, released just a couple days before the budget. The Survey surely speaks highly of "the Indian economy coming through with resilience and strength

with recovery on firmer footing and growth being broad-based". Further, it expects the economy to revert to pre-crisis growth levels next year, i.e. 9% +/- 0.25% real GDP growth in 2011-12. This apart, it is also imperative to acknowledge some good **positive components of our current economic performance:**

First, the real GDP growth is now estimated at 8.6% in 2010-11 marking progressive recovery from 6.8% in 2008-09 to 8% in 2009-10. Besides high growth of manufacturing and services sectors, the most notable feature turned out to be a strong agricultural recovery – with the over-all growth of 5.4% in 2010-11 after a dismal (-) 0.1% growth in 2008-09 and 0.4% in 2009-10. This has led to significant easing of supply side constraints of essential goods. Indeed, there are now excesses of food-grains stocks with the FCI, of sugar with sugar mills and of cotton and vegetables (including onions) with farmers.

- Second, the moderation of fiscal imbalance, which is reflected in a decline in fiscal deficit/GDP ratio from 6.4% in 2009-10 to 5.1% in 2010-11 (against budget estimate of 5.5%). At the same time, revenue deficit to GDP ratio has dropped from 5.2% to 3.4% (budget estimate of 4%). This achievement is entirely attributable to (a) windfall gains of 2G license fees, and (b) remarkable tax buoyancy. But fiscal management could have been much better had it not been for a huge adverse variance of almost 10% (or an increase of about Rs.95,000 crores) in revenue expenditure. Instead, the FM preferred to be more extravagant with respect to allocations for subsidies, pensions and social sector expenditure rather than use such great opportunity for further strengthening of fiscal management or indulging in capital formation, particularly in the infrastructure sector.

- Third, India's exports performance during April-January 2010-11 has turned out to be very impressive with growth rate of 29.4% (US$184.6 bn), while imports growth remained relatively moderate at 17.6% (US$273.6 bn). This has helped reigning in of trade deficit to US$89 bn – moderately higher compared to the corresponding period of the previous year. If this trend continues for a longer period, the fears of widening of the current account deficit to GDP (CAD) ratio to unsustainable level of 3 to 3.5% would now be assuaged substantially.

- Last, after a major setback to rising trends in gross domestic saving as well as investment to GDP ratios in 2008-09, there has been some noticeable recovery in both these rates during 2009-10. Given the fact that there is going to be an improvement in the fiscal situation as well as in the overall real GBP growth rate in 2010-11, it would sound reasonable to project some further gains in theses rates in the current year. In 2009-10, the savings and investment rates were 33.7% and 36.5%, respectively. The Survey also mentions about incremental capital output ratio (ICOR) of India having been estimated at 4.1:1 for the Eleventh Plan. It further states that "given that economy still has excess capacity, these two indicators lead to projection of GDP growth just short of 9 per cent"

In substance, what stands out both from the FM's speech as well as the Survey is that at the macro level there are now (a) consistent supply side improvement (especially of agricultural produce); (b) better fiscal balances; (c) mitigating changes in external sector balances; and (d) positive momentum to savings and investment rates. ***So, all*** is ***well*** on the macro front!

However, the negative side of the economic balance sheet is also onerous and overweighing:

- **First, the high inflation rate:** although food inflation rate has now dropped to 10.4% for the week ended February 12, 2011(lower than earlier levels ranging between 18 to 20%), it still remains well above the double-digit level. At the same time, the fuel price index has been progressively rising and is currently around 12.6% on y-o-y basis There may not be much respite from such high inflationary levels for quite some time, despite the fact both GOI and RBI expect general inflation to drop from the present about 8.3% to about 6.5 to 7% by end March 2011. Most of the recent upsurge in international crude oil prices has yet to be transmitted to the consumers. Further, the Survey itself points out that "the inflation in food items might have spilled over into a more generalised phenomenon. .... The rise in wage goods and levels of inflation in intermediates has implications for the industrial output".

Already some fault-lines are getting exposed – witness the current global surge in crude oil prices and the response of the Chief Economic Advisor Dr. Kaushik Basu: "under such circumstances (if oil price rise is significant) the government will either have to bear the additional cost or pass it on to the consumer. ... either decision would be difficult".

In a separate highly analytical and brilliant discourse on "Inclusive Growth and Inflation", the Survey, among other things, highlights challenges in designing inflation control measures and talks about a set of policies including the use of Competition Act, 2002 in tackling issues of hoarding and cartelisation and reforming Agricultural Produce Market Committees (APMC) Act and dealing with various barriers to trade through tolls and checks. Many of these are tough tasks to handle and the FM will have to struggle to reach out to his political adversaries for consensus solutions!

- **Second, a sharp deceleration in industrial growth:** the average industrial growth in the last five months (Aug-Dec 2010) more than halved to 5.6% from 12.7% in the first four months of the FY (Apr-July 2011). If there is going to be a continued failure in restoring high industrial growth in 2011-12, not only will there be adverse implications on the overall real GDP growth, but also on the tax buoyancy implicit in the budgetary estimates for the next year.

  Admittedly, there are some positive proposals in the budget – the continuation of the current reduced level of CENVAT (10%) and several other visionary statements – witness, taking the share of manufacturing sector from the present 16% to 25% over a period of next ten years; improving transparency and accountability in procurement, allocation, utilisation and pricing policies of natural resources; etc. But the challenges are in the implementation, while being faithful to "coalition dharma"!

  Also, there are some conflicting messages from the tax proposals – witness the FM's statement: "as a measure to ensure sharing of corporate tax liability, I propose to levy MAT on developer of Special Economic Zones as well as units operating in SEZ. The very objective of SEZ policy – as proclaimed by the Government from time to time – is to promote competitive industrial and services sector (essentially IT sector) and strengthen India's export performance. And for realising this, there is a provision of assured tax holiday in the SEZ policy with certain conditions. Where is then the stability of tax policy environment so vital for the success of the avowed goal of enhancing the contribution of the manufacturing sector to the economy?

- **Third, the high current account deficit to GDP ratio:** in contrast to what Survey suggests as stated earlier, the RBI has in recent times been flagging off its concerns about unsustainable CAD ratio – expected to be in the range of 3 to 3.5% in 2010-11. As a concomitant to the challenging task of maintaining external balance (sustainable CAD to GDP ratio), it is necessary to carefully evaluate the current status of forex reserves. India reached its all-time high forex reserves of $310 bn by end-March 2008 (imports cover of over 14 months) – and after dropping to $252 bn by end March 2009 – these reserves have recovered gradually since then to $299 bn by Feb 11,2011 (imports cover reduced to about 10 months now).

  But more worrisome part is that there are significant components of short-term credit repayment obligations (including FCCB repayments) and FII investments. For example, the recent report stated that the market valuation (as opposed to book value) of cumulative FII investment is as high $274 bn (Dec. 2010). Thus, there is a substantial "flighty" nature of funds in our existing forex reserves, which could undermine the external stability of the economy. The success of the new budget proposal in attracting foreign investors, if it really happens in mobilising long-term corporate bonds could mitigate this situation. But that is a big if!

  In this context, it may be worthwhile to also quote from the recently released RBI Fiscal Stability Report (Dec. 2010): "Our concern has been not so much the quantum of flows, which we have been able to absorb because of the widened current account deficit, but rather the nature of these flows. Much of the capital has come in the form of short-term portfolio flows and debt flows which are significantly prone to sudden stops and reversals".

- **Fourth, continuing concerns about investment confidence:** contrary to what has been stated in the

Survey on investment ratio, the recently released CSO estimates on gross fixed capital formation (GFCF) to GDP ratio for 2010-11 reveal that this ratio has progressively declined from the high of 32.9% in 2007-08 to 30.8% in 2009-10 and further to an estimated 29.3% in 2010-11. Also, there are reports showing fall of 22% in FDI inflows in the country from $27 bn in 2009 to $21 bn in 2010.

Further, although the stock markets so far have responded positively to the budget (the SENSEX scaling up from the recent low of 17,750 a few days before the budget to 18,490 on March 3, 2011), it will be imprudent to ignore the persistent high volatility in the SENSEX trends in the recent months, especially after it reached the peak of around 21,000 sometime in November 2010. Such volatility may be good from the view point of speculators and active market players (makers or breakers!), but unnerves a mass of retail investors.

Strategic Framework of the Budget

It is against this economic backdrop, that we need to evaluate the ultimate soundness of the budgetary strategy and its likely economic impact. Already, many of the key points and issues on this score have found their reflections in our earlier discussions. But what stands out is that in the quest for sharing goodies and meeting the expectations of almost all sectors of the economy and almost all sections of the society, the FM has constructed multiple facets in his budgetary strategy. Even in the midst of all such hodgepodge, four key planks of the budgetary strategy emerge, namely,

First, fiscal consolidation: prima facie this process seems to be back on a right track. Thus, fiscal deficit to GDP ratio is estimated to drop further to 4.6% in 2011-12 from the revised estimate of 5.1% in the current year,

while revenue deficit will remain unchanged at 3.4%. The effective revenue deficit to GDP ratio, however, is expected to drop from 2.3% to 1.8% (this is a new concept introduced in this budget.

The eventual success of this strategy would depend upon the realization of several key assumptions and many of them are suspect. For example, the FM is ambitious in expecting a sharp compression in total expenditure growth - 3.4% in 2011-12 as compared to 18.7% growth in the current year.

The long-term trend rate of expenditure growth is around 14% and there were only a very few years in the past when such growth rate was restricted to less than 5 per cent. There is, doubtless, under-budgeting of subsidies and various other social services expenditure programs. Illustratively, the revised budget estimate of public spending on subsidies in 2010-11 turns out to be Rs.164,153 crores (as against budget estimates of Rs.116,224 crores), but the allocation for 2011-12 is reduced to only Rs.143,570 crores. Admittedly, subsidies reforms are going to be undertaken by the government; but would the gains of all that accrue in the current year?

The fiscal deficit management is also based on the expectations of sustained buoyancy in tax revenues. Thus, gross tax revenues are expected to increase by 18.5% in 2011-12 on top of an increase of 26% in 2010-11. Incidentally, the budget is revenue neutral in terms of new tax proposals (gains from some of the indirect tax proposals are more than offset by reliefs in the personal income tax). Further, there are downside risks about growth prospects of industrial output and corporate sector's profitability. This is inevitable given the adverse impact of inflation on consumer demand for manufactured goods and cost-push pressures (through fuller transmission

of energy, interest and wage cost hikes in FY 2011-12) on corporate profitability. Last, there are expectations of Rs.40,000 crores through PSUs disinvestments, the success of which would be governed largely by favourable stock market sentiments.

Second, steering economy to the projected real GDP growth: the budget mentions 14% growth rate of GDP in nominal terms. By implication, if the real GDP growth rate hovers around 9%, then the average inflation has to be less than 5 per cent. On current reckoning, both seem to be ambitious propositions. Therefore, while realisation of nominal GDP growth of 14% may not be a major casualty – given the prospects of high average inflation in the range of about 5.5 to 6%, the real growth rate may plummet to 7.5 to 8% during 2011-12. We perceive that even this growth rate is predicated on the assumption that the global economy does not suffer any major hick ups and the FM will be able to push through implementation of various economic policy agenda set out in the budget (Appendix II).

Third, the implementation of plethora of policy changes and programs: please see the Appendix II to gauge how huge are legislative, executive and implementation tasks going to be – and most of them to be accomplished in a single financial year 2011-12.

Last, restoration of confidence in the investment environment: there are series of proposals, which are expected to create increasingly investment-friendly environment – both for domestic as well as foreign investors (FDI, FIIs, individual investors, etc. – some these are already referred to earlier). But the crux of the matter is how the government is going to overcome governance and regulatory/institutional deficits as well

as daunting issues of land acquisition and environmental clearances. These are precisely the reasons why actual implementation (of both domestic and foreign investment projects) continues to languish around 40% of the investment proposals.

In Summing Up:

Evidently, the strategic budgetary framework is comprehensive and FM's intentions are seen to be positive and sincere. But fault-lines and downside risks are far too many both in fiscal and growth scenarios. They manifest not only in the current wayward global scenario, but also in the domestic growth parameters. Thus, it is difficult to visualize a return to more broad-based high real GDP growth rate of around 9% in 2011-12.

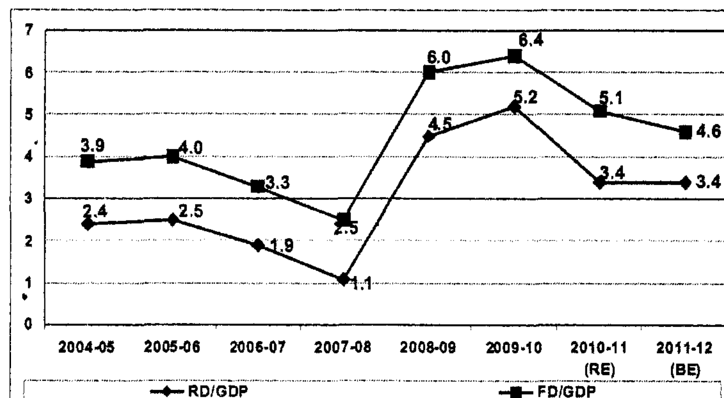
Such high growth phase of the economy will be predicated on (a) agricultural sector achieving at least 3.5 to 4% growth – series of well-meaning proposals for improving productivity and promoting some specific crop focused schemes have to be implemented; (b) removal of bottlenecks in infrastructure and mega industrial projects. But as mentioned before, there are some conflicting signals – some good proposals (National Manufacturing Policy) accompanied by some bad ones (bringing SEZ developers and units within the purview of MAT); (c) adhering strictly to fiscal consolidation targets, which could improve public sector saving to GDP ratio and afford increased fiscal space for private sector investment; and (d) lastly, rolling-back inflation rate to a more tolerable level of less than 5 percent.

While being sceptical about the overall growth scenario, we hope that the FM and the UPA government strive for extreme focus at least on providing stability to agricultural performance through prompt and effective implementation of

series of proposals such removal of production and distribution bottlenecks in items like fruits and vegetables, milk, meat poultry and fish; spreading green revolution to eastern region; integrated development of 60,000 pulses villages in rain-fed areas; promotion of oil palms and vegetable clusters, etc. Simultaneously, the basic food economy of cereals and pulses also calls for strengthening in the wake of their stagnant productivity performance for far too long, through initiating land reforms and institutional changes of contract and corporate farming.

Given the enormity of tasks in strategizing the budget implementation and governance system (reaching out to political adversaries – cutting across the party lines; and also consensus building within the government per se), one gets a sinking feeling that the budget 2011-12 will be a roll-over phenomenon – the continuation of the same reforms agenda for some other more opportune time in future!

Improvement in Key Parameters of Fiscal Consolidation (% of GDP)



A List of Proposed Legislations in the Financial sector

(i) The Insurance Laws (Amendment) Bill, 2008

(ii) The Life Insurance Corporation (Amendment) Bill, 2009

(iii) The revised Pension Fund Regulatory and Development Authority Bill, first introduced in 2005

(iv) Banking Laws Amendment Bill, 2011

(v) Bill on Factoring and Assignment of Receivables

(vi) The State Bank of India (Subsidiary Banks Laws) Amendment Bill, 2009

(vii) Bill to amend RDBFI Act 1993 and SARFAESI Act 2002

A List of Proposed Legislations on Tax Reforms

(i) Direct Tax Code Bill, introduced in the Parliament in August 2010, proposed to be effective from April 1, 2012

(ii) GST – Constitutional Amendment Bill to be introduced in the current session of the Parliament

A List of Proposed Other Bills & Programs

(i) Public Debt Management Bill of India Bill to be introduced in 2011-12

(ii) Companies Bill introduced in Parliament in 2009 – received from Parliamentary Standing Committee will introduced in Lok Sabha in the current session

(iii) Financial Sector Legislative Reforms Commission (Justice B. N. Srikrishna) expected to complete work in 24 months

(iv) Direct Transfer of Subsidy Scheme –kerosene, LPG and fertilisers

(v) National Mission of Sustainable Agriculture

(vi) Integrated Development of 60,000 Pulses Villages

(vii) Promotion of Oil Palm cultivation in 60,000 hectares

(viii) Vegetable Cluster Initiative

(ix) National Food Security Bill to be introduced during the course of this year

(x) National Manufacturing Policy

(xi) National Mission for Hybrid and Electric Vehicles

(xii) Seven New Mega Leather Clusters

(xiii) Setting up of State Innovation Councils in each State and Sectoral Innovation Councils

(xiv) Setting up of 15 more Mega Food Parks

(xv) National Mission for Protein Supplements

Note: Thus, the FM has huge tasks before him in converting all these policy intentions into implementation. Every such effort will not only require techno-managerial support, but also call for reaching out to adversarial political parties as well as cooperation and support from within the coalition partners and from his own ministerial and party colleagues.

III

Impact on Capital Market

Kanu Doshi*
Bhargava Vatsaraj *

I. Introductory:

Budget 2011 was greeted with a big cheer by the Capital Market by almost 750 points rise in SENSEX (Bombay Stock Exchange Sensitive Index of 30 shares) on first two days (28th Feb & 1st March 2011) because Capital Market had heaved a sigh of relief since its worst fears of rise in excise duty from 10% to 12% on several important industrial inputs did not materialize. Similarly, strong determination to achieve 9% GDP growth; estimate of raising Rs. 40,000 cores by way of PSU disinvestment proceeds; permitting increased inflow of foreign money in Debt Funds & Corporate Bonds; increased inflow of Foreign Investment in Equity Schemes of Mutual Funds; increased spending on Infrastructure Sector; promise of DTC 2010 becoming Law in next session of Parliament; possible passage of GST by 2013; all cumulatively had a bullish impact and therefore capital market was all set for a long rally and a great bull party.

****Both Chartered Accountants and faculty members at Welingkar Institute of Management, Mumbai and S.P. Jain Institute of Management, Mumbai respectively.***

Then came concerns from Lybia, rise in Oil prices, triple calamity in Japan & yet another scam, 'Cash for Vote', and the market lost all its momentum and is now in uncertain zone in the short term.

However, be that as it may, we still examine in the following pages impact of the Budget proposals on specific sectors of Indian economy:

INDUSTRY SPECIFIC ANALYSIS

PLASTICS:

Ever since 1957, the Plastic Industry in India has made significant achievements with commencing production of Polystyrene. Today, Indian Plastic processing sector comprises of over 30,000 units producing a variety of items through injection moulding, blow moulding, extrusion and calendaring.

The Indian plastic industry has taken great strides and has grown to the status of a leading sector with a sizeable base. Continuous advancements in Technology, processing machineries, expertise and cost effective manufacturing is replacing the typical materials. Indian Plastic industry is now 0.50 per cent of India's GDP. The export of plastic products also yields about 1 per cent of the country's exports.

The sector has a large presence of small scale companies in the industry, which account for more than 50 per cent turnover of the industry and provides decent employment.

- As the Plastic industry is heavily dependent on automotive sector, launching of new cars in the small segments is expected to drive the demand for plastics. India is likely to dominate world's Plastic Industry with the domestic per capita consumption set to double by 2012. Plastic plays a significant role in the key sectors of the economy, including agriculture, water management, automobiles, transportation, construction, telecommunication and electronics, besides defence and aerospace, computers and power transmissions. There are no major proposals in the budget affecting this Industry.

POWER:

India is world's 6th largest energy consumer, accounting for 3.40 per cent of global energy consumption. With India's economic rise, the demand for energy has grown at an average of 3.60 per cent per annum over the past 30 years. The total demand for electricity in India is expected to cross 9,50,000 MW by 2030.

Investments:

Aided by the ambitious plan to add around 78.7 GW of additional generation capacity in the 11th plan by the year 2012, according to CRISIL Research estimates, about Rs. 7,50,000 crores is likely to be invested in the power sector over the next five years.

Indirect Tax Proposals:

- No excise duty on equipment for Ultra Mega Power Project
- On-going metro projects will be provided financial help for speedy execution
- Excise duty on LED bulbs reduced from 10 per cent to 5 per cent and full exemption on the special CVD of 4 per cent.

CEMENT

Sector **Structure/Market** Size

India is the world's second largest producer of cement.

The industry's capacity utilization currently hovers around 78 per cent, down from 87 per cent last fiscal. It may fall to 77 per cent in 2011 - 2012. With country's GDP to grow **8** per cent annually going **forward,** cement industry is to grow in double digit over long term and outlook for demand remains positive. Demand for cement from sectors such as road, railways, ports and power projects is expected to improve with the Centre investing about Rs. **4,60,000** crores (USD 1 trillion) in the Twelfth Plan (2012 - 2017).

For inclusive growth of all sectors, emphasis should be to create demand for real estate sector with focus on affordable housing, higher infra spending and incentive for public private partnership (PPP) to sustain robust demand.

New Investments:

- Cement and gypsum products have received cumulative foreign direct investment (FDI) of USD 1,971.79 million between April 2000 and September 2010.
- Dalmia Bharat Enterprises plans to invest USD 554.32 million to set up two green-field cement plants in Karnataka and Meghalaya.
- Bharathi Cement plans to double its production capacity by the end of the current financial year by expanding its plant in Andhra Pradesh, with an investment of USD 149.97 million.
- Madras Cements is planning to invest USD 178.4 million to increase the manufacturing capacity of its Ariyalur plant in Tamil Nadu to 4.5 MT from 2 MT by April 2011.
- My Home Industries plans to scale up its cement production capacity from the existing 5 million tonnes per annum (mtpa) to 15 mtpa by 2016.

- Shree Cements plans to invest USD 97.13 million this year to set up a 1.5 million MT clinker and grinding unit in **Rajasthan.**

  Jaiprakash Associates plans to invest USD 640 million to increase its cement capacity.

- Swiss cement giant Holcim plans to invest USD 1 billion in setting up 2-3 green-field manufacturing plants in the country in the next five years to serve the rising domestic demand.

Indirect Tax Proposals:

- Basic Custom Duty on two critical raw materials of cement industry viz. **petcoke** and gypsum is proposed to be reduced from 5 per cent to 2.5 per cent.

STEEL:

India became the fourth largest producer of crude steel in the world in 2010 as against the eighth position in 2003 and is expected to become the second largest producer by 2015. Led by strong demand for autos and engineering services, the domestic steel demand in India remains robust.

Growth Aspects:

The Steel industry plays a major role in India's economic development. Steel industry has a high growth potential. In order to realize the growth potential in the steel industry, it is essential to ensure that the industry remains competitive. One is the availability of inputs.

Shortage of inputs like coke has led to increase in costs. Proper infrastructure facilities like transport infrastructure, power, etc, are of prime importance.

Expectations:

However, sharp rise in steel price will push product prices higher adding to inflationary pressure.

Steel manufacturers have increased prices by 30 per cent in the last two months anticipating Australia to hike the coke price due to the recent floods that hit its coal mines. Most developed countries have regulations aimed to protect the domestic steel industry.

Indirect Tax Proposals:

- Full exemption from basic customs duty is extended to stainless steel scrap.
- Basic custom duty on ferro-nickel is reduced from 5 per cent to 2.5 per cent.
- Statutory rate of export duty on iron ores is increased from 20 per cent to 30 per cent while unifying the effective rate of export duty on iron ore fines and lumps at 20 per cent.
- Iron ore pellets are fully exempted from the export duty.

Other Proposal:

Allocation of Rs. 2,14,000 crores for infrastructure in F.Y. 2011–2012 will increase the demand for steel.

REAL ESTATE:

The real estate sector in India provides a big investment opportunity. India, in particular Mumbai and Delhi, are good real estate investment options for 2011. Residential properties maintain their growth momentum. Real estate companies are also coming up with residential and commercial projects in Tier-II and Tier-III cities and the growth is due to increase in demand for organized realty and availability of land at affordable prices in these cities.

Tata Housing is planning to launch about 10 new residential projects in both affordable and luxury segments in 2010-2011, with an investment of about USD 268.9 million along with its partners.

The International Finance Corporation will continue to invest USD 1 billion in India every year for the next two or three years.

A dozen new Special Economic Zones (SEZs) are to come up in the next few years.

Other Proposals:

- Existing scheme of interest subvention of 1 per cent on housing loan further liberalized.
- Existing housing loan limit enhanced to Rs. 25 lakhs for dwelling units under priority sector lending.
- Provision under Rural Housing Fund enhanced to Rs. 3,000 crores.
- To enhance credit worthiness of economically weaker sections and LIG households, a Mortgage Risk Guarantee Fund to be created under Rajiv Awas Yojana.

ENGINEERING:

Engineering in India gives sense of pride to the Indian industry and provides confidence to the global technical and engineering community. Engineering and R & D Services is a USD 10 billion industry.

Indirect Tax Proposals:

- The benefit of full exemption from basic customs duty and CVD currently available to 'Tunnel Boring machine' and parts thereof for hydro-electric power projects is extended to such machines for highway development projects also.

- The concessional import duty of 5 per cent basic customs duty, 5 per cent CVD and Nil Special Additional Duty (SAD) currently applicable to high-speed printing machinery is extended to mailroom equipment compatible with such printing machinery imported by registered newspaper establishments.
- A concessional rate of 5 per cent basic customs duty, 5 per cent CVD and Nil SAD is extended to parts and components for manufacture of 23 specified high voltage transmission equipments.
- Full exemption from basic customs duty is extended on bio-based asphalt sealer and preservation agent, millings remover and crack filler, asphalt remover and corrosion protectant and sprayer system for bio-based asphalt applications.

TEXTILES:

Indian Textile industry contributes 14 per cent of the total industrial output and 15 per cent of exports.

The Government expects the industry numbers to triple to USD 220 billion from the current USD 70 billion.

Indirect Tax Proposals:

- Optional levy on branded garments or made up articles of textiles to be converted into a mandatory levy at unified rate of 10 per cent.
- Full exemption from excise duty has been provided in cases of specified parts of sewing machines (other than those with inbuilt motors) and Cotton stalk particle board.
- Full exemption from excise duty available to automatic looms and projectile looms is withdrawn.
- Optional excise duty payment abolished.

AUTOMOBILES AND FORGINGS:

World over the Automobile Industry forms about 10 per cent of a country's Gross Domestic Product (GDP). In the last recessionary period, all major economies tried to give a boost to their automobile sector by providing fiscal support to meet their GDP growth objectives. In the last budget Government had partially rolled back the stimulus provided to the auto players by increasing the excise duty to 10 per cent, due to which the automotive sector emerged stronger. It has continued its growth momentum in the current fiscal (YTD FY2011) with 30 per cent growth in sales.

Indirect Tax Proposals:

- On Motor Vehicles, which are registered as Ambulance and Factory Built Ambulance concessional rate of 10 per cent excise duty is proposed.
- Concessional Excise duty of 10 per cent is proposed for hydrogen vehicles based on fuel cell technology. Concessional rate of 5 per cent of excise duty is extended to specified parts of vehicles and plug in kits for conversion of normal fuel vehicles into hybrid vehicles.

  The increase in flow of money to the rural areas from Rs. 3,75,000 crores to Rs. 4,75,000 crores may lead to demand creation in rural areas.

MEDIA & ENTERTAINMENT:

Media, the fourth estate, when entwined with the entertainment component, represents an effective facet of consumers in India.

Technology has played a key role in influencing the entertainment industry, by redefining its products, cost structure and distribution.

The phenomenal development witnessed in recent years in media and entertainment has made it one of the rapidly performing sectors in our economy.

Indirect Tax Proposals:

It is proposed to exempt colour, unexposed cinematographic jumbo rolls of 400 feet and 1000 feet from CVD by providing full exemption from custom duty.

- Basic custom duty on waste paper is proposed to be reduced from 5 per cent to 2.5 per cent.

Reduction in Basic custom duty on waste paper will result in reduction in cost of raw material for print media. Cinematographic jumbo rolls of 400 feet and 1000 feet exempted from custom duty will also result in reduction in cost of raw material for print media.

FINANCE SECTOR:

India's financial markets continued to gain strength in the wake of steady reforms since 1991. Prudent regulations and financial institutions protected the Indian economy from global financial shocks. Bank credit continued its momentum during 2010-2011.

RBI issued guidelines to banks for mainstreaming micro-credit and enhancing the outreach of microcredit providers.

The momentum in the micro-finance sector has brought into focus the issue of regulating the sector.

CAPITAL MARKETS:

Primary Market

The year 2010-2011 has seen the Indian capital market move towards strong growth. The cumulative amount mobilized as on 30 November 2010-2011 through initial public

offers (IPOs), follow on public offers (FPOs) and rights issues has marginally declined.

Secondary Market:

As on 31 December 2010, Indian benchmark indices the Sensex and Nifty, rose by 17.0 per cent and 17.9 per cent respectively over the closing value of 2009-10. The free float market capitalization of Nifty, the Sensex, Nifty Junior, and BSE 500 also showed an increase of 19.8 per cent, 22.8 per cent, 15.5 per cent and 20.8 per cent respectively.

INSURANCE SECTOR:

The insurance sector was opened for private participation with the enactment of the Insurance Regulatory and Development Authority Act 1999.

Since the opening up of the sector, the number of participants has gone up from six insurers to 48 insurers operating in the life, non-life, and reinsurance segments.

Indirect Tax Proposals:

- Services provided by Life Insurance companies in the area of investment proposed to be brought into service tax bracket.

The Direct, indirect and other proposals have positive and favorable impact on the finance sector.

PHARMA:

The domestic pharma industry continues to grow at 11-12 per cent.

Exports of pharmaceuticals has consistently outstripped imports, India currently exports drug intermediates, active pharmaceutical ingredients (APIs), finished dosage formulations, bio-pharmaceuticals and clinical services.

The top five destinations of Indian pharmaceutical products are the USA, Germany, Russia, the UK and China. The domestic pharma sector has also expanded in recent years.

Indirect Tax Proposals:

- P & P medicines imported for retail sale is being exempted from Special Additional Duty of Customs.
- Customs duty on four life savings drugs and bulk drugs is being reduced from 10 per cent to 5 per cent with NIL CVD (by way of excise duty exemption).
- Basic Customs duty on lactose for use in the manufacturer of homeopathic medicines is being reduced from 25 per cent to 10 per cent.

Indirect tax proposals will have favourable impact on pharma sector.

RETAIL SECTOR:

The Indian modern retail segment is at a nascent stage with penetration of less than 6 per cent, in an overall retail industry size of $350 billion.

A favorable demographic profile and an increasing purchasing power coupled with a changing mindset towards an organized retail format augurs well for the modern retail players.

Organized retail in India has the potential to add approximately over Rs. 2,000 billion (US$45 billion) business generating employment for some 2.5 million people in various retail operations and over 10 million additional workforce in retail support activities including contract production and processing, supply chain and logistics, retail real estate development and management etc.

Indirect Tax Proposals:

- Full exemption of excise duty is withdrawn on consumer goods which will attract 5 per cent concessional rate of excise duty which will lead to increase in MRP cost.
- Concessional CVD @ 5 per cent (by a way of central Excise exemption) and full exemption on SAD is being provided to **LEDs** used for manufacture of LED Lights and Light fixtures.

SUGAR:

Sugar production in India is cyclic in nature.

The estimated sugarcane production as per the first advance estimates 2009-10 is 24.95 million tones against a production of 27.39 million tones as per the fourth advance estimates 2008-09.

Indirect Tax Proposals:

- Basic custom duty is reduced on specified agriculture machinery for sugarcane harvesters from 5 per cent to 2.5 per cent and on parts and components required on manufacture of equipments reduced from 7.5 per cent to 5 per cent .

Other Proposals:

- The target of credit flow to the farmers has been increased from Rs. 3,75,000 crore this year to Rs. 4,75,000 crore in 2011-2012.

  Banks have been asked to step up direct lending for agriculture and credit to small and marginal farmers.
- The existing interest subvention scheme of providing short term crop loans to farmers at 7 per cent interest will be continued during 2011-2012 and enhance the

additional subvention to 3 per cent in 2011-2012. The effective rate of interest for such farmers will be 4 per cent per annum.

All these budget proposals will help sugarcane farmers to increase their productivity and profitability.

TELECOM:

The Indian telecom industry has grown by leaps and bounds. Currently, with 750 million subscribers, it still stands at an all India penetration level of 60 per cent, and rural penetration of as low as 30 per cent, thus providing ample growth opportunity. Of late, the sector had witnessed high competition, impacting players' earnings profile.

Teledensity:

With increasing private sector participation, the share of the private sector in total telephone connections has increased to 84.5 per cent in November 2010 from a meager 5 per cent in 1999.Teledensity, an important indicator of telecom penetration, rose from 7.02 per cent in March 2004 to 64.34 per cent in November 2010.

Manufacturing:

Indian telecom industry manufactures a complete range of wire-line telecom equipment using state-of-the-art technology. Considering the growth of wireless, there are opportunities for domestic and foreign investors in manufacturing sector. Presently most of the wireless core equipment is being imported and there is great potential to manufacture these items in the country.

Internet / Broadband:

The number of broadband subscribers grew from 8.77 million in March 2010 to about 10.71 million up to November

2010 indicating an annualized growth of 22 per cent. Newer Access technologies like Broad Band Wireless Access (BWA) can significantly transform the character of internet/broadband scenario in India. This will encourage further expansion of wireless service with a vision of providing 'Broadband for all'.

Future Outlook:

3G telecom services: The explosive growth of the telecom industry in India is being followed by the urge to move towards better technology and the next level of service delivery.

One of the key new frontiers is 3G technology.

The auction of 3G/WBA spectrum has been successfully conducted.

Indirect Tax Proposals:

- Full Exemption from Basic Custom Duty is being extended to parts/ components required for the manufacture of PC connectivity cable and sub-parts of Parts & Components of Battery charger, hands free head phones and PC connectivity cable of mobile handsets including cellular phones.
- Full exemption from Special Additional Duty (SAD) u/s 3(5) of the Custom Tariff Act 1975, presently available up to 31.03.2011 on parts, components and accessories for manufacture of mobile handsets including cellular phones is being extended upto 31.03.2012.

The industry had expected for an exemption of service tax on broadband. However, budget has not made any announcement.

Conclusion:

Over all, capital market should remain active and worth participating by retail investors, directly or through mutual funds.

The views expressed in this booklet are not necessarily those of the Forum of Free Enterprise.

SHAILESH KAPADIA

(24-12-1949 – 19-10-1988)

Late Mr. Shailesh Kapadia, FCA, was a Chartered Accountant by profession and was a partner of M/s G.M. Kapadia & Co. and M/s Kapadia Associates, Chartered Accountants, Mumbai.

Shailesh qualified as a Chartered Accountant in 1974 after completing his Articles with M/s Dalal & Shah and M/s G.M. Kapadia & Co., Chartered Accountants, Mumbai. Shailesh had done his schooling at Scindia School, Gwalior and he graduated in Commerce from the Sydenham College of Commerce & Economics, Mumbai in 1970.

Shailesh enjoyed the confidence of clients, colleagues and friends. He had a charming personality and was able to achieve almost every task allotted to him. In his short but dynamic professional career, spanning over fourteen years, Shailesh held important positions in various professional and public institutions. His leadership qualities came to the fore when he was the President of the Bombay Chartered Accountants' Society in the year 1982-83. During his tenure he successfully organized the Third Regional Conference at Mumbai. He was member, Institute of Fiscal Studies, U.K.; member of the Law Committee and Vice-chairman of the Direct Taxation Committee, Indian Merchants' Chamber. He was also a Director of several public companies in India and Trustee of various Public Charitable Trusts.

He regularly contributed papers on diverse subjects of professional interest at refresher courses, seminars and conferences organised by professional bodies.

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

- Eugene Black
Former President,
World Bank

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of Free Enterprise

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In recent years the Forum has also been focusing on the youth with a view to developing good and well-informed citizenship. A number of youth activities including essay and elocution contests and leadership training camps are organised every year towards this goal.

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