KEEP YOUR EXPECTATIONS LOW

In a spirited panel discussion moderated by *Business Today* editor Chaitanya Kalbag, Yashwant Sinha, MP and former finance minister, M. Damodaran, former SEBI chairman, Satya Poddar, Partner, Ernst & Young, Samiran Chakraborty, Regional Head of Research, Standard Chartered Bank and Nilesh Shah, President, Corporate Finance, Axis Bank, shared their views. Edited excerpts

Chaitanya Kalbag: All indicators point to a very disturbing situation. Mr Chidamabaram has already pushed in measures that should have been part of the Budget. I think something is afoot.

Yashwant Sinha: Whenever a finance minister sits down to prepare the Budget, there are five or six issues he has to keep in mind. The first is macroeconomic issues: the current macroeconomic issues are the various deficits, inflation which refuses to go away, interest rates as a result of that, and then savings and investment, which will include the flow of foreign funds – FII and FDI.

Now, we discussed this last year, that the last Budget was the last chance Budget of the UPA government because the next Budget would be just before elections, and this year is the last full Budget of the UPA government. Next year would be a vote on account Budget. So, whatever has to be done, has to be done now. Last year's Budget was clearly regressive. We went backwards. And now when the old finance minister or the new finance minister has taken over again (Chidambaram taking over from Pranab Mukherjee), he is trying to reverse everything that Pranab Mukherjee did. So much change does not even occur when governments change.

CK: We talk about the problems of the coalition, but in this case, they are both from the same party.

Sinha: The same party, the same prime minister. The prime minister is as much involved in the Budget exercise personally as perhaps the finance minister. And he is privy to every decision that the finance minister takes. In fact, the Budget speech is taken by the finance minister to the prime minister for a look; the prime minister proofs the Budget speech, only then it goes into print. The only freedom the finance minister enjoys is to insert a quotation... or some poetry.

The finance minister has options, he has very difficult options. I understand, he has reduced the expenditure of the government by over ₹100,000 crore in this year's Budget. But he has a very difficult task. The starting point has to be control of the fiscal and revenue deficit. Whatever maybe the immediate price that the government has to pay, it is important in the national interest that the government does it. A bitter pill today will lead to better health tomorrow. If we don't do it, then we are going further downhill. That is the starting point. If the FM is able to rein in the fiscal deficit at 5.3 per cent in this year's Budget and 4.6 per cent in next year's Budget, then I will compliment him and say he has made a strong beginning. Austerity will not save us tonnes of money, but will send out the right message.

It appears on the expenditure front in these nine years, the government has followed a very expensive, reckless policy. I am reminded about the comment that Dr I.G. Patel made about the Rajiv Gandhi era that "he has spent as if money didn't matter."

This is why fiscal deficit has to be reined in, which will have an impact on inflation.

CK: Mr Damodaran, would you like to say something about the situation?

M. Damodaran: Austerity sends a message, but it is not the complete package. By doing a little less of the same, you cannot get a solution that is sustainable and can serve you in the long run. I believe that somebody should take time off from the here

"IT NEEDS REAL FIGHTING SPIRIT TO REDUCE THE BURDEN OF SUBSIDIES"

YASHWANT SINHA, Former Finance Minister

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-32-

and now, and look at the Budget in detail and see what needs to survive.

I also believe the huge positive we have is that there is a recognition and understanding of the nature and dimensions of the problem. What you need is putting in structural solutions, and they will emerge only from zero-based Budgeting.

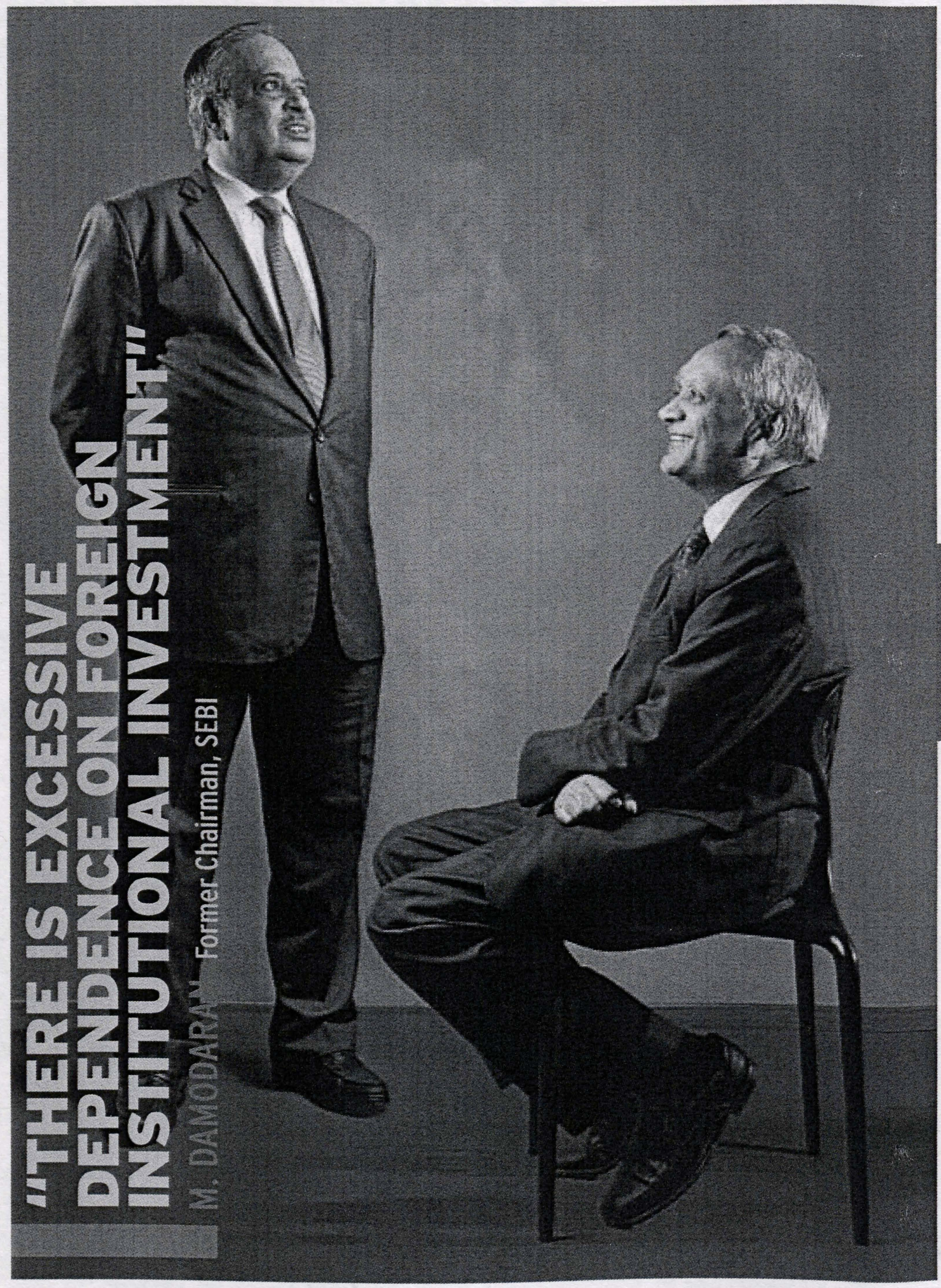
Two-three points I think are important. One, I think there is excessive dependence now on foreign institutional investment, especially through participatory notes, and to my mind, in the long term, this can be hugely destabilising. It is all right in the short term, you find that flow of money has dried up and you are agnostic about the instruments through which the money comes in. That is not a long-term solution. We need to ensure that the Indian contribution to the Indian growth story is more than what it is at this point of time.

In India, we find increasingly a practice which is called nothing succeeds like a successor, the predecessor is necessarily wrong.

CK: We did some analysis and it showed that in the last nine years this government has been constantly reversing direction, you do something and then you undo it.

Damodaran: In fact, if you talk to people within and outside the country they will tell you, make whatever provisions you want to, but do two things: let those provisions stay unchanged for a while, so that we get used to it and we can plan our businesses and our life on that basis. Number two, state it simply, we do not want too many ifs and buts, which then makes it paradise for lawyers. Make laws a little simpler .

These are the two things people are asking for. Some continuity, some certainty, some clarity on what the provisions are.



CK: So, Mr Poddar, taxation is being frequently referred to. I am very interested to know what you have to say.

Satya Poddar: On the taxation side, the government has been trying to mobilise additional tax revenues. As a result rather than mobilising additional revenues, the tax system has become less productive than before. Compliance has gone down. A very aggressive tax administration is scaring foreign investors. There are increasing volumes of disputes in the courts on issues which should not have been debated at all. In countries like Britain, Japan, there are no more than one or two court cases of transfer pricing. In India there are 4,000 transfer pricing cases each year and none of them gets resolved and then the government of India says or the ministry of finance says that we have ₹40,000 crore in demand of transfer pricing cases which is a method of bringing back illegal money. Now transfer pricing and illegal money have absolutely nothing in common. Transfer pricing is nothing but a division of a declared income between two governments.

"COMPLIANCE HAS GONE DOWN. AN AGGRESSIVE TAX ADMINISTRATION IS SCARING FOREIGN INVESTORS"

SATYA PODDAR, Partner, Ernst & Young

Now take the example of GST, (goods and services tax) in 2006/07 they announced they will have GST in five years. For the first four years nothing was done, no serious study, no task force was created and the issues were discussed at very casual meetings more like a tea party.

Number one on the GST front, they need to go back to the basics. The constitutional amendment Bill that was tabled was clearly flawed. The government was not serious about implementing it and there was no consensus on it. Now they have reached a compromise. In my view, compromise is still the second best. The government should still take some time to see if they can get a better model.

My own feeling is that the Centre has given up. Mr Chidambaram's view is let me get GST, no matter how good or bad.

Now you talk about taxation of the rich. My own view is who are the rich that you are trying to tax, and I divide the rich into three packets: the working rich, the investor rich and the invisible rich. Working rich are basically the employees who do work. All of their income is fully reported and is fully taxable and they are the ones who are in the universe of tax returns filed. I have a feeling that 80 to 90 per cent of the so-called rich, say, more than ₹50 lakh to ₹1 crore of income, are really the employees who have done well through their efforts and are getting good salaries.

Then you have the investor rich. The investor rich are essentially those who have done well, but they get their income predominantly from capital gains and dividends and maybe interest. And those incomes by law are not taxable. Capital gains are all exempt on listed securities. Dividends are not taxable at the personal level, they are only taxable at the corporate level and even interest income – if they have tax-free bonds or other instruments – even that is not taxable. So those incomes perhaps are declared because they are not taxable in any case. Now that's where you have no tax. Now when you say the rich should pay more tax, I say by all means, but then define the rich to include all the three categories. If you simply increase the tax rates in the name of rich paying more tax you are basically going to increase more burden on the employee class which is already a very significant contributor to the tax system.

CK: Dr Chakraborty, how do you see things from the commercial capital of the country?

Samiran Chakraborty: I would start by saying that the drop in growth rate from nine per cent plus to just five per cent in five quarters. What we are observing today is probably that five per cent is being arrested; we are not dropping any further for almost four quarters now. We are kind of stagnating around that five per cent mark. We are yet to see distinct macro improvement coming in terms of growth numbers. So, my point is very simple that our growth slowdown is primarily investments slowdown, which is now getting translated into a consumption slowdown. Now, the investments slowdown is because of three broad reasons – one is obviously the high interest rate effect, and two is all kinds of approval related issues, and three is that at this point of time if we take the top 500 companies in India, their debt equity is at a 10-year high. We will see a pretty slow recovery in investment because of high leverage.

So, essentially 2013 is also going to be a year of relatively slow growth. I completely endorse the view of fiscal consolidation. There is a lot of skepticism in the market whether it can deliver on the 5.3 and 4.8 [fiscal deficit] or not. He does not have an option of presenting a radical Budget this time around.

CK: Mr Shah, since you watch the markets so closely, what I am interested in hearing from you is: what continues to influence investors' sentiments? Some of us are very worried about what is

- 33 -

coming our way, but others are very happy.

Nilesh Shah: One simple point is that, from the domestic investor point of view the market is nearing an all time high, but if you are a global investor it is 30 per cent lower than the all-time high because of rupee depreciation.

One thing we need to remember, globally there is huge liquidity, almost $7 trillion has been injected into the global coffers, which can come to India. Interest rates globally are one of the lowest in the history of mankind. And India, today can take advantage of the highest ever liquidity and lowest ever interest rates. 2003 to 2008 was the golden period of Indian growth. One of the prime factors was drop in interest rates. The government of India used to borrow at 14 per cent in 1996/97 and it came down to around five per cent in 2003/04. Interest today is one-third of our total income. The government spends one-third of its income just paying interest rates. If we can bring down interest rates through some efforts, it releases so much of pressure from the fiscal deficit side. These are the things which can be done.

CK: Mr Sinha, where do we go from here?

Sinha: Whoever it was in 2009, and you know who it was, inherited a badly damaged economy and I said in the Lok Sabha one day, "I am glad we did not come in power." Because if we had come in power in 2009, we would have been squarely blamed for ruining a perfectly healthy economy. Be that as it may, I think the 2014 situation is going to be very grim. A modern economy runs on sentiment. It is so much arithmetic, but it is also sentiment, and sentiment depends on the political will of the government of the day.

I don't think this Budget is going to help this way or that way because everyone is looking forward to 2014 or whenever the next elections are held. So, really the challenge is for the next government, whichever is to ensure that sentiment in the economy improves.

So, I don't expect very much to happen in this Budget which will help the economy move forward. On the taxation front, which has been a major part of discussion we had here, I would entirely agree with Mr. Poddar, that it is better not to have GST than to have a moth-eaten GST. As far as DTC is concerned, the recommendations of the parliamentary standing committee are with the government and they are in a position to pick up elements which are useful from the DTC and introduce them in this Finance Bill. As far as GST is concerned, I have been saying it for a couple of years now that you leave the states, for the time being, why don't we have a central GST. Let's have a central GST and this will then become a powerful tool to convince the states that GST can work. If it can work it at the central level, it can work at the state level.

I don't agree that we should be adventurous as far as taxation is concerned. It pays to be conservative. Let the rates be stable. Let's not indulge in all this talk of taxing the super rich and inheritance tax and all that. This is not the time to do it.

CK: What would you do, Mr Damodaran, if you were finance minister?

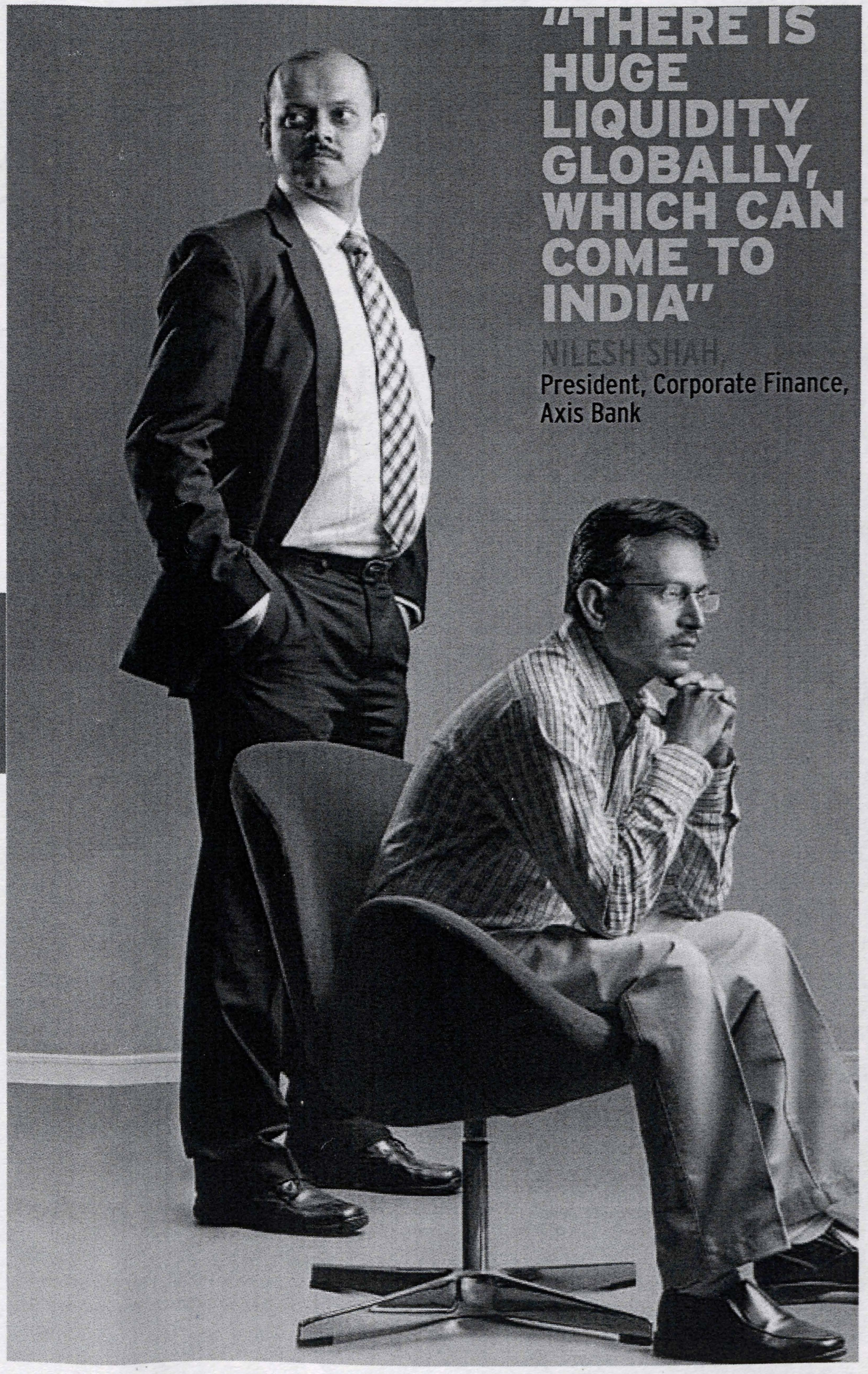
Damodaran: Won't be, luckily. My wish list is: not higher taxes but better tax administration. Secondly, I would like to see investments in skill building. We talk about demographic dividend, but this is not a dividend, unless you invest in skills, skilling and re-skilling. In fact, some of the NREGA funds you can scale down and use that for skill building which this country needs, otherwise those large numbers between the 18 and 35 age group will be a liability.

CK: Dr Chakraborty, what you would like to see that would make you more optimistic about this Budget?

Chakraborty: After the promises that the FM has made in the last few weeks, any slippage on the fiscal side will spell disaster for foreign investment sentiment. We need a more balanced approach to the fiscal deficit where we need to get our tax-GDP ratio back to about the 12 per cent mark. We need to keep the tax rates as far as possible stable. We are almost on the verge of overhauling the direct tax structure and indirect tax structure, before that overhauling happens, a kind of ad hoc measure to tweak things would not be a great idea. In terms of expense reduction, capital spending should get priority and revenue spending, as much as possible, should be curbed. And lastly, financial savings side is a serious problem that is not getting highlighted enough. So, unless we get the savings rate back up to 33-34 per cent, it is very, very difficult to imagine that we will get out of the five-six per cent of low-level growth.

"ESSENTIALLY, 2013 IS ALSO GOING TO BE A YEAR OF RELATIVELY LOW GROWTH"

SAMIRAN CHAKRABORTY, Regional Head, Research, StanChart



CK: Mr Sinha, how can we reduce the monstrous subsidies?

Sinha: Subsidies have always been treated as holy cows. It needs real fighting spirit to reduce the burden of subsidies. The best way to deal with subsidies is to target them properly. Now this is where the cash transfer scheme becomes useful. The other is that, we should evolve a formula, that the moment your input cost goes up, your output price will go up. You raise the minimum support price for agricultural produce, automatically in PDS foodgrain prices will go up. Now where it is serving an economic growth purpose, you should let it survive, and all the rest of it should go to a targeted population.

CK: Dr Chakraborty, do you see the risk of an asset price bubble?

Chakraborty: It's difficult to define bubbles, let me put three things: when we did this huge cash infusion in the economy post the financial crisis, there was no capacity in the economy to absorb the cash. That's why we saw inflation playing up.

Second, because you don't have tax-adjusted real returns on different kinds of financial instruments, some of the money is going into real estate and gold, creating a bubble-like situation. And the third kind of bubble could get created in the equity market but the valuations are not as much stretched as they were before the crisis, there is a little bit of room on the equity side.

CK: It has been a fascinating discussion. Any final comments?

Damodaran: There are limits to talking up the economy, now we'll have to walk up the economy.

Poddar: Don't spring any more surprises. Stay bold and demystify.

Sinha: My advice is: keep your expectations low. ◆

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- 34 -