Insight beyond information

EXECUTIVE BRIEFINGS
POLITICS AND ECONOMY: REFORMS

Adit Jain, IMA India
July 2017

The reform agenda: on track?

Two weeks ago, The Economist Newspaper, a London-based weekly, ran an India briefing entitled 'The Constant Tinkerer'. Whilst largely well researched, some of the arguments presented failed to give consideration to Constitutional limitations that would for instance prevent the federal Government from legislating ideal policies. The Goods and Services Tax is a case in point. Admittedly, the law in its present form is far from perfect, but the fact is it needed a consensus from 28 states and 7 Union Territories with their own agendas and insecurities. Getting everyone to agree on a common denominator was from any benchmark a painfully demanding task and inevitably necessitated compromises. The briefing failed to notice that many of the shortcomings of the current GST structure were agreed upon during the tenure of the previous administration. Re-negotiating those, even if it were possible, would have undone years of progress. However, the article did serve to raise the question as to whether the BJP administration has done enough by way of reform. This paper will present the facts – as we see them – in areas of indisputable progress, those that are wanting and finally, those where the jury is still out.

Clear winners

The first category contains a number of obvious candidates. The most prominent is perhaps the Direct Benefits Transfer (DBT) programme. This effectively comprises two initiatives: Aadhar-based authentication and the *Jan Dhan* banking exercise. By directly transferring cash to validated beneficiaries DBT has helped reduce fake recipients, parallel markets and fund diversions in Government welfare programmes. This has, according to the government, enabled notable savings of Rs 360 billion in FY16 and Rs 570 billion in FY17. From 34 schemes in 2015 the DBT's canvas now stretches across 140 and it is estimated that a total of 528 schemes can eventually be brought within its fold. It is possible to save more than 1.5% of GDP annually through the use of DBT in central Government schemes alone. A similar figure can be added for savings under state Government programmes.

A second area of progress is infrastructure where the Government has correctly tightened its administrative machinery and ramped up the speed of implementation. It perhaps realised early on that private investors were hesitant to commit new investments while banks were in no position to lend. It went about reviving stalled projects and assuming a larger share of expenditure on its own books. For instance, in the case of roads and highways, it doubled its capital expenditure from Rs 275 billion to Rs 541 billion, resolved 62 of 72 stalled projects and increased the rate of tender awards from 2,000-4,000 kms to 10,000 kms a year, all within two years. In the case of the Railways, spending was nearly tripled from Rs 460 billion to Rs 1.2 trillion and project approval durations cut from 2 years to 6 months. In the power sector, almost all states have been brought on board the *Ujjwal Discom Assurance Yojana* (UDAY) scheme for the revival of distribution utilities. The results are encouraging – technical and commercial losses are down from 26% to 22% and under-recoveries of utilities from Rs 0.6/unit to Rs 0.49/unit, in less than two years.

In the domain of legislation too, the Government has some achievements to its credit. The more significant ones includes the Real Estate Regulation and Development Act that brings the realty sector into the fold of independent regulation; the Enforcement of Security Interest and Recovery of Debts Act which amends four separate financial laws to make them more effective; a new Mines and Minerals

Development (MMDR) Act to enable easier transfer of mining leases; the new Insolvency and Bankruptcy Code to reform India's archaic bankruptcy system; and finally, a host of GST-related laws.

In broader areas of policy, the Government can claim credit for having pushed the envelope on federalism by significantly enhancing the fiscal latitude for state Governments. Their share in central tax resources has been increased from 32% to 42% albeit with a consequent reduction in federal support for state schemes. But states now have a larger amount to spend at their discretion in place of standardised central templates. In a similar vein, the replacement of the Planning Commission by the Niti Aayog represents a structural shift towards involving states in the formulation of national policies. Finally, there are successes in the domain of foreign policy, many of which have been led personally by the Prime Minister.

Work to be done

In areas where one might find fault, perhaps the most prominent pertains to the tax administration. While policy-level reforms have been enacted to increase tax collections and clamp down on evasion, commensurate efforts to reform the administration itself possibly fall short of expectations. For instance, the treasury continues to maintain a poor record on disputes and appeals with anecdotal evidence suggesting that it loses a vast majority of them as they are ultimately deemed flimsy. Unless accountability is enforced and data on appeals and refunds made public, matters are unilkely to improve. The tax department's efficiency levels are also uninspiring. Its disposal rate of pending assessments has fallen from 80% in the early 2000s to 68% in 2014-15. The backlog is increasing by 10 million cases a year causing delays and scope for harassment. Another need is for more scientific and localised methodologies to arrive at tax collection targets as unreasonable ones drive arbitrary demands. At a more fundamental level, there is need to widen the tax base beyond the current paradigm. As we have argued in an earlier paper, almost 38% of India's GDP is not subject to direct tax. Such a high percentage, which excludes agriculture and the poorest 20% of the population, leads to an unreasonable allocation of the tax burden across income classes.

Analysts have bickered that the inability to reform the land acquisition regime is one of the failings of this Government. Whilst this it true, to the extent that it has been unable reform the law on acquisitions, the fact remains that the battle is really at the state level. Without the cooperation of the states, a central law has limited value since most aspects of land fall beyond its purview. A more valid criticism would pertain to labour reforms or lack thereof. The Government has made minor amendments to labour laws and commenced a process to collapse the multitude of current laws into 4 or 5 simple codes. However, it has generally avoided difficult subjects such as those relating to retrenchment, trade unionism, contract labour, etc. These discourage the hiring of permanent workers by industrial enterprises and raise the cost of doing business. Effectively they undermine the long term welfare of the very population they were meant to serve. A few states have gone ahead with reforms at their level, since labour is a concurrent subject, and it is possible that as more and more states join the bandwagon the Government may provide a push at the federal level.

The jury is still out

The final category comprises areas where efforts have been made but results may not yet be visible. The most obvious of these is the GST, which came into force on July 1 but can hardly be assessed at this time. The challenges stem from the multiplicity of tax rates and the sheer newness of the tax. However, the efforts by the administration to smoothen the transition and provide leeway wherever possible are equally significant and should help compensate. A more pertinent issue relates to the recovery in industrial investment, which is as yet a hesitant one. Proposed investments dropped from Rs 5.6 trillion in 2012 to Rs 3.1 trillion in 2015. To arrest this trend, the Government simplified the process of environmental and forest approvals, fast-tracked infrastructure projects, eased labour laws for small companies and increased FDI limits in many sectors. So far, these have had modest results with planned investments increasing to Rs 4.1 trillion in 2016. However, this should pick up in 2017 and 2018. One indication of this stems from the trend in actual investments ('implemented' as opposed to 'proposed') as this ultimately defines the attractiveness of a country. This shows a slight uptick – from Rs 820 billion in 2012 to Rs 1.0 trillion in 2016 – and should lead to an improvement in investor sentiment. Indeed, DIPP data shows that proposed investments had already reached Rs 2.1 trillion in the first four months of 2017.

Finally, the all-important issue of banking NPAs remains an inconclusive one. Whilst some aspects of the problem lie in the domain of the central bank others, specifically legislative and financial ones, are the Government's responsibility. On the former, as noted above, the Government has taken steps by way of enacting the Insolvency Code and amending other laws to enable faster debt recovery. On the latter, it has done relatively less. A Rs 700 billion recapitalisation plan over five years, will clearly not be enough in view of the fact that bad loans stand at around Rs 12 trillion if all dubious assets are counted. Unless banks are allowed to raise funds from the market, diluting the Government's equity in the process, it is difficult to see a permanent solution. So far, the Government has not committed itself on this issue either way.

In the final count, any economic analysis that seeks to evaluate a Government mid-way through its term suffers from the obvious shortcoming that not enough time has elapsed to appraise large scale or structural initiatives. This can be further complicated by a difficulty in separating what should be attributed to the current administration versus the previous one. However, by most benchmarks, the current Government has a number of achievements to its credit and if it remains focussed on its economic agenda for the rest of its term, it should surely be able to add another feather or two in its cap. Economic growth now at over 7%, from a wobbly 5.5% a few years ago, would constitute decent performance. On this issue at least there can be no debate.