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ASG Analysis: India's FY 2022-23 Union Budget Focuses on Long-Term Ambitions

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Key takeaways

- The Modi administration's ~$530 billion budget, released February 1, focuses on setting a long-term policy agenda around increased infrastructure spending and capital expenditures to spur robust economic growth over time. While it has been presented as a landmark point on the journey to Prime Minister Narendra Modi's "India@100" vision, many of its specific expenditures are also targeted at demonstrating results ahead of India's next general elections in 2024 and fast-approaching state-level polls in 2022.

- Unlike other significant election year budgets, this one does not focus on sweeping populist measures, significant tax breaks for India's substantial middle class, or increases in social sector spending. Instead, it centers on the growth and development of both hard infrastructure – ports, roads, airports, housing, etc. – and digital infrastructure under the prime minister's "Gati Shakti" program, the National Master Plan for Multi-Modal Connectivity.

- The development of India's digital economy is front and center in the FY 2022-23 budget. The budget includes incentives to promote the application of technology across the economy, and especially around financial inclusion, the energy transition, and climate change. It also includes important measures to continue the Indian government's shift toward greater digital service delivery.

- Unlike in previous years, this budget does not include large divestment targets, corporate taxes, or tariff measures under the Modi government's "Atmanirbhar Bharat" ("Self-Reliant India") or "Make in India" programs. It instead ensures policy continuity in its support of the 14 national Production-Linked Incentive Schemes, continues efforts to support a dynamic start-up economy, and empowers states to participate in a to-be-launched Special Economic Zone 2.0 policy that will enable them to become partners in "Development of Enterprise and Service Hubs." The overall goal is to make domestic manufacturing more competitive and integrate India into regional and global supply chains.

- While the budget release comes amid another Covid-19 wave, social spending remains consistent with the original FY 2021-22 budget prior to its amendment last summer. Health and employment are not front and center in the budget recommendations, though there is a clear focus on using technology to strengthen service delivery.

State of the economy

On February 1, Prime Minister Narendra Modi's government released its budget for the fiscal year beginning on April 1. This budget marks the midpoint of PM Modi's second term in office. While the overwhelming story of this budget is continuity in policymaking, the subtext continues to be his government's ambition to restructure India's government and economy in a durable way. The budget predicts an 8 to 8.5 percent growth rate over the next year, which is slightly more conservative than the International Monetary Fund's projection of 9 percent. These growth rates are from a deflated base reflecting the unprecedented economic pain inflicted by Covid-19 and the sluggish growth that preceded it.

The budget document and the corresponding Economic Survey, released the day before, tell an optimistic story about India's economic recovery from the pandemic. They highlight recent positive steps, including the privatization of Air India and its acquisition by Tata Group, and ongoing steps to deregulate sectors and simplify regulatory processes in consultation with the private sector and other stakeholders. Going forward, the government anticipates continuing but declining pandemic impacts on economic growth and revenue, but growing disruptions to global trade flows that could be a drag on growth.

Modi's government continues to frame its agenda around the long-term India@100 agenda (i.e., 100 years since India's independence in 1947) that the prime minister announced in his Independence Day remarks last August. This is somewhat surprising, given the Bharatiya Janata Party's tendency toward populism and the competitive pressures it faces ahead of state-level elections later this year. Capital expenditures, largely associated with the Gati Shakti national master plan for economic connectivity and infrastructure development, are projected to increase by 35 percent over last year, with fewer limits on states' ability to access an estimated $13.3 billion in long-term, zero-interest financing for infrastructure projects.

Increased capital expenditures

The budget's focus is an increase in government infrastructure spending and, consequently, a 43 percent rise in sovereign borrowing over last year. The budget includes a significant increase in capital investments in logistics, transportation, and public infrastructure that will promote inter-state connectivity. This budget commits $100 billion (2.9 percent of GDP) to jumpstart infrastructure development – an increase over the $74 billion allocation to capital expenditures in the previous fiscal year. Finance Minister Nirmala Sitharaman framed the increase as another step to boost private investment and local demand, the two key pillars of the Make in India agenda.

THIS BUDGET COMMITS $100 BILLION (2.9 PERCENT OF GDP) TO JUMPSTART INFRASTRUCTURE DEVELOPMENT.

The Gati Shakti master plan for infrastructure connectivity, which is guiding the allocation of much of the government's capital expenditure increase, has been defined by the prime minister as a generational, $1.3 trillion project to reduce logistics costs across the economy from an estimated 13 percent of GDP to 8 percent. This includes a government commitment to build 25,000 kilometers of roads over the coming year, as well as multiyear commitments to introduce a "Unified Logistic Interface Platform" to assist just-in-time inventory management; significantly expand multimodal logistics infrastructure; and install fiber optic cables to connect all of India's villages, even in remote areas, by 2025, through a public-private partnership model. The government's intent to bring together 16 key government ministries under a common National Master Plan to improve inter-ministerial coordination may help expedite processes and approvals required for infrastructure projects. Separately, the government has decided to expand the single window portal for environmental clearances to encourage sustainable infrastructure development. These measures, along with the already running single window clearance process for investments, tie in with the Modi government's goals of improving the country's business climate.

The Gati Shakti framework also includes steps to promote exports by improving trade facilitation and streamlining customs administration processes, though progress in this area has been relatively slow in recent years. State governments will be able to access as much as $13.3 billion in financing to develop domestic infrastructure, including around the "smart cities" programs and broader digital initiatives.

Several other measures represent significant opportunities for private industry. While total private equity and venture capital investment in India last year was estimated at around $74 billion, the government announced its intention to develop a committee to promote further growth in foreign capital inflows. One related measure includes a new cap on capital gains taxes at 15 percent, which is a significant simplification from the past graded rate system that maxed out at 37 percent. The government also announced a new commitment to improve the ability of investors to make exits, including by creating a new Center for Processing Accelerated Corporate Exits (C-PACE) to propose measures to reduce the time it takes to navigate regulatory hurdles.

The budget is also more forward-leaning in its policy statements related to promoting innovation in emerging technologies, including artificial intelligence (AI); lower-earth orbit satellites and other geospatial systems; commercial unmanned aerial systems (drones); advanced semiconductor, genomics, and pharmaceuticals; green energy sources; and electric vehicles and other efficient mobility systems. The government also signaled its intention to introduce blended finance facilities around climate, AI & deep-learning, pharmaceutical, and agricultural innovations, where these funds would be entirely managed by private fund managers and the government's share of the funding would be limited to 20 percent of the funds. Limited details exist about this proposal.

Digital initiatives

The trend toward digitization remains front and center. The budget includes additional steps on e-governance related to health; micro, small, and medium enterprises (MSMEs); workforce development and education; agriculture; and land records management, among other areas.

In this budget, Finance Minister Nirmala Sitharaman announced digitization initiatives in key sectors:

- **Education**: A new digital university will provide access to students across the country. Content will be made available in different Indian languages and platforms. The budget also announces new public funding for "Digital Teachers" educational content in all of India's spoken languages for distribution via the internet, mobile phones, television, and radio.
- **Health**: The budget envisions a National Digital Health Ecosystem, including the expansive application of Electronic Health Records (EHR) with interoperability among facilities. This would use a unique health identity and consent framework, which would be consistent with the forthcoming Data Protection Act and is part of the government's desire to promote improved, universal access to health facilities.
- **Agriculture**: The budget envisions a public-private partnership initiative to improve the use of digital services by farmers to reduce logistics costs and streamline the value chain.
- **Energy**: The government allocated an additional $2.6 billion to the Production-Linked Incentive program to promote domestic manufacturing of high-efficiency solar panels.

- Other initiatives include expanded workforce training programs, enabling "Drone-As-a-Service" in varied applications, strengthening digital banking and payments, and digitizing government procurement.

The government used this budget to announce plans to tax virtual digital assets, including crypto assets, NFTs, and other emerging categories of digital assets, at an initial flat rate of 30 percent, without the ability to access additional deductions on related income. The broader regulatory framework around digital assets is still under development, and opportunities continue to exist to collaborate with regulators and policymakers to shape India's role. The move to tax virtual digital assets is a significant step toward a normalized regulatory approach.

One additional feature of note is the government's focus on improving monitoring and accountability around major public infrastructure projects. That includes the use of digital tracking, geospatial monitoring, and the use of drones to observe project development over time. This emphasis continues the trend toward digitization of public services over Prime Minister Modi's eight years in office.

Climate and sustainability

Building on PM Modi's commitments at the COP26 summit in Glasgow, the budget offers more detailed information about the Indian government's short- and long-term strategies for low-carbon development, including:

- **Urban development**: The budget describes a plan to constitute a high-level committee of urban planners, economists, and other experts to review related policies and planning, including around building bylaws, digitization, and mobility initiatives. Minister Sitharaman describes cities as the "centers for sustainable living" and indicated that the India@100 framework envisions over half of India's population living in cities by 2047.
- **Green finance**: The government announced its Green Bond program for financing public infrastructure. The Finance Ministry has committed to standing up a Task Force on Sustainable Finance to further policymaking in this area, and the Reserve Bank of India also announced it has created a Sustainable Finance Group that would identify additional measures to promote investment in sustainable infrastructure and counter climate change-related financial risks.
- **Clean and sustainable mobility**: The government announced it would introduce a new battery swapping policy around electric vehicles, aimed at improving sector-wide interoperability, alongside plans for improving the distribution of charging stations. The budget also includes other incentives to encourage the production and adoption of electric vehicles and advanced battery technologies.
- **Blended fuels**: The budget includes measures consistent with the goal of achieving a 20 percent blending of ethanol in petroleum, which the prime minister announced last June. The budget includes a new, modest differential excise duty (INR 2 / Liter) targeting unblended fuels to encourage use of blended alternatives.

Next steps

The Modi government has in the past pointedly underscored its belief that the annual Union Budget document isn't the only occasion for the government to introduce significant policy reforms. To that end, it has already indicated that India will very soon be launching its national hydrogen policy. The Modi government also set forth an ambitious plan for executing new trade agreements to encourage exports, though India's willingness to support high standard agreements remain in doubt.

It remains to be seen whether further steps will be taken to fill perceived gaps in this year's budget, the most contentious of which is the lack of attention to social spending, an area where the government had to introduce a significant midyear expansion last year in spite of mounting debt. Opposition criticism has focused on this shortfall, pointing to a recent national survey which indicated that 84 percent of Indians have experienced decreased income due to the pandemic. The social welfare allocations included in this budget make a mid-term upward adjustment likely. Social stimulus will likely expand the fiscal deficit, contribute to rising debt, and could cause further inflationary trends. The latter is already a hot-button political issue due to rising global oil and gas prices.

It is also notable that this government does not mention the privatization of or further disinvestment in state assets, which was a prominent headline in last year's budget. The government scaled back its disinvestment targets after achieving only about 45 percent ($10.4 billion) of $23.4 billion in receipts from the sale of government assets last year. The budget assumes $8.6 billion from the sale of government assets this fiscal year, indicating the government's reduced ambitions even after the headline grabbing sale of Air India and the proposed Initial Public Offer of the Life Insurance Corporation of India.

Tax reform measures, both in terms of relief for MSMEs and in terms of simplification, are also largely absent from this budget. The budget does not consider the benefits of a simplified and less costly Goods and Services Tax, which would alleviate a significant complaint made by foreign firms operating in the market, nor does it offer ideas to address the lingering debt issues confronting public sector banks. Often, the center appears to have chosen capital-intensive, government-centric interventions, as is the case with the extension of credit guarantees for MSMEs over tax administration changes that are widely sought by private firms.

The budget seems likely to be passed by Parliament essentially as presented by the end of the budget session on April 8. However, as always in India, the programmatic details around implementation comes later – and therein often lies the real challenge.

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