

## OUR VIEW



## A little more generosity to shareholders please

*India Inc appears to be upping dividend payouts in response to a taxation shift due in 2020-21. Now let's use higher dividend yields to lure retail investors to equity markets*

Indian companies seem to be in a rush to reward their owners with larger chunks of their profits than seen in recent times. Interim dividend payouts are being announced at an impressive pace. These decisions can be traced to the recent budget declaration that the tax burden on dividends will be shifted from companies to shareholders from next fiscal year. The dividend distribution tax paid by firms is to be axed, and shareholders would have to count what they get as part of their income and pay tax on it in accordance with the applicable slab. Currently, the dividend earnings of individuals are exempt from tax up to an annual ₹10 lakh, after which a 10% rate applies. Come April, this personal tax liability will rise significantly for those in higher slabs. Promoters with large holdings, it appears, are keen to rake in the moolah before the new rule kicks in. The number of companies that have declared dividends this month has reportedly more than doubled over the previous year. Corporate motivations, however, are immaterial in the larger scheme of things. What's important is that higher payouts extend into the years ahead and turn into a trend that serves to attract more and more retail investors to Indian equities.

For that, ideally, there should be no tax on dividends at all. Corporate profits are subject to tax in any case and what shareholders get by way of dividends is just a part of that money. The double taxation that such a system imposes on the money made by a company acts as profit dampener, leading many entrepreneurs to pass off their personal spending as business expenses. In time to come, perhaps

the government should consider turning dividends entirely tax free. While it may sound unfair for wealthy owners of companies not to pay any tax on the large sums they earn this way, it is also true that it would encourage Indians of relatively modest means to buy shares for their original purpose: To get some of the money that companies make. As of now, the chief lure that is dangled by stock markets is capital appreciation. People are expected to buy shares in the hope that their market prices will go up and their portfolios will be worth more. The volatility of stock indices, however, tends to put off large numbers. Those who would rather not bear much risk, therefore, opt for "safe" bank deposits and other debt avenues. If the dividend yield, defined as the annual payout as a percentage of a stock's price, of blue chips were to rival the interest available on deposits and the like, then they would get interested in long-term holdings. Any increase in their value would be a bonus.

That is how it is in many developed economies, where interest rates tend to be low and dividend yields high. In the UK, the US and Australia, investors could get as much as 5% annually on the money they put into equities. Most companies listed in India, in contrast, pay less than ₹2 as dividend for every ₹100 invested. At one time, this low yield was said to be because profits needed to be retained to plough back into businesses for expansion. But corporate investment levels have fallen, and the focus of many firms is on profitability. Logically, dividends should get more generous, too. If payouts attract first-time equity buyers, it would aid the cause of vibrant capital markets in India.

## GUEST VIEW

## The government may be faced with a big dilemma in 2020-21

*The Centre could either roll back some investment plans or further slash its consumption outlays*



**ALOK SHEEL**  
is RBI chair professor at ICRIER

The Union budget has set a fiscal deficit target of 3.5% of gross domestic product (GDP) in 2020-21, as against 3.8% in 2019-20. The target overshoots the 3% level mandated under the Fiscal Responsibility and Budget Management (FRBM) Act by 0.5 percentage points. Is this, then, a stimulative budget set against the background of falling growth? And, is the target realistic?

The deficit in itself is not a robust stimulus measure. Ceteris paribus, lower growth increases the (cyclical) budget deficit even in the absence of expenditure growth due to a contraction in tax revenue. But the structural deficit remains unchanged. Had the FRBM Act distinguished between the cyclical and structural components of the budget deficit by factoring in revenue shocks, Indian budgets could have found the fiscal space to increase expenditure and still adhere to FRBM targets. In the absence of such accounting, our budgets tend to be pro-cyclical, overestimating deficits during downturns, and underestimating them when growth is above potential.

The best measure of a fiscal stimulus is expenditure growth. Overall expenditure growth is budgeted to grow by just 12.7%, marginally higher than the nominal GDP growth, and much lower than the 13.2% growth in 2019-20. This could hardly be termed stimulative. It is, how-

ever, still too high to deliver on the budgeted deficit of 3.5%, as an analysis of budgeted revenue receipts indicates.

It is possible to achieve any deficit target, revenue shortfalls withstanding, by spending less than budgeted, as there are limits to the extent to which tax revenue shortfalls can be made good by non-tax revenues.

The tax revenue shortfall in 2019-20 was about 1.5% of GDP. This was partly made good by two developments. First, higher-than-budgeted non-tax revenue, in particular a sharp increase in dividends received from the Reserve Bank of India. Second, a reduction in the states' share in total tax revenue. In 2019-20, the net tax revenue accruing to the Centre rose from 6.9% of GDP to 7.4%, thanks to a decline in the share of states from 4% of GDP to 3.2%. While this may have helped contain the Centre's fiscal deficit, it cannot contain the consolidated deficit of the Centre and states. These two adjustments, combined with a compression of expenditure by 0.4% of GDP compared to what was budgeted, helped restrict the fiscal deficit at 3.8%. Had there been no expenditure compression, the deficit would have been 4.2%.

The most striking feature of the Centre's pattern of receipts of late is the decline in tax revenue relative to

growth in national income. Tax buoyancy was 0.75 in 2018-19, and just over 0.53 in 2019-20, or an average of 0.65 over the two years, on account of a broken indirect tax system and the sharp reduction in corporate tax rates. Seen against the backdrop of the 1.5% of GDP shortfall in tax revenue estimated this year, the revenue buoyancy implicit in the budget projections is an ambitious, and improbable, 1.2.

If tax buoyancy is assumed at 0.65, the projected tax-GDP ratio would be 10.6, lower than the projected 10.8. This would push the deficit to 3.7% from the budgeted 3.5%.

The budget expects to realize the equivalent of 0.9% of GDP through the sale of equity in public enterprises. This seems unlikely at a time of weakening growth and animal spirits, and when these realizations in the last three years were just 0.6%, 0.5% and 0.3%, respectively. If the realization in 2020-21 is 0.5%, the deficit would expand to 4.1%.

If the fiscal deficit target is to be adhered to, expenditure growth might need to be limited to 7.5%, as against the budgeted 12.7%. Where might this compression take place?

Unlike 2019-20, which was an election year, 2020-21's budget privileges investment over putting more income in the hands of the middle class and rural consumers. The outlays on agriculture and rural development, taken as a proxy for rural upliftment, are budgeted to grow by just 13.4% in 2020-21, compared to an estimated 34.8% in the preceding fiscal year. The outlays on IT, telecom, transport and urban development, taken as a proxy for investment in physical infrastructure, are projected to grow by 28.9% in 2020-21, compared to an estimated 8.7% in 2019-20.

The option before the government would be to either roll back its enhanced outlays on investment, or further cut back its reduced outlays on consumption. Past history indicates that the former is more likely.

*These are the author's personal views*

## QUICK READ

The Union budget's stimulative effect was weak and the government seems unlikely to meet its fiscal deficit target for 2020-21. Revenue buoyancy could let it down, as also its ambitious disinvestment plan.

Short of funds, it will probably scale back its enhanced investment agenda, though it could opt to reduce its proposed consumption spending.

## 10 YEARS AGO



## JUST A THOUGHT

Dividends may not be the only path for an individual investor's success, but if there's a better one, I have yet to find it.

JOSH PETERS

## GUEST VIEW

## Is RBI raising systemic risks by pushing retail credit?

DEEP NARAYAN



is visiting faculty of finance at IIM Calcutta and risk management consultant

Both the government and Reserve Bank of India (RBI) have acted in line with their stated commitment towards the defined fiscal and monetary stability framework. Given the pressures of a dwindling growth rate and limited fiscal and monetary growth room, this is commendable. However, it is critical that the decisions taken to revive growth have a high likelihood of success without increasing systemic risk in the medium to long run. In this context, it may be argued that RBI's recent push for retail credit growth would add to systemic risk, while the benefits for India's gross domestic product (GDP) may be limited.

Credit-driven economic booms always end in economic misery. However, to pump-prime an economy, very few tools exist other than credit. Credit is a necessary evil, and thus there is all the more reason to handle it with care. In current economic growth frameworks, economic growth requires capital. Quite often, credit creation is the ultimate source of capital. If the government

spends by increasing its fiscal deficit, government debt increases. If the private sector borrows to invest and kick-start growth, its leverage increases. The best use of credit is when it is used to finance real assets in the economy. When credit does not create real assets, it inevitably creates financial assets such as bonds held by investors, loans held by banks, or accounts receivables held by firms. An overabundance of financial assets created by credit is a precursor to a crisis.

Taking a consumer loan to splurge on a vacation or celebratory dinner does very little to support long-term growth. It creates economic activity only in the immediate period. Which sector should be pushed to ramp up credit and how that money is used become important if reviving sustainable growth is the objective. In a paper titled *Who Gets The Credit And Does It Matter*, Thorsten Beck *et al* studied the growth dynamics of 45 countries for the period from 1994 to 2005. They concluded that only loans to firms are linked to GDP growth, the argument being that firms use credit to increase their capital stock, and thus, real assets. Loans to households, while having desirable social outcomes in terms of boosting consumption and allowing households to tide over short-term cash flow mismatches, do not add to

sustainable GDP growth. Of course, consumer loans such as education loans, which upgrade human resources, are a notable exception. Another kind of consumer loan, the home loan, need not always add to incremental capital stock. Given how slowly the supply of homes responds to demand in the short term, excess credit supply is known to add to risk. In fact, mortgage booms have played key roles in most credit blow-ups.

It is debatable whether consumer loans need a push at all. Retail loan growth, while currently below its 2016 peak of 20%, has been managing to grow at around 15%. In December 2019, RBI cautioned lenders on household debt levels and the associated risk on retail loans. Higher growth in household debt is associated with higher chances of a banking crisis (*Household Debt And Monetary Stability*, IMF, 2017).

But surprisingly, RBI reduced the risk weight for consumer loans other than credit card debt from 125% to 100% in

September 2019. Recently, RBI decided to waive lenders' cash reserve requirement against new exposure to home, auto and Micro, Small and Medium Enterprises (MSME) loans. Home loan growth was hovering around 15% for the last two years. In contrast, growth of commercial credit (loans to industry and services as per RBI), which last exhibited 20%-plus growth in June 2012, has been falling. Since 2016, its annual growth averaged around 6%, with a strong downward trend observed since March 2019. Efforts to revive commercial lending have not borne fruit. This misplaced belief—"if not commercial, let retail loans revive the economy"—needs to be re-looked. The simplistic understanding that any credit uptick can revive the economy needs to change.

## QUICK READ

Taking a consumer loan to splurge on a vacation or celebratory dinner does very little to support long-term growth. It creates economic activity only in the near term.

With low job growth, it is difficult to see how household leverage will not increase. If home balance sheets weaken, it could have profound social and economic implications.

tion here being that consumption will drive the current capacity utilization of 69% to somewhere above 85%, which will trigger capital expenditure. This assumes that the consumer loan boom, already a decade old, will continue for another 3-4 years. Two of the best domestic retail lenders have already shared warnings about retail loans. In an environment of low job growth, it is difficult to see how household leverage will not increase. If capacity utilization does not pick up sufficiently to revive growth, then along with banking and corporate balance sheets, household balance sheets will also be weakened. Over the next 3-5 years, the downside of RBI's retail push appears at least as significant as the upside.

The government and RBI must make more determined efforts to revive corporate activity. Policy stability and confidence in the business environment may push commercial credit better than mere interest rate cuts. Among the options available, using good old government spending to stimulate infrastructure spending, and eventually the economy, appears to be a wiser option. At least its risks are well understood and it's better than risking household balance sheets, given the latter's profound economic and, more importantly, social implications.