Budget 2016: The right nudge to channelize savings in the economy

Shalini Dhawan

A few years ago, UK Prime Minister David Cameron set up the famous ‘nudge’ unit (Behavioural Insights Team) to try and use behavioral insights to push people towards desired policy objectives. Automatic enrollment into pension plans has long been cited as a classic example of a ‘nudge’ policy. Employees automatically enrolled into a pension plan are infact very less likely to ‘opt out’. The upcoming Budget 2016 could be a powerful nudging tool that can be used to push Indian investors to take actions that are highly beneficial to themselves over the long run. The deductions under Section 80 C for life insurance premiums and equity linked savings schemes (ELSS) are good examples of such nudge policies.

The introduction of the National Pension Scheme (NPS) is one the most prominent example of a nudge policy in India. By offering an additional tax exemption of Rs. 50,000, it spurred individuals to put away additional money towards their retirement. The Association of Mutual Funds of India (AMFI) has asked that pension plans of mutual funds should also be given this exemption. As India’s population growth peaks and its youth surge starts to wane, such nudges will become more and more important. The health insurance deduction of Rs. 15,000 under Section 80 D incentivizes individuals to make a provision for medical emergencies while gaining tax benefits. Section 80 G promotes charitable giving by granting exemptions to charitable donations.

It is important to keep in mind that a nudge must not be converted to a coercive restriction. Policies that push the envelope too far such as the restrictions on gold imports can backfire. Similarly bans on alcohol have had other undesired consequences.

Nudge policies can be enacted through both the tax and spending side of the government’s balance sheet. Brazil’s Bolsa Familia is a famous example of this type of policy on the spending side – granting money to families based on the high school attendance records of their children.

Nudge policies are distinguished from others by their structure rather than their substance. They can move citizens towards undesirable outcomes as much as desirable ones. Similarly subsidies on diesel instead of clean energy can incentivize consumers to own multiple vehicles which tend to increase pollution levels in cities. The unlimited deduction on mortgage interest for non-occupied homes encourages more allocations to real estate.

Here’s a wish list from the Union Budget 2016 thinking both from the Indian investor’s perspective as well as the Indian government’s point of view

1. Increase in the Sec 80C deductions limit

The increase in the Sec 80 C deductions could be made specifically in the direction of incentivizing investors to invest in equity linked savings schemes for longer tenures thereby spurring retail participation in the Indian stock markets. These long term investments in equities could help individual investors plan for their retirement corpus using equities and give access to capital for Indian businesses. The increases in limits could also be in the direction of infrastructure bonds thereby harnessing the savings of individual investors towards India’s infrastructure while offering investors tax benefits.

2. Increase in the 80CCC NPS Limit

India’s exemption limit for pensions at Rs 50,000 per year while commendable is also inadequate. An index by Mercer puts India last in its ranking of retirement systems. The current limits under Section 80C cannot be strictly called a pensions exemption. A concentrated effort is needed by both investors and the government to spur retirement savings in the country.

3. Addition of equity assets to the list of assets eligible for capital gains exemptions on reinvestment

Indian household assets are still heavily skewed towards real estate and gold and the challenge before any government is to push investors towards productive investments. Recent issues of gold bonds have helped greatly in tackling this challenge but there is a long way to go.

A great deal of investor wealth remains trapped in real estate due to capital gains exemptions on reinvesting in real estate under Sections 54. AMFI has asked for such an exemption to be extended to infrastructure funds. Adding equity assets to this list will be a strong nudge towards higher allocation to productive assets among investors.

4. Status quo on the taxation of long term capital gains on equity assets, increase in the period of holding for long term capital gains

At present the long term capital gains tax on equity assets is zero if held for more than a year. An alternative to imposing a

tax on such funds or securities is to increase the minimum holding period for them to qualify as long term. This would incentivize investors towards long term investing rather than speculation.
The Government has already moved towards cash transfers of many subsidies such as LPG. These can be linked to the recipient's behavior such as school records or employment history.

All in all, the wishlist could be longer, the essence would be use the Union Budget 2016 as a 'nudge' to capture the high savings rate of a young country like India and channelize these savings to a bigger and better economy.

Shalini is a member of The Financial Planners' Guild , India (FPGI). FPGI is an association of Practicing Certified Financial Planners to create awareness about Financial Planning among the public, promote professional excellence and ensure high quality practice standards.