BUDGET 2015-16: EXPECTATIONS

Expenditure priorities and medium-term fiscal roadmap of Central Government expected to be clarified by 2015-16 Budget

FEBRUARY 2015

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Government of India (GoI) will present its Budget for 2015-16 on February 28, 2015. After the new Government was sworn in during May 2014, it had a short period of six weeks before presenting the Revised Budget for 2014-15. With the benefit of an additional seven months of lead time, the Union Budget for 2015-16 is expected to bear a far stronger imprint of the new Government's economic vision and road map for the next few years. Of particular significance would be its expenditure priorities and its medium term fiscal agenda, which would influence the direction and momentum of economic growth going ahead. Changes in taxation rates are, however, expected to be limited, in pursuance of the goal of maintaining a relatively stable policy regime, the anticipated shift to the goods and services tax (GST) and given the lack of fiscal space to cut rates to stimulate growth. With the new Government having demonstrated its intentions of undertaking reforms throughout the fiscal year, we do not expect a concentration of big-bang announcements in the Budget.

In our view, the most important expectation from the Union Budget for 2015-16 would be the manner in which it focuses on reviving investments, particularly in the infrastructure sector, without deviating from the medium-term fiscal consolidation agenda. Given the limited fiscal space, we expect a clear prioritisation of expenditure, with greater emphasis on areas that can create a larger multiplier effect on growth as well as projects with a relatively short gestation period. In this context, we expect sectors such as roads, railways, housing and urban development to receive substantial budgetary funding. Equally important would be measures to increase public expenditure on big-ticket and longer gestation projects such as ports, high speed railway, smart cities etc., through innovative financial means that do not impact the Government's fiscal balances, such as sovereign-supported bonds and other non-budgetary channels.

Moreover, to augment fiscal space for a substantial expansion in infrastructure spending, the Budget would likely give additional focus on paring of leakages and better targeting of subsidies, particularly through widening direct transfer of benefits to the intended beneficiaries, a trend that has already gained momentum with the Government's ambitious *Jan Dhan Yojana*. It is widely expected that post the all-India rollout of the modified direct benefit transfer scheme for LPG on January 1, 2015 (with two-thirds of active consumers covered as of February 5, 2015), LPG subsidies could be reduced for certain categories of consumers.

Given the Government's emphasis on manufacturing and infrastructure investments, the ability of the Banking sector to be able to support such financing needs is critical. In this context, the Budget is expected to provide a road map for recapitalisation of Public Sector Banks (PSBs), whose capital needs are estimated at over Rs. 2 trillion over FY 2015-19. Supportive measures to enhance access to long term debt, in the form of strengthening bond markets, infrastructure debt funds, Infrastructure Investment Trusts (InvITs) as well as easing the tax rules to make it more attractive for the functioning of Real Estate Investments Trusts (REITs) are anticipated in the Budget.

Few changes in taxation rates are expected in the upcoming budget, with a view to maintaining a relatively stable policy regime and in anticipation of the shift to the GST by April 1, 2016 that would subsume most indirect taxes. The Budget may, however, offer additional clarity on the revenue neutral rate to be adopted for the GST as well as the grants to be extended to the States to ensure an early rollout of the GST. The Government's repeated claim that it believes in a stable and predictable tax regime is likely to be reiterated in the Budget Speech for 2015-16. In addition, there may be explicit pronouncements on contentious issues such as commitment to avoid retrospective taxation and a deferral of the implementation of General Anti Avoidance to FY2016-17 (assessment year 2017-18).

Given the lack of fiscal space, we do not expect widespread reduction in tax rates. In particular, with the restrictions on import of gold having been eased post the withdrawal of the 20:80 scheme, we expect customs duty on gold to be retained in order to encourage financial savings. Moreover, it is likely that customs duty may be re-imposed on crude oil to boost revenue buoyancy. In terms of direct taxes, our key expectation is some upward revision in slabs for personal income tax to offset the impact of inflation and support consumption growth.

However, it is likely that the Budget will attempt to rectify inverted duty structures for certain imported items and reduce minimum alternate tax (MAT) to spur domestic manufacturing. In ICRA's view, the modest taxation benefits likely in light of the fiscal constraints would have a limited impact on competitiveness, particularly as compared to the steps being taken by the Government to diminish supply-side bottlenecks and impediments for certain sectors in acquiring land. To ensure the success of its ambitious 'Make in India' programme, the Government is expected to continue to focus on facilitating 'ease of doing business', labour market reforms and skill development initiatives. Although, most of these would be in the domain of administrative reforms, the broad vision may possibly be reiterated in the Budget.

A key factor that would impact the magnitude of GoI's net tax revenues in 2015-16 is the revised percentage of taxes to be devolved to State Governments for the years between 2015-16 to 2019-20, as per the recommendations of the Fourteenth Finance Commission (FFC), which would be incorporated in the Union Budget for 2015-16. Moreover, the latter is likely to clarify whether the distinction between plan and non plan will be discontinued as well as the new framework for plan allocations to State Governments following the replacement of the Planning Commission by the NITI Aayog.

The Budget for 2014-15 had retained the prevailing targets of compressing the fiscal deficit to 3.6% of GDP in 2015-16 and 3.0% of GDP in 2016-17. The fiscal space expected to be created in FY16 as compared to FY15 by way of lower fuel subsidy outgo post the deregulation of diesel and higher excise collections related to the hike in duty imposed on diesel and petrol, would help to offset the likely increase in taxes to be devolved to the State Governments by GoI based on the recommendations of the FFC (that are not yet in the public domain) and higher expenditure towards food subsidy post the all-India rollout of the higher coverage under the National Food Security Act (NFSA). Given the emphasis placed by the Reserve Bank of India (RBI) on fiscal consolidation in recent monetary policy statements, ICRA expects GoI to retain the fiscal deficit targets of 3.6% of GDP for 2015-16 and 3.0% of GDP for 2016-17, and to focus on creating additional fiscal space for expanding infrastructure spending through paring of leakages, better targeting of subsidies, innovative means of raising funds and additional cess on petroleum products.

To conclude, the areas of critical importance within the Budget would be the quality of fiscal consolidation that is attempted, and further measures to revive investments in infrastructure and manufacturing, to complement the steps initiated over the last several months. The latter included measures such as expediting clearances for stalled projects, easing of norms for foreign investments in important sectors like Railways and Defence, allocation of coal blocks through the auction route, and an ordinance to exempt five key categories of projects (defence, rural infrastructure, affordable housing and housing for poor, industrial corridors, and infrastructure including projects under public private partnership where the ownership of land continues to vest with the Government) from certain provisions of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 such as conducting social impact assessments and obtaining prior consent of land owners while acquiring land. Therefore, in addition to the Budgetary announcements, investor sentiments going forward will be driven by the continuation of such administrative steps, as well as the ability of the Government to obtain approvals from both Houses of Parliament for the recent ordinances, particularly those related to land acquisition, mining and insurance.

ICRA's sector specific views are given in this detailed note.

FISCAL PERFORMANCE OF GOVERNMENT OF INDIA

Likely fiscal performance in 2014-15: GoI had pegged its fiscal deficit for 2014-15 at Rs. 5.3 trillion in the Budget presented in July 2014 post the Parliamentary Elections (refer *Table 1*). While the provisional fiscal data for GoI for April-December 2014 (refer *Table 2*) indicates that the fiscal deficit stood at 100.2% of the Revised Budget Estimates (RBE), this does not necessarily imply that the budgeted target will be breached, as inflows of certain revenue streams are expected to be disproportionately higher in the last quarter of the fiscal, particularly tax collections (35% of total gross tax inflows in 2013-14 were raised in Q4 of those years; refer *Chart 1*), disinvestment flows and revenues from the upcoming telecom auctions.

Notwithstanding the seasonal uptick in tax collections in Q4 and the additional buoyancy offered by the hikes in excise levied on petrol and diesel on taxes garnered in the ongoing quarter, we expect a shortfall of around Rs. 800 billion relative to the GoI's BE for 2014-15 for net tax revenues. Although the stake sale in Coal India in January 2015 has boosted disinvestment revenues, there is likely to be some slippage compared to the BE for disinvestment, which would be partly offset by the additional revenues of Rs. 50-70 billion expected in excess of the budgeted amount for other communication services.

Actual spending upto December 2014 (refer *Table 3*) stood at 62% and 58%, respectively, of the budgeted allocation for plan revenue and plan capital expenditure. Based on the rule that not more than one-third of the budget estimates (BE) may be spent in the last quarter of the fiscal, ICRA expects an amount of Rs. 330-340 billion of the budgeted allocation for plan expenditure to remain unspent at the end of 2014-15. Moreover, fiscal prudence measures announced earlier and savings related to the budgetary allocation for fuel subsidies (related to the moderation in under-recoveries with the fall in crude oil prices and deregulation of diesel prices) would curtail the pressure on non plan revenue expenditure by an estimated Rs. 120-150 billion and Rs. 50-60 billion, respectively. However, the impact of the same would be partly offset by release of higher-than-budgeted funds for CST compensation.

With the shortfall in revenues likely to exceed the expenditure savings described above, some further expenditure pruning to the tune of around Rs. 400 billion may be required to prevent a slippage relative to the fiscal deficit target of Rs. 5.3 trillion in the RBE for 2014-15. Moreover, the contraction in capital spending in the first nine months of FY15 as compared to the same months of FY14 has raised concerns regarding the quality of the fiscal outcome for this year.

Table 1: Fiscal Balances for GoI for 2012-13, 2013-14 and 2014-15

	2012-13 Actual		2013-14 prov.		2014-15 RBE	
	Rs. billion	% GDP	Rs. billion	% GDP	Rs. billion	% GDP
Revenue Receipts	8,792	8.8%	10,153	8.9%	11,898	9.4%
Tax Revenues	*7,419*	7.4%	*8,160*	7.2%	*9,773*	7.7%
Revenue Expend.	12,435	12.4%	13,756	12.1%	15,681	12.4%
Major Subsidies	2,475	2.5%	2,476	2.2%	2,514	2.0%
Revenue Balance	**-3,643**	**-3.6%**	**-3,603**	**-3.2%**	**-3,783**	-3.0%
Capital Receipts	258.9	0.3%	275.55	0.2%	634.25	0.5%
Capital Exp, Net Lending	1,518	1.5%	1,754	1.5%	2,163	1.7%
Fiscal Balance	**-4,902**	**-4.9%**	**-5,081**	**-4.5%**	**-5,312**	-4.2%

Source: GoI Budget Documents; ICRA Research; CSO

Table 2: GoI's Fiscal Balances in April-December 2014

	2014-15 RBE	April-December 2014		
	Rs. billion	Rs. billion	% of RBE	Growth
Revenue Receipts	11,898	6,938	58%	9%
Tax Revenues$	9,773	5,457	*56%*	5%
Non Tax Revenues	2,125	1,481	*70%*	27%
Revenue Expenditure	15,681	10,955	70%	9%
Revenue Deficit	**-3,783**	**-4,018**	**106%**	
Capital Receipts	634	20	*3%*	-64%
Capital Exp, Net Lending	2,163	*1,326*	*61%*	-12%
Fiscal Deficit	**-5,312**	**-5,324**	**100%**	

Source: GoI Budget Documents; CGA, Ministry of Finance, GoI; ICRA Research
$ Net of Refunds, Net of States' share in Central Taxes

Based on the assumption that nominal GDP for 2014-15 would be Rs. 129 trillion, the Budget for 2014-15 had pegged the fiscal deficit for the current year at 4.1% of GDP (refer *Table 4*). However, under the new 2011-12 series, nominal GDP for 2014-15 has been pegged at a lower Rs. 126 trillion by the advance estimates released by the CSO, which would make the task of restricting the fiscal deficit at 4.1% of GDP slightly more stringent.

Based on the comments made by various Finance Ministry Officials, we expect GoI's fiscal deficit for FY14-15 to be restricted to 4.1% of GDP, although this would entail some compression or deferment of expenditure.

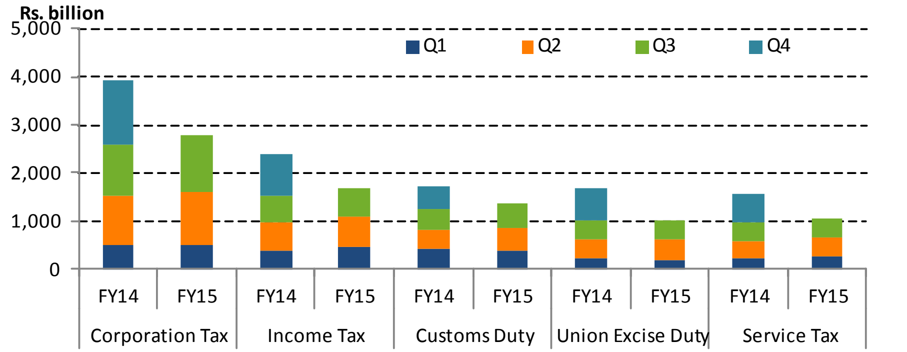
Key expectations for 2015-16: A key factor that would impact the magnitude of GoI's net tax revenues in 2015-16 is the revised percentage of taxes required to be devolved to State Governments. The Thirteenth Finance Commission had set the share of States in the net proceeds of shareable Central taxes at 32%, in each of the years between 2010-11 and 2014-15. This ratio may be revised upwards for the years between 2015-16 to 2019-20 by the FFC, which submitted its report to GoI in December 2014. Other important recommendations would include the magnitude of grants to be provided by the Centre to the States and the sharing of each of taxes and grants amongst States during the award period (i.e. 2015-16 to 2019-20).

Moreover, the Budget for 2015-16 is likely to shed light on other issues related to fiscal federalism such as the new framework for plan allocations by the Centre to the State Governments following the replacement of the Planning Commission by the NITI Aayog. Moreover, the Budget is likely to clarify whether the distinction between plan and non plan in Government budgeting will henceforth be discontinued.

Furthermore, the Budget may reveal changes in the design of existing schemes to offer more flexibility to the State Governments in implementing Centrally Sponsored Schemes (CSS), to improve efficiency of spending and enhance outcomes. For instance, the ratio of labour and materials for projects under the National Rural Employment Guarantee Scheme may be changed to spur creation of durable assets.

All State Governments are required to identify beneficiaries and rollout the NFSA by April 1, 2015, which would result in an increase in the food subsidy expenditure of GoI. The Central Government had previously estimated its annual food subsidy expenditure following the rollout of the NFSA at Rs. 1,311 billion at 2014-15 costs, as compared to the total food subsidy outgo of Rs. 850 billion in 2012-13, Rs. 920 billion in 2013-14 RE and Rs. 1,150 billion in 2014-15 BE (which had assumed mid-year rollout of the NFSA by all States, that has not been achieved).

Chart 1: Trends in Tax Collections (Net of Refunds, Gross of States' share in Central Taxes, Rs. billion)



Source: GoI Budget Documents; CGA, Ministry of Finance, GoI; ICRA Research

Table 3: Trends in Expenditure in April-December 2014

	April-Dec 2014			Q2FY15	Q3FY15	2014-15 BE
	Rs. billion	% of RBE	Growth	Growth	Growth	Growth Forecast #
Revenue Expenditure	**10,955**	**70%**	**9%**	**4%**	**14%**	**14%**
Non Plan	8,133	73%	11%	3%	16%	9%
Plan	2,823	62%	3%	7%	8%	29%
Capital Expenditure, Gross Lending	**1,408**	**62%**	**-11%**	**16%**	**-32%**	**21%**
Non Plan	705	67%	-13%	2%	-17%	21%
Plan	704	58%	-9%	29%	-45%	21%

Source: GoI Budget Documents; CGA, Ministry of Finance, GoI; ICRA Research

However, lower crude oil prices are likely to substantially ease the pressure on GoI's fiscal balances in 2015-16. GoI's fuel subsidy burden is expected to decrease by Rs. 250 billion in FY16 as compared to FY15. Moreover, the additional revenue impact of the hike in excise duties levied on petrol and diesel in four tranches since November 2014, is estimated at Rs. 500 billion for GoI in FY16. The fiscal space created by way of lower fuel subsidy and higher excise collections in FY16 as compared to FY15 is thus estimated at Rs. 750 billion or ~0.6% of GDP, which may be augmented further if customs duty is re-imposed on crude oil. Fiscal space thus created would help to offset the likely increase in taxes to be devolved to the State Governments by GoI post the recommendations of the FFC and higher expenditure towards food subsidy post the rollout of the NFSA.

Nevertheless, additional fiscal space needs to be created for a substantial expansion in infrastructure spending in order to provide a durable boost to economic growth, through paring of leakages and better targeting of subsidies. For instance, post the all-India rollout of the modified direct benefit transfer scheme for LPG on January 1, 2015 (with two-thirds of active consumers covered as of February 5, 2015), LPG subsidies could be reduced for certain categories of consumers.

The Budget for 2014-15 had retained the prevailing targets of compressing the fiscal deficit to 3.6% of GDP in 2015-16 and 3.0% of GDP in 2016-17. ***Given the emphasis placed by the RBI on fiscal consolidation in recent monetary policy statements, ICRA expects GoI to retain the fiscal deficit targets of 3.6% of GDP for 2015-16 and 3.0% of GDP for 2016-17, and to focus on creating additional fiscal space for expanding infrastructure spending through paring of leakages, better targeting of subsidies, innovative means of raising funds and additional cess on petroleum products.***

Table 4: Fiscal Deficit Targets for GoI

	Performance/ Targets in Budget 2014-15		Targets set in Oct 2012
	Based on earlier GDP data	Based on new GDP data	
2012-13	-4.8%	-4.9%	-5.3%
2013-14	-4.5%	-4.5%	-4.8%
2014-15	-4.1%	-4.2%	-4.2%
2015-16	-3.6%	-3.6%	-3.6%
2016-17	-3.0%	-3.0%	-3.0%

Source: GoI; ThFC Report; ICRA Research

SECTOR SPECIFIC EXPECTATIONS

Banking and Finance

- Provide PSBs with a road map to adequate capitalization over FY2015-19. For PSBs eligible for additional GoI equity, adequate budgetary allocations could be made so that an estimated Rs. 2 trillion-plus could be accessed over 2015-19. For PSBs ineligible for such equity infusion, enablers may be created (e.g. provision to issue non-voting shares etc.) so that they can raise an estimated Rs. 2 trillion from the market over the same period.Announcement on setting up a 'bad bank' or any other mechanism to reduce vulnerable advances of PSBs (gross NPAs plus standard restructured advances), which were relatively high at around 11% as on March 31, 2014.
- Launch of affordable urban housing schemes to improve inclusive growth.
- Income tax amendments to provide tax reliefs to NBFCs at par with Banks.
- Taxation issues pertaining to securitisation transaction.

Coal:

- Steps to ensure fast auction of the remaining coal blocks.
- Policies towards setting up of logistical infrastructure for transporting the expected rise in coal production, if Coal India has to achieve the target of 1 billion MT of coal by March 2020 as per GoI's objective.

Oil & Gas

- Road map on LPG (Domestic) and SKO (PDS) subsidy rationalisation.
- Predictable and equitable under-recovery sharing formula for the upstream companies.
- Adequate and timely provision of subsidy to the oil marketing companies (OMCs).
- Customs duty changes on Crude oil and Petroleum products.
- Declared goods status for Natural Gas.
- 100% depreciation on fuel quality upgradation projects for the refining business.

Power

- ❑ Higher budgetary allocation towards the renewable energy sector for funding of grants, viability support as well as incentives to be offered under GBI framework.
- ❑ Need for implementation of gas pooling & viability support framework for the stranded gas based projects.
- ❑ Encouragement of PPP route for investments in dedicated railway connectivity projects from coal mining areas to end user projects.
- ❑ Clarity on the timelines & a broader policy framework to scale up the solar capacity addition programme of 100 GW.
- ❑ Increase in limit of overall funding availability through tax free bonds for financing infrastructure projects.

Fertilisers

- ❑ Urea price revision and road map for introduction of Nutrient Based Subsidy (NBS) scheme for urea, given that the farm gate price differential has widened between subsidised urea and decontrolled P&K fertilisers. This has led to high subsidy burden for GoI with rising cost of production of domestic urea
- ❑ Adequate and timely provision of subsidy.
- ❑ Further rationalisation of subsidy for NPK fertilisers.
- ❑ Road map for the Direct Benefit Transfer (DBT) scheme for subsidy payout.

Infrastructure/Construction

- ❑ Budgetary allocation towards specified large infrastructure projects such as low-cost airports, inland waterways development and smart cities.
- ❑ Measures to improve the pace of existing programmes in the roads, railways, ports, and urban infrastructure sectors.
- ❑ Guidelines for provision of single-window clearance and increasing role of e-governance to fast-track pre-execution process and improve monitoring of infrastructure projects.
- ❑ Measures to attract private sector investments by way of simplifying regulatory environment, as well as providing incentives in the form of extension of tax holiday, relief on applicability of MAT during tax holiday, import duty exemption on the capital equipment, and coverage of projects involving upgradation of existing infrastructure under 80IA.
- ❑ Measures to improve long term funding availability to the sector.

Roads

- ❑ Increased budgetary allocations to the sector to meet the target to build 30Kms/day.
- ❑ Roadmap for setting up of an independent road sector regulator (announced earlier but yet to take off) and clarity on its role.

- Higher project awarding targets under EPC mode, which would reduce the project funding liability from the developers, through additional budgetary support or alternate funding avenues.
- Increasing role of e-governance to fast-track pre-execution process and ensuring award of projects only when all requisite approvals and RoWs are in place
- Measures to improve long term funding availability to the sector; relief on applicability of MAT during tax holiday which can ease out additional cash burden on projects during initial ramp up phase.

Housing

- Rationalisation of tax structure (dividend distribution tax, long term capital gain tax) for REITs to make it more attractive for developers/sponsors as well as domestic and NRI investors.
- Incentives on principal repayment, such as decoupling it from other tax saving instruments under Section 80C.
- Guidelines for streamlining the approval process or introduction of single window clearance systems for approvals for housing projects and introduction of Real Estate Regulatory bill to bring much-needed transparency in the sector.
- Recognition of low cost housing and township projects as infrastructure.

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