Union Budget FY16

Investing in Fiscal Federalism

Economics Knowledge Banking

February 28, 2015

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Key Highlights of Union Budget FY16

- Government extends commitment to fiscal consolidation and lowers fiscal deficit target to 3.9% of GDP from 4.1% in FY15
  - 14th Finance Commission dictates overall budget arithmetic
  - Fiscal targets rolled over by one year; revised medium-term fiscal roadmap reads as 3.5% (Previous: 3.0%) in FY17 and 3.0% in FY18
  - FRBM targets chiseled to focus on expenditure allocation to crucial sectors
- New measures announced to boost investor sentiment, kick-start infrastructure investments and enhance social inclusion
- Capital spending to receive a fillip with FY16 growth of ~25% from 2.5% in FY15 (Commits to higher PSU capex to the tune of INR 700 bn)
- Overall subsidy outlay lowered from 2.1% of GDP in FY14 to 1.7% in FY16
- Increases share of states in tax devolutions by 10 ppt to 42%
- Tax receipts to be supplemented by other sources of income like dividends & profits (INR 1007 bn), spectrum auction (INR 429 bn), and disinvestments (INR 695 bn)
- Net market borrowing at INR 4.56 trillion, nearly unchanged from FY15 levels

Our take on FY16 Union Budget: 5 Themes

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✓ **Theme 1: <u>Increased emphasis on capex expenditure</u> to revive growth**

- Led by public sector investment in roads, highways, ports and railways
- Creates a National Investment and Infrastructure Fund of INR 200 bn

✓ **Theme 2: Underlying credibility in fiscal arithmetic**

- We see no risk to the fiscal deficit target of 3.9% of GDP
- While increase in services tax by 2% to 14% will garner additional tax revenues, given the higher devolution to states, net tax revenue could see a shortfall if overall tax revenues do not grow at the envisaged pace
- Quality of spending to improve. Ratio of capital to revenue expenditure to improve to 0.16 from 0.13 in FY15

✓ **Theme 3: Disinvestment – The Big Bet**

- We believe Government will be proactive on disinvestments to garner revenues and counter the fiscal squeeze on account of higher devolution of tax proceeds to states

✓ **Theme 4: Emphasis to key reforms**

- *Make in India* key focus to boost manufacturing, reduction in corporate tax, fungibility between FDI and FII
- Efforts to monetize existing unproductive gold holdings in the country through Gold Monetization, announcement of Monetary Policy Committee

✓ **Theme 5: Revival in investor sentiment**

- Investor sentiment to receive a shot in the arm with postponement of GAAR for 2 years and phased reduction in corporate tax by 5 ppt to 25%

Budget at a Glance

Budget at a Glance (` bn)					Growth (%)	
	FY14 (Actual)	FY15 (BE)	FY15 (RE)	FY16 (BE)	FY15 YBL	FY16 YBL
Total Receipts**	**10,566**	**12,637**	**11,685**	**12,218**	**10.6**	**4.6**
Revenue Receipts	10,147	11,898	11,263	11,416	11.0	1.4
Net Tax Revenue	8,159	9,773	9,085	9,198	11.4	1.3
Non-Tax Revenue	1,989	2,125	2,178	2,217	9.5	1.8
Non-Debt Capital Receipts	419	740	422	803	0.9	90.0
Divestment	244	584	314	695	28.7	121.7
Total Expenditure	**15,594**	**17,949**	**16,812**	**17,775**	**7.8**	**5.7**
Non-Plan Expenditure	11,061	12,199	12,132	13,122	9.7	8.2
Subsidies	2,546	2,607	2,667	2,438	4.7	-8.6
Food	920	1,150	1,227	1,244	33.3	1.4
Fertilizer	673	730	710	730	5.4	2.8
Petroleum	854	634	603	300	-29.4	-50.2
Plan Expenditure	4,533	5,750	4,679	4,653	3.2	-0.6
Revenue Expenditure	*13,718*	*15,681*	*14,888*	*15,360*	8.5	3.2
Capital Expenditure	*1,877*	*2,268*	*1,924*	*2,414*	2.5	*25.5*
Revenue Deficit	**3,570**	**3,783**	**3,625**	**3,945**	-	-
Primary Deficit	**1,286**	**1,042**	**1,013**	**995**	-	-
Fiscal Deficit	**5,029**	**5,312**	**5,126**	**5,556**	-	-
Memo Items:						
Revenue Deficit-GDP Ratio	**3.1**	**2.9**	**2.9**	**2.8**	-	-
Primary Deficit-GDP Ratio	**1.1**	**0.8**	**0.8**	**0.7**	-	-
Fiscal Deficit-GDP Ratio	**4.4**	**4.1**	**4.1**	**3.9**	-	-
Subsidies-GDP Ratio	**2.2**	**2.0**	**2.1**	**1.7**	-	-

Budgeted Nominal FY16 GDP growth at 11.5%

Service tax increased by 2% to 14%

Wealth tax replaced with additional surcharge of 2% on super rich

Higher disinvestment and dividend proceeds estimated

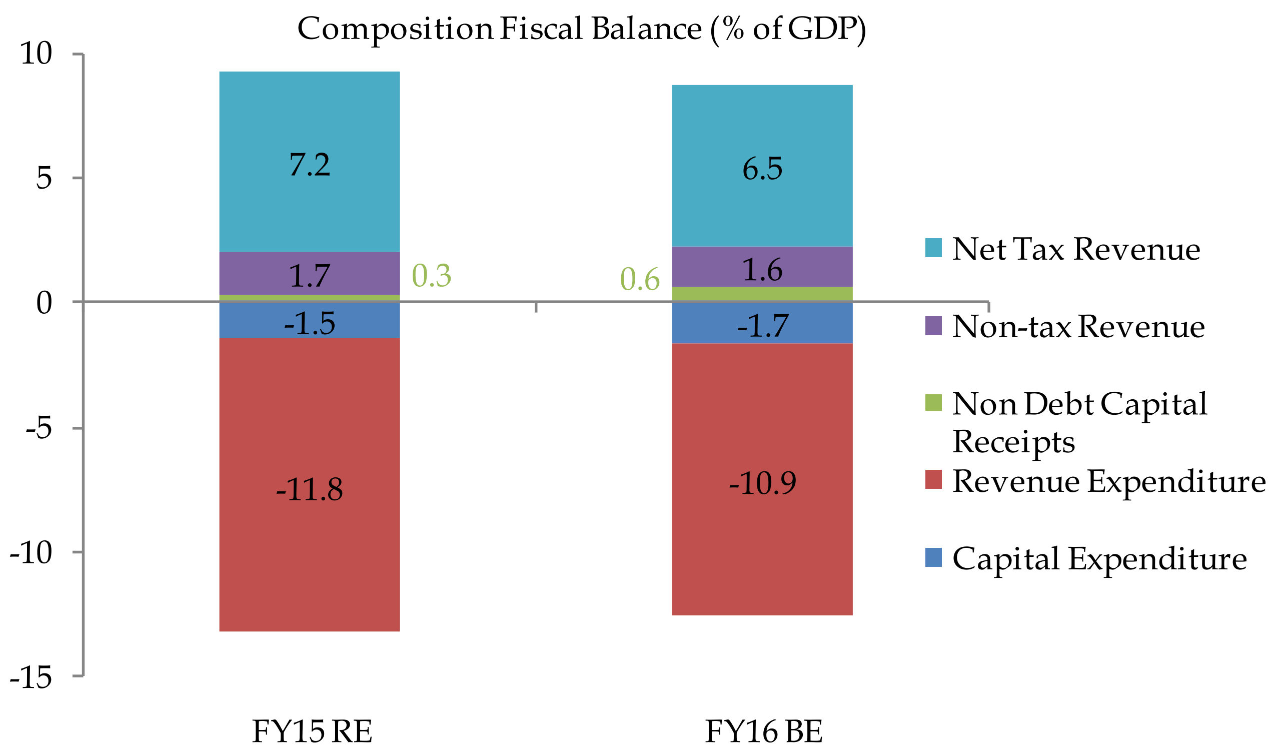
Subsidies budgeted to reduce to 1.7% of GDP

Capital expenditure budgeted to grow at a healthy pace of 25%

Fiscal deficit target of 3.9% of GDP creates fiscal space to support investment revival

*** As per CGA; ** Excluding debt capital receipts**

Fiscal Policy Strategy for FY16



- **The government aims for fiscal consolidation in FY16 via a compression in revenue expenditure**
  - **Net tax revenues to decline to 6.5% of GDP due to higher devolution to States**
  - **Capital expenditure is expected to increase by 0.2% of GDP in FY16**

Rupee in and out: FY16 versus FY15

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Rupee goes to

(For every Rupee spent in the Budget)

- Plan assistance to States & UTs: 12 (17)
- Central Plan: 15 (11)
- Interest Payments: 26 (24)
- Defence: 14 (13)
- Subsidies: 14 (16)
- Other-Non Plan Expenditure: 21 (19)

₹

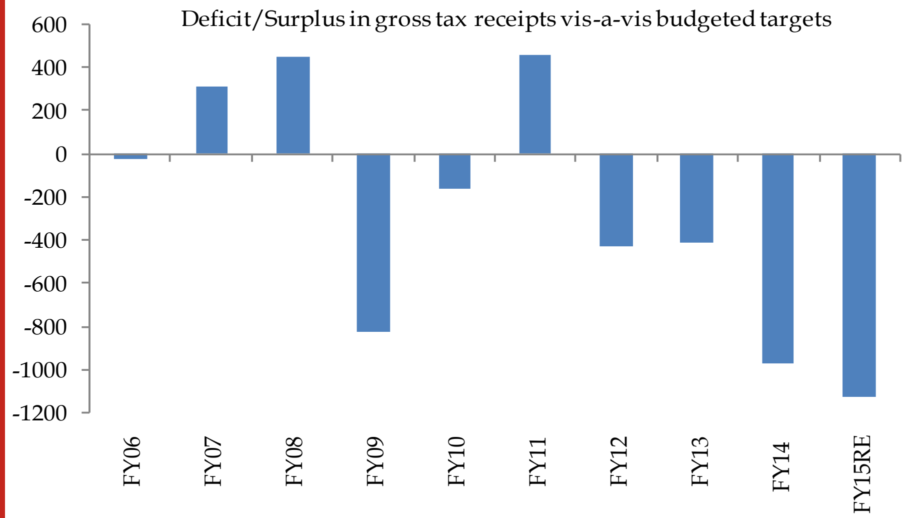
Rupee comes from

(For every Rupee earned in the Budget)

- Corporation tax: 21 (21)
- Income Tax: 14 (14)
- Customs: 9 (9)
- Union Excise Duties: 10 (9)
- Service tax and other taxes: 9 (8)
- Non-tax revenue: 10 (11)
- Non-debt capital receipts: 3 (2)
- Borrowings and Other Liabilities: 24 (26)

FY15 estimates in brackets

FY16 to see an improvement in buoyancy of gross tax revenues



Gross tax revenue in FY15 undershoots budgeted target by a whopping INR 1131 bn despite a windfall gain of INR 230 bn owing to excise duty hikes on petrol and diesel

Shortfall predominantly driven by service tax

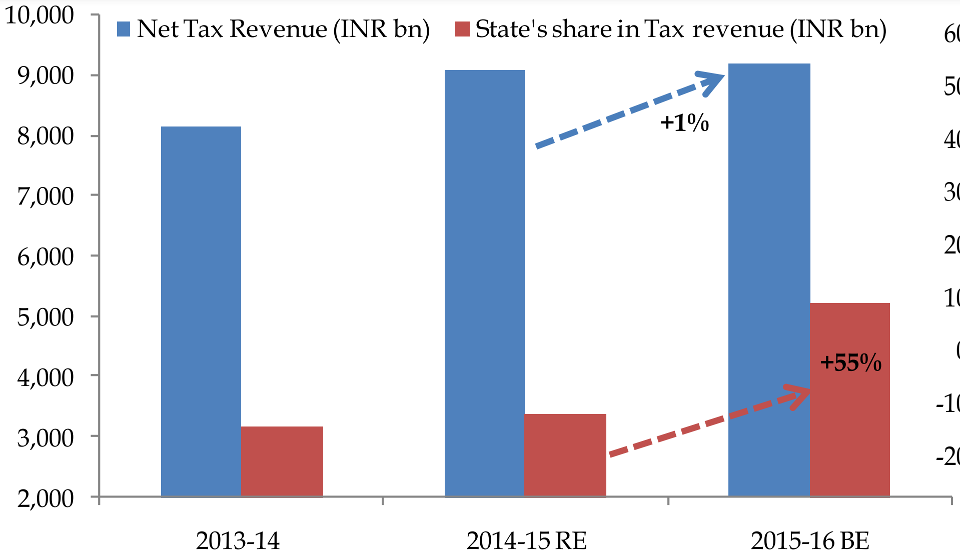
All sources of tax collections record a shortfall in FY15, led by service tax collections

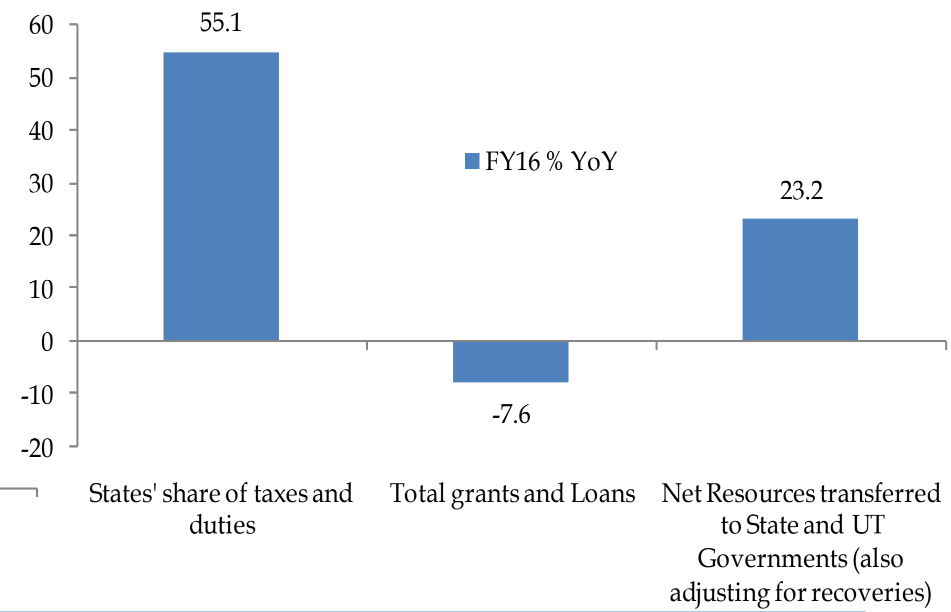
For FY16, the government has budgeted a growth of 15.8% in gross tax collections, lower than FY15 BE of 19.7% but higher than RE of 9.9%

	Taxes (INR bn)					Growth (%)	
	FY14 (Actuals)	FY15 (BE)	FY15 (RE)	Shortfall	FY16 (BE)	FY15 RE	FY16 BE
Gross Tax Revenue	11,387	13,645	12,514	-1,131	14,495	9.9	15.8
Corporation Tax	3,947	4,510	4,261	-249	4,706	8.0	10.5
Income Tax	2,429	2,843	2,786	-57	3,274	14.7	17.5
Service Tax	1,548	2,160	1,681	-478	2,098	8.6	24.8
Customs	1,721	2,018	1,887	-131	2,083	9.7	10.4
Excise	1,702	2,071	1,855	-216	2,298	9.0	23.9
Others	41	44	44	0	36	6.0	-18.5

- ✓ **The government has budgeted for an increase in the Tax-GDP ratio from 9.9% in FY15 to 10.3% in FY16 with an assumption of 11.4% Nominal GDP growth**
- ✓ **Real GDP growth is expected to recover towards 8.1-8.5% in FY16**

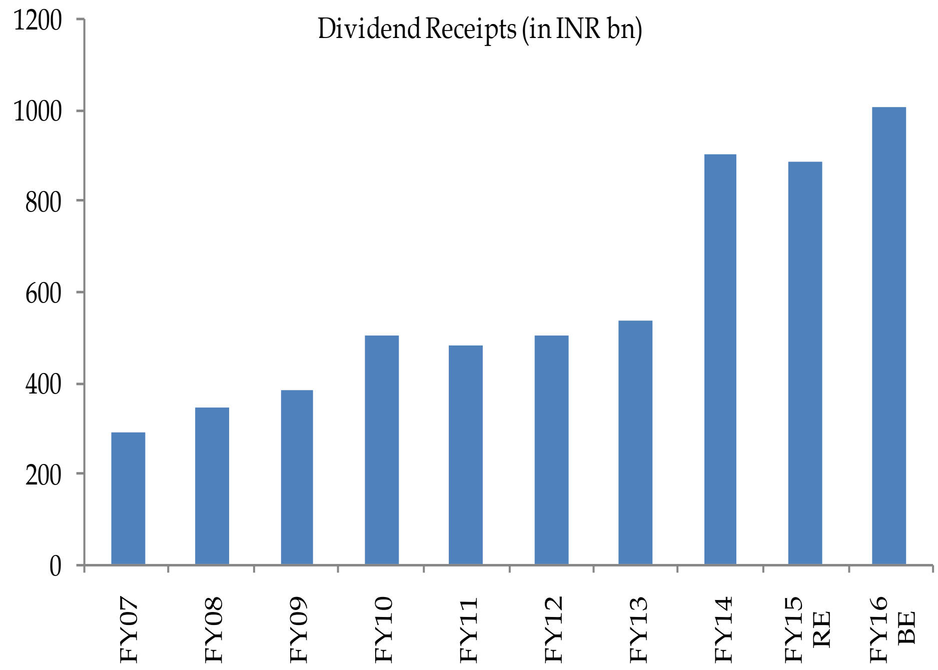
Higher devolution to states to keep net tax revenues unchanged in FY16





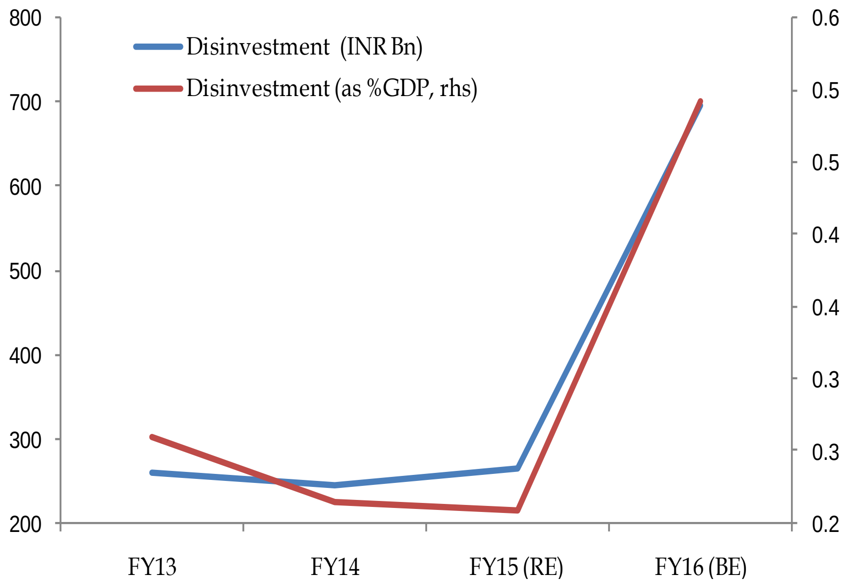
- **Implementing recommendations of the 14th Finance Commission, budget increases share of tax devolution to states by 10% to 42% for the period 2015-2020**
  - **As such, net tax revenues are budgeted to increase by 1.3% in FY16**
- **Net resources transferred to State and UTs (adjusting for recoveries) are estimated go up by 23.2% in FY16 compared to revised estimate of 32% in FY15**
  - **States share of taxes and duties will record a growth of 55.1% in FY16, up from INR 3378 bn to INR 5240 bn**
  - **But, overall grants to states has been reduced in FY16 to the tune of 7.6%**
- **This will empower States to play a bigger role in policy making and reduce their dependency on grants from the Centre**

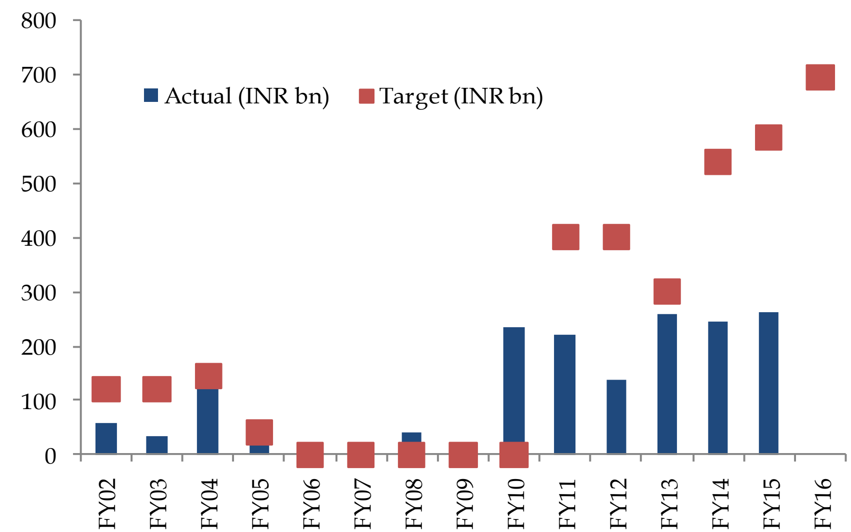
Other sources of income to play a crucial role: Dividends



- **The government has upped the dividend & profits target to INR 1007 bn for FY16 vis-à-vis FY15 RE of INR 887 bn**
  - **Of this, surplus from RBI is budgeted at INR 645 bn, the highest on record**
  - **Of these, PSU dividend is budgeted at INR 362 bn vis-à-vis INR 284 bn in FY15**

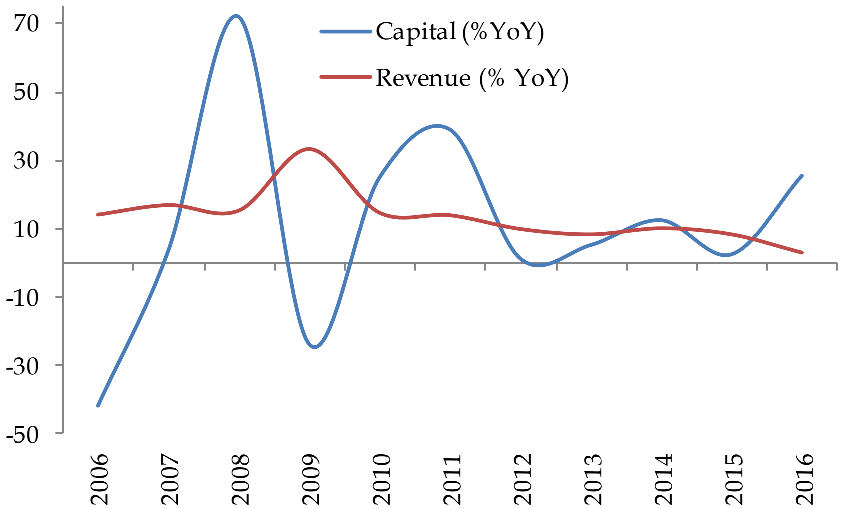
Other sources of income to play a crucial role: Divestment

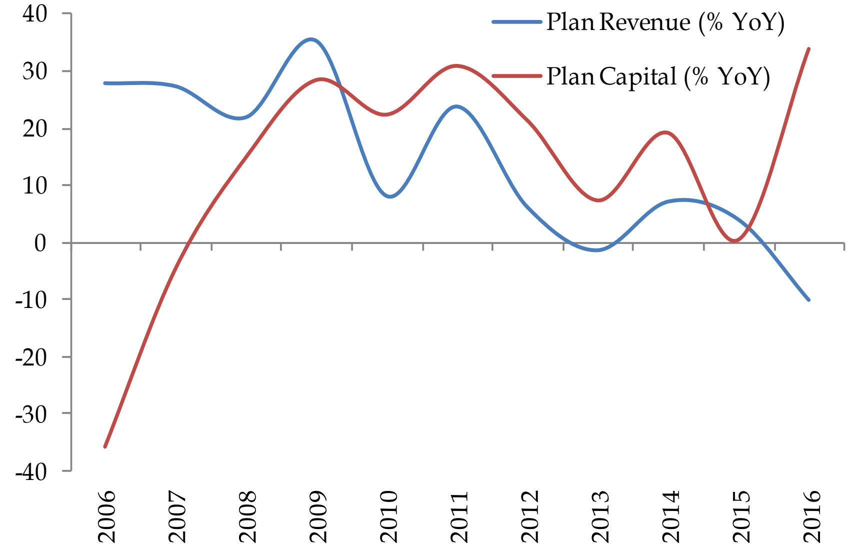




- **Government could raise just INR 314 bn (0.2% GDP) in FY15, as against budget target of INR 584 bn (0.5% of GDP)**
- **In FY16, the target for disinvestment has been upped significantly to INR 695 bn (0.5% of GDP) for FY16**
  - **Of these, INR 285 bn are budgeted on account of strategic disinvestments**
  - **Given the poor track record of Government on raising intended disinvestment proceeds, there is a need to begin in earnest disinvestment agenda from Q1 FY16**

An ‘expenditure switch’ model





Growth in capital expenditure budgeted to growth at 25.5%- highest since FY11

Plan Revenue expected to fall sharply by 10%, plan capital expected to rise sharply by 33.9%

- **Total expenditure is expected to rise by 5.7% as compared to 7.8% in FY15**
- **Centre’s kitty of Plan spending has declined post higher devolution of resources to states. Yet plan capital spending has been budgeted to increase by 33.9% and plan revenue expected to decline by 10%**
- **Internal & External Budgetary support for Plan spending also budgeted to rise by a mammoth 34% against decline of 10% in FY15**

Subsidy/GDP ratio projected to fall below 2%

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Major Subsidies (INR bn)				Growth (%)	
	FY14 (Actual)	**FY15** (RE)	**FY16** BE	**FY15 RE / FY14**	**FY16 BE/ FY15 RE**
Total Subsidies	2,546	2,667	2,438	4.7	-8.6
(as % of GDP)	***2.2***	***2.1***	***1.7***	***-***	***-***
Food	920	1227	1244	33.3	1.4
Fertilizer	673	710	730	5.4	2.8
Petroleum	854	603	300	-29.4	-50.2
Others	99	128	164	29.3	28.1

- **Total expenditure on subsidies is expected to decline by 8.6% largely on the back of 50% decline in petroleum subsidy**
- **Despite moderate increase in MSPs and offloading of stocks, the rise in food subsidy is reflective of previous backlog**
- **Mid-term review had estimated this backlog to be anywhere between 0.3%-1.0% of GDP**
- **Although not explicitly mentioned, the petroleum subsidies have been calculated on basis of crude oil price of ~ 70/bbl**
- **Subsidies have been adequately provided for in FY16**

Funding of FY16 Fiscal Deficit

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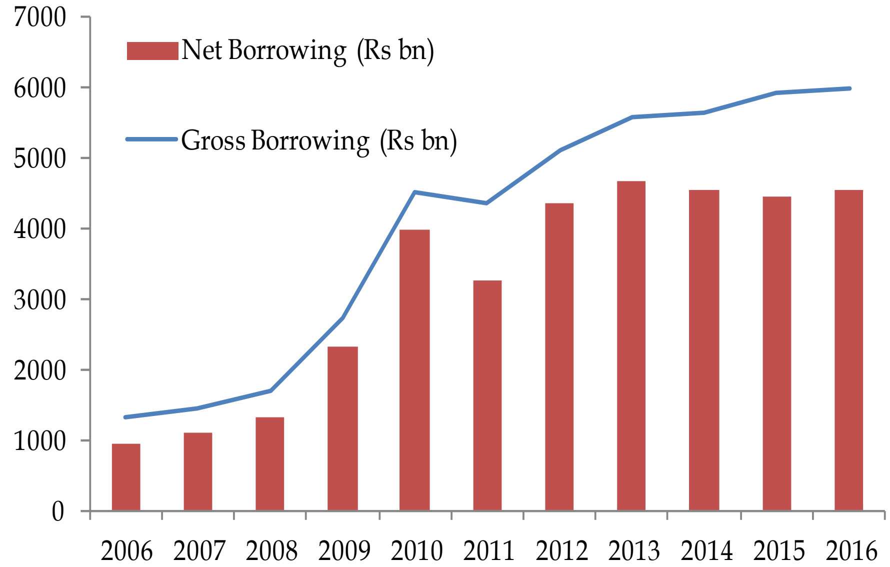
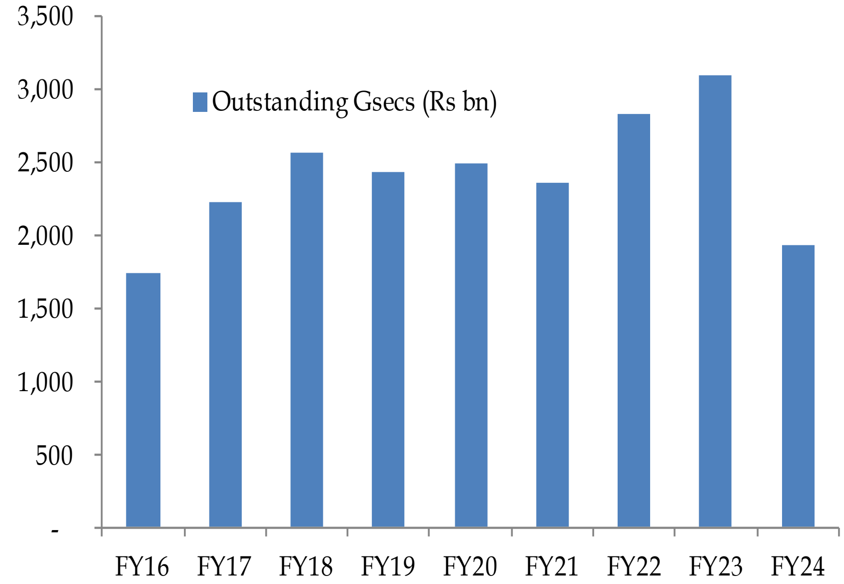
Financing of Fiscal Deficit (INR bn)				
	FY14	FY15	FY15	FY16
	(Actuals)	(BE)	(RE)	(BE)
Fiscal Deficit	5,029	5,312	5,126	5,556
Financed By:				
External	73	57	97	112
Domestic	4,956	5,254	5,029	5,445
Market Borrowings	4,687	4,612	4,532	4,564
Short-Term Borrowings	77	346	512	301
Small Savings	124	82	333	224
State Provident Fund	98	120	100	100
Draw-Down of Cash Balances	-192	172	-157	120
Others	162	-77	-291	136

- ✓ **Market borrowings continue to be the primary source of funding, with financing through dated government securities contributing ~82% of funding**
- ✓ **Net T-Bill issuance is expected reduce from INR 512 bn in FY15 to INR 301 bn**
  - **Net issuance of 1Y T-Bill is expected to decline from INR 123 bn in FY15 to INR 81 bn in FY16**
- ✓ **The government expects INR 120 bn net drawdown in cash balances for FY16**
- ✓ **It appears that the government expects provident fund receipts (besides SPF) to contribute ~INR 206 bn in FY16 thereby providing a buffer to 'other receipts'**

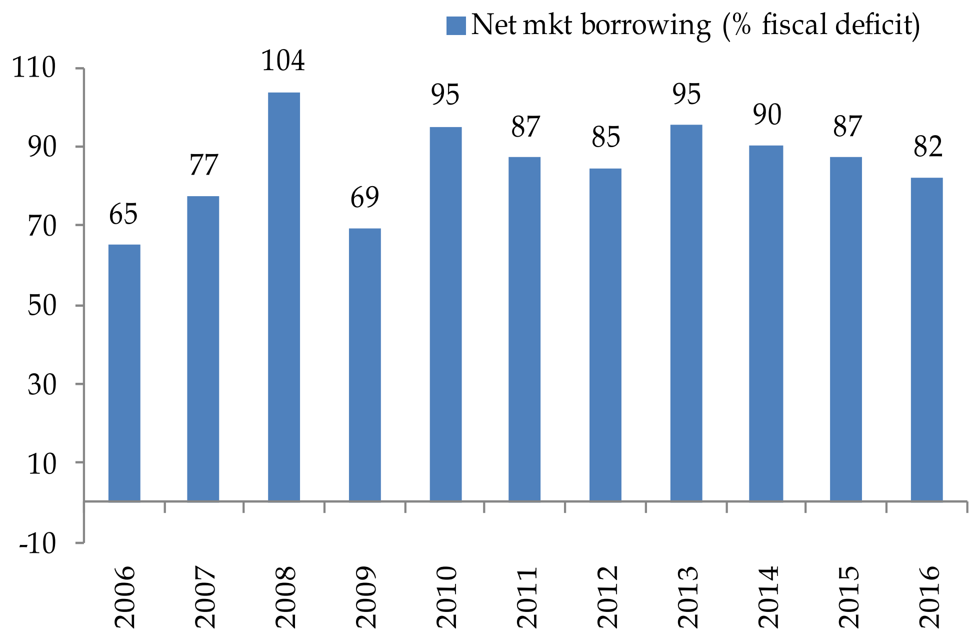
Where do borrowings stand?





- ✓ **Gross and net market borrowing has been budgeted to grow by 1.3% and 0.7% in FY16 to INR 6.00 tn and Rs 4.56 tn respectively**
- ✓ **The government has also budgeted Rs 500 bn of debt switches/buy backs for FY16 owing to the large redemption pressure over FY16-FY18**

…where do borrowings stand?



- The increase in FY16 borrowing has been miniscule compared to FY15 – INR 80 bn for gross and INR 32 bn for net
- More importantly, on a net basis
  - Market borrowing is expected to provide 82.1% of the funding, lower than the 89.1% average funding seen in the last 5-years

Market impact of FY15 Budget

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Bond

- Supply is likely to absorbed by the market on the back of relatively weak credit demand and healthy foreign appetite for domestic debt
  - We expect the FII debt limits in g-sec to be increased by USD 5 bn in FY16
- We don't expect any slippage to the market borrowing estimate as
  - The government is likely to remain committed to the deficit target
  - Room exists for drawing down government's surplus cash balances
- With inflation momentum likely to remain subdued in the near term, we expect 10Y g-sec yield to move lower towards our target of 7.35% in FY16 on the back of 50 bps incremental monetary easing from the RBI
  - While impending interest rate hike in the US in 2015 could provide some volatility, the risk is skewed to the downside if commodity prices continue to remain soft through FY16, thereby taking 10Y g-sec yield potentially to 7.15%

Rupee

- Credible fiscal consolidation, focus on quality of adjustment, and thrust on investment revival is likely to be supportive of sustainable pickup in growth momentum
  - Despite the likelihood of a risk off environment linked to interest rate hikes from the Fed, we continue to expect INR to trade in the range 62-64 on an average basis through FY16

Flagship Programs: Make in India

GAAR to be deferred by two years	• Ensure a steady flow of foreign investment into the economy
Rate of Income-tax on royalty and fees for technical services reduced from 25% to 10%	• Help start ups and facilitate technology transfers; to benefit tech through savings on overseas fees
Tax Pass through is allowed in Category I and Category II alternative investment funds	• To provide private equity to start ups and promote investments in SMEs and infrastructure projects
Rationalized capital gains regime for the sponsors exiting at the time of listing of the units of REITs and InvITs	• Help release large funds locked in various completed projects and therefore facilitate take off of new infra projects
All goods, except populated printed circuit boards for use in manufacture of ITA bound items, exempted from SAD	• Addresses duty anomalies that made importing of goods cheaper thereby, boosting manufacture of electronics

Flagship Programs: Skill India

IT based Student Financial Aid Authority to administer and monitor Scholarship as well Educational Loan Schemes	• Promotion of higher education to harness India's comparative advantage stemming from technological capability
Creation of IITs and IIMs in every state	• Priority to higher level education and research initiatives would be a vital tool to further propel the high skill intensity- IT, software services sector exports
National Skills Mission through the Skill Development and Entrepreneurship Ministry	• Promoting Sector specific vocational training and standardizing procedures and outcomes across our 31 Sector Skill Councils
Setting aside Rs 1500 cr to employ rural workforce	• Enhancing rural youth employability which forms 70% of workforce, is the key to harness demographic dividend

Budget Themes: Infrastructure

Infrastructure	
Public Spending	▪ Increased outlay on **roads** by INR 140 bn and **Railways** by INR 100 bn ▪5 new Ultra Mega **Power** Projects each of 4000 MW in 'Plug-and-Play' mode ▪Budgeted **public sector capex** for infrastructure (roads, highways, ports and railways) at INR 700 bn ▪INR 250 bn crore in 2015-16 to the **corpus of Rural Infrastructure Development Fund (RIDF)** set up in NABARD ▪Earmarked a sum of INR 12 bn towards **infrastructure work in DMIC**
Financing	▪**National Investment and Infrastructure Fund (NIIF)** to be established with an annual flow of INR 200 bn ▪**Tax free infrastructure bonds** for the projects in the rail, road and irrigation sectors ▪Conversion of existing excise duty on petrol and diesel to the extent of Rs. 4 per litre into **Road Cess** ▪**Self-Employment and Talent Utilization** to be established as an incubation programme. INR 10 bn to be set aside as initial amount in NITI ▪Foreign investments in Alternate Investment Funds to be allowed
Regulatory	▪PPP mode of infrastructure development to be **revisited and revitalised** ▪**Ports** in public sector will be **corporatized** ▪A need for procurement law to contain malfeasance in public procurement ▪**Remove distinction between FII and FDI** and replace with composite caps

Budget Themes: Financial Sector

Financial Sector	
Regulatory reforms	▪ To create **Monetary Policy Committee** in consultation with RBI ▪ To set up **Public Debt Management Agency** bringing both external and domestic borrowings under one roof ▪ Forward Markets commission to be merged with SEBI ▪ To create a Task Force to establish sector-neutral financial redressal agency
Monetising Gold	▪ *Gold monetization scheme* to allow the depositors of gold to earn interest in their metal accounts and the jewellers to obtain loans ▪ Sovereign Gold Bond as an alternative to purchasing metal gold scheme
Future Roadmap	▪ India Financial Code to be introduced soon in Parliament ▪ Vision of putting in place a direct tax regime, which is internationally competitive on rates, without exemptions

Tax Relief

- Proposal to **reduce corporate tax from 30% to 25% over the next four years**
- Additional deduction of INR 50000 for contribution to the New Pension Scheme

Budget Themes: Ease of Doing Business

Ease of Doing Business	
Simplification of tax procedures	▪Penalty provision in indirect taxes are being rationalized to encourage compliance and early dispute resolution ▪Central excise/Service tax assesses to be allowed to use digitally signed invoices and maintain record electronically ▪Provision of indirect transfers in the Income-tax Act suitably cleaned up ▪Domestic transfer pricing threshold limit increased from INR 0.05 bn to INR 0.20 bn ▪MAT rationalized for FIIs and members of an AOP ▪Online central excise and service tax registration to be done in two working days

Budget Themes: Social Sector Schemes

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From Financial Inclusion to Financial Security

- **Pradhan Mantri Suraksha Bima Yojna** to cover accidental death risk of INR 0.2 mn for a premium of just INR 12 per year
- **Atal Pension Yojana** to provide a defined pension, depending on the contribution and the period of contribution
- Unclaimed deposits of about INR 30 bn in the PPF and INR 60 bn in the EPF corpus to be used to subsidize the premiums on these schemes

Social Sector Schemes

Education	▪ A senior secondary school within 5 km reach of each child, up gradation of over 80,000 secondary schools and adding 75,000 junior/middle to the senior secondary level ▪ Girl Child & their Education: Constructing toilets in the elementary schools and also Launch of the Beti Bachao-Beti padhao campaign
Rurban Development	▪ **'Housing for all'** by 2022 to 4 cr houses in rural and 2 cr in urban areas ▪ Each house in the country should have basic facilities of 24-hour power supply, clean drinking water, a toilet, and be connected to a road ▪ At least one member from each family should be employed ▪ Electrification, by 2020, of the remaining 20,000 villages in the country, including by off-grid solar power generation. ▪ Connecting each of the 1.78 lakh unconnected habitations by all weather roads

Budget Themes: Agriculture and others

Agriculture	
Infra-Financing	▪ Allocated INR 53 bn to support micro-irrigation, watershed development and the Pradhan Mantri Krishi Sinchai Yojana ▪To work with the States, in NITI, for the creation of a Unified National Agriculture Market
Credit	▪ Allocated INR 250 bn cr in to the corpus of Rural Infrastructure Development Fund (RIDF) ▪ INR 450 crore for Short Term Cooperative Rural Credit Refinance Fund

Alternate themes	
Safe India	▪INR 1000 crore to the Nirbhaya Fund
Green India	▪Target of renewable energy capacity revised to 175000 MW till 2022, comprising 100000 MW Solar, 60000 MW Wind, 10000 MW Biomass and 5000 MW Small Hydro. ▪Clean energy cess increased from INR 100 to INR 200 per metric tonne of coal, etc. to finance clean environment initiatives.
Swachh Bharat	▪100% deduction for contributions, other than by way of CSR contribution, to Swachh Bharat Kosh and Clean Ganga Fund

Thank You

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Note: Data in this report has been sourced from CEIC, Bloomberg, GoI Budget Documents & Economic Survey, CGA, Ministry of Petroleum & Natural Gas, IMD, RBI, IMF, and YES BANK Limited

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