From the desk of the Economist

INDIA

Budget 2009-10

Certain hits and certain misses

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Highlights

- **The union budget for 2009-10 leaves the markets disappointed with dramatic moves across the board**
- **The reason for the general 'disappointment' is the absence of recommitment to fiscal consolidation and reforms; something that was evident in the Economic Survey 2008-09 released last week**
- **Government expenditure continued to soar. But a healthy balance of expenditure increases and duty cuts/hikes have been undertaken**
- **The finance ministry has targeted a fiscal deficit to GDP ratio at 6.8%; higher than our expectations of 6.5%. The 0.3 percentage point difference has partially come in from a higher spending and partially from certain tax benefits**
- **Consumption demand has been given a boost**
- **Though the fiscal deficit/GDP ratio is budgeted to be significantly higher than the interim budget estimates; we continue to re-iterate our stand of no rating downgrade**
- **We feel that fiscal consolidation will not be easy to come by and will be a long drawn-out process; hence yield curve steepening may continue to crowd out private investment**
- **Going forward, it'll be extremely important for the government to address issues like disinvestment; provide a road map for GST and reform agenda for the next few years; speed up reforms already undertaken; and lay out the new FRBM targets**

SEE THE DISCLOSURES APPENDIX FOR IMPORTANT DISCLOSURES

The union budget for 2009-10 leaves the markets disappointed with dramatic moves across the board – sensex tumbles down by over 6%; INR by 1% and 10-year g-sec spikes up to 7.00% again. The reason for the general 'disappointment' is the absence of recommitment to fiscal consolidation and reforms; something that was evident in the Economic Survey 2008-09 released last week.

The expenditure side story:

Government expenditure continued to soar. Total government expenditure has shot up by over 13% in FY10 vs. FY09. And where is this extra money going? This is illustrated in the table below. The good news is that the increase in capital expenditure (27% YoY) overshoots the increase in revenue expenditure (12%).

a) Non-plan expenditure – some respite in subsidies

The bulk of the revenue expenditure increase has come from increase in defence expenditure and increase in grants to states and union territories. Expenditure on social and economic services has been hiked by 19% and 8% respectively. The good news is the reduced amount of subsidies announced. The reduction in subsidies has come because of a reduction in fertilizer subsidy (down 24% vis-à-vis last year) and interest subsidies; although the food subsidy has been hiked by 20%. Going forward, the amount allocated to both are contingent on urea prices (fertilizer subsidy) and monsoon (food subsidy)

Fig 1 Non-plan expenditure (INR bn)

	2008-09 (RE)	2009-10 (BE)	% change in FY10 over FY09
Non-plan expenditure (INR bn)	**6180**	**6957**	**13**
Food subsidy	436	524	20
Fertilizer Subsidy	758	500	-34
Social services	281	334	19
Education	59	77	31
Medical, public health	15	27	80
Economic Services	220	238	8
Agriculture & allied activities	59	24.7	-58
Foreign trade & export promotion	28	18.4	-34
Energy	-1.5	8	633
Science technology& Environment	40.6	46.6	15
Irrigation & Flood control	2.6	3.1	19
Transport	14.3	16	12

Source: GoI; ING research

b) Plan expenditure - Capital expenditure gets a boost

A significant increase in plan expenditure is seen in the following sectors: Industry & minerals; science & technology; energy; irrigation and control. The increase in outlay on rural employment (NREGA) at 7% may look small because the current comparison with the revised estimates for FY09 and not the budget estimates. All-in-all, social services and economic services have been given a reasonable boost.

We had highlighted our expectations of an increase in government spending by about 1% of GDP in our report titled 'Budget expectations – walking a tightrope' but the increase in fiscal deficit is slightly higher than our expectations. The finance ministry has targeted a fiscal deficit to GDP ratio at 6.8%; higher than our expectations of 6.5%. The 0.3 percentage point difference has partially come in from a higher spending (over and above the interim budget estimate) to the extent of 1.2% of GDP vs. our expectations of 1%. Also, the slippage in the budget has partially been because of lower revenue targets. Though, as per our expectations, excise duty has been selectively rolled back , service tax cuts haven't come through.

Fig 2 Plan Expenditure (INR bn)

	2008-09 (RE)	2009-10 (BE)	% change in FY10 over FY09
Plan expenditure (A + B)	**2829**	**3251**	**15**
A. Budgetary support for central plan	**2041**	**2398**	**17**
B. Central assistance for states and UTs	**788**	**853**	**8**
C. Internal and extra budgetary resources of PSUs	**1839**	**2080**	**13**
Central plan Outlay (A + C)	**3880**	**4478**	**15**
Rural development	410	438	7
Rural employment	367	391	7
Agriculture & allied activities	100	106	6
Irrigation and flood control	3.6	4.3	19
Energy	988	1155	17
Industry and minerals	271	357	32
Transport	782	943	21
Communications	202	167	-17
Science technology& Environment	85	112	32
General Economic services	52.7	62.7	19
Social services	976	1117	14
General services	7.6	14	84

Source: GoI, INR research

Revenue budget

The following changes have been announced on the revenue side: a) Corporates tax stays unchanged B) Exemption limit for personal income tax has been hiked by INR 15000 for senior citizens and INR 10000 for the others. Also, surcharge of 10% on personal income tax has been eliminated. The loss of tax revenue from 'income tax' is evident from the table below. Also, custom duty cuts for certain sectors will result in additional revenue loss.

Fig 3 Tax revenue

(INR bn)	2008-2009 Revised Estimates	2009-2010 Budget Estimates	% change
REVENUE RECEIPTS			
1. Tax Revenue			
Gross Tax Revenue	6279	6411	2.1
Corporation tax	2220	2567	15.6
Income tax	1226	1129	-8.0
Other taxes and Duties	4	4	6.3
Customs	1080	980	-9.3
Union Excise Duties	1084	1065	-1.7
Service Tax	650	650	0.0
Net Tax Revenue	4660	4742	1.8
2. Non -Tax Revenue	962	1403	45.8
Total Revenue Receipts	5622	6145	9.3

Source: GoI

We feel that the budget has addressed some key issues…

a) A healthy balance of expenditure increases and duty cuts/hikes have been undertaken. Reeling manufacturing industry – specifically the IT industry; construction industry; transport; have been given certain duty benefits. Also, interest subsidies have been provided for SMEs, rural housing and education. At the same time, duty benefits have been withdrawn for some (please see appendix). Also, the increase in expenditure hasn't been excessive and also hasn't been skewed towards any particular sector.

b) Consumption demand has been given a boost: Some relief on the personal income tax together with a continued incentivisation to rural India and emphasis on infrastructure are positive for consumption demand.

c) Though the fiscal deficit/GDP ratio is budgeted to be significantly higher than the interim budget estimates; we continue to re-iterate our stand of no rating downgrade. Though the budget may lack the mention of disinvestment and fiscal consolidation explicitly; it did talk about the role of private sector; private finance and foreign capital. The mention of an extended role of IIFCL is important here. To ensure that infrastructure projects do not face financing difficulties arising from the current downturn, the Government has decided that IIFCL will refinance 60 per cent of commercial bank loans for PPP projects in critical sectors over the next fifteen to eighteen months.

..it may have missed some

a) No roadmaps. Going forward, it'll be extremely important for the government to address issues like disinvestment; provide a road map for GST and reform agenda for the next few years; speed up reforms already undertaken; and lay out the new FRBM targets

b) The surge in government market borrowing from INR 3.6 tn to INR 4.51 tn is excessive. But the additional borrowing from hereon may be limited to about INR 400 bn (considering extra borrowing of INR 180 bn already done during the year and INR 330 bn worth of MSS de-sequestering). Though this is higher than our expectations; the timing of auctions and another OMO calendar may provide some relief to the market. But all-in-all, we feel that fiscal consolidation will not be easy to come by and will be a long drawn-out process; hence yield curve steepening may continue to crowd out private investment.

c) Impact on certain sectors like auto and cement may be neutral: Though the allocation for these sectors has been increased under JNNURM; the increase in MAT may undo some of the increase in profits.

Appendix

Tax changes:

- Personal Income Tax: Increase in deduction under section 80-DD in respect of maintenance, including medical treatment, of a dependent who is a person with severe disability to Rs.1 lakh from the present limit of Rs.75,000.
- Fringe Benefit Tax: Abolished
- Exports: Extension of the sun-set clauses for these tax holidays by one more year i.e. for the financial year 2010-11.
- MAT: Increase in the rate of MAT to 15 per cent of booked profits from the present rate of 10 per cent. Extension in the period allowed to carry forward the tax credit under MAT from seven years to ten years
- New Pension System: Exemption of the income of the NPS Trust from income tax and any dividend paid to this Trust from Dividend Distribution Tax. Similarly, all purchase and sale of equity shares and derivatives by the NPS Trust will also be exempt from the Securities Transaction Tax
- Commodity Transaction Tax – abolished
- Customs duty: customs duty of 5 per cent on Set Top Boxes to encourage domestic value addition
- Customs duty: reduction in the basic customs duty on LCD panels from 10 per cent to 5 per cent to support indigenous production of LCD televisions
- Full exemption from CVD of 4 per cent was available to accessories, parts and components imported for the manufacture of mobile phones till the 30th of June, 2009. The exemptions has been reintroduced for another year
- Customs duty: reduction in the basic customs duty on permanent magnets - a critical component for Wind Operated Electricity Generators - from 7.5 per cent to 5 per cent
- Customs duty: reduction in customs duty from 10 percent to 5% on nine specified life saving drugs. They will also be totally exempt from excise duty and countervailing duty.
- Customs duty: hiked on gold bars; gold jewellery and silver
- CENVAT: restoring the erstwhile optional rate of 4 per cent for cotton textiles beyond the fibre stage. Restoring the rate of 8 per cent Central Excise duty on manmade fibre and yarn on a mandatory basis and on stages beyond fibre and yarn at that rate on optional basis
- CENVAT: full exemption to petro-diesel blended with bio-diesel from excise duty
- CENVAT: reduction in basic customs duty on bio-diesel from 7.5 per cent to 2.5 per cent - at par with petro-diesel.
- Petrol driven trucks were chargeable to excise duty of 20 per cent. Excise duty on these trucks has been reduced to 8 per cent to equate the duty with similar vehicles run on diesel.
- Service tax: The Export Promotion Councils and the Federation of Indian Export Organizations (FIEO)has been exempted from the levy of service tax on the membership and other fees collected by them till 31st March, 2010 .

Disclosures Appendix

IMPORTANT DISCLOSURES

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