Economics

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EXPECTATIONS FROM THE UNION BUDGET 2012-13

The Union Budget for 2012-13 (FY13) is to be presented in the Parliament on 16th March. This will be a critical Budget as it sets the tone for policy stance relating to not just fiscal issues but also monetary policy and economic reforms. Also, it is being announced at a time when the economy has shown distinct signs of a slowdown and is looking for a boost from the government through appropriate policy announcements. Global as well as the domestic investors would also be looking for signals.

The theme of the FY13 budget would be on:

- Striking a balance between fiscal consolidation and public spending while maintaining sustainable inclusive growth
- Focusing on growth in rural areas and provision of more education and health facilities through centralized sponsored schemes
- Focusing on increasing infrastructure investment
- Moving towards implementing GST and DTC
    - Revision of tax slabs, rates and so on

Projections made in the Union Budget for 2011-12:

Table 1: Selected Projections

Rs. crore	FY12
	Budget Estimates
Total Expenditure	12,57,729
Revenue Receipts	7,89,892
Tax Collections	6,64,457
Interest Payments	2,67,986
Subsidies	1,43,570
Gross borrowings	4,17,128
Net Borrowings	3,43,000
Disinvestment	40,000
Fiscal Deficit	4,12,817

Source: Finance Ministry

India's fiscal deficit was targeted at 4.6% of the Gross Domestic Product (GDP) for FY12 at the beginning of the year. However, on account of a sharp increase in expenditures and fall in revenues as a result of higher spending on oil subsidies and other social spending programs, as well as lower tax collections due to the slowdown in the economy, fiscal deficit is likely to slip to 5.5-5.7% of GDP.

India's fiscal deficit has already reached 92.3% of the targeted budget in the first nine months of FY12. As of December 2011, the amount of fiscal deficit reached Rs. 3,81,012 crore, an increase of 122% from the same period last year.

Total expenditures amounted to Rs. 8,96,361 crore during the Apr-Dec 2011 period, 71.3% of the FY12 budget estimate. Meanwhile, revenue is falling short of the target. This amount includes Rs. 4,20,414 crore of taxes collected, which was merely 63.3% of targeted tax revenues.

Further, the Government is set to borrow beyond its target for FY12. At the beginning of the year the Government estimated gross borrowings to the extent of Rs. 4,17,128 crore. However, on account of the developments in revenue collection and expenditure, the Government increased its borrowings programme by about Rs. 90,000 crore. Borrowings for the period of 1st Apr- 17th Feb FY12 stood at Rs. 4,75,000 crore. While it is not clear whether the additional borrowing of Rs 90,000 crore includes the slippage on account of disinvestment, it may be assumed that this amount could go up in case this programme does not fully fructify.

Macro-economic environment:

The economic conditions in India during FY12 have been challenging with the development of a sharp trade-off between inflation and growth being the driving factor. Policy formulation has been difficult on account of the persistently high inflation and slowing industrial growth clubbed with sluggish investment climate in the country. Further, volatility in the foreign exchange market has added to the difficulties of the policy markers.

Based on CSO's projections for the year, industrial sector growth is expected to be subdued this year with manufacturing growing at 3.9% as against 7.6%, construction at 4.8% compared with the 8.0% growth in FY11 and the growth in mining and quarrying is likely to be negative 2.2% as against the 5% growth in the previous year. Service sector has acknowledged robust growth of around 9% throughout the year while electricity, gas and water supply segment is to register 8.3% growth this year. GDP growth would be 6.9% as against 8.4% last year.

Inflation has been persistently high around 9% throughout 2011 and it is only from December onwards that there has been a decline in the prices of primary articles, taking the headline inflation down to 6.6% for January compared to 9.1% for November. The declining trend in the food inflation is likely to help bring down Wholesale Price Index (WPI) though admittedly the base year effect has moderated such increases. However, though core inflation has started to come down since January, it needs to be tracked for some more time before we are confident that it will remain at lower levels. Therefore, RBI will lower interest rates only after it is convinced that inflation has come down permanently.

Monetary Policy Outlook:

So far in the current financial year, the major driving factor for the RBI's monetary policy had been the growth-inflation trade-off. However, in recent times the persistent deficit in liquidity conditions and the volatility in the exchange rate have also called for the Central Bank's attention.

RBI in its recent monetary policy review cut cash reserve ratio (CRR) by 50 bps in order to ease the prolonged tight liquidity conditions prevailing since November. The 50 bps cut in the CRR (to 5.5%) would infuse approximately Rs. 32,000 crore into the banking system. The RBI has also infused liquidity into the system through Open Market Operations (OMOs) to the extent of Rs. 95,190 crore so far in the financial year (as on 10th February 2012). Further, the RBI has indicated that it would conduct more rounds of OMO auctions as and when the need arises.

Budget expectations:

Expectations from the Budget should be looked at against the overall macro economic background. Further, while the two major tax reforms, i.e. direct and indirect taxes have been defined broadly by the DTC and GST, modifications in the present system have to be consistent with this overall framework.

Growth

The Government's objective in the budget should be regaining the growth momentum. It is expected that recovery in economic growth would be possible by the second half of FY13 if the global economy starts mending from the slump and monetary easing by India's central bank starts early next fiscal. Growth target for this year would be around 7.5% with inflation of around 6-6.5%, thus implying a **nominal GDP growth of 13.5-14%** for the year. This will be lower than that in FY12 which is 16.1%.

Fiscal Consolidation

It is important to understand that the deterioration in fiscal health cannot be repaired in a single year. The Government is expected to bring fiscal deficit under control over a period of time and provide a realistic roadmap rather than ambitious, unattainable target. Therefore, transition to the FRBM will be in a phased manner. Overtime, not only the ratio of Fiscal Deficit to GDP should be reduced, but the composition also needs to be changed and without expenditure restructuring, fiscal consolidation cannot be successful. The **fiscal deficit ratio would be targeted at around 5% of GDP**, which will be an improvement over the revised estimate of 5.5-5.7% for FY12.

Taxation

Given that there is a possibility of slippages in the fiscal targets of the Government for FY12 and the fall in tax collections during the first nine months of FY12, one can expect that the Finance Ministry would try and increase revenue collections by increasing excise duty and service tax from 10% to 12%, therefore also laying ground for a GST at 12%. The other sources of increasing tax collections would be as follows:

- Increasing taxes on cigarettes, etc in order to improve human and fiscal health
- Increase import duty on crude oil from 0% to 5%
- Abolishment of Kerosene subsidy
- A reduction in the overall Cenvat rate may be considered. The revenue risk could be compensated by a non-refundable cess on polluting goods and services.
- Rationalization and simplification in terms of reduction in surcharges for corporates, withdrawal of some tax exemptions and increase in the rate of Minimum Alternate Tax (MAT).

Personal taxation

Deduction under section 80C may be revised to Rs. 1,50,000 from the existing limit of Rs. 1,00,000 to provide enhanced options of investment to the assessee. There could also be some concessions given to interest on bank deposits to encourage savings. The limit of deduction on interest paid against self-occupied property may be revised up to Rs. 3,50,000.

Capital markets

Presently Securities Transaction Tax (STT) paid on purchase or sale of equity shares, derivatives, equity oriented funds and equity oriented mutual funds, etc is not allowed as deduction under the head capital gains, and allowed only under profit and gains from business or profession only if the assessee is engaged in the trading of shares. The STT paid may be included in the cost of acquisition and selling expenses under Capital Gains. This will help the capital market.

Infrastructure

In order to sustain a healthy GDP growth rate, equivalent investment in infrastructure is required. The Government can undertake several measures in order to encourage investment in infrastructure sector. A few have been noted below:

- Focus on fiscal incentives, which help in increasing the infrastructure spending in the country. For e.g.: 80 CCF tax benefit/rebate up to Rs. 20,000 on investment in infrastructure bonds need to be increased to Rs. 1,00,000.
- Increase in outlay to Jawaharlal Nehru National Urban Renewal Mission (JNNURM). This will not just lead to higher investments but also bring about improvements in the quality of urban infrastructure.
- Specialized institutions should be allowed to fund infrastructure projects as most banks are ill-equipped as it creates inherent Asset –Liability Mismatch (ALM) issues.

Banks

It has been observed that most banks are not well equipped for project financing as it creates ALM. In other words, bank deposits are of shorter duration while project financing is longer term. Therefore, the budget could provide an incentive to lengthen bank deposit maturity structure by offering fiscal concessions to bank deposits of maturity of 3 yrs and above instead of the 5 yrs and above currently.

Agriculture

The Agriculture Ministry has demanded lowering of interest rates on crop loans to 3% from 4% for those farmers who pay in time. Ministry has also suggested that the target of credit flow to agriculture sector by banks and FIs be retained at Rs. 4,75,000 crore in FY13 as well. Further, strong emphasis is laid on rural infrastructure to provide impetus to rural demand.

Food Security Bill

The Finance ministry should roll out the Food Security Bill in the Budget FY13. It is believed that the implementation of the bill would take place in the later part of FY13. However the allotment of around Rs. 5,000 crore could be made in the Budget itself. Currently the food subsidy stands at Rs. 63,000 crore and the Ministry expects that the subsidies provided under this Bill would increase the expenditure to the extent of 2% of the current expenditure.

Small and Medium Enterprises (SMEs)

Access to finance can be enhanced by making NBFCs a vital intermediary financial institution for micro and small enterprises. These enterprises need to be actively promoted through supportive policies. Support through venture capital and private equity funds, SME dedicated banks, securitization of trade receivables and SME exchanges/ platforms would help this sector.

Health care

The Budget should raise the healthcare expenditure to a sizeable portion of the Gross Domestic Product (GDP) from 1.9% to 3.5% and target 5% in the budget of FY14. The Government should also reduce import duty on sophisticated medical equipment for India to be at par with the rest of the world and provide incentives for doctors who work in rural areas.

Real Estate

The Union Budget could target increasing business friendliness of the Indian tax administration and relax norms for repatriation of FDI in real estate. In case of SEZs clarity should be provided on its status in the light of the Direct Tax Code (DTC). For residential housing, scope of the1% subsidy announced last year should be amplified and broadened to include a wider price band to benefit home buyers, especially in lower income groups.

Power

The power sector would be expected to get some relief especially in terms of assistance on the interest to be paid on borrowed capital. The sector is under pressure of high bank debt which is difficult to service given the cost and pricing structures presently in the country. Restructuring of State Electricity Boards (SEBs) would be high on the agenda of the Budget given their tenuous state of financial health.

Defence

In order to modernize and strengthen the armed forces, India's defence budget for FY13 is likely to touch Rs. 2,00,000 crore as against Rs. 1,64,415 crore, which was 2.5% of the GDP for FY12. The defence budget for FY12 had seen a 11.6% hike and if the trends and the need of the Armed Forces is to continue in FY13, as there is need to modernise against the background of political developments across our borders.

Pharmaceuticals

Excisable goods used for R&D purposes could be exempted from Central Excise Duty besides import of all capital goods, raw materials, consumables. Even reference standards for R&D purposes to be fully exempted from customs duty and other related duties. This will definitely boost R&D activities significantly. The Budget can provide a new drug delivery system by extending weighted deduction for R&D activity beyond 2012, giving incentives for core R&D activity players as well as incentives for expenditure incurred overseas.

Disinvestment

This would once again be important for the government and the decision on the 2G spectrum could also lead to some action on further auctions in this field. Disinvestment targets could be pegged to the last year's level of Rs. 40,000 crore on the back of an assumption of a recovery in the economy and the markets recovering.

Subsidies

Bringing down subsidies would be a challenge, and while the Budget will plug it at a level lower than the revised number for FY12, there will be a move to open up prices of petro products, which will result in higher prices of diesel and petroleum to begin with.

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