



INDIA'S BUDGET 2016-17

MARCH 2016

KEY TAKEAWAYS

- The government, by maintaining its commitment to fiscal deficit targets, has strengthened faith in India's macroeconomic stability and allowed room for the Reserve Bank of India (RBI) to cut interest rates.
- The budget emphasizes measures to alleviate stress on rural citizens, which is both politically and economically smart.
- Though investors looking for big bang reforms may be disappointed, the budget includes some measures designed to improve the ease of doing business and improve India's investment climate.

OVERVIEW OF THE BUDGET

India's 2016-17 budget, released February 29, strikes a careful balance between growth and fiscal discipline. The government has committed to increasing public investment to catalyze growth at a time when private investors look reluctant to invest. Amid tepid global demand due to the Chinese economic slowdown, the budget aims to revitalize domestic demand as the chief driver of economic growth. The focus of the budget is on the agricultural and infrastructure sectors, two of the most critical sectors that require immediate attention. At the same time, the budget maintains India's commitment to fiscal consolidation, boosting confidence in the country's macroeconomic fundamentals.

The clear shift in focus towards agriculture and allied sectors is expected to stimulate consumption. Prime Minister Narendra Modi's massive victory in 2014 raised hopes among analysts and investors that his government would usher in major economic reform. Through his first two years in power, his National Democratic Alliance (NDA) government leveraged its political capital to concentrate on roads, railways and the ease of doing business, in a bid to build trust with the private sector. However, the benefits of this strategy have yet to reach the rural community. Poor weather conditions compounded this problem, and serious agrarian distress, followed by an electoral defeat for the NDA in the

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politically significant and largely agricultural state of Bihar, led the government to reconsider its economic focus. In the new budget, the government has devoted its attention to a series of focused relief measures instead of big bang reforms.

Several initiatives, viewed together, constitute the first steps towards a comprehensive social safety net. The government has extended access to agricultural credit and health insurance. Finance Minister Arun Jaitley also announced carefully crafted measures to promote affordable housing, spread digital literacy, create a conducive environment for technology driven start-ups, especially for lower caste entrepreneurs, and support education, while pledging more funds to anti-poverty programs such as the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS). The MGNREGS is a right to work program that guarantees 100 days of unskilled work to every household, and though there has been some confusion about the extent of the NDA government's commitment to maintaining the scheme, increased allocations should alleviate fears that it might be dismantled. One new initiative is the National Dialysis Services Programme, which aims to help poor patients with renal problems under the National Health Mission. The program also promises to cut customs duty for some equipment used in a dialysis machine. Jaitley's ambitious proposal to give 50 million households liquefied petroleum gas connections in the next three years will reduce reliance on unsafe and unclean cooking fuels.

Jaitley also deserves praise for striking a tricky balance in his third Union Budget and eschewing the allure of populist measures to bolster his government. While the budget was short on the big bang reform some observers are eager to see – there was little movement towards a goods and services tax, for instance, and not much on subsidy rationalization – Jaitley announced the NDA government's intention to stick to its fiscal targets, which is encouraging and offers headroom to the RBI to cut key interest rates. Maintaining India's deficit target of 3.5% also signals the government's commitment to macroeconomic stability, matched by the budget document's conservative assumptions on tax revenue and growth rates. The attention to infrastructure creation – building roads and railways, improving installed power capacity and connecting villages to the grid – is welcome. According to several studies, every rupee spent on such works contributes two rupees to the country's output each year. It is also encouraging that the government is sticking with Aadhaar, its potentially game-changing unique identity scheme, and will give it statutory backing. Aadhaar can be used to revolutionize service delivery and dramatically reduce leakages – the direct benefits transfer trial for fertilizer subsidies in 20 districts announced in the budget will be a pivotal test case for the system.

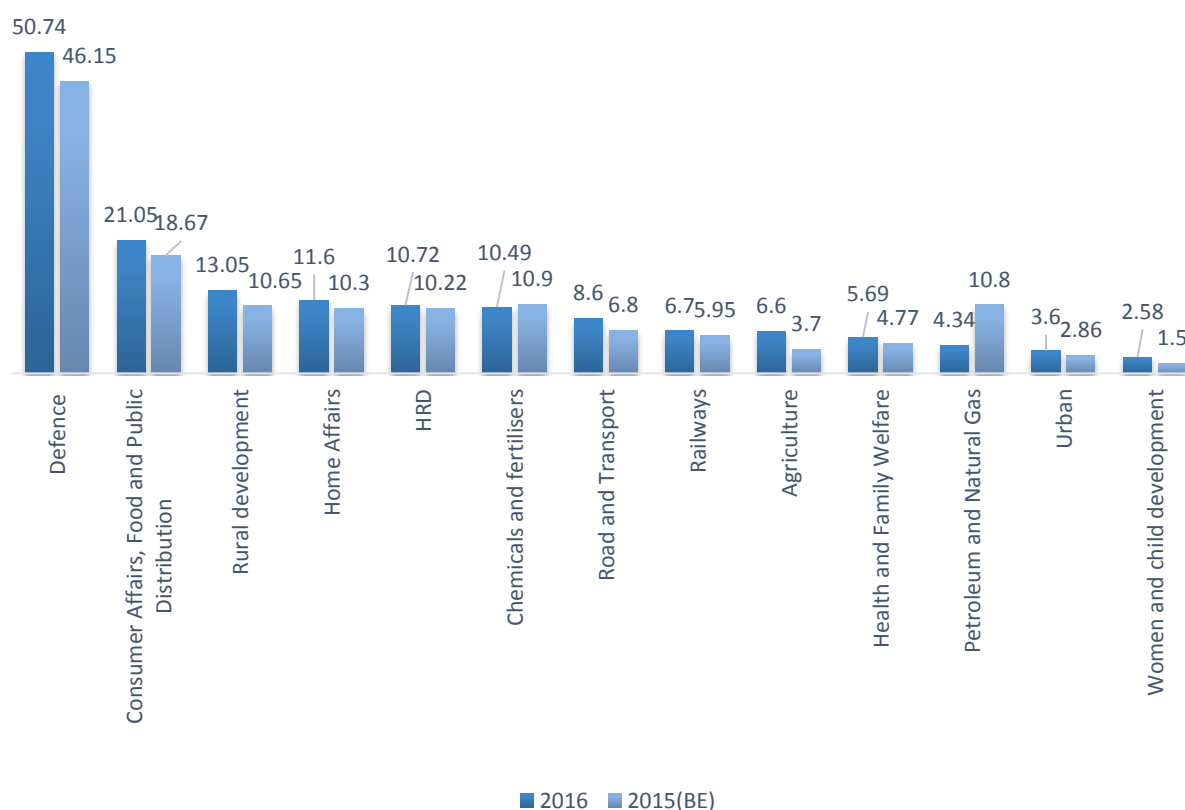
However, the Modi administration continues to send mixed messages on the retrospective tax law, denouncing it without repealing it. Nevertheless, the Prime Minister has reiterated his commitment to a predictable tax regime and is taking clear steps to ensure the rest of the government is on board. And while it is encouraging that the finance ministry recognizes the seriousness of the challenge faced by public sector banks reeling from a substantial increase in non-performing assets, the amount set aside for their recapitalization is paltry compared to the scale of the problem. The finance minister has subsequently indicated potential consolidation of public sector banks and a resurgence in efforts to collect from large defaulting borrowers.



Politically, though, this is a smart budget. Perhaps unsurprisingly for a government that has faced criticism from the opposition – and lost an important state election in Bihar – for not doing enough to alleviate rural distress, much of the budget focuses on the revival of agriculture and on increasing rural incomes. Stimulating rural demand in the short term and transforming agriculture in the long run is also economically prudent. By concentrating on the farmer, at least in the budget speech, the finance minister has staved off an outcry from the opposition, which should strengthen the government's position in Parliament and help its legislative agenda. The Modi government has authored a budget that is a step in the right direction – economically responsible, politically pragmatic and socially prudent.

SECTOR HIGHLIGHTS

*Key sector allocations (in USD billion)**



**The sectors with allocation greater than 0.88% of the total budget outlay have been selected for comparison.*

Emphasis on farming and rural development

The budget includes \$16 billion in measures to benefit the rural population, including job creation schemes and funds earmarked for rural infrastructure development. In a speech just before the budget was announced, Prime Minister Modi promised to double farmers' income by 2022.

Key measures include:

- A package of Rs 87,765 crore (~\$12.8 billion) aimed at the rural sector
- An allocation of Rs 35,984 crore (~\$5.3 billion) for the farming sector and Rs 86,500 crore (~\$12.6 billion) for irrigation, staggered over the next five years under NABARD, the development bank of India
- Rs 5500 crore (~\$817 million) for crop insurance
- The agriculture credit target has been increased from Rs 8.5 lakh crore (~\$124.2 billion) to Rs 9 lakh crore (~\$131.5 billion)
- Direct benefit transfer on pilot basis for fertilizer subsidies using Aadhaar
- 100% FDI permitted under the Foreign Investment Promotion Board (FIPB) route in the food processing sector
- Increasing the MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) fund allocation to Rs 38,000 crore (~\$5.6 billion). The MGNREGA offers a right to work guarantee and has been credited with alleviating rural distress and preventing distress migration.
- Rs 19,000 crore (~\$2.7 billion) is being set aside for the Pradhan Mantri Gram Sadak Yojana, which is to build roads to connect all villages by 2019. Increased connectivity will not only improve rural infrastructure but also help increase rural incomes.

Drive for infrastructure growth

Jaitley unveiled a slew of measures to boost the infrastructure sector. The budget hikes public investment in the sector by 22.5% and allocates \$32 billion to construct 10,000 km of new national highways and revamp an additional 50,000 km of existing highways.

Some proposals include:

- Total outlay for infrastructure Rs 2,21,246 crore (~\$32.3 billion)
- Rs 55,000 crore (~\$8 billion) for roads and highways development
- Alterations to the Motor Vehicles Act to facilitate entrepreneurship in the road transport passenger sector
- Partnerships with states to plan a revival of underserved airports and improve regional connectivity

The government also seeks to revitalize the management of stressed assets by altering the norms for asset reconstruction companies and increase the availability of cheap financing alternatives for the infrastructure sector. The railway budget offers an array of possibilities for logistics. Some key announcements, like that of the creation of a transport development corporation and multi-modal depots, have already received positive feedback from the industry.

Focus on skill development

To meet the objective of training ten million young people for employment over the next three years, the budget includes several measures to boost spending on education.

Key proposals include:

- Regulatory architecture to develop 10 public and 10 private educational institutions as world-class education and research institutes, with full autonomy from existing regulators
- The government will facilitate a digital repository of graduation certificates and diplomas



- Rs 1,000 crore (~\$147 million) for higher education financing to help educational institutes
- Rs 1,700 crore (~\$250 million) for 1,500 multi-skilled development centers

Reforms to improve corporate governance and ease of doing business

Though there are few new major reforms, the budget seeks to enable an efficient and effective government, cutting down on red tape and making it easier to do business.

Key initiatives include:

- Steps taken to strengthen PPPs through a proposed dispute resolution mechanism and provision for renegotiation of PPP contracts, which would help revitalize pure PPP to finance infrastructure projects
- A task force to rationalize human resources in the government and in autonomous bodies
- An amendment to help banks recover loans from defaulters more efficiently
- Amendments in the Companies Act to improve the environment for start-ups
- Proposal to increase the investment limit of foreign entities in Indian stock exchanges from 5% to 15%, on par with domestic institutions
- Proposal to permit residency status along with five-year business visa to foreign investors

Financial sector set for a major overhaul

The government has pledged to introduce amendments to crucial acts and bills, such as the bankruptcy code.

Other proposals include:

- A comprehensive bankruptcy code for financial firms
- Statutory backing for a monetary policy framework and a monetary policy committee
- A financial data management center
- Rs 25,000 crore (~\$3.7 billion) for the recapitalization of stressed public sector banks (PSBs), which are reeling from bad loans and non-performing assets
- New derivative products to be developed under SEBI for the commodity derivatives market
- The RBI to help retail participation in government securities

