



Union Budget 2009-10: Focus on Growth and Inclusive Development

The Union Budget for 2009-10 was presented by the newly-formed Government at the Centre against a backdrop of relative stability on the domestic political front and continuing economic uncertainty in the global arena. While the expectations were enormous, so were the challenges, given that further counter-cyclical measures seeking to stimulate economic growth had to be weighed against their impact on the fiscal balances in the light of the burgeoning fiscal deficit.

Against this backdrop, the budget's overarching priority has been on reviving growth and promoting inclusive development with a focus on stepping up investments in the infrastructure and social sectors. Thus, outlays on various social sector schemes, such as the National Rural Employment Guarantee Scheme, have been increased substantially. Emphasis has been placed on infrastructure development, with increased allocation for roads, highways, urban infrastructure and power, though increase in MAT rates is a clear negative, even after accounting for the extension in tax credit period. The proposal for IIFCL to refinance up to 60% of loans extended by commercial banks for PPP projects, as well as evolving a mechanism for 'take-out' financing is a positive for financing infrastructure projects.

The manner in which the additional expenditure will be offset by increased revenue mobilisation remains a matter of concern. The changes in direct and indirect tax rates are expected to result in a mere 2% increase in tax revenues relative to the revised estimates for 2008-09. In addition, the Government's capital receipts from disinvestment are estimated at only Rs. 11.2 billion. While a slippage in the deficits compared to the Interim Budget estimates was perhaps unavoidable, it was expected that the Budget would indicate a clear roadmap towards fiscal consolidation. However, the Budget has only mentioned that fiscal deficit will be reduced to 4% of GDP in 2011-12 from the current 6.8 %.

Additionally, the State Governments have been permitted to incur a fiscal deficit of up to 4% of their gross state domestic product (GSDP) in 2009-10, higher than both the initial target of 3% set under the Debt Consolidation and Relief Facility and the relaxed target of 3.5% of GSDP announced previously. The combination of higher deficits and therefore higher borrowing programmes of the Central and State Governments is likely to result in some upward pressure on bond yields and negatively impact the banking sector.

The Budget has met expectations with respect to areas such as abolition of Fringe Benefit Tax, extension of tax holidays for the IT and ITES sector and tax holiday on production of natural gas from NELP blocks. The CENAVT rate cuts that were announced previously were not rolled back, which should provide relief to the manufacturing sector. A reaffirmation of the deadline for introduction of the proposed Goods and Services Tax (GST) at April 1, 2010 is another positive. The biggest disappointment in the Budget is clearly the lack of policy announcements on the expected big ticket reforms, especially with respect to FDI limits, financial sector reforms, opening up the coal sector to private participation and disinvestment. However, as the Budget Speech clearly stated, "a single Budget Speech cannot solve all our problems, nor is the Union Budget the only instrument to do so."

ICRA's Sectoral Analysis

AVIATION

Proposals

- IIFCL to evolve a Takeout financing scheme and refinance 60% of commercial bank loans for PPP projects.
- Abolition of Fringe Benefit Tax.

Impact

The increased thrust on PPP projects and funding support by IIFCL could favourably impact the pace of development of airport infrastructure in the country. However, the extent to which long term finances become available for the sector as a result of the policy pronouncements made is uncertain at this stage. The abolishment of fringe benefit tax which was levied on some of the operational expenses of the airlines like expenses for the crew, expenses on in-flight entertainment and catering, hotel accommodations for the passengers in case of delays and cancellations etc., would reduce the costs of the airlines.

ROADS AND PORTS

Proposal

- Significant increase in allocation for NHAI as well as other social sector programmes like Pradhan Mantri Gram Sadak Yojana under Bharat Nirman.
- IIFCL to evolve a Takeout financing scheme and refinance 60% of commercial bank loans for PPP projects.
- Increase in the rate of MAT to 15% from 10%; however the time period for carrying forward the tax credit under MAT extended to 10 years from 7 years.

Impact

The increased outlay under NHAI and PMGSY would favourably impact companies involved in road construction. The takeout financing through IIFCL would facilitate the availability of long term capital, which is an important requirement for infrastructure projects. The government also seeks to expedite the infrastructure development process by removing various policy, regulatory and institutional bottlenecks; however, the nature of the measure remains to be seen. However, this is one sector which could benefit the most if some tangible measures are taken in the area of Viability Gap Funding, setting up of empowered regulator and drawing up of Model Concession Agreement which are acceptable to all stakeholders. The increase in MAT from 10% to 15% would have an adverse impact on the sector owing to the long gestation period for such projects.

OIL & GAS

Proposals

- Government to set up an Expert Group to advise on a viable and sustainable system of pricing petroleum products.
- Government to develop a blueprint for long distance gas highways leading to a national gas grid.
- Investment linked tax incentives to the business of laying and operating cross country natural gas or crude or petroleum oil pipelines for distribution on common carrier principle.
- Section 80 IB (9) of the Income Tax Act, which was hitherto available in respect of profits arising from the commercial production or refining of mineral oil, also to natural gas.

Impact

Formation of an expert group to advise on a sustainable pricing policy for the petroleum products is a positive development for the PSU Oil Marketing Companies (OMCs). Setting up of national gas grid should increase the penetration of natural gas and benefit gas transmission companies, city gas distribution companies, pipeline manufacturers and pipeline contractors. The Investment allowance for cross country gas/crude oil/petroleum pipelines should lead to lower pipeline tariff. Extension of tax holiday benefit for natural gas producers should help incumbent E&P companies as well as prospective entrants to the industry. This clarification should enable increased participation of E&P companies in the forthcoming rounds of NELP. However the Increase in MAT to marginally impact the IRR of new Greenfield refineries under development.

POWER

Proposals

- Significant increase in allocation under APDRP and Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY).
- Extension of Section 80 IA benefits till March 2011.
- Increase in MAT rates from 10% to 15%.

Impact

Increased allocation for APDRP may result in loss reduction for the state sector utilities, which would positively impact all players in the sector, while increased allocation for RGGVY will boost rural demand. Creation of gas grid and incentives for the NG sector will improve fuel availability for gas based power plants in the long-term. Long-term refinancing will boost funding for the power sector while extension of Section 80 IA benefits will benefit power projects commencing operations by March 31, 2011. The increase in MAT however is a negative- it will negatively impact profitability of merchant power plants. While tax burden on power companies working in the cost plus or tariff bid based environment will be a pass through, this will increase tariff burden on the final consumer.

TELECOM

Proposals

- Extend full exemption from CVD (4%) applicable to accessories, parts and components imported for the manufacture of mobile phones for one year (till June 30, 2010).
- Rate of Minimum Alternate Tax (MAT) to be increased to 15% of book profits from the present rate of 10%. Also the period allowed to carry forward the tax credit under MAT to be increased from seven years to ten years.

Impact

- Companies that have set up facilities for manufacturing mobile handsets in India to benefit in the form of lower costs.
- CDMA operators to benefit in the form of lower cost of handset purchases and hence lower subsidies to be extended for the handsets.
- Increased MAT rate to result in higher tax outflows.

CONSTRUCTION / INFRASTRUCTURE

Proposals

- Increased budgetary outlay for Bharat Nirman, NHAI and JNNURM.
- Increase in MAT rate from 10% to 15% of book profit.
- Refinancing of commercial bank loans for PPP projects by IIFCL and take-out financing initiatives.
- Restoration of full exemption on goods such as pre-fabricated concrete slabs/blocks used for further construction.

Impact

The increased outlay under Bharat Nirman and JNNURM together with increased budgetary allocation to NHAI, APDRP etc. should translate into more growth opportunities for the construction and infrastructure sector. While the initiatives for take-out financing and refinancing of loan to infrastructure projects are a positive, the extent to which credit flow to the sector improves remains to be seen. Increase in MAT rate to 15% would directly increase tax outgo particularly impacting projects claiming benefits of tax holidays.

REAL ESTATE

Proposals

- Overall increase in allocation for programs like Rajiv Awaas Yojana (RAY) and Indira Awaas Yojana (IAY). Allocation of Rs. 20 billion for Rural Housing Fund in the National Housing Bank (NHB).

Impact

Overall the budget did not contain any of the concessions that the sector was looking for. Increased outlay for Rajiv Awaas Yojana and Indira Awaas Yojana could favourably impact the Slum Rehabilitation Schemes as well as boost demand for affordable housing projects in Rural India.

CAPITAL GOODS

Proposals

- Increased allocation for schemes in the power and infrastructure sector as well as housing projects/schemes.
- Long-term refinancing facilities for infrastructure projects.
- Reduction in duty on ferromagnets for windmills for above 0.5 MW.
- Increase in custom duty on concrete batching plants from 0% to 7.5%.

Impact

Increased allocation and long term funding availability for power and infrastructure projects will induce more investment in these sectors and thereby benefit equipment manufacturers, especially electric equipment and construction equipment manufacturers. Increased allocation for RGGVY and APDRP will particularly benefit equipment manufacturers and contractors operating in the T&D space. Reduction on import duty on ferromagnets will benefit WTG manufacturers while increased duty on batching plants will benefit manufacturers in this segment.

CEMENT

Proposals

- No direct proposals.

Impact

There is no significant proposal for the cement sector. However, the increase in outlay on schemes like Bharat Nirman and focus on infrastructure development should boost demand for cement. In particular, increase in allocation under NREGS will boost rural demand including demand for rural housing, which has been a key demand driver for cement in the recent past.

STEEL

Proposals

- Development of a blueprint for a long distance gas highway, and extension of section 80-IB(9) to the natural gas sector.
- Significant increase in outlay on rural housing and urban infrastructure.

Impact

The Budget has a number of proposals for some key infrastructure sectors which are likely to positively impact steel demand in the country. The fillip provided to the natural gas sector through an income tax holiday and blueprint for a national gas grid would encourage investments in pipelines for gas transportation, increasing steel demand. Similarly the focus on the development of highways, besides leading to an additional demand of construction steel, is also likely to benefit the commercial vehicle and therefore the steel sectors. Higher outlays in urban infrastructure and rural housing too would result in higher demand of steel.

FERTILISER

Proposals

- Move towards a nutrient based subsidy regime as opposed to a product based subsidy regime prevailing currently.
- Revised Budget Estimate for fertilizer subsidy in 2008-09 is Rs. 958.49 billion (includes Rs. 200 billion by way of bonds) vis a vis Rs. 309.86 billion (BE). Budgeted subsidy for 2009-10 is Rs. 499.80 billion.
- Thrust to agriculture so that it grows at an annual rate of 4%.
- Thrust on irrigation schemes and farm loan waiver extension.

Impact

Clarity is required as to how the nutrient based subsidy scheme will be made applicable for the different segments of the industry, by and large, the scheme should favour the efficient producers of fertilizers. The long term goal of moving towards direct subsidization of farmers could be difficult to implement because of several constraints. Nevertheless, the statement is an expression of intention to decontrol the industry and should be positive for the efficient producers of fertilizers. The Subsidy allocation for 2009-10 should be sufficient in light of the fall in feedstock/intermediates/finished fertilizers prices in the international market in relation to 2008-09. ON an overall basis the thrust on irrigation, farm loan waivers and other agri oriented proposals should lead to increased demand for fertilizers.

PHARMA

Proposals

- Custom duty on certain life saving drugs to be reduced to 5% from current 7.5-10%.
- Increase in MAT to adversely impact facilities located in tax free zones.

Impact

The reduction in custom duty from 10% to 5% and countervailing duty exemption (by virtue of excise exemption) for influenza vaccine and specified life saving drugs (including bulk drugs used for these) will bring down the drug cost and benefit patients. Similarly reduction in customs duty from 7.5% to 5% on two specified life saving devices used in treatment of heart conditions will largely benefit patients. Abolition of FBT will result in tax savings for companies. However increase in MAT may result in higher tax outgo for companies located in tax free zones.

AUTO / TWO-WHEELER

Proposals

- Reduction in specific component of Excise Duty on large passenger cars and utility vehicles with engine capacity of 2,000 cc and above from Rs. 20,000 per vehicle to Rs. 15,000 per vehicle.
- Reduction in Excise Duty on petrol driven trucks from 20% to 8% bringing it in line with diesel driven vehicles. Excise duty on chassis of such trucks reduced from '20% + Rs. 10,000' to '8% +10,000'.
- Allocation for the National Highway Authority of India (NHAI) increased by 23% from Rs. 129.66 billion.

Impact

Increased investment in NHAI/ infrastructure is a significant positive for the commercial vehicle segment. Excise duty cuts provided as part of the stimulus package have been retained, which is a positive. As against the expectation of rationalization in excise duty between large passenger cars/utility vehicles and small cars, the reduction in ad valorem component by Rs. 5,000 per vehicle is unlikely to have major impact on manufacturers of large passenger vehicles including utility vehicles. Lower excise duty on petrol driven trucks is a positive; however given the small base, it may not have a material impact. Imposition of service tax on goods carried by railways, coastal cargo and inland airways, in line with road transport, would benefit the road transport sector.

AUTO ANCILLARIES

Proposals

- Roll-out of the GST regime by April 1st, 2010.

Impact

Timely implementation of the GST regime is likely to reduce the complexity in the current scheme of tax incidences and also reduce overall costs in the industry. Boosts given to the commercial vehicle segment through infrastructure spend is a positive. Retention of excise duty cuts (provided earlier as part of fiscal stimulus) is also a positive, supporting OEM demands for the sector. The possibility of inverted duty structure has gone up in India in wake of India's growing engagement with a number of free trade agreements. Identification and elimination of such instances could have benefited the industry.

HOTELS AND TOURISM

Proposals

- Around 64% increase in allocation for the 2010 Commonwealth Games from Rs. 21.12 billion to Rs. 34.72 billion.
- Elimination of Fringe Benefit Tax (FBT).

Impact

Increase of investment in road infrastructure likely to trickle down towards promoting travel and tourism. Higher spend on the Commonwealth Games to help showcase India as a key Asian tourist destination and help attract foreign travellers. Elimination of FBT to directly benefit hotel companies through reduced tax outflow and indirectly by driving higher corporate spend on employee travel and boarding.

RETAIL

Proposal

- A clear roadmap for implementing Goods and Services Tax (GST) w.e.f April 1st 2010.
- Introduction of investment-linked tax incentive for 'cold-chain' and warehousing facilities for storing agriculture produce.

Impact

A clear roadmap for introduction of GST will eventually streamline pricing divide between organised and un-organised sector. The Indian organised retail industry is currently in a nascent stage, requiring significant investments in back-end infrastructure and effective logistics management. Extension of investment-linked tax incentives in the area of 'cold-chain' and warehousing facilities for agriculture produce would facilitate necessary investments and help organised retail to improve efficiencies and profitability in the long-term.

TEXTILES

Proposals

- Interest subvention of 2% on pre-shipment and post-shipment export credit extended beyond September 30, 2009 till March 31, 2010 (an earlier interest subvention of 4% was withdrawn in October 2008, with reinstatement of 2% subvention in December 2008).
- Optional excise duty of 4% on cotton textiles chain (beyond the fibre stage) reinstated from the earlier across-the-board cut of 4%; this will restore option to manufacturers towards availing export rebate of the duty paid from CENVAT credit.
- Excise duty on man-made fibre and yarn increased from 4% to 8% on a mandatory basis; excise duty on stages beyond fibre and yarn increased from 4% to 8% under the existing optional scheme; similar duty increase on intermediates.
- Basic customs duty on wool and cotton waste reduced from 15% to 10%.

Impact

The extension of interest subvention will benefit exporters through lower interest costs on working capital loans. The impact of the restoration of the optional excise duty on the cotton textiles chain is negligible. However, the increase in duties for the manmade fibre/yarn industry is negative.

FMCG

Proposals

- Increased allocation of funds for rural, agricultural-centric and employment generation schemes.
- Abolition of Fringe Benefit Tax.
- Retention of 4% excise duty on certain food items including biscuits, sharbats, cakes and pastries.

Impact

Thrust on rural economy and employment generation is a positive for the sector, since such schemes are expected to increase consumer spend. Reduction in personal income tax to benefit the sector by increasing the disposable income available with consumers. Scrapping of Fringe Benefit Tax is also a positive given its significant impact on FMCG companies.

INFORMATION TECHNOLOGY

Proposals

- Extension of availability of benefits under Section 10A/ 10B and EoU units by one more year.
- Creating safe harbour provision in transfer pricing regulation (Automatic route upon fulfilling some conditions). Introduction of fast-track tax dispute resolution mechanism.
- Abolition of FBT.
- Abolition of duplicity of indirect taxes for software licensing.

Impact

The extension of sunset clause for STPI by one year and abolition of FBT is positive for the IT sector. However increase in MAT from 10% to 15% will mitigate the benefit to a large extent for financial year 2009-10 and onwards. The creation of an alternative dispute resolution mechanism within the Income Tax Department for the resolution of transfer pricing disputes and formulation of "safe harbour" rules for services will facilitate ease of international business, transparency and reduce litigation costs. On the packaged software front, tax exemption from Excise and CVD for "rights transfer" will avoid duplicity of indirect taxes with IT services already taxed.

MEDIA AND ENTERTAINMENT

Proposals

- Extension of the stimulus package, comprising a waiver of 15% agency commission on Directorate of Advertising and Visual Publicity (DAVP) advertisements and a 10% hike in the advertisement rates subject to documentary proof of loss of revenue in non-governmental advertisement, for another six months till December 31, 2009.
- Levy of 5% customs duty on the import of set top boxes.

Impact

Compensation to print media companies for loss of revenues (on drop in the print advertisement spends as fallout of the economic slowdown) is positive for the sector. Import duty on set-top box is marginally negative for Direct To Home (DTH) / Conditional Access System (CAS) Broadcasters; though there would be long term benefits by encouraging local manufacturing. The sector to be significant beneficiary of the withdrawal of FBT.

EDUCATION

Proposals

- Students from economically weaker sections to get full interest subsidy for education loans (during moratorium period).
- Extension of benefits for deduction of interest on education loan to all fields of study, including vocational studies.
- Allocation for 'Mission in Education through ICT' increased to Rs. 9 billion.

Impact

- Provides impetus to demand for professional courses, which will positively impact private institutions providing higher education.
- Increased allocation for 'Mission in Education through ICT' to benefit companies providing services for setting up of IT infrastructure in educational institutes.

BANKS

Proposals

- Public Sector Enterprises such as banks and insurance companies to remain in public sector and will be given full support including capital infusion to grow and remain competitive.
- IIFCL to refinance 60 per cent of commercial bank loans for PPP infrastructure projects in critical sectors over the next fifteen to eighteen months.
- Agriculture credit targets increased by 12.5% to Rs. 3,250 billion. Interest subvention on short term crop loans to be continued. Additional incentive to borrowers who repay such loans on time.
- Increased allocation to NHB for providing rural housing refinance and to SIDBI for micro and small enterprises.

Impact

The increase in Fiscal Deficit and corresponding impact on bond yields will negatively impact the banking sector. The Government's commitment to recapitalise banks is a positive. The refinancing facility from IIFCL could help in correcting ALM mismatches arising on long duration exposures. The additional interest rate subvention scheme to encourage prompt repayment by farmers and should improve credit culture.



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