BUDGET 2014 ANALYSIS

AVALON Consulting

25 GLORIOUS YEARS

Budget

2014

COMME CI COMME ÇA

Budget at a glance

Budget 2014 is comme ci comme ça (so-so) on most fronts, and may not have been the bold game-changing plan of action many had expected it to be. However, through the various proposals, the new government has clearly stressed its commitment to four focus areas – bringing about fiscal prudence, making subsidies productive, reviving economic growth and boosting business confidence.

1 A commitment to reign in fiscal deficit from 4.1% to 3% over the next three years by managing expenses and by increasing revenues through economic growth, together with steps to increase investments, ought to help sort out some structural issues and reduce inflation.

2 The FM has not cut subsidies but has promised to change the colour of subsidies from unproductive dole to useful asset-creating expenditure. The government's plan to make subsidies targeted at the poor will make subsidies a lot more productive and will reduce the burden eventually.

3 A concrete plan to boost economic growth by increasing investments has been iterated through investments in infrastructure, sops for affordable housing, increasing the home loan interest deduction limit under Sec 24 and increasing the limit under Sec 80C to boost demand for housing. A parallel thrust is made to nudge PSUs to make capital investments of Rs. 2.5 trillion by clearing their pending proposals. The FM also listed out various initiatives to make funding possible- FDI to go up to 49% in insurance and defence production, public sector banks to dilute the government's stake through the primary market and $9.7 bn to be raised through disinvestment in Public Sector companies, to attract FDI in real estate by reducing the qualifying minimum size to merely 20,000 sq. m., Rs. 100 billion fund to provide risk capital for start-ups, banks to be allowed to raise long term funds to invest in infrastructure projects with exception from CRR and SLR requirements, etc. Reduction in personal taxes by raising the exemption limits, leaves more money for domestic consumption.

4 A committed plan to boost business confidence and ease of doing business was outlined through various measures including removing various bottlenecks by streamlining the way the Government works, putting in place a 24X7 transparent eBiz platform for all clearances and various compliances, implementing the advance tax ruling and other measures to reduce the harassment of tax payers by the authorities, reviving the mining industry by solving the impasse in the coal sector and providing proper fuel linkage for all productive investments, etc. Intent to introduce GST this year indicates that indirect taxes will get streamlined. Rules relating to Transfer Pricing are also sought to be rationalised.

In this document, we have examined the various budget proposals pertaining to key sectors such as infrastructure, auto, agriculture, pharma, healthcare, consumer goods, engineering etc in the light of the industry's expectations from the budget.

What is in it for foreign investors?

FIIs read the pulse in the run up to the elections when they were net buyers and domestic institutions were net sellers. Even the not-so-clear statement on retrospective tax cases of the past will restore some confidence to invest in India because of the statement of intent for the future. One can expect investments from Japan, China in select manufacturing zones.

Raising the FDI limits to 49% could see fresh investments in defence production and probably less so in Insurance till the sector comes out of its problems. Foreign retailers, who manufacture goods in India, will be allowed to do ecommerce in India and will not have to do it through local partners. M&S, Nike, Benetton, etc. stand to benefit. Joint ventures attracted to the plan to start 100 smart cities could also be expected soon.

STRENGTHENING THE CORE

In addition to increasing the overall outlay on strengthening infrastructure, there is an emphasis on restyling the PPP model and ensuring long term funding for the sector

1 REVAMPING THE PPP MODEL IS A WELCOME CHANGE

An institution to provide support to PPPs (public-private-partnerships) called 3P India will be set up with a corpus of Rs 500 cr. 3P India will renovate the PPP model and help resolve disputes amongst various stakeholders.

This will revive the stalled infrastructure projects. (Currently there are around 110 central infrastructure projects which are stalled and have led to cost overruns of Rs. 1.57 lakh cr.)

2 ENSURING LONG-TERM FUNDING IS A POSITIVE MOVE

Banks would be permitted to provide long-term funding to infrastructure sector with minimum regulatory pre-emption such as cash reserve ratio, statutory liquidity requirements and priority sector lending. Further, prior to this budget, no infrastructure-financing companies could give loans for more than 8-10 years to Indian infrastructure companies. By minimizing the regulatory restrictions on banks, this budget has given a boost to infrastructure financing companies to give long term loans (25 years)

3 INNOVATIVE FUNDING MECHANISMS WILL CHANNELIZE INVESTMENTS

As an innovation, a modified Real Estate Investment Trusts type structure for infrastructure projects is also being announced as Infrastructure Investment Trusts (InvITs), which would have a similar tax efficient pass through status, for PPP and other infrastructure projects.

Present corpus of pooled municipal debt obligation facility will increase with participation of several banks to finance infra projects in urban areas on shared risk basis to Rs 50,000 cr.

A look at sector specific investments points to a change from previous budgets

PORT INFRASTRUCTURE

In last year's budget only 2 harbor ports were announced as compared to 16 new ports this year, to be completed by 2017. Over Rs. 11,000 cr. earmarked for Tuticorin, Kandla and other ports and Kakinada port and adjoining area to be developed.

ROADS

Investment in NHAI and state highways to the tune of Rs. 37,887 cr. including Rs. 3,000 cr. for Northeast.

AIRPORTS

Scheme for development of new airports through the PPP mode in Tier 1 and Tier 2 cities.

WATERWAYS

Rs. 4,200 cr. set aside for the Jal Marg Vikas project on river Ganga connecting Allahabad to Haldia, over 1,620 km.

RAIL

Rs. 1,000 cr. will be provided for rail connectivity in North-east region. Plan to introduce bullet train on the Mumbai-Ahmedabad sector, a diamond quadrilateral for high speed trains and allowing foreign direct investment in railway projects.

METRO

Development of Metro rails in PPP mode-Rs. 100 cr. set aside for metro scheme in Ahmedabad and Lucknow.

REAL ESTATE

Vision of developing 100 smart cities with an allocation of Rs. 7,060 cr. Increased Income Tax exemption, and deduction on interest paid on home loans is expected to boost housing demand.

URBAN INFRA

20-fold increase in allocation for water resources (including Rs. 36 billion under National Rural Drinking Water Programme and Rs. 10 billion for a new irrigation scheme).

PIPELINE

Additional 15,000 km gas pipeline to be set up in the country.

DRIVING IN THE SLOW LANE

The auto industry had a long wishlist for the finance minister, but on the whole, reforms will have only a mild positive impact

The industry had pinned its hopes on a slew of reforms - some immediate and some longer-term, pertaining to changes in regulatory and policy measures and changes in trade policy/FTAs. The finance minister was only mildly generous.

Near term industry expectations from budget 2015

1. Continuing with the reduced excise duty structure beyond Dec 31, 2014 and having a stable taxation regime
2. Allowing standard deduction for car purchase for salaried individuals
3. Reducing duty on components under chapter 84 to 10% to address inverted duty structure and credit accumulation at OEMs
4. Withdrawal of 1% duty on natural calamities and contingency duty on vehicles
5. Accelerating depreciation rate on motor cars to 25%
6.
7. Allowing interest paid on car loans by salaried people as deduction under chapter VI A
8. Announcement of roadmap for GST implementation as early as possible
9. Retaining the customs duty on CBUs of passenger vehicles and 2 wheelers, while raising customs on CV imports close to WTO bound rate of 40%

Industry wish-list also included longer term reforms

The industry expected a clear roadmap pertaining to various initiatives which would push the demand for CVs. These included:

- Rolling out an incentive-based fleet modernisation programme (especially for CVs).
- Legal provisions for preventing of overloading of vehicles
- Extension of the JNNURM-type scheme beyond 31st March 2014
- Building of new highways and roads
- Declaring a realistic timeline and roadmap for future emission norms
- Implementation of large infrastructure projects which will push demand for CVs.

The industry was also hopeful of a change in trade policy/FTAs, which were expected to assist in promoting local automotive manufacturing and exports, ensuring and addressing all embedded taxes and duties in export products actually exported from India, keeping sensitive automotive CBU items (20 tariff lines) in India's negative list in FTAs with competing economies and entering into FTAs with countries which are potential markets rather than potential threats (as in case of the EU and the US).

The budget delivered only a fraction of the expected reforms. However, no announcements were negative for the industry

Measures to aid recovery to have a more immediate impact

Excise duty cut benefits have been retained till December 31.

A 15 % investment allowance was sanctioned for a three-year period to the manufacturing companies that are looking to invest more than Rs. 25 cr. in plant and machinery. **This will aid auto component SMEs to upgrade.**

Revised personal tax slabs are expected to boost income levels of the middle class and spur demand, especially in 2-wheelers and A-segment cars.

Measures for infrastructure development to have long term positive impact

Investment of Rs 37,880 cr. in roads is proposed, with a target of national highway construction of 8,500 km in the current fiscal. This will entail long term benefits for logistics, and hence, CV industry.

The aim of making Indian railways the largest freight carrier of the world, if successful, will impact long haul transport negatively and boost short / medium haul transport. However, this is more long term and depends on the details, which are unclear.

SOWING THE RIGHT SEEDS...

BUT A LONG WAIT FOR THE FRUITS

The 2014-15 budget has proposals on some key initiatives required to improve the viability of the farmer. However, while it is broad in coverage, it lacks the depth to ensure results on the ground.

On the positive side, the budget addresses key drivers of farm health and productivity

FARMING METHODS
Setting up of agriculture research centers and universities, introducing a dedicated channel - Kisan TV - to disseminate information, and bringing in a technology led second green revolution, all augur well for improving farming practices and hence productivity.

BIOTECH
Promoting bio-tech clusters in Mohali, Pune and Kolkata will help research on seeds and tissue culture – thus providing better inputs to the farmer.

IRRIGATION
The 'Pradhan Mantri Krishi Sinchayee Yojna' will assist in promoting local means to improve water availability and insulate farming activity from the vagaries of the monsoon.

SOIL HEALTH
Soil Health cards will enhance the farmer's awareness of soil testing and soil nutrition. It will also help in creating and maintaining a national database of soil conditions – which would be helpful to agri-input firms as well as for policy formulation.

WAREHOUSING
Proper storage facilities are a key missing link in ensuring less wastage and hence better returns to the farmer. An allocation of 5,000 Cr. is a step in the right direction – though a lot more would be required before the situation can be addressed completely.

PRODUCE MARKETING
The price stabilisation fund and encouraging farmer markets will help in providing better and stable realisation to the farmer – ultimately leading to farm prosperity.

FINANCE
There are several moves to provide credit to the farming community, including landless farmers. However the key initiative is the allocation towards NABARDs Producers Development and Upliftment Corpus (PRODUCE) for building 2,000 producers organizations over the next two years

FOOD PROCESSING
Excise duty on specified food processing and packaging machinery has been reduced from 10% to 6%. This will help improving the viability of fruits and vegetables processing and lead to reduced wastage of fresh produce

ORGANIC FARMING
Special focus on developing commercial organic farming in NE Region, and an allocation of Rs. 100 cr. for the same

Some of the fundamental issues were left untouched or suffer from lack of clarity

The key issues not addressed by the budget are

a. Urea prices: The imbalance in soil nutrient levels, caused primarily due to the artificially low prices of Urea, has not been adequately addressed. The 'new urea policy' has not been elaborated.
b. Restructuring the APMCs: The lack of proper price discovery for the farmer and the necessity to part with margin due to the archaic APMC establishments, will continue.
c. Cold Chain Infrastructure: The budget is silent on the key issue of cold chain infrastructure. The existing schemes of subsidy on cold chains is not helping much in pushing the cause. A more comprehensive program is required. Whether this will be part of the Rs. 5,000 Cr. allocation to upgrade warehousing infrastructure, is not clear from the budget proposal.
d. Market making: The key is to promote transparency and competition at the Mandis. The proposal of setting up Farmer's Markets in towns is difficult to scale up. Such mechanisms increase the transaction cost for both farmers and consumers, and may not lead to higher earnings for the farmers.

4%
Sustainable Growth

₹ 8 lakh cr.
Target for agriculture credit

₹ 5,000 cr.
Warehouse Infrastructure Fund

₹ 50,000 cr.
Short Term Cooperative Rural Credit

The amounts allocated towards many of these initiatives fall woefully short of what is required to be invested. The intent of involving private sector remains on paper. Ambiguity surrounding many fundamental issues is also a spoiler.

NO SHOT IN THE ARM THIS

The intent of providing free drugs and services to the entire population is noble but there is no clarity on funding source or mechanism of delivery.

The pharma industry had a lot of expectations out of the budget 2014-15. Some of the key expectations were as follows:

WEIGHTED TAX DEDUCTION ON SCIENTIFIC RESEARCH
Expenditure related to research conducted in-house i.e. clinical trials, bioequivalence studies, regulatory and patent approvals, should be eligible for weighted tax deduction, even if these activities are outsourced.

CLARITY ON TAXING GIVEAWAYS TO DOCTORS
Expenditure incurred on provision of gifts to doctors is scrutinized by income tax authorities. The ambiguity of the circular notifying this, has created widespread concern. As an interim measure, the CBDT should constitute a panel with industry representation to define expenses as 'ethical' or 'unethical' and lay down guidelines for implementation.

CLARITY ON FDI PROVISIONS
Ambiguity on coverage (e.g. whether allied activities such as R&D, clinical trials are covered). Currently, there are no specific guidelines laid down on whether the FDI provisions are applicable to pharmaceutical companies undertaking allied activities e.g. R&D, clinical trials etc.

RATIONALISATION OF EXCISE DUTY ON ACTIVE PHARMA INGREDIENTS (APIS)
12% central excise duty is levied on APIs, whereas formulations are subject to central excise duty of 6%. The excise duty rate of APIs should be rationalised and brought on par with pharma goods. Alternatively, the Government may introduce a refund mechanism to enable Pharma manufacturers to avail refund of excess cenvat credit.

ADOPTION AND IMPLEMENTATION OF UNIFORM MARKETING GUIDELINES (e.g. the Uniform Code of Pharmaceutical Marketing Practices circulated by the DoP).

RATIONALISATION OF CLINICAL TRIAL GUIDELINES
Currently, there are no specific guidelines laid down on whether the FDI provisions are applicable to pharmaceutical companies undertaking allied activities e.g. R&D, clinical trials etc.

UPDATING OF GOVERNING LAWS SUCH AS DRUGS & COSMETIC ACT to reflect the current industry scenario.

STAKEHOLDER CONSULTATION while introducing and implementing drug pricing guidelines.

The budget was silent on most of the expected reforms in the pharma sector

FOCUS AREA	ANNOUNCEMENTS	IMPACT
Free drugs and diagnosis	In a move towards "Health for All", two key initiatives - free drug service and free diagnosis service would be taken up on a priority basis	
HIV/AIDS diagnostics kits	Full exemption from customs duty for HIV/AIDS drugs and diagnostic kits imported under National AIDS Control Programme funded by the Global Fund to fight AIDS, TB and Malaria	
Clinical trials	Service tax has been levied on clinical trials on humans. Will result in increased costs of clinical trials and make India less competitive for global pharma companies	
Capital investment	Lowered threshold limit of investment in plant & machinery for providing investment allowance of 15% - from Rs. 100 cr. to Rs. 25 cr.	
Drug testing labs	The Government has also announced creation of new drug testing laboratories	

A CLEAN BILL OF HEALTH

Raising the FDI cap in insurance from 26% to 49% is a big positive push and will help drive deeper penetration of healthcare. However, the key demand for Infrastructure status remains unaddressed in this Budget.

Focus Area	Announcements	Impact
Insurance	• FDI cap in Insurance raised from 26% to 49%	
Higher Education*	• Opening up of 4 additional AIIMS and 12 government medical colleges has been announced • Source of funding and mechanism to ensure quality has not been specified	
Skill Development*	• Increased focus on addressing the skill gap via the National Skill Programme • Detailed plan not specified	
Research*	• Announced setting up of 15 Model Rural Health Research Centers • Strengthening of five research centers • Two National Institutes of Ageing • National level research and referral Institute for higher dental studies	
Biotech Clusters	• Development of biotech clusters in Faridabad and Bengaluru • Agri-biotech cluster in Mohali to be scaled up and to include global partnerships • Two new clusters to be established in Pune and Kolkata	
Medical Tourism	• Medical tourism has been given a new thrust with suggestion of e-visas at airports on arrival for tourists	
Waste Treatment	• For ensuring safe disposal, medical waste treatment facilities have been exempted from service tax	
Global Alliances	• Plans of striking global partnerships to help grow the UNESCO financed International Centre for Genetic Engineering and Biotechnology, Delhi	

* These announcements are expected to have no immediate impact, however the impact will be positive in the long term

Long-awaited reforms in Healthcare

- **Infrastructure status** to the sector
- **Extension of tax holiday for healthcare projects in urban areas** is essential to enable companies to commit the substantial investments required in the healthcare sector
- There was hope of the government **increasing health expenditure closer to 2.5% of GDP** as well as encourage industry to **address needs of unserved areas**
- The government **was expected to promote health insurance coverage** for citizens by bringing it in the **negative list for service tax**
- To make the bio-pharma drugs affordable, the government was expected to announce steps providing incentives to **enhance affordability and usage of such medications**

HIGH ON HEALTH, LOW ON FIZZ

FM gives more pocket money and tells citizens and FMCG industry to stay healthy, stay clean

No surprises for the FMCG sector

The Union Budget 2014-15 has thrown no surprises at the FMCG and Retail sectors. The Finance Minister has put a little more money into the hands of the consumer by raising **direct taxation exemption limits** and the aggregate spending effect is expected to add some cheer to consumer goods companies in this year, if the poor monsoon doesn't play any more spoilsport.

Within foods and beverages, the FM has provided a prescriptive pill for healthy living by significantly **raising excise duty on cigarettes and cigars** (in the range of 11% to 72%) and other forms of tobacco. Strangely, beedis remain untouched. Similarly, **fizzy drinks are a no-no with duty being upped by another 5%**. This could come as an incentive to natural beverages such as juices and dairy drinks. **A reduction in duty on food processing and packaging machinery** (from 10% to 6%) is expected to have a trickle-down effect as companies in expansion mode gain and pass on this benefit to consumers.

It's a soap story in personal care with soap manufacturers benefiting from the **exemption in customs duty of 7.5% in a host of inputs – fatty acids, palm oil derivatives and industrial grade crude oils.** Duty on crude glycerine has also been reduced from 12.5% to 7.5%.

Additionally there was small screen cheer within consumer durables with **import duty on LCD and LED television panels below 19" being reduced to zero from 10%.**

Cautious enthusiasm for retail

While keeping the doors closed to 100% FDI in multi brand retail, the budget has opened up the e-commerce sector by permitting foreign entities who entered the country as manufacturers to sell via ecommerce platforms. This is expected to benefit those brands who have entered the country as manufacturers and already set up a local sourcing base.

Other than this, footwear retailers and brands were the other beneficiaries in the reduction in excise duty of low priced (Rs. 500 to Rs. 1,000 MRP per pair) footwear where excise duty has been halved to 6%.

With these measures, the Government has signalled its cautious approach to liberalising the retail sector.

STILL IN THE WORKS

Clear and strong ideas were expected to boost consumer demand by controlling inflation and to build capacity in core industries to unlock supply constraints. This hope has been belied for now.

With the Manufacturing Index of Industrial Production experiencing a growth of -0.8% during FY14, there were many expectations from the Union Budget 2014-15 to turn things around.

However, neither are there any innovative ideas for picking up manufacturing nor is there a clear roadmap on how various initiatives are going to be delivered on the ground.

Some of the announcements in the Budget with a bearing on the Engineering & Capital Goods sector relate to –

Reduction of PSU capex from Rs. 2.52 lakh cr. to Rs. 2.48 lakh cr. A significant increase was expected to spur growth in the Engineering and Capital Goods sector, however there seems to be an intent to rely more on the PPP model.

Many proposals regarding the **development of smart cities and industrial corridors** across the country have been mooted. This is likely to spur demand in construction machinery, material handling, power equipment, small machinery and equipment.

There are **proposals to improve the road network and airport modernisation** in the tier 1 and 2 cities which could also create demand for capital goods.

Efforts to rationalise coal linkages to optimise the transport of coal and reduce the **cost of power** have been made.

10 year tax holiday for enterprises that commence power generation, transmission and distribution before Mar 31, 2017 has been announced.

Investment allowance of 15% for manufacturing companies investing more than Rs. 25 cr. in any year with benefit extending till Mar 31, 2017 has been announced.

Customs duty exemptions for equipment meant for various energy projects have been given.

Perhaps it is early days to judge and the small titbits provided may be enough for the ever resilient Indian industry to pick itself up, dust itself off and get going.

Excise duty reduction from 10% to 6% for food processing machinery has been proposed.

Encouragement for **MSME entrepreneurs** is articulated in the form of Rs. 10,000 cr. Fund of Funds for provision of various forms of funding and **higher capital ceiling** for defining an MSME.

CONCLUSION

While the budget may have seemingly fallen short of industry expectations, it certainly sets the right tone for growth, channelises funds where necessary and eases funding bottlenecks to an extent. Infrastructure is a clear focus area and measures have been clearly taken to improve the investment climate. The thrust on education, skill development and measures to encourage job creation are also welcome. While targets to reduce fiscal deficits may seem a tad ambitious and clarity on many reforms is awaited, all in all, the Budget provides the right impetus for growth.

Contact Us

MUMBAI
mumbai@consultavalon.com
Ph: +91 22 6619 1100

Bangalore
bangalore@consultavalon.com
Ph: +91 80 6771 0709

DELHI
delhi@consultavalon.com
Ph: +91 11 4051 1600

CHENNAI
chennai@consultavalon.com
Ph: +91 44 4345 5345

SINGAPORE
admin@apex-avalon.sg
Ph: +65 8411 0216

www.consultavalon.com
www.apex-avalon.sg