*Union Budget 2018-19: An Assessment**

This article analyses the key features of the Union Budget 2018-19 presented on February 1, 2018 and passed in the Parliament in March 2018. Drawing on the impetus provided by reforms – the goods and services tax; digitisation; demonetisation; the Insolvency and Bankruptcy Code (IBC) – and a turnaround in the performance of the economy in the second half of 2017-18, the Union Budget for 2018-19 tries to balance prudence with the political compulsions of a pre-election year. It focuses on the rural economy and agriculture, the social sector (education, health and social protection), senior citizens, infrastructure and the financial sector. The step-up in allocations to these sectors are sought to be financed by augmenting direct tax collections and by sustaining the disinvestment drive. The Budget has deviated from the earlier fiscal consolidation path and aims at achieving the fiscal deficit of 3 per cent of GDP by 2020-21.

Key Thrust Areas of the Union Budget 2018-19

- Boosting the supply chain in agriculture from production to marketing: remunerative minimum support prices; agri-markets and connectivity; horticulture, organic farming; food processing and exports.
- Enhancing rural welfare: expansion of programmes for free LPG connections (PM's Ujjwala Scheme); electricity (PM's Saubhagya Yojana); sanitation (PM's Swachh Bharat Mission); housing (PM's Awas Yojana); and rural employment.
- Education - leveraging on technology and increasing investment in research and related infrastructure; health – wellness centres; and social protection – health and other insurance for disadvantaged households.
- Promotion of medium, small and micro enterprises (MSMEs) – addressing balance sheet stress and financing constraints; and employment – incentivising women employment in the formal sector; fixed term employment for all sectors; skilling (PM's Kaushal Kendra Programme).
- Building infrastructure in defence, urbanisation (smart cities mission); tourism; roads; railways; airports; ports and inland waterways.
- Finance: developing the corporate bond market; reforming stamp duty regime for financial transactions; long term capital gains tax; bank recapitalisation; hybrid instruments for foreign investment; strengthening the monetary policy framework with the introduction of standing deposit facility by the RBI.

Annex 1 lists the key policy initiatives laid out in the Budget.

I. Fiscal Deficit

In 2017-18, there is a fiscal slippage of 0.3 per cent of Gross Domestic Product (GDP) in the revised estimates from the budgeted 3.2 per cent. The slippage is even higher for the revenue deficit (RD) at 0.7 per cent of GDP and for the effective revenue deficit (ERD)[1] at 0.8 per cent. For 2018-19, the Gross Fiscal Deficit (GFD) is budgeted at 3.3 per cent of GDP, implying a slippage from the targets indicated in the

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[1] Effective Revenue Deficit is the difference between revenue deficit and grants for creation of capital assets signifying that amount of capital receipts that are being used for actual consumption expenditure of the Government.

Table 1: Fiscal Deficit: Actual *vis-à-vis* Observable Targets (Per cent of GDP)

	2017-18			2018-19		
	RE	MTEF	FRBM Review Panel	BE	MTEF	FRBM Review Panel
FD/GDP	3.5	3.2	3.0	3.3	3.0	3.0
RD/GDP	2.6	1.9	2.1	2.2	1.6	1.8
ERD/GDP	1.5	0.7	-	1.2	0.4	-

Medium Term Expenditure Framework (MTEF)/Fiscal Responsibility and Budget Management (FRBM) review roadmap (Table 1). The achievement of the target of 3.0 per cent of GDP has been deferred to 2020-21 as per the proposed new regime of the FRBM. The Government has further decided to insert adequately defined "escape and buoyancy clauses" to determine when the targets may be relaxed or tightened as the case may be[2]. The Government has also decided to do away with the deficit targets on revenue account, *i.e.* RD and consequentially, ERD.

The decomposition of GFD for 2018-19 shows that although the revenue deficit-GDP ratio is budgeted to reduce in 2018-19 *vis-à-vis* 2017-18, it continues to pre-empt almost 67 per cent of the borrowed resources as against 59 per cent in 2016-17 (Table 2).

The fiscal slippage in 2017-18 needs to be seen in the context of the reforms that are underway, especially the GST and its implementation as well as the fact that less than the full year's collections were available. Nevertheless, it might have implications for macro-economic stability while undermining the confidence of external investors (RBI, Sixth Bi-monthly Monetary Policy Statement, 2018). The fiscal credibility is particularly important from ratings agencies' perspective, considering that India remains a relatively high debt and high deficit country among similarly rated countries (Annex II). Also, given that India's combined deficit remains high *vis-a-vis* its Asian peers, there is a need for radical programme of deep fiscal adjustment requiring close coordination between the Union and the State governments (Joshi, 2017) (Annex III).

Table 2: Decomposition of GFD (Per cent)

	2015-16		2016-17		2017-18		2018-19
	BE	Actual	BE	Actual	BE	RE	BE
Revenue Deficit	71.0	64.3	66.3	59.1	58.8	73.8	66.6
Capital Outlay	39.1	42.5	41.0	46.3	49.4	42.1	44.6
Net Lending	2.4	1.0	3.2	3.6	5.1	0.9	1.5
Disinvestment	-12.5	-7.9	-10.6	-8.9	-13.3	-16.8	-12.8

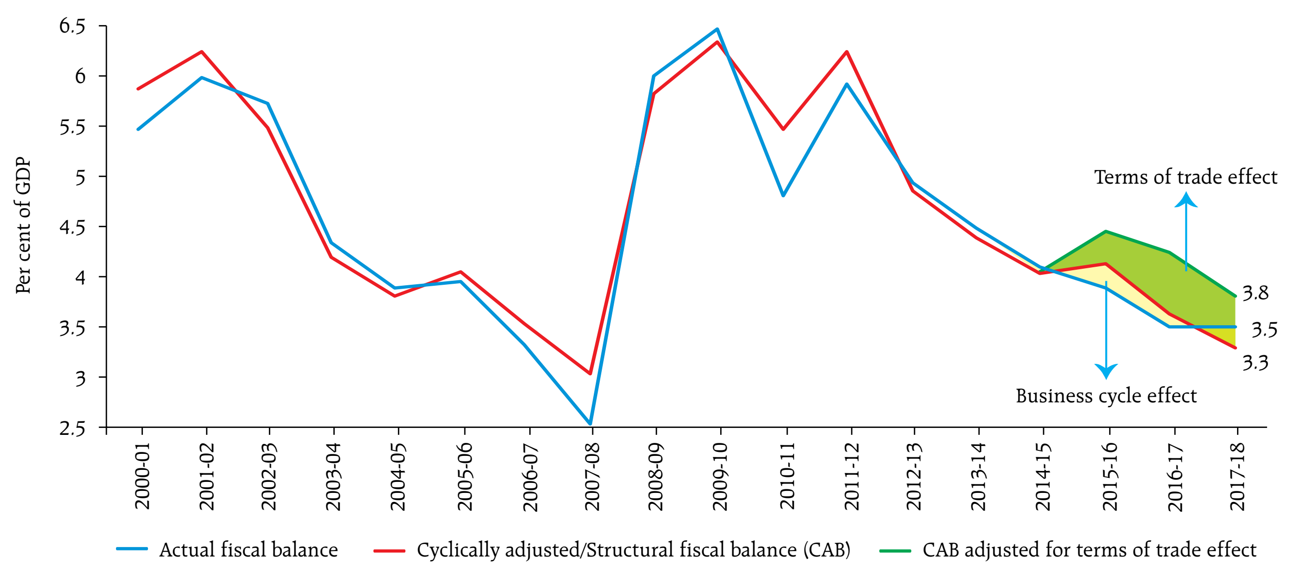
While the headline fiscal deficit numbers have been widely analysed *vis-à-vis* observable parameters, assessing the fiscal deficit with respect to certain unobservable parameters also provide some useful insights. International institutions like the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) have conducted extensive research in this area and are encouraging economies to adopt and publish fiscal stance after due adjustments for the impact on account of business cycle and other unobserved cyclical factors like asset and commodity prices (Bornhorst *et al.*, 2011; Fedelino *et al.*, 2009; Girouard and Andre 2005). This is crucial, particularly to enhance fiscal transparency as weakening of the fiscal balance can sometimes be masked temporarily by high output/asset price upturns. Conversely, during a recession, the fiscal balance can be overstated on account of cyclical factors.

In 2017-18, growth slowed cyclically and this contributed to some loss of tax revenue. Computing the cyclically adjusted fiscal deficit as per the IMF definition[3], the business cycle impact on fiscal deficit

[2] Fiscal Policy Strategy Statement, 2018-19

[3] These have been computed based on HP and BK based potential output estimates and using revenue elasticities, both aggregated and disaggregated, as estimated for India using the IMF, OECD and ECB approach in Ghosh and Misra (2015) and Misra and Trivedi (2016).

Chart 1: Fiscal Deficit : Actual *vis - a vis* Unobservable Parameters



is estimated to be about 0.17 per cent of GDP in 2017-18. This implies that but for the negative output gap, the gross fiscal deficit would have been 3.3 per cent of GDP and not the headline 3.5 per cent. However, this fiscal leeway gets wiped out if one takes into account the terms of trade benefit that the fisc had enjoyed due to decline in oil prices since 2015-16 on dual grounds: lower subsidies on Kerosene and LPG as well as higher excise on petrol and diesel as low prices were not completely passed on to consumers. While the benefit due to terms of trade effect is estimated at its highest in 2016-17 at 0.62 per cent of GDP, for 2017-18 it is placed at 0.48 per cent[4] taking the overall fiscal balance adjusted for cyclical and terms of trade effect to about 3.8 per cent (Chart 1). Going forward in 2018-19, with oil prices rising and output gap remaining close/slightly below the potential, fiscal deficit may not enjoy these terms of trade and business cycle benefits as indicated in the last row of Table 3.

Table 3: Business Cycle and Terms of Trade Effect (as per cent of GDP)

Year	Actual Fiscal Deficit	Business Cycle Benefit	Terms of Trade Benefit	Total Benefit
2015-16	3.9	0.24	0.32	0.56
2016-17	3.5	0.13	0.62	0.75
2017-18 RE	3.5	-0.17	0.48	0.31
2018-19 P	3.3	**Zero/negative**	**negative**	**negative**

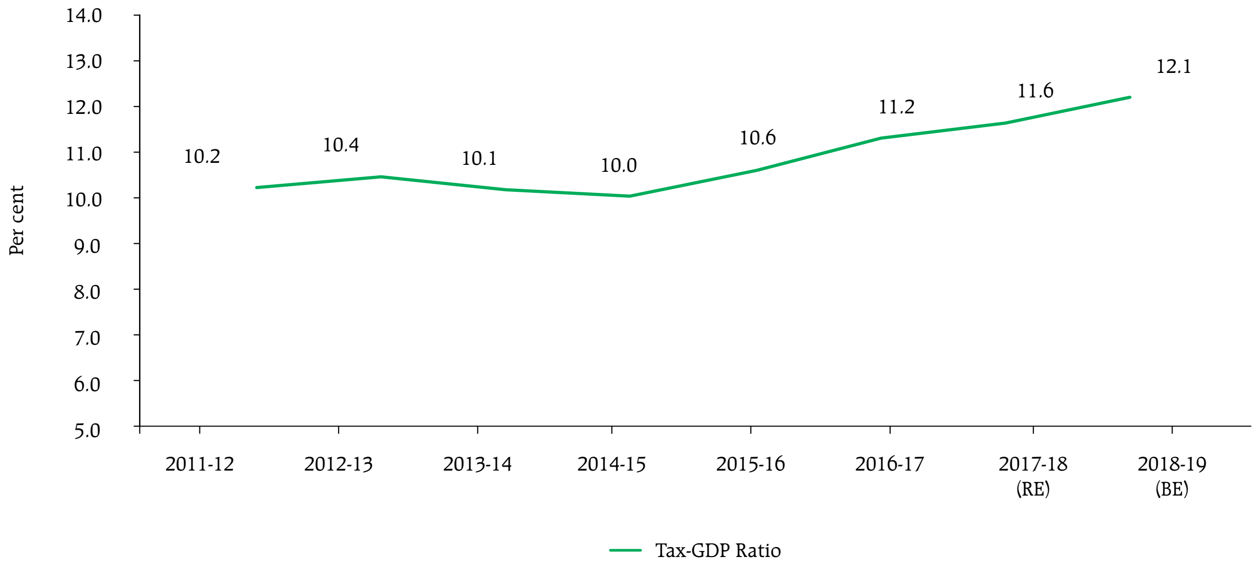
[4] Terms of trade effect have been estimated by (1) subtracting the excess excise in petrol and diesel in these years from its long term trend and (2) by adding the estimated additional subsidy that GoI would have given based on the average long run elasticity of subsidies to oil price gap. While the methodology remains as in the literature, it may be noted that terms of trade benefit has generally been computed for oil exporting countries during oil price rise (Parkyn, 2010 and Turner, 2006). However, given that India is an importer of oil, terms of trade benefit is associated with oil price decline.

II. Receipts

II.1 *Tax Revenue*

The Union Budget has estimated gross tax revenue to grow by 16.7 per cent in 2018-19 to 12.1 per cent of GDP (Annex IV). Net of devolution of tax revenues to States, net tax revenue is budgeted to grow by 16.6 per cent to 7.9 per cent of GDP. This is the highest budgeted tax-GDP ratio so far, reflecting the formalisation of GST and widening of the tax base (Chart 2).

Chart 2: Tax-GDP Ratio:Budgeted to be Highest so far



The budgeted buoyancies for all tax categories of direct taxes are higher in 2018-19 than the average of the preceding eight years (2010-11 to 2017-18) (Table 4).

II.1.1 *Direct Taxes*

Direct taxes are budgeted to grow by 14.4 per cent in 2018-19, mainly on account of an estimated 19.9 per cent growth in income tax collections. The number of taxpayers has increased post demonetisation. During the current financial year, 6.84 crore income-tax returns were filed as compared to 5.43 crore returns filed during the last financial year, which translates into a growth rate of 26 per cent[5]. Direct Taxes collections during 2017-18 have helped in making up for the shortfall in non-tax revenue.

The Government aiming to provide relief to salaried taxpayers, has announced a standard deduction of ₹ 40,000/- in lieu of the present exemption in respect of transport allowance and reimbursement of miscellaneous medical expenses. On the other hand, the existing 3 per cent education cess will be replaced by a 4 per cent "Health and Education Cess" to be levied on the tax payable.

The corporate tax rate of 25 per cent for companies whose turnover was less than ₹ 0.5 billion in financial year 2015-16 has now been extended

Table 4: Tax Buoyancy

	Average Tax Buoyancy (2008-09 to 2017-18)	Post Crisis Tax Buoyancy (2010-11 to 2017-18)	2017-18 Revised Estimates	Budgeted Tax Buoyancy for 2018-19
1	2	3	4	5
Gross Tax Revenue	1.01	1.22	1.34	1.45
Corporation Tax	0.87	0.87	1.62	0.88
Income Tax	1.17	1.37	2.09	1.72
Customs Duty	0.23	0.46	-3.98	-1.46
Union Excise Duty	0.84	1.21	-2.74	-0.54
Service Tax	0.75	0.79	-6.85	-8.66

5 GoI, Press Information Bureau, April 02, 2018

to companies with turnover up to ₹ 2.5 billion. The estimate of revenue forgone due to this measure is ₹70 billion during the financial year 2018-19. The lower corporate income tax rate for 99 per cent of the companies, however, will benefit the entire class of micro, small and medium enterprises as it will leave them with higher investible surpluses. Also, it will encourage higher tax compliance in the MSME sector.

II.1.2 *Indirect Taxes*

Indirect taxes collection in 2017-18 exceeded 2016-17 collections by 8.7 per cent, despite receiving GST revenues only for 11 months, instead of 12 months. Indirect taxes are budgeted to grow by 19.1 per cent during 2018-19, with GST collections budgeted at ₹7.4 trillion - an increase of 67.3 per cent and 21.5 per cent after adjusting for loss of one month collection (Table 5). On GST, while on one hand concerns have been raised on the significantly high budgeted numbers given that rationalisation of rates is still underway, on the other hand, international evidence suggests that implementation of VAT/ GST have resulted in a higher government revenue-GDP ratio over time (RBI, 2017). About 1.03 crore taxpayers have been registered under GST so far (till February 25, 2018) of which 16.42 lakh are Composition Dealers which are required to file returns every quarter[6].

Customs duty on certain items have been increased – illustratively, the duty on mobile phones has been increased from 15 per cent to 20 per cent and on certain parts of TVs to 15 per cent. Though the increase in customs duty is expected to incentivise the domestic value addition and the Make in India initiative and may also promote creation of more jobs in the country, it may likely be seen as a protectionist measure attracting retaliatory actions from trading partners.

Table 5: GST Collections

	2017-18 (RE) (₹ billion)	2018-19 (BE) (₹ billion)	Year-on-Year Growth Rate (Per cent)
CGST	2214	6039	172.8
IGST	1619	500	-69.1
Compensation Cess	613	900	46.7
Total	**4446**	**7439**	**67.3**

6 GoI, Press Information Bureau, February 27, 2018

II.2 Non-Tax Revenue

Receipts from non-tax revenues are budgeted to increase in 2018-19 by 3.9 per cent. Dividend and profits from public sector enterprises (including public sector banks) and surplus transfer from the RBI were lower than the budgeted amount by 25.3 per cent during 2017-18 and are effectively budgeted to increase on the lower base (Table 6). With the merger of the Railway Budget with the Union Budget, the Railways has stopped paying dividend on the capital at charge since 2017-18.

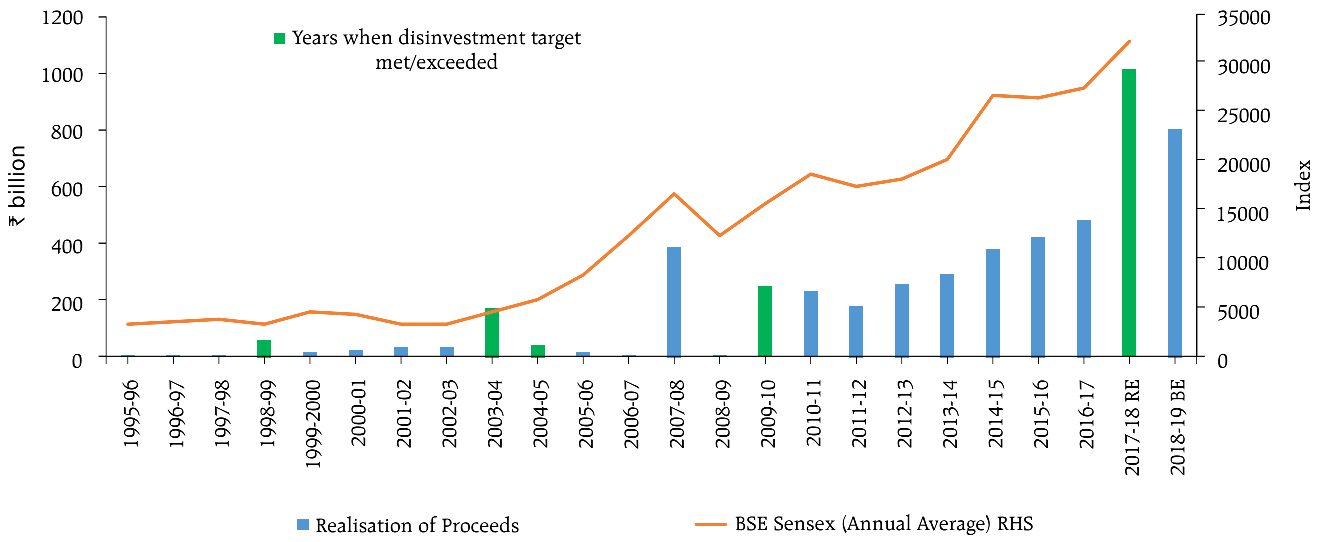
Within receipts from economic services, net receipts from communication services (*i.e.*, spectrum auctions) are budgeted to be significantly higher in 2018-19 than in 2017-18 (RE) - by 58.3 per cent. Notably, net receipts from communication services were budgeted at ₹443.4 billion in 2017-18, but actual receipts (₹307.4 billion) fell short mainly because of deferment of spectrum auctions.

It is observed that non tax revenues provided strong support to central government receipts in 2015-16 (27.0 per cent growth) and 2016-17 (33.2 per cent growth). With non-tax revenues in 2017-18 and 2018-19 being lower than 2016-17, the pressure will be higher on the government to achieve the tax revenue and the disinvestment targets.

Table 6: Dividends and Profits

	₹ Billion			Growth Rate (Per cent)		
	2016-17	2017-18 (RE)	2018-19 (BE)	2016-17	2017-18 (RE)	2018-19 (BE)
Dividend and Profits	1230.2	1064.3	1073.1	9.7	-13.5	0.8
From PSEs	518.5	548.1	524.9	69.4	5.7	-4.2
From RBI/ Banks/FIs	711.6	516.2	548.2	-12.7	-27.5	6.2

Chart 3: Disinvestment Proceeds and Stock Market Performance



II.3 Non-debt Capital Receipts

The target for disinvestment has been pegged at ₹800 billion in 2018-19 (BE). In 2017-18 (RE), the Government exceeded the target by ₹275 billion facilitated by buoyant stock markets (Chart 3). Net recoveries of loans and advances are budgeted to decline by 30.2 per cent over 2017-18 (RE). Total non-debt capital receipts, which were ₹330 billion higher in 2017-18 (RE) than BE, are estimated to decline by 21.5 per cent in 2018-19 (BE). With the realisation of budgeted targets for disinvestment in 2017-18 for the first time since 2009-10, there is optimism on the prospects for 2018-19. This will support revenue mobilisation efforts and render the deficit financeable. Any corrections in the stock market may, however, make it challenging for the Government to meet its budgeted target in 2018-19.

III. Expenditure

Total expenditure is budgeted to grow by 10.1 per cent in 2018-19 (12.3 per cent in 2017-18 RE) (Table 7). Revenue expenditure is budgeted to grow at a higher rate than capital expenditure.

The Budget estimates for different expenditure categories deviate from the MTEF Statement (an FRBM document), which was laid before the Parliament in August 2017. Total expenditure is budgeted to be 4.4 per cent higher than in the MTEF statement, mainly on account of higher revenue expenditure, particularly pensions and petroleum subsidies (Table 8). Expenditure projections diverging in the span of five months, *i.e.*, from the MTEF in August 2017 may pose risks to credibility of the fiscal policy stance. With the revenue-capital ratio slated to worsen from 6:1 in 2016-17 to 7:1 in 2018-19, the quality of public expenditure may remain a concern.

Table 7: Expenditure of Central Government

Item	Per cent of GDP			Growth Rate		
	2016-17	2017-18(RE)	2018-19(BE)	2016-17	2017-18(RE)	2018-19(BE)
Total Expenditure	12.9	13.2	13.0	10.3	12.3	10.1
Revenue Expenditure	11.1	11.6	11.4	9.9	15.0	10.2
Capital Expenditure	1.9	1.6	1.6	12.5	-3.9	9.9

Table 8: Budget Estimate (BE) *vis-s-vis* MTEF Statement

(₹ Billion)

Expenditure Items	2018-19		Difference= BE-MTEF	
	Budget Estimate	Projection by MTEF Statement	₹ Billion	Per cent
I. Revenue Expenditure	21417.7	19990.1	1427.7	7.1
of which				
(i) Interest	5758.0	5644.0	114.0	2.0
(ii) Pension	1684.7	1443.2	241.5	16.7
(iii) Major Subsidies	2643.3	2630.0	13.4	0.5
a. Fertiliser	700.8	700.0	0.8	0.1
b. Food	1693.2	1750.0	-56.8	-3.2
c. Petroleum	249.3	180.0	69.3	38.5
II. Capital Expenditure	3004.4	3410.0	-405.6	-11.9
III. Total Expenditure	24422.1	23400.1	1022.1	4.4

III.1 *Capital Expenditure*

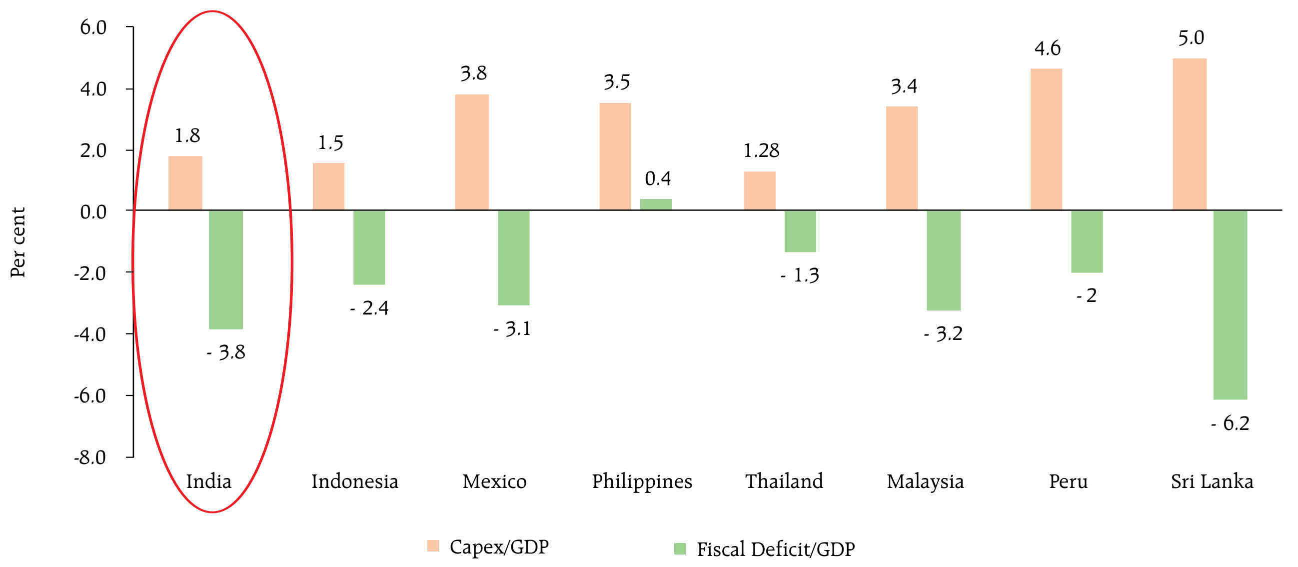
Capital expenditure which is growth inducing has been proposed to be raised by 9.9 per cent in 2018-19 over the revised estimates of 2017-18, marking a decline of 3.0 per cent when compared with BE of 2017-18. Capital Outlay (capital expenditure excluding loans and advances) is budgeted to increase by 12.6 per cent in 2018-19, a marginal rise over BE but sharply higher than 1.6 per cent in 2017-18 (RE). Capital outlay on major infrastructure is estimated to grow by a robust 23.0 per cent in 2018-19 (BE) - as against a decline of (-) 2.1 per cent in 2017-18 (RE) - led by the railways, roads and bridges (Table 9). Expenditure on civil aviation, on the other hand, is in contraction, as it has been since 2016-17, the sector is being encouraged to tap the market through borrowings and asset monetisation rather than rely on budgetary support. The budgeted allocation for communications (growth of 0.5 per cent over 2017-18 RE) may not seem to be in consonance with the objective of gradual transformation towards a digital economy.

In a partial equilibrium framework, a rise of ₹207 billion in capital outlay is likely to increase output by ₹434 billion (about 0.2 % of GDP in 2018-19), assuming the capital outlay multiplier to be 2.10 (Jain and Kumar; 2013). It may be noted that amongst its peer EMEs, India's share of GDP spent on capital expenditure is low despite relatively higher fiscal deficit (Chart 4) (Akin *et al*; 2017). Actual capital expenditure, however, would be higher than the budget estimates if the internal and extra budgetary resources (IEBR) deployed by the central Public Sector Units (PSUs) and commercial departmental undertakings are considered. It, therefore, needs to be recognised that the Government is now financing important expenditure of capital nature through extra budgetary resources (EBR).

Table 9: Capital Outlay

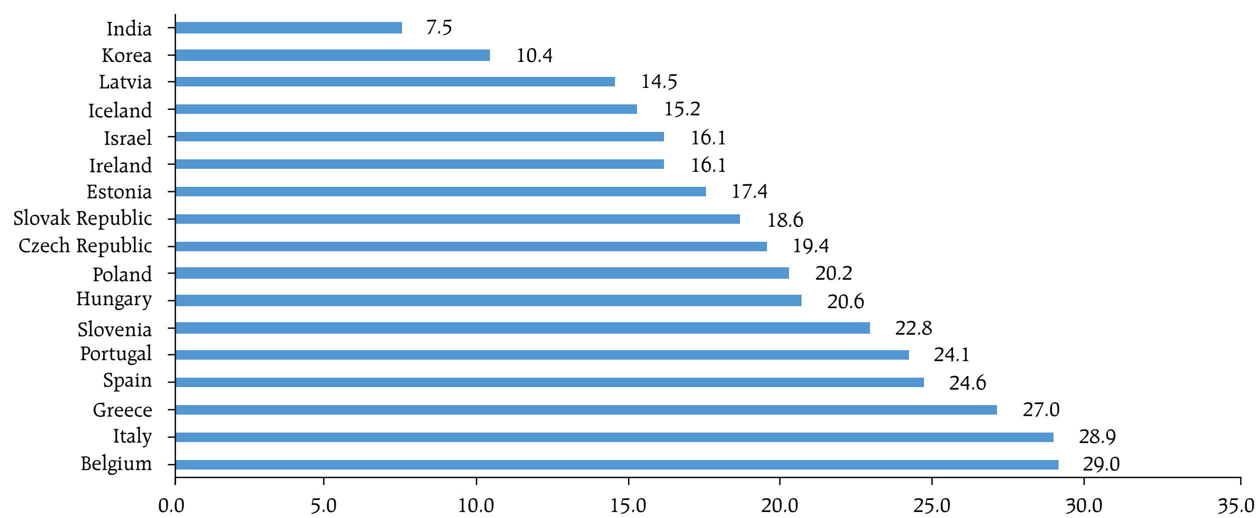
	2015-16	2016-17	2017-18 (RE)	2018-19 (BE)	2016-17	2017-18(RE)	2018-19 (BE)
	(₹ Billion)				(Percent Change)		
1. Total Capital Outlay (Excluding defence)	1467.3	1614.3	1640.1	1846.8	10.0	1.6	12.6
1.1 Major Infrastructure	737.8	1001.2	980.4	1206.1	35.7	-2.1	23.0
Irrigation	0.9	0.8	3.2	6.2	-8.5	285.5	95.3
Energy	19.4	45.3	28.0	52.6	133.2	-38.3	88.1
Indian Railways	350.1	452.3	400.0	530.6	29.2	-11.6	32.7
Roads and Bridges	296.4	437.7	480.3	557.2	47.7	9.7	16.0
Civil Aviation	33.6	27.1	18.4	7.2	-19.4	-31.9	-60.9
Ports and Light Houses	1.9	3.2	1.7	3.3	66.9	-46.5	91.7
Communications	35.5	34.8	48.8	49.0	-2.0	40.4	0.5
1.2 Industry and Minerals	36.2	41.4	42.6	45.0	14.1	3.0	5.5
1.3 Science, Technology and Environment	40.4	52.3	53.2	70.5	29.5	1.7	32.5
1.4 Others	652.9	519.4	563.9	525.3	-20.4	8.6	-6.8

Chart 4: Government Capital Expenditure and Fiscal Balance Average of FY 2014 - FY 2016[7]



With the National Health Protection Scheme under the ''Ayushman Bharat'' programme aimed at interventions in the primary, secondary and tertiary care system and the reform of the education system, the expenditure on health and education, together, is budgeted to grow by 4.6 per cent as per the Union Budget 2018-19. In terms of GDP, the social sector expenditure, primarily constituting health and education in India continues to remain woefully below peers (Chart 5).

Chart 5: Social Sector Expenditure as % GDP (2016)



Source: OECD Statistics and RBI

[7] Average of three years viz., 2013-14 to 2015-16 has been taken for Central Government capital expenditure and fiscal balance for the countries depicted in the graph. The data has been sourced from ADB Statistical Database; Central Bank of Mexico; Central Bank of Sri Lanka; Budget Management Department, Philippines; Central Bank of Peru and Union Budget Documents, India.

III.2 *Subsidies and Interest Payments*

Subsidies and interest payments constitute a major portion of government's committed revenue expenditure. In contrast to 2017-18 (RE) when major subsidies declined by ₹106.2 billion from the budget estimates in a broad-based manner, they are slated to increase by 15.1 per cent in 2018-19 mainly on account of increase in food subsidies by 20.7 per cent. The share of major subsidies is, however, budgeted to remain unchanged at 1.4 per cent of GDP in 2018-19 (BE) (Table 10).

Given the likely hardening of global crude and gas prices, petroleum and fertiliser subsidies, however, may rise. Owing to the farmer distress, minimum support prices have also risen reflecting itself in slight increase in food subsidy. Going forward, the budgetary outgo on major subsidies, however, should fall in the medium term *via* targeting and better coverage, through the direct benefit transfer (DBT) scheme and digitisation, which could reduce leakages.

Interest payments are budgeted to increase by 8.5 per cent in 2018-19 over 2017-18 (RE). In 2018-19 (BE), interest payments have been estimated at ₹5758 billion constituting 26.9 per cent of budgeted revenue expenditure and 23.6 per cent of the total budgeted expenditure of the central government, respectively. They are budgeted to be around 3.1 per cent of GDP in 2018-19 marginally lower than 3.2 per cent in 2017-18 (RE). The buoyancy in revenues are expected to mitigate the interest payment outgo of the Government[8].

Annex V presents the key receipts, expenditure and deficit indicators at a glance.

IV. Financing of Deficit

Gross market borrowing for 2018-19 is estimated at ₹6,055 billion, higher by about 1.1 per cent over the preceding year's level. Net market borrowing at ₹3,991 billion is, however, estimated to decline by 2.6 per cent during the same period on account of higher repayments during the year (Table 11). Switches (gross) of securities (which is cash neutral) and net buyback of ₹281 billion and ₹719 billion, respectively, are also provided for[9]. Net market borrowing through dated securities accounting for 63.9 per cent of the GFD in 2018-19 (BE) is lower than 68.9 per cent in 2017-18 (RE). The Union Budget has provided for gross issuance of cash management bills (CMBs) at ₹1 trillion for cash management operations and not for funding the GFD. The net issuances of CMB is nil for 2018-19 (BE). Government aims to raise ₹50 billion *via* Sovereign Gold Bonds (SGBs) in 2018-19. Going forward, fiscal slippage concerns and concomitant higher borrowing requirements may have implications for the economy wide cost of borrowing and could crowd out productive private sector investment (RBI, MPR, 2018). Also, the potential interest savings due to reduced reliance on the market may not

Table 10: Major Subsidies of Central Government

(Amount in ₹ Billion)

Items	2016-17 (Actuals)		2017-18 (BE)		2017-18 (RE)		2018-19 (BE)	
	Amount	% to GDP	Amount	% to GDP	Amount	% to GDP	Amount	% to GDP
Total Major Subsidies	**2,040.2**	**1.3**	**2,403.4**	**1.4**	**2,297.2**	**1.4**	**2,643.4**	**1.4**
i. Food	1,101.7	0.7	1,453.4	0.9	1,402.8	0.8	1,693.2	0.9
ii. Fertiliser	663.1	0.4	700.0	0.4	649.7	0.4	700.8	0.4
iii. Petroleum	275.4	0.2	250.0	0.1	244.6	0.1	249.3	0.1

[8] Medium Term Expenditure Framework Statement, 2017

[9] It may be noted that subsequent to budget announcement, the GoI, in its press release dated March 26 2018 has announced a reduction in financing *via* market borrowing by ₹500 billion, with ₹250 billion each to be financed by buybacks and National Small Savings Fund (NSSF).

Table 11: GFD Financing

(₹ Billion)

Item	2016-17 (Actual)	2017-18 (RE)	2018-19 (BE)
1	2	3	4
Gross Fiscal Deficit	**5,356.18**	**5,948.49**	**6,242.76**
	(100.0)	(100.0)	(100.0)
Financed by			
Net Market Borrowings*	3,381.49	4098.57	3991.20
	(63.1)	(68.9)	(63.9)
Other treasury bills	170.57	700.07	80.00
	(3.2)	(11.8)	(1.3)
Securities Issued against	674.35	1,026.28	750.00
Small Savings (net)	(12.6)	(17.3)	(12.0)
External Assistance	179.97	24.18	-25.89
	(3.4)	(0.4)	-(0.4)
State Provident Fund	177.45	150.00	170.00
	(3.3)	(2.5)	(2.7)
NSSF	154.51	-415.54	0.00
	(2.9)	-(7.0)	(0.0)
Reserve Fund	-64.36	6.70	31.14
	-(1.2)	(0.1)	(0.5)
Deposits and Advances	177.92	168.45	159.10
	(3.3)	(2.8)	(2.5)
Draw Down of Cash Balances	-88.95	-393.79	430.66
	-(1.7)	-(6.6)	(6.9)
Others	593.23	583.58	656.54
	(11.1)	(9.8)	(10.5)

*Includes Dated Securities and 364-day Treasury Bills, taking into account the net impact of switching of securities and buybacks.

Note: Figures in parenthesis represent percentages to GFD.

accrue with higher recourse to NSSF and other small savings.

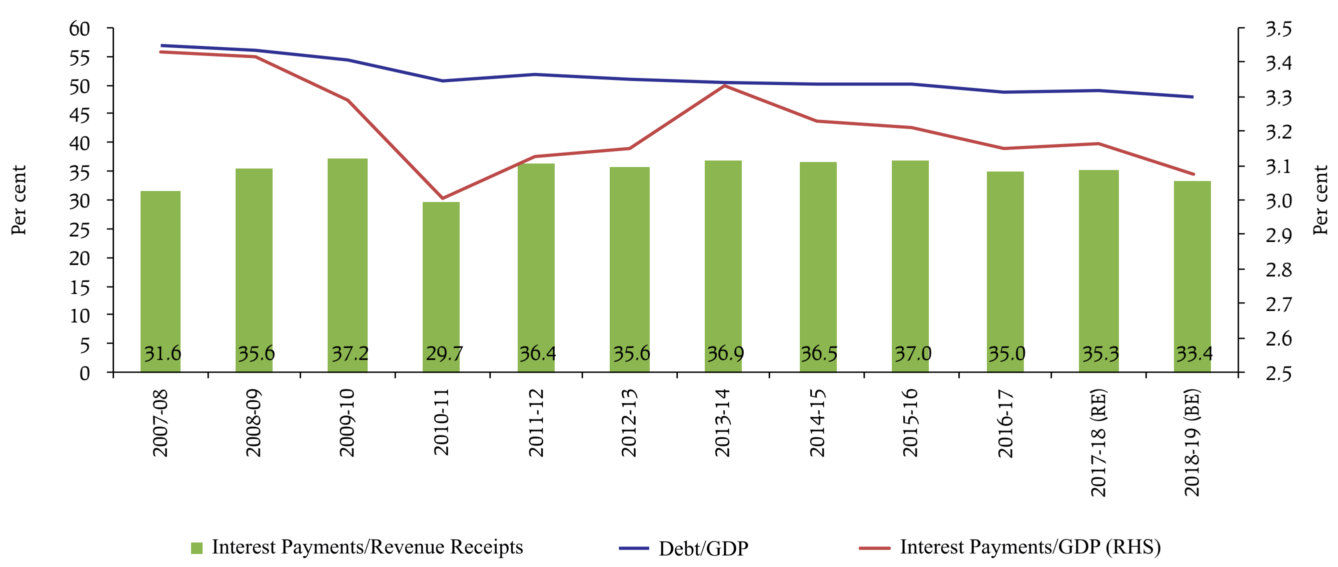
V. Liabilities

Total liabilities-GDP ratio of the Central Government is budgeted to decline to 47.8 per cent in 2018-19 from 49.1 per cent in 2017-18 (RE). Notably, the Government has accepted the key recommendation of the Fiscal Reform and Budget Management Committee, 2017 relating to adoption of the Debt Rule and has decided to bring down Central Government's Debt to GDP ratio to 40 per cent by 2024-25. Interest payments as proportion of revenue receipts, which is an indicator of debt servicing capacity, is budgeted to decrease marginally from the previous year (Chart 6).

VI. Resource Transfers from Centre to States in 2018-19

Following the recommendation of the 14th Finance Commission, the States' share of tax devolution was increased from 32 to 42 per cent of the divisible pool, serving the twin objectives of increasing the flow of unconditional transfers to the States and yet leaving appropriate fiscal space for the Union to carry out specific-purpose transfers to the States.

Chart 6: Debt and Interest Burden of the Central Government



Given the above background, gross transfer to state governments is expected to increase marginally during 2018-19, largely driven by tax devolution and 'finance commission grants', even as growth in transfer through different schemes has decelerated sharply. Centre is expected to transfer ₹7,881 billion in the form of tax devolution to the state governments in 2018-19, which is around 17.0 per cent higher than the transfer made a year ago. This sharp increase is expected assuming a buoyant tax collection in 2018-19.

In the Fiscal Policy Strategy Statement, it is highlighted that state governments seem to be moving close to their targeted fiscal consolidation – in part because the centre has guaranteed them a large increase in their indirect tax take, as part of the GST agreement. The transfer of GST compensation cess to states is fiscal neutral as the above amounts have been levied as a cess over the peak rate of 28 per cent on certain specified luxury and demerit goods, like tobacco and tobacco products, pan masala, aerated waters, motor vehicles. This is proposed to be introduced for a period of five years to compensate States for any revenue loss on account of implementation of GST. The amounts are transferred to a non-lapsable fund in the public account called the GST Compensation Fund as per the Section 10 of the GST (Compensation to States) Act, 2017.

Growth in transfer under centrally sponsored schemes, which has a share of around 22.0 per cent in the gross transfer, is expected to decelerate sharply by 5.3 percent in 2018-19 as against a growth of 16.8 per cent a year ago. The transfer to states (per cent to GDP) is expected to increase by 10 basis points in 2018-19 in both gross and net terms (Table 12).

Table 12: Resource Transfer to States

		2016-17	2017-18 (RE)	2018-19 (BE)	2016-17	2017-18 (RE)	2018-19 (BE)	2017-18 (RE)	2018-19 (BE)
		Amount			Share in Total Transfer			Growth	
		₹ Billion			Per cent			Per cent	
I.	**Devolution of States' share in Taxes**	**6080.0**	**6730.1**	**7880.9**	**61.7**	**60.3**	**62.1**	**10.7**	**17.1**
II.	**Some Important Items of Transfer**	**480.5**	**393.9**	**544.8**	**4.9**	**3.5**	**4.3**	**-18.0**	**38.3**
	Of which								
	a. Externally Aided Projects - Loan	177.6	175.0	200.0	1.8	1.6	1.6	-1.5	14.3
	b. Special Assistance	109.0	70.0	150.0	1.1	0.6	1.2	-35.8	114.3
III.	**Finance Commission Grants**	**955.5**	**1014.9**	**1093.7**	**9.7**	**9.1**	**8.6**	**6.2**	**7.8**
	Of which								
	a. Grant for Rural Local Bodies	313.7	390.4	450.7	3.2	3.5	3.6	24.5	15.4
	b. Grants for Urban Local Bodies	145.0	172.5	198.7	1.5	1.5	1.6	19.0	15.2
	c. Post Devolution Revenue Deficit Grants	413.1	358.2	345.8	4.2	3.2	2.7	-13.3	-3.5
IV.	**Total Transfer to States [Other than (I)+(II)+(III)]**	**2289.6**	**2967.2**	**3109.9**	**23.2**	**26.6**	**24.5**	**29.6**	**4.8**
	a. Under Centrally Sponsored Schemes (Revenue)	2258.5	2637.8	2777.5	22.9	23.6	21.9	16.8	5.3
	b. Under Central Sector Schemes	24.1	317.65	321.9	0.2	2.8	2.5	1219.7	1.3
V.	**Total Transfer to Delhi and Puducherry**	**51.1**	**52.7**	**65.0**	**0.5**	**0.5**	**0.5**	**3.1**	**23.3**
VI.	**Gross Transfers to States/UTs**	**9856.7**	**11158.8**	**12694.4**	**100.0**	**100.0**	**100.0**	**13.2**	**13.8**
VII.	**Less Recovery of Loans and Advances**	**125.8**	**93.0**	**96.0**	**-**	**-**	**-**	**-26.1**	**3.2**
VIII.	**Net Transfers (VI-VII)**	**9731.0**	**11065.8**	**12598.4**	**-**	**-**	**-**	**13.7**	**13.9**
IX.	**Gross Transfers / GDP (per cent)**	**6.5**	**6.7**	**6.8**	**-**	**-**	**-**	**-**	**-**
X.	**Net Transfers / GDP (per cent)**	**6.4**	**6.6**	**6.7**	**-**	**-**	**-**	**-**	**-**

Source: Union Budget 2018-19

VII. Other Important Measures with relevance to Reserve Bank of India

VII.1 *Bank Recapitalisation*

The bank recapitalisation program has been launched with bonds of ₹800 billion being issued this year. The programme has been integrated with an ambitious reform agenda, under the rubric of an Enhanced Access and Service Excellence (EASE) programme. This recapitalisation will pave the way for the public sector banks to lend additional credit of ₹5 trillion. Recapitalisation is a significant step by the Government in strengthening the balance sheet of banks and should enable banks to scale up credit to productive sectors. Although the bond-based recapitalisation is budget-neutral, it effectively results in increasing the Government's shareholding in public sector banks through rights shares and this might be perceived as roll-back of reforms by investors.

VII.2 *Standing Deposit Facility*

The Finance Bill proposes an amendment to section 17 of the RBI Act to enable the introduction of the standing deposit facility (SDF). This will considerably strengthen the conduct of monetary policy as it will provide the RBI the wherewithal to absorb exceptionally large expansion of liquidity without having to provide collateral to market participants. This additional instrument in the toolkit of the RBI will address episodes such as demonetisation and surges of capital inflows, and may even obviate the need for issuances under the Market Stabilisation Scheme which carry fiscal costs.

VII.3 *Minimum Support Prices*

Minimum support prices (MSP) for rabi crops at least at one and a half times of the cost has been extended to all kharif crops with a view to ensuring remunerative prices for farmers. It may be noted that Rabi MSPs fixed for crop year 2017-18 (market year 2018-19) were one and a half times of A2+FL costs, not overall C2 costs which also include the imputed costs of owned land and interest on owned fixed capital. Further, for all crops (kharif and rabi) taken together, CPI-weighted MSPs were more than 1.5 times A2+FL costs, but only 14 per cent higher over C2 costs[9]. In addition, there are several proposals that could reduce volatility in food inflation, *viz.*; higher procurement will stabilise market prices around MSPs; inclusion of tomatoes, onions and potatoes under 'Operation Greens'; and adoption of cluster based models in a scientific manner at district levels. Although the exact impact of MSP increase on inflation cannot be fully assessed at this stage but it does pose upside risks to inflation outlook (RBI, Sixth Bi-monthly Monetary Policy Statement, 2018).

VIII. Overall Assessment

Summing up, the Union Budget for 2018-19 is confronted with a tight trade-off between the rigours of fiscal consolidation and the demands for stimulating the economy. While the waning of the drag from demonetisation and GST implementation will have favourable effects on economic activity and boost tax revenues, terms of trade losses associated with the hardening of international crude prices could restrict fiscal space. Meanwhile, sizeable outlays on agriculture and infrastructure will impose pressure on revenues, necessitating adherence or even over-achievement of disinvestment targets that are in some sense autonomous to the decision to divest and contingent upon market conditions.

Turning to revenues, GST collections could benefit from delayed buoyancy as the system stabilises

[9] A2 + FL includes all expenses in cash and kind on account of hired labour including human, bullock, machine, seed, insecticides, pesticides, manure, fertilizers, irrigation charges and miscellaneous expenses and imputed costs of family labour (FL). C2 includes A2+FL costs as well as imputed costs of owned land and interest on owned fixed capital.

and this could encourage further reforms in the form of moving towards a simpler and more equitable rate structure. The increase in customs duties on selected items is essentially a revenue raising effort. On direct taxes, while the proposal to extend the rate of 25 per cent to companies with turnover up to ₹2.5 billion will entail revenue losses, the benefit to MSMEs from the supportive tax regime could increase buoyancy and compliance. The surge in the number of tax assesses, especially new ones, augurs well for raising the tax-GDP ratio to at least the levels of peers. Against this background, achieving the disinvestment target assumes crucial importance and will warrant a strategic approach that takes advantage of market conditions and investor appetite.

As regards the interaction of the Budget with the financial system, recapitalisation of banks could lend tailwinds to the recent recovery in bank credit and, in turn, support overall growth. The introduction of the Standing Deposit Facility is a big positive for macroeconomic and financial stability.

Finally, the emphasis on the rural economy is welcome and it is a step forward in the vision of doubling farm incomes by 2022 set out by the Government. This would revive rural demand and set the stage for a durable upturn in growth. The push towards digitisation, delivery of Aadhar enabled public services and the focus on employment will make the revival of growth inclusive and equitable.

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Annex I

Key Policy Initiatives

Agriculture and social sectors: Budget speech emphasizes the government's commitment to doubling farmers' income. Budget proposes to launch new schemes or extend existing schemes in agriculture and social sectors. Important measures are as follows:

- **Minimum Support Price (MSP) and Operation Green:** Minimum support prices (MSP) for rabi crops at least at one and a half times of the cost has been extended to all kharif crops with a view to ensuring remunerative prices for farmers.
- **Irrigation:** Augmented the scope of Long Term Irrigation Fund already set up in NABARD. Ground water irrigation scheme under Prime Minister Krishi Sinchai Yojna- Har Khet ko Pani will be taken up in 96 deprived irrigation districts where less than 30 percent of the land holdings gets assured irrigation presently. An amount of ₹26 billion has been allocated for the purpose.
- **Rural livelihood and housing:** Establish a dedicated Affordable Housing Fund (AHF) in National Housing Bank, funded from priority sector lending shortfall and fully serviced bonds authorized by the Government of India; Substantially increase allocation of National Rural Livelihood Mission.
- **Health and Social Protection:** The budget announced a flagship National Health Protection Scheme providing coverage for secondary and tertiary care hospitalization upto 5 lakh rupees per family per year for 10 crore poor and vulnerable families. The budget highlights that this will be the world's largest government funded health care programme.
- **Education:** To improve the quality of education, the budget proposes training of 13 lakh untrained teachers; increasing digital intensity in education and moving gradually from "blackboard to digital board", setting up Ekalavya schools for tribal students on par with Navodaya Vidyalayas. It proposes stepping up investments in research and related infrastructure by an initiative called ***RISE*** (*Revitalising Infrastructure and Systems in Education)* with a total investment of ₹1,000 billion in the next four years.

Infrastructure and MSMEs: Important measures pertaining to infrastructure and MSMEs include the following:

- **Tourism:** Tourist amenities at 100 Adarsh monuments of the Archaeological Survey of India will be upgraded. Ten prominent tourist sites will be developed into Iconic Tourism destinations by following a holistic approach.
- **Highways:** To raise equity from the market for its mature road assets, NHAI will consider organizing its road assets into Special Purpose Vehicles and use innovative monetizing structures like Toll, Operate and Transfer (TOT) and Infrastructure Investment Funds (InvITs).
- **Railways:** Railways' Capex for the year 2018-19 has been pegged at ₹1485 billion primarily for capacity creation - 18,000 kilometers of doubling, third and fourth line works and 5000 kilometers of gauge conversion.
- **Aviation:** New initiative NABH-Nirman to expand airport capacity more than five times to handle a billion trips per year.
- **Information Technology and Digital India:** NITI Aayog will initiate a national program to direct our efforts in the area of artificial intelligence, including research and development of its

applications. Digital India program allocation doubled to ₹30.7 billion in 2018-19. ₹100 billion for creation and augmentation of telecom infrastructure.

- **Medium, Small and Micro Enterprises (MSMEs):** Leverage financial information database for improving MSME financing leveraging on increased formalization of MSMEs due to demonetization and GST. The budget also proposes to onboard public sector banks and corporates on Trade Electronic Receivable Discounting System (TReDS) platform and link this with GSTN.

Building Institutions and Improving Public Service Delivery:

- The Government will bring out an industry friendly 'Defence Production Policy 2018' to promote domestic production by public sector, private sector and MSMEs. Measures will be undertaken to develop two defense industrial production corridors.
- Evolve a scheme to assign unique ID for enterprises (along the lines of Aadhar for individuals).
- Develop a National Logistics Portal as a single window online marketplace for all stakeholders.
- Capital of the Food Corporation of India will be restructured to enhance equity and to raise long-term debt for meeting its standing working capital requirement
- It is proposed to allow strong Regional Rural Banks to raise capital from the market to enable them increase their credit to rural economy.
- To promote gold as an asset class, Gold Monetization Scheme will be revamped to enable people to open a hassle-free Gold Deposit Account.
- The Government will review existing guidelines and processes and bring out a coherent and integrated Outward Direct Investment (ODI) policy

Financial sector:

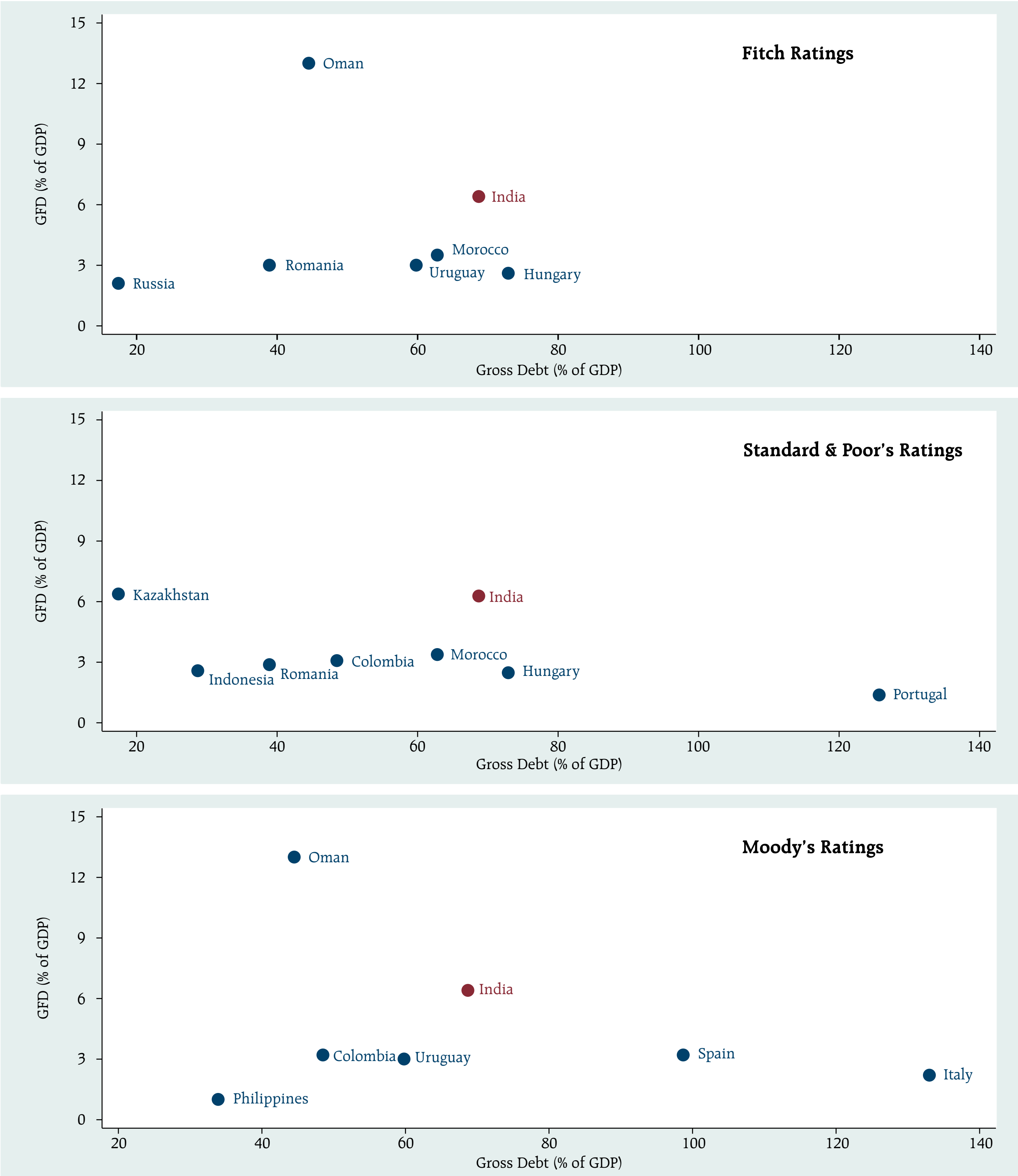
- **Bank Recapitalisation:** The bank recapitalisation program has been launched with bonds of ₹ 800 billion being issued this year. The programme has been integrated with an ambitious reform agenda, under the rubric of an Enhanced Access and Service Excellence (EASE) programme.
- **Bond markets**: The Government announced that SEBI will consider mandating, beginning with large Corporates, to meet about one-fourth of their financing needs from the bond market. Rating requirement for bond issue will move from 'AA' to 'A' grade. The Government will also undertake reform measures with respect to stamp duty regime on financial securities transactions in consultation with the States and make necessary amendments the Indian Stamp Act. These steps have potential benefits (positives) for the bond markets.
- **Amendment of RBI Act to enable Standing Deposit Facility:** The Finance Bill proposes an amendment to section 17 of the RBI Act to enable the introduction of the standing deposit facility (SDF).
- The Government will establish a unified authority for regulating all financial services in International Finance Service Centers (IFSCs) in India.
- The Government does not consider crypto-currencies as legal tender or coin and will take all measures to eliminate use of these crypto-assets in financing illegitimate activities or as part of the payment system.

Tax Proposals:

- **Long term capital gains (LTCG):** Currently, long term capital gains (LTCG) arising from transfer of listed equity shares, units of equity oriented fund and unit of a business trust are exempt from tax. The budget proposes to tax long-term capital gains exceeding ₹ 1 lakh at the rate of 10 per cent without allowing the benefit of any indexation. All gains up to 31st January, 2018, however, will be grandfathered. The gains from equity shares held up to one year will continue to be taxed at the rate of 15 per cent on short capital gains. The budget proposed to introduce a tax on distributed income by equity oriented mutual fund at the rate of 10 per cent to provide a level playing field across growth oriented funds and dividend distributing funds.
- **Reduction in tax rate:** Tax rate has been reduced to 25 per cent for companies who have a reported turnover of up to ₹2.5 billion in 2016-17.
- **Increase in customs duty to incentivise 'Make in India' initiatives:** In a departure from recent policy to reduce customs duty, the budget announced undertaking an increase in customs duty to incentivize domestic value addition in certain sectors, like food processing, electronics, auto components, footwear and furniture.
- **Excise duty:** Road and infrastructure cess on petrol and diesel increased from ₹6 per litre to ₹8 per litre. Adjustment is made on basic excise duty (decrease of ₹2 per litre) on these items so that the net impact is nil.

Annex II

General Government GFD and Debt of countries with similar ratings as India



Note: GFD, here, refers to negative of 'overall balance' as defined in IMF Fiscal Monitor.
Source: Fiscal Monitor (IMF, October 2017) and authors' Calculation.

Annex III

General Government Overall Balance of Emerging Market Economies

General Government Overall Balance (per cent of GDP)			
Serial No.	**Country**	**2016**	**2017**
Latin America			
1.	Argentina	-5.8	-6.6
2.	Brazil	-9.0	-9.2
3.	Chile	-2.9	-3.1
4.	Colombia	-3.0	-3.2
5.	Mexico	-2.8	-1.4
6.	Uruguay	-4.0	-3.0
7.	Venezuela	-17.8	-18.5
Africa and Middle East			
8.	Egypt	-10.9	-9.5
9.	Saudi Arabia	-17.2	-8.6
10.	South Africa	-4.0	-4.5
Asia			
11.	China	-3.7	-3.7
12.	India*	-7.1	-5.9
13.	Indonesia	-2.5	-2.7
14.	Malaysia	-3.0	-3.0
15.	Philippines	-0.4	-1.0
16.	Sri Lanka	-5.4	-5.2
17.	Thailand	0.6	-1.4
Europe			
18.	Hungary	-1.8	-2.6
19.	Poland	-2.4	-2.7
20.	Romania	-2.4	-3.0
21.	Russia	-3.7	-2.1
22.	Turkey	-2.3	-3.2

***:** RBI internal staff calculation (data for 2016 is based on Revised Estimates and for 2017 is based on Budget estimates, respectively of 29 states and Union Government).

Source: International Monetary Fund, Fiscal Monitor, October 2017

Annex IV

Tax Revenues

	As percent of GDP			Growth (%)		
	2016-17	2017-18 (RE)	2018-19 (BE)	2016-17	2017-18 (RE)	2018-19 (BE)
1	2	3	4	5	6	7
Corporation Tax	3.2	3.4	3.3	7.0	16.3	10.2
Tax on Income	2.4	2.6	2.8	26.8	21.0	19.9
Customs Duty	1.5	0.8	0.6	7.1	-40.0	-16.8
Union Excise Duty	2.5	1.7	1.4	32.5	-27.4	-6.3
Service Tax	1.7	0.5	0.0	20.4	-68.8	-100.0
Gross Tax Revenue	11.2	11.6	12.1	17.9	13.4	16.7

Annex V

Budget at a Glance

(Amount in ₹ Billion)

Items	2016-17 (Accounts)	2017-18 (Budget Estimates)	2017-18 (Revised Estimates)	2018-19 (Budget Estimates)	Variation (%)	
					Col. 4 over Col. 2	Col. 5 over Col. 4
1	2	3	4	5	6	7
1. Revenue Receipts (i+ii)	**13,742.0**	**15,157.7**	**15,054.3**	**17,257.4**	**9.5**	**14.6**
	(9.0)	***(9.0)***	***(9.0)***	***(9.2)***		
i) Tax Revenue (Net to Centre)	11,013.7	12,270.1	12,694.5	14,806.5	15.3	16.6
ii) Non-tax Revenue	2,728.3	2,887.6	2,359.7	2,450.9	-13.5	3.9
of which:						
Interest Receipts	162.3	190.2	135.5	151.6	-16.5	11.9
2. Capital Receipts	**6009.9**	**6,309.6**	**7123.2**	**7164.8**	**18.5**	**0.6**
	(3.9)	***(3.8)***	***(4.2)***	***(3.8)***		
of which:						
i) Net Market Borrowings	3381.5	3,482.3	4098.6	3991.2	**21.2**	**-2.6**
ii) Recoveries of Loans	176.3	119.3	174.7	122.0	-0.9	-30.2
iii) Miscellaneous Capital Receipts	477.4	725.0	1,000.0	800.0	109.5	-20.0
3. Total Receipts (1+2)	**19,751.9**	**21,467.4**	**22,177.5**	**24,422.1**	**12.3**	**10.1**
	(12.9)	***(12.8)***	***(13.2)***	***(13.0)***		
4. Revenue Expenditure	**16,905.8**	**18,369.3**	**19,443.1**	**21,417.7**	**15.0**	**10.2**
	(11.1)	***(10.9)***	***(11.6)***	***(11.4)***		
5. Capital Expenditure	**2,846.1**	**3,098.0**	**2,734.5**	**3,004.4**	**-3.9**	**9.9**
	(1.9)	***(1.8)***	***(1.6)***	***(1.6)***		
8. Total Expenditure (6+7)	**19,751.9**	**21,467.4**	**22,177.5**	**24,422.1**	**12.3**	**10.1**
	(12.9)	***(12.8)***	***(13.2)***	***(13.0)***		
of which						
i) Interest Payments	4,807.1	5,230.8	5,308.4	5,758.0	10.4	8.5
ii) Defence	2,517.8	2,623.9	2,671.1	2,827.3	6.1	5.8
iii) Major Subsidies	2,040.2	2,403.4	2,297.2	2,643.4	12.6	15.1
9. Revenue Deficit (4-1)	**3,163.8**	**3,211.6**	**4,388.8**	**4,160.3**	**38.7**	**-5.2**
	(2.1)	***(1.9)***	***(2.6)***	***(2.2)***		
10. Effective Revenue Deficit	**1,506.5**	**1,258.1**	**2,496.3**	**2,206.9**	**65.7**	**-11.6**
	(1.0)	***(0.7)***	***(1.5)***	***(1.2)***		
11. Gross Fiscal Deficit	**5,356.2**	**5,465.3**	**5,948.5**	**6,242.8**	**11.1**	**4.9**
(8-(1+2ii+2iii))	***(3.5)***	***(3.2)***	***(3.5)***	***(3.3)***		
12. Gross Primary Deficit (11-6i)	**549.0**	**234.5**	**640.1**	**484.8**	**16.6**	**-24.3**
	(0.4)	***(0.1)***	***(0.4)***	***(0.3)***		

Note: Figures in parenthesis are per cent to GDP