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Institute of South Asian Studies
National University of Singapore
29 Heng Mui Keng Terrace
#08-06 (Block B)
Singapore 119620
Tel: (65) 6516 4239 Fax: (65) 6776 7505
www.isas.nus.edu.sg
http://southasiandiaspora.org

Merging the Railway and General Budgets: A Positive Development for India

The Indian government has announced a slew of reforms in the budget process. A significant feature of this reform process is the decision to merge the Railway budget with the General budget. This decision certainly has a large number of advantages as a separate Railway budget had outlived its significance. The process to commercialise tariff fixation and free it from political influence is essential. This paper analyses the urgent issues that need attention to make the Railways a more financially stable enterprise. Private participation in the railways has been very limited. Innovative funding and greater capex (capital expenditure) in building the railway infrastructure deserves priority. The paper also analyses the attendant issues that need to be accorded greater attention in a time bound manner.

Vinod Rai[1]

Advancing the Budget Presentation Date

Until the year 2000, the Union Budget was presented in the parliament at 5pm on the last working day of the month of February. This practice was inherited from the pre-independence era, when the British Parliament would pass the budget in the noon followed by India in the

[1] Mr Vinod Rai is Visiting Senior Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore. He can be contacted at isasvr@nus.edu.sg. The author, not ISAS, is liable for the facts cited and opinions expressed in this paper.

evening of the day. It was Mr Yashwant Sinha, the then Finance Minister of India in the National Democratic Alliance (NDA) government of Atal Bihari Vajpayee, who changed the tradition by presenting the 2001 Union Budget at 11am.

The current practice is thus of presenting the annual budget at 11am on the last day of February. However, in a decision taken by the union council of ministers, it has been decided to present the Union budget a month in advance. This will ensure that the budget is passed by 31 March of any year, as a consequence of which taxation proposals contained in the budget will be implemented from 1 April of the new financial year itself. One immediate effect of this decision in the current year is that it may lead to lesser expenditure by the ministries thereby restricting the fiscal deficit. Going forward, in the next financial year, gross tax revenue may go up substantially (assessments vary from Rs 70,000 crore to Rs 1.20 lakh crore) since the new tax proposals will become effective from 1 April. The government has separately set up a committee of officials to examine the feasibility of having a new financial year replacing the existing financial year of April-March.

Advancing the budget approval process before the end of the fiscal year will ensure that the allocation to the different departments of government will be known well in advance or rather than at the beginning of the financial year. It will facilitate better expenditure planning and ensure that it is evenly spread out over the year and does not get bunched in certain months. This will maintain the equality of expenditure and enable better monitoring of the same. Traditionally when the initial expenditure was being incurred as a vote-on-account, new schemes contemplated in the budget could not be launched till the budget was actually approved. No such restriction would apply in the changed scenario. The government has also decided to remove the distinction between plan and non-plan classification in its accounts. The distinction of expenditure between plan and non-plan had become dysfunctional and hindered a holistic evaluation of the outcomes achieved via the two modes of expenditure. This will certainly simplify the decision making process and help in the efficient use of resources. It would also introduce greater transparency in the government accounting as expenditure would merely be classified as revenue and capital along solely commercial principles governing current and capital expenditure.

Merging the Railway Budget with the General Budget

In a major reform, the government has decided to merge the Railway budget with the General budget. This decision puts an end to a tradition which was started in 1924. A separate budget for the railways was certainly in order then as its revenues alone were far more than the revenue earnings of rest of the government departments in pre-independence India. In fact it was expected that the railway's revenue surplus would augment the revenue of the government. Today, of course, the situation stands significantly altered since the Railways' share of the Union budget is only about 10%. In fact defence and the oil sector have greater budgetary devolutions. Having a common budget also provides a comprehensive view of the financial position of the government. It would bring the railways in to the centre of the entire planning process and afford it a better focus.

Besides the fact that the Railways was the largest revenue earning entity of the government, the rationale for a separate budget had merit, as it is unlike any other Central ministry in size and scope. It is an operational ministry as it earns as well as spends, unlike other ministries that only spend. Its gross earnings (Rs.1.68 lakh crore in 2015-16) are among the highest for any Indian organisation, public or private. The Railways have a staff strength of about 13.5 lakh employees, which is larger than the size of the Indian Army. The pension liabilities of its retired employees, numbering roughly 13.8 lakh, is met entirely out of its own earnings unlike other ministries.

This decision will also end the practice of the Railways paying a dividend to the Central government. This was in the region of about Rs 10,000 crore annually in gross terms. Whilst the amount is more commonly referred to as a dividend, it may not be accurate to call it so in corporate terms. Actually this amount is merely the repayment of loan that the Finance ministry provides to the Railways as 'loan in perpetuity'. It is otherwise referred to as Gross Budgetary Support (GBS) in the general budget. Dividends usually imply interest payments on capital at large. At present all that happens is that GBS which was being extended by one hand is taken back as dividend by the other hand. The new arrangement will leave no difference between gross amount of GBS and net amount of GBS thereby providing a clearer picture.

The Railways will soon be having a regulator in the form of the Railway Development Authority. While this authority is not being positioned as a regulator, it will be mandated to fix tariffs. This can help the Railways get the benefit of realistic passenger fares being fixed on commercial considerations. Presently the Railways has to meet social obligations like concessional fares and providing services to commercially unviable areas. Though it is not as yet clear, in the revised scenario the Finance ministry may bear the cost of these social obligations or subsidies as it does for other departments who have to introduce socially significant schemes. The introduction of tariff fixation by a regulator will be of great benefit to the Railways since it has been losing market share to bulk cargo. A wagon or rake is typically better suited to carry bulk cargo over long distances since it is cheaper than road transport and is also less polluting. Revised fixation of rates and better marketing of its services can help the Railways make good the share of bulk cargo it had lost to road transport.

A benefit that may accrue to the Railways is that its pension liabilities will be taken over by the Finance ministry. Pension liabilities of Railways are to the tune of about Rs 8,000 crore annually. In addition to this, with the implementation of the 7th Pay Commission's recommendations, it will have to bear an additional burden of Rs 40,000 crore. There is, as yet, no clarity on this aspect as the Finance ministry believes that since the Railways has its own revenue source, it should continue to bear the pension and subsidy liabilities. The Railways also shoulders Rs 35,000-crore subsidy burden. The Finance ministry may henceforth bear social obligations like subsidies, concessional fares and such other concessions that it provides to different categories of passengers. In fact the government has decided to constitute a committee to look into the aspect of concessions to as many as 53 categories, including senior citizens, sportspersons, freedom fighters and differently-abled among passengers. Indian Railways spends a whopping Rs 34,000 crore annually towards social service obligations, which essentially includes cross-subsidies involving fares and freight. It offers 43 per cent subsidy on a single train journey to its passengers. This is in addition to the free journeys permitted to certain sections like Members of Parliament, Members of Legislative Assemblies and railway officers.

It is no doubt true that the Indian Railways is a state enterprise and hence it could be expected to fulfil some social obligations too. However, it needs to be recognised that passenger fares per kilometre as charged by the Indian Railways is barely 10% to 15 % of that levied by the rail system in Japan, Germany or even Russia. In fact in China too, the fares levied are about three times those in India. This is a consequence of generations of railway ministers playing to the gallery and not raising passenger fares. We saw a piquant situation once when, since the Railway minister announced an increase in passenger fares, his party chief gave him the marching orders and his successor reversed the earlier decision! That is the extent of populism in objecting to passenger fares that might only reflect just a fraction of the commercial cost involved in running the Railways. This malaise can, to a certain extent, be remedied by making the Railways a part of the larger budgetary exercise.

A separate Railway budget had led to politicisation of the Railways' decision making process thereby making the fixing of fares on commercial considerations totally not feasible. Railway ministers used the Railway budget to garner political mileage to reach out not only to their constituencies but to the States where their parties had better representation. With the focus now shifting away from the entire budget making process, (which would take up two months) the *Rail Bhawan* (the headquarters of the Railway ministry) and its field units can concentrate better on the implementation part. In other words, the focus can be totally devoted to execution.

The following is a very interesting reflection on the amount of investment that successive governments have made since independence: when the British left India, India possessed 53,000 km of rail network. Today the network is 65,000 km. Thus 12,000 km is all that independent India has added to the network! The Railways still ply on bridges which are 100 years old and urgently need to be replaced. All this has not been possible because India has not been able to generate any surplus from Railway earnings. In an interesting analysis made in a white paper submitted by the Railways itself, it was revealed that since independence freight loading has grown by about 13 times whereas passenger kilometre by 16.5 times. As against this, the route kilometre has grown only by 23%. This would imply that the Railways is serving 15 times more passenger and freight traffic with an infrastructure which has grown by only 23%. This has resulted in heavy wear and tear of the existing set up thereby, inter alia, jeopardising passenger safety, an aspect that any government can ill-afford to neglect. The slow growth of rail network has also impaired the speed with which passenger trains can ply considering that slow moving goods trains and express trains ply on the same track.

In the ten-year period from 2004-05 to 2013-14, Railways presented annual plans of around Rs. 3.86 lakh crore. Of this 60% went into construction of new lines, doubling, traffic facilities, gauge conversion, passenger amenities, staff amenities, electrification, rolling stock, tracks, bridges, signalling & telecommunication, etc. This figure was almost 78% in each of the two years 2012-13 and 2013-14 out of total Plan of Rs 1.24 lakh crore in these two years alone. This reflects the urgent need for infrastructure – whether new construction or capacity augmentation or rehabilitation, safety, as years pass by. The numbers for the same ten-year period showed that 39.8% of the total Plan was through General Budgetary Support, 33% through internal resources, 26.7% through Market borrowings and 0.5% through BOT/PPP (Build-Operate-Transfer/Public-Private Partnership). By 2013-14, Budgetary Support had gone up to 44.2%, while internal resources had come down to 22.5%, with borrowings remaining at almost the same levels of 24%.

Since independence the share of Railways in transportation has steadily declined, with a corresponding increase in the share of roads. A sector report on Railways by National Transport Development Policy Committee (NTDPC) has indicated that Railways' share (in originating tonnage) has come down from 89 per cent in 1951 to 30 per cent in 2007-08. In passenger traffic too, the share of Railways (in PKMs) has declined from 74.3 per cent in 1951 to 12.9 per cent in 2004-05. In an attempt to overcome this extreme inadequacy in the railway infrastructure the government has permitted 100% private sector investment in majority of railway infrastructure segments, such as suburban rail, metro rail, locomotives and rolling stock, manufacturing and maintenance, signalling and electric works and dedicated freight lines. The priority areas as identified by government for inducing capital investment are areas such as dedicated freight corridors, high-speed train project, doubling/tripling train tracks in heavy traffic zones, modernisation of 400 railway stations, and technology upgrades of signalling systems, instrumentation and other safety measures. An agreement has been reached for the Life Insurance Corporation to provide Rs 1.5 lakh crore on what is termed as 'fairly favourable terms' over a period of five years towards investment in infrastructure. The investment will be made through entities such as the Indian Railways Finance Corporation (IRFC). The Railways sector in India has so far not been very successful in attracting significant private investment and the share of private investment has increased to only 4 percent in 11th Five Year Plan from a mere 0.7 percent in the 10th Five Year Plan. Private investment in the Railways sector is very low as compared to other transport sectors like roads, ports etc.

So far the experience of Indian Railways with public private partnership (PPP) has been a mixed one. The reasons have been manifold, chief among these is the dual role played by Indian Railways which acts as both a regulator and operator. Also the legislative, commercial and regulatory powers are vested in a single entity. There have been issues of poor project structuring as for example for the redevelopment of the New Delhi Railway Station as a world class station. The bid for projects was scrapped twice, first due to issues of cross ownership among bidders, and the second time due to denial of permissions from other stakeholders like

Municipal Corporation of Delhi, Delhi Development Authority etc. The redevelopment plan envisages vertical growth of stations with opening of shopping malls, eateries, parking lots, among others. On the station redevelopment front, there is a lot of scope as the public transporter is opening up 408 major stations for private sector participation. The proposed stations will be offered through online auctions.

Way Forward

The Indian Railways has seen very concerted efforts in the recent past to expand, modernise, decentralise decision-making, improve efficiency, meet customer expectations, move to clean energy and introduce greater transparency through e-tendering. However, unless it can involve innovative forms of financing and more positive collaboration with the private sector, its lack of infrastructure would only increase. It is clear that Indian Railways is being forced to look outward for finance and techno managerial skills. The rationale for doing projects in PPP format appears to be resource constraint rather than this route being a more efficient and/or cost effective service delivery mechanism. The Railways need to have a clear roadmap – a blueprint for projects to be done in PPP format and selected on the basis of their amenability to PPP and driven by value for money philosophy rather than a resource augmenting measure.

The private sector should be invited as it has greater flexibility in adjusting its resources (personnel, equipment, and materials) to a constantly changing situation. When entrusted with a long-term contract and a wider scope of work, private firms can balance expenditures over the project life and make effective trade-offs between investment, maintenance and operational costs subject to environmental, social and economic considerations. Also, large firms have continuous access to latest technology as they are massively investing in research and development and constantly improving the quality and efficiency of construction techniques, processes and equipment.

Railways has addressed these issues through a framework created to attract private investment. The framework provides following five models for implementation of various types of rail-connectivity and capacity augmentation projects:

i. Non-Government Private Line Model

ii. Joint Venture (JV) model

iii. Build, Operate and Transfer (BOT) model

iv. Capacity augmentation with funding provided by customers

v. Capacity augmentation through annuity model

The financial position of the Indian Railways needs to be buttressed due to the triple onslaught of a fall in revenues, a sudden spike in expenditure due to recommendations of the Seventh Pay Commission, and an increasingly unsustainable interest burden on market borrowings. The operating cost is almost creeping up to 1 now (which would imply that there is virtually no net gain). This has to be urgently remedied by increase in efficiency and innovative low cost funding. Better and more commercially based freight and passenger tariff and getting back the share of traffic that has been lost has to be the stated objective.

Finally, considering the fact that the entity is large and much is at stake even if the budget has been merged, there is wisdom in ensuring that a separate white paper is presented to the Indian parliament on the Railways along with the Economic survey put out by the Finance ministry a few days before the budget is presented. This will ensure that undivided attention continues to be focussed on the reforms that the government has initiated. Another critical reform area that appears to be in the pipeline, but requires a strict timeline, is the accounting standards followed in the railway system. Whilst the Railways follow accounting standards which are fairly comparable to those in commercial entities, yet to ensure better transparency and a more accurate assessment of its commitments, a switchover to accrual accounting at the earliest is advised. A project for the same has been launched and efforts are underway to ensure its introduction by 1 April 2019. It is imperative that the timelines are adhered to.

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