RAILWAY BUDGET

Analysis of Railway Budget 2014-15, Economic Research Department **July 2014**

Increased passenger amenities, more safety measures, timely completion of projects and increased financial discipline are the primary highlights of the Railway Budget 2014-15. The growth in total receipts at 14% is in line with a 13% decadal average. We believe, if the economy picks up, there may be an upside to the budgeted projections. From this point, the Railway Budget numbers look reasonable and well balanced. In a welcome departure, the Budget proposes a multi-pronged approach to make Railway journey safe and secure and comfortable for passengers. More thrust has been placed on passenger amenities, cleanliness and efficient station management. It is also indicated that the Railways will take round the year decisions to improve the efficiency of the Indian railways and the fare hike will now be decided by Railway Tariff authority and could be a bi-annual exercise depending of fuel cost. Our estimates shows that based on current fuel prices, a 5%-8% increase may be further warranted. Also, given the severe fiscal constraints, FDI in Railways is necessary. We recommend If FDI in railways is allowed under approval route, 'national security' concerns can be looked into by Foreign Investment Promotion Board (FIPB). We also recommend that India should learn from Japan and Britain in involving private participation in Railways. Beginning in the late 80s, Japan privatized Japanese National Railways (JNR) by converting JNR into seven different companies through a process called 'vertical integration' In fact, the Railways is moving in that direction by unbundling the different services. On the whole, the Government has decided not to go the populist way but to restore credibility with tight discipline on execution.

Increased passenger amenities, more safety measures, timely completion of projects and increased financial discipline are the primary highlights of the Railway Budget 2014-15 presented by the Minister of Railways Shri D. V. Sadananda Gowda in Parliament today.

The Budget seeks a course correction in the light of mismanagement and populism in starting projects and severe fund crunch that have inflicted the Railways over the years. For this, structural reforms will be introduced and resources will be mobilized through PSU surplus, FDI and PPP.

RAILWAY FINANCE: PRAGMATIC AND VISIONARY, IMPLEMENTATION IS THE KEY

In the Rail Budget, Government has planned highest ever plan outlay of ₹65,445 crore with a gross budgetary support of ₹30,100 crore and with higher allocation of ₹2,200 crore for safety measures in FY15 from ₹2000 crore in FY14.

Table 1: Plan Outlay

₹ Cr	FY12	FY13	FY14 (RE)	FY15 Interim Budget	FY15 (BE)
Gross Budgetary Support	20,000	24,000	26,000	30,223	30,100
Railway Safety Fund	NA	2,000	2,000	1,223	2,200
Diesel Cess	1,041	NA	NA	NA	NA
Internal Resources	14,219	18,050	14,260	10,418	15,350
Market Borrowing	20,594	15,000	15,103	NA	11,790
PPP	1,776	1,050	6,000	NA	6,005
Total Plan Outlay	57,630	60,100	63,363	64,305	65,445

Source: SBI Research, NA: Not Available

Table 2: Railway Budget at a Glance (Rs Crore)

Components (Rs Cr)	2009-10	2010-11	2011-12	2012-13	2013-14 (RE)	2014-15 (Interim Budget)	2014-15 (BE)	FY15 (interim Budget)/ FY14 (% Gr)	FY15 (BE)/ FY14 (% Gr)	Decadal CAGR % (Decade ended FY14)
Total Receipts	89,229	96,681	106,245	126,180	144,168	164,955	164,374	14.4	14.0	13.0
Gross Traffic Receipts	86,964	94,536	104,110	123,733	140,500	160,775	160,165	14.4	14.0	12.8
Passenger Earnings	23,488	25,793	28,246	31,323	37,500	45,255	44,645	20.7	19.1	11.5
Freight Earnings	58,502	62,845	69,548	85,263	94,000	105,770	105,770	12.5	12.5	13.2
Other Earnings*	4,974	5,898	6,316	7,147	9,000	9,750	9,750	8.3	8.3	15.4
Total Miscellaneous Receipts	2,265	2,145	2,135	2,448	3,668	4,180	4,209	14.0	14.8	19.8
Total Expenditure	83,685	90,335	99,463	112,565	128,385	145,301	149,176	13.2	16.2	12.7
Dividend	5,543	4,941	5,656	5,349	7,840	9,117	9,135	-	16.5	14.9
Revenue net of dividend payouts	1	1,405	1,126	8,266	7,943	10,538	6,063	32.7	(23.7)	16.1
Memoranda										
Gross Traffic Receipts(% of GDP)	1.34	1.21	1.16	1.22	1.24	1.26	1.25			
Net Revenue (% of GDP)	0.09	0.08	0.08	0.13	0.14	0.15	0.12			
Operating Ratio	95.34	94.65	94.77	90.17	90.58	89.7	92.4			

Note:1. ***Other earnings are defi**ned as the sum of other coaching earnings, sundry other earnings and suspense.

Source: Railway Budget & SBI Research

RAILWAY BUDGET 2014-15

The Budget seeks a course correction in the light of mismanagement and populism in starting projects and severe fund crunch that have inflicted the Railways over the years. For this, structural reforms will be introduced and resources will be mobilized through PSU

According to the Rail Budget estimates for FY15, the Railways will earn Rs 1,64,374 crore through various resources and will spend Rs 1,49,176 crore. The operating ratio is expected to be 92.5% which is 1% below than FY14. Based on trends in the first two months, we believe that the freight traffic is realistic at 4.9%. Additionally, the 2% growth in Passenger Traffic over FY14 looks eminently achievable. The growth in total receipts at 14% is in line with a 13% decadal average. We believe, if the economy picks up, there may be an upside to the budgeted projections. From this point, the Railway Budget numbers look reasonable and well balanced.

CONSUMER IS THE KING

- The Budget proposes multi-pronged approach to make Railway journey safe and secure and comfortable for passengers. More thrust has been placed on passenger amenities, cleanliness and efficient station management.

- On safety and security, the Budget has proposed introduction of advance technology for rail-flaw detection to check causes of accidents, and a pilot project will be launched on automatic door closing in mainline and sub-urban coaches. In order to make women safer while travelling, the Railway will recruit 4000 women constables. Coaches for ladies will be escorted.

- Revamping Railway Reservation System into Next Generation e-Ticketing will be taken up with provision of platform tickets and unreserved tickets also over internet. The Railway has proposed real-time tracking of trains and rolling stocks, mobile based Wakeup Call System for passengers, mobile based destination arrival alert and Wi-Fi Services in A-1 and A category stations and in select trains.

- The Railway Budget 2014-15 has proposed 58 new trains which includes five Jansadharan Trains, 5 Premium Trains, 6 AC Express Trains, 27 Express Trains, 8 Passenger Trains, 2 MEMU services and 5 DEMU services besides extending 11 existing trains. Provision has been made for 28 surveys for new lines and doubling or gauge conversion of lines.

- Special packaged trains on identified pilgrim circuits, two tourist trains and a special train featuring life and work of Swami Vivekananda has been proposed in the Budget.

- The Budget has a clear passenger centric focus on suburban and metropolitan rail services. 864 additional state-of-the-art EMUs will be introduced in Mumbai in two years. Study to explore possibility of enhancing existing railway network for better connectivity needs of Bengaluru will be taken up.

Table 3: Number of Train announced in Budget

New Trains	FY11	FY12	FY13	FY14 (RE)	FY15 Interim Budget	FY15 (BE)
Premium trains	10	12			17	16
Express trains	61	75	75	67	38	27
Passenger trains	28	13	21	26	10	8
MEMU	9	8	8	5	4	2
DEMU	8	22	9	8	3	5

Source: SBI Research

- In a bid to modernise Indian Railway network, Bullet train has been proposed on Mumbai-Ahmadabad sector besides increasing speed of trains to 160-200 kmph in select 9 sectors.

- The Railway has also planned setting up of Diamond Quadrilateral Network of High Speed Rail connecting major metros and growth centers of the country.

- Additionally, there is an added provision online booking facility of Railway Retiring Room will be extended to all the stations during the course of the year. Indian Railways is expanding the scope of online booking for people to book a Train, book a Coach, book a Berth and book a Seat in Chair Car.

FDI & PPP: THE WAY FORWARD

- <u>FDI in Railways:</u> Growth of Railway Sector depends heavily on availability of funds for investment in rail infrastructure. Internal revenue sources and government funding are insufficient to meet the requirement. Hence, Ministry of Railways is seeking Cabinet approval to allow FDI in Rail Sector.

- <u>PPP mode of investment projects:</u> Developing identified stations to international standards with modern facilities, harnessing solar energy, facilitating connectivity to new and upcoming ports, setting up of Private Freight Terminal to develop network of freight terminals. It is estimated that overall resources worth ₹6005 crore to garner through PPP, which seems at the higher side.

RAILWAYS GOES ON TAP

- It is indicated that Government will not depend on Budget to take any major decisions and round the year can propose measures to improve the efficiency of the Indian railways.

OTHER INITIATIVES

- Indian Railways has also planned to move into paperless offices over the 5 years.

- In order to make Railway management more efficient, Budget has proposed setting up of Railway University for training in both technical and non-technical subjects besides establishing Innovations and Incubation Centre to harness the ideas generated from staff.

- To augment resources of Railways, the Budget has proposed schemes to facilitate procurement of parcel vans and rakes by private parties, special milk tanker trains, increased movement of fruits and vegetables in partnership with Warehousing Corporation and setting up Private Freight Terminals on PPP model. This will not only boost up IR's revenue, but also mitigate supply bottleneck of perishable goods. Railway connectivity can defiantly reduce the time and cost between farms to fork, albeit expected to rein food inflation.

- The Railway has proposed to bring in more transparency in administration and execution of projects. The status of ongoing projects will be available online, E-procurement will be made compulsory for procurement of higher amount and online registration of demands for wagons will be introduced within next two months.

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SPECIAL FOCUS: CROSS SUBSIDIZATION: THE LONG HAUL

The earning from railway primarily comes from freight, on the contrary the net earnings from passenger services has been at loss for long. A decade of high growth and increase in industrialization has intensified labour mobility across the country. Concomitant to domestic growth the increase in railway coverage and frequency have also increased considerably. While the passenger-miles increases with the pace of economic activities the earning from passenger segment remained under stress, as the passenger fare has remained largely untouched since FY2002-2003 to 2014.

Table 4: Operational losses of various Classes of Passenger Services (₹ in Crore)

Class of Passenger	FY06	FY07	FY08	FY09	FY10
AC 1st Class	-33	-20	-15	-59	-53
1st Class	14	-14	-6	-70	-33
AC sleeper	79	73	123	-177	-372
AC 3 Tier	95	424	548	541	212
AC Chair car	89	-5	115	5	-2
Sleeper Class	-1927	-1888	-2384	-3175	-5334
Second Class	-763	-1216	-993	-2933	-3401
Ordinary (All Class)	-2771	-2913	-3541	-6382	-7763
EMU suburban services	-807	-891	-922	-1651	-2214

Source: CAG & SBI research

On the contrary the freight tariff continues to increase in a staggered manner. With sluggish industrial and mining activities in the last few years restricting growth in freight segments, the only resolution is to increase in passenger fares, although the scope remains limited.

Railway Finance broke down during 2008-2010, due to the substantially higher increase in operating expenses caused by implementation of the 6th Pay Commission. The Railways could generate only a Net Surplus of only ₹ 75 lakh in 2009-10. The cross subsidization (net earnings from freight over net earnings from passengers) topped as high as above 100 in 2009-10. Although in the recent years it has improved more through default. We envisage that further increases in freight will make it less competitive vis-a-vis road transport. Therefore it will aggravate the arithmetic of cross subsidization. Interestingly, in a path breaking decision an independent Rail Tariff Authority is also being set-up to advise the Government on fixing of fares and freight. Hence the impediment of rationalizing tariff only in Railway budget is no more valid.

SPECIAL FOCUS: FOREIGN DIRECT INVESTMENT AND PPP

Despite being the premier transport organization of the country and the largest rail network in Asia and World's second largest under one management, Railway is not considered a part of infrastructure sector. At present, there is a complete ban on any kind of FDI in railways except mass rapid transport systems.

Currently, FDI is prohibited in railway transport other than mass rapid transport system and component manufacturing. The Government has showed its intent on Diamond Quadrilateral project of high-speed trains and a network of freight corridors. These projects require very large capital investments.

In the cusp of massive infrastructure thirst, the funding requirement has become a challenging task. In the Indian Railways Vision 2020, it was said that approximately ₹1.4 lakh crore of investment is required in Indian Railways every year for over the next 10 years. Given very low investment in IR in last couple of years, the next six years would require nearly ₹14 lakh crore of investment.

As Government's fiscal support to IR is not enough compare to its requirement, we urge for selective FDI allowance in various area in IR. We acknowledge the sensitivity of Railways in terms of foreign participation, thus selective participation of foreign capital and choice of FDI route can take care of such concerns. Under the present regime, FDI can come in automatically (automatic route) or through Government approval (approval route). If FDI in railways is allowed under approval route, 'national security' concerns can be looked into by Foreign Investment Promotion Board (FIPB).

SPECIAL FOCUS: INTERNATIONAL LEARNINGS

While considering privatization, India has the advantage of learning from two global precedents, Japan and Britain. Japan had a most successful model in transforming railway from public to private. Beginning in the late 80s, Japan privatized Japanese National Railways (JNR), which earlier suffered from high debt, poor management, and virtually non-existent operating profits. The new model converted the JNR into seven different companies through a process called 'vertical integration'. It involved separating tracks, trains, and other rolling stock vertically among different companies. In fact, the Railways is moving in that direction by unbundling the different services.

This process led to significant cost efficiencies resulting in low transaction costs, ease in creating performance schedules, and increased incentives for the track authorities to undertake improvement and safety measures. The lesson from Argentina is also equally impressive. India must learn from its developing counterpart which privatized its railways back in the 1990s.

SBI GLIDE PATH FOR INDIAN RAILWAYS

- Indian Railway (IR) should be given infrastructure sector status
- India has the advantage of learning from Japan which transformed a Japanese National Railways (JNR) from a high debt, poor management, and virtually non-existent operating profits to a profit making entity through 'vertical integration'
- IR should get split to tracks, trains, and other rolling stock vertically among different companies. This process led to significant cost efficiencies resulting in low transaction costs, ease in creating performance schedules, and increased incentives for the track authorities to undertake improvement and safety measures
- Port connectivity projects, setting up of electric/diesel locomotive manufacturing units and new coach manufacturing units are the first to open to private sector participation
- Non-core segments such as running hospitals and schools for its employees that shares nearly 10% of the capital should be handed over to private players through a transparent bidding process could significantly cut costs
- Splitting up of railways into smaller companies could improve decision-making and enhance efficiency
- PPPs could also be used in setting up of private freight terminals, logistics parks, wagon investment schemes and licensing of freight service operators
- Disinvestment in railway PSU, commercialisation of railway land and modernisation surcharge is some of the important way of raising capital for the IR
- Moving towards differential pricing according to different zone and segments. For example operating ratio in Kolkata metro is highest.

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CONCLUSION

The newly elected BJP lead NDA has presented its maiden Railway budget for the year FY2014-15. On the whole, the Government has decided not to go the populist way but to restore credibility with tight discipline on execution.

ANNEXURE

		FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Macro	GDP	9.5	9.6	9.3	6.7	8.6	8.9	6.7	4.5	4.7
	Industrial Production	8.0	12.9	15.6	2.5	5.3	8.2	2.9	1.1	-0.1
Freight	Freight(Mn tn)	667	728	794	833	888	922	969	1010	1054
	YoY%	10.7	9.2	9.1	5.0	6.5	3.8	5.1	4.2	4.3
	Freight Earnings (Rs Crores)	36287	41717	47435	53433	58502	62845	69548	85263	94000
Traffic	Passenger Traffic Number									
	Total (Million)	5832	6334	6536	7047	7383	7809	8224	8640	9089
	YoY%	6.5	8.6	3.2	7.8	4.8	5.8	5.3	5.1	5.2
	Suburban Total (Million)	3437	3629	3702	3929	4012	4220	4377	4541	4770
	YoY%	4.9	5.6	2.0	6.1	2.1	5.2	3.7	3.7	5.0
	Non-suburban (Million)	2395	2705	2835	3118	3370	3589	3847	4099	4319
	YoY%	8.9	12.9	4.8	10.0	8.1	6.5	7.2	6.6	5.4
	Passenger Kilometres									
	Total (Million)	616632	695821	771070	839203	904761	980131	1046522	1116902	1181484
	YoY%	7.1	12.8	10.8	8.8	7.8	8.3	6.8	6.7	5.8
	Suburban Total (Million)	107417	112954	120957	126007	132213	138750	144058	149460	156997
	YoY%	2.6	5.2	7.1	4.2	4.9	4.9	3.8	3.7	5.0
	Non-suburban (Million)	509215	582867	650113	713196	772548	841381	902464	967442	1024487
	YoY%	8.1	14.5	11.5	9.7	8.3	8.9	7.3	7.2	5.9
Financials	Total Receipts (Rs Crore)	55773	64786	73277	81659	89229	96681	106245	126180	144168
	Total Expenditure (Rs Crore)	48464	50333	54943	72485	83685	90335	99463	112565	128385
	Net Revenue (% of GDP)	0.20	0.35	0.37	0.16	0.09	0.08	0.08	0.13	0.14
	Gross Traffic (% of GDP)	1.54	1.51	1.44	1.42	1.34	1.21	1.16	1.22	1.24
	Operating Cost Ratio	83.2	78.2	75.9	90.0	95.3	94.6	94.8	90.2	90.6
Investments	Electrification (route Kms)	17907	17786	18274	18559	18927	19607	20275	599	...
	Track Renewals (Track Kms)	4725	4686	4002	3841	3840	3465	3300	...	...
	Construction of New Lines (route Kms)	180	250	156	357	258	709	727	...	...

Source: Budget documents & SBI Research