

Building on 8 per cent Economic Growth

Finance Minister P Chidambaram unveiled yet another budget which has left everyone pleased. With no increases in income tax and corporate tax, even the Opposition had nothing to criticise. **Yogi Aggarwal** analyses Budget 2006.

Every year at the end of February, two important events mark the economic calendar of the country. The more important and eagerly awaited one is the Union Budget which presents the monies to be spent and received by the government during the next fiscal year, and the changes in the taxes and levies proposed. More important, it is an occasion for a statement on the direction of economic policy.

Preceding the presentation of the Budget is the Economic Survey which gives the government's version of how the economy has performed in the last year and what course corrections are necessary.

Three things matter most in the budget – the new taxes, how the government balances its books, and the pattern of revenue and expenditure. Businessmen, the stockmarkets and economists read the budget for whether or not it will stimulate growth and its effect on various industries.

The Budget for the financial year

2006-07 presented by finance minister P Chidambaram had an easier task than during the last two occasions. The economy was galloping ahead at 8.1 per cent GDP growth, government policies had the air of stability, and the reforms were well established, backed by a national consensus.

The Budget presented on February 28 managed to stay the course on reforms. Though vast sums were needed for infrastructure projects, Chidambaram did not feel the need to increase taxes. The policy of lowering tax rates to reasonable levels had served reformers well. Not only have tax revenues been going up by around 20 per cent annually, tax revenue as a percentage of GDP has gone up from 9.2 per cent in 2003-03 to 9.8 per cent the next year to 10.5 per cent in 2005-06 to a budgeted 11.2 per cent for the year beginning in April 2006. This is the strongest case for the reforms made in the taxation system.

Nevertheless the finance minister thought some changes were necessary. It



was necessary to re-align the tax structure to tap the 54 per cent of GDP currently generated by services. An eight per cent service tax introduced a few years back on a limited number of services has gradually been expanded to include more services. This year some more were added and the service tax rate moved up to 12 per cent. There were no changes in the income tax or corporate tax rates.

Eventually the aim, Chidambaram said, was "that the country should move towards a national level Goods and



MORE RUPEE POWER: With no tax hikes, families have every reason to have wider smiles

Services Tax (GST)" which would be introduced in 2010. "The world over," he said, "goods and services attract the same rate. That is the foundation of the GST." In other words, service tax will be the same as excise duty.

There were some other taxation proposals worth noting:

- ❖ The fringe benefit tax, payable on company expenses on its employees, which was taxed for the first time last year, has been lowered.
- ❖ The peak rate of customs duties on non-agricultural goods has been reduced from 15 to 12.5 per cent. Eventually they are to be brought down to Asean levels of around 8 to 12 per cent. This would lower the cost of imports and put greater competitive pressure on Indian industry.
- ❖ Excise duty on small cars has been reduced from 24 to 16 per cent. It is hoped this will increase the demand for such cars and help in making India a global manufacturing hub for cars and auto components.
- ❖ The securities transaction tax has been increased. This would increase costs for day traders in the stock market.
- ❖ Foreign funds have been encouraged to invest in government securities and corporate bonds by increasing the total foreign fund limit on the former from \$1.75 billion to \$2 billion and on corporate bonds from \$500 million to \$1.5 billion. At the same time it is proposed to have



UNDERSCORING THE COMMITMENT TO AGRICULTURE: The budget has been faithful to the long standing policy of supporting agriculturists

Budget at a glance

	'04-05 Actuals	'05-06 Budget Estimate	'05-06 Revised Estimate	'06-07 Budget Estimate
All figures in Rs.00,00,000. \$1 = Rs 45 approximately				
1 Revenue Receipts	306013	351200	348474	403465
2 Tax Revenue (Net to Centre)	224798	273466	274139	327205
3 Non-Tax Revenue	81215	77734	74335	76260
4 Capital Receipts (5 + 6 + 7)†	191669	163144	160231	160526
5 Recoveries of Loans	62043*	12000	11700	8000
6 Other Receipts	4424	-	2356	3840
7 Borrowings & Other liabilities†	125202	151144	146175	148686
8 Total Receipts (1 + 4)†	497682	514344	508705	563991
9 Non-Plan Expenditure	365406	370847	364914	391263
10 On Rev. Account of which,	296857	330530	326142	344430
11 Interest Payments	126934	133945	130032	139823
12 On Capital Account	68549^	40317	38772	46833
13 Plan Expenditure	132276	143497	143791	172728
14 On Revenue Account	87495	115982	114153	143762
15 On Capital Account	44781	27515	29638	28966
16 Total Expenditure (9 + 13)	497682	514344	508705	563991
17 Revenue Expenditure (10 + 14)	384351	446512	440295	488192
18 Capital Expenditure (12 + 15)	113331	67832	68410	75799
19 Revenue Deficit (17-1)	78338	95312	91821	84727
20 Fiscal Deficit[16-(1 + 5 + 6)]	125202	151144	146175	148686
21 Primary Deficit (20-11)	-1732	17199	16143	8863

* Includes receipts from States on account of Debt Swap Scheme † Does not include receipts in respect of Mkt Stabilisation Scheme, which will remain in the cash balance of the Central Govt & will not be used for expenditure ^ Includes repayment to National Small Savings Fund

Source: Union Budget 2006-07

an exchange for trading in corporate bonds.

- ❖ Some companies, despite handsome profits, get away from paying tax because of various concessions. To plug this loophole a minimum alternate tax, or MAT, of 7.5 per cent was introduced last year compared to the corporate tax rate of 35 per cent. MAT has now been raised to 10 per cent and a loophole on capital gains plugged.

The stockmarket greeted the budget proposals by a 0.86 per cent rally that day — the Bombay Stock Exchange's Sensex went up 88 points to close at 10,370. The next day it went up further by 1.8 per cent and closed at 10,565 points. Both industrialists and analysts were largely satisfied with the proposals. The Budget is increasingly being seen by industry observers as a non-event, indicating the stability of economic policy and maturity of the economy. As expected, the budget proposals didn't fiddle too much with the tax rates, just some fine-tuning.

Nevertheless there is going to be a marked shift in tax revenues. The tradition-



MORE TRAFFIC: Excise cut on small cars is slated to make India a manufacturing hub for automobiles

al heavy revenue earners like excise and customs duties will lose in importance as services become an important source. Service taxes are the fastest growing generators of revenue, increasing 62 per cent in 2005-06 and another budgeted 50 per cent in the coming year to generate \$7.7 billion.

Their contribution to government revenues will move up. Simultaneously rates of excise duties are being cut. This year they are only budgeted to grow at a modest six per cent to \$26.4 billion. Corporate tax collections are expected to grow by over 28 per cent to \$29.6 billion; this is due to expectations of buoyant profits. Since profit growth of the corporate sector has flattened recently, there are some doubts whether this will be realised.

Total revenue receipts were estimated at \$89.6 billion, with revenue expenditure at \$108.4 billion. Consequently, the revenue deficit was estimated at \$18.8 billion or 2.1 per cent of the GDP. The fiscal deficit is estimated at 3.8 per cent of GDP. This follows the fiscal and revenue deficits in 2005-06 being 4.1 per cent and 2.6 per cent respectively. The fiscal deficit

has fallen from around six per cent in the '90s. The efforts to reduce the deficits are in line with the government's commitment on the Fiscal Responsibility Act.

Suman Bery, director general of the National Council for Applied Economic Research, a respected think tank, says, "Eliminating the revenue deficit by the end of this government's term looks hard; the target of three per cent fiscal deficit still looks manageable."

The budget also sets the pace for economic policy. Three things stand out: a commitment to agriculture and the social sectors, investment in infrastructure, and a plan to make India a global manufacturing hub in automobiles, textiles, leather and chemicals.

The first is a political compulsion, the second requires resources the government does not have, while the third objective is best achieved by reducing levies and leaving industry alone. The budget just doesn't generate the resources to meet all these requirements.

On the Web

Union Budget: www.indiabudget.nic.in

There is talk of public-private-partnership for infrastructure projects but no clear idea on how this is to be achieved. The government hopes to bring in more funds by opening the corporate debt market to foreign inflows. Deepak Parekh, chairman of HDFC, the largest housing finance company, says, "We are going to need ample liquidity. The mega projects alone will soak up so much money."

These include investment of around \$12.4 billion for ports, a similar amount for airports, 53,000 MW of power (at \$1.1 million per MW it works out to \$58.9 billion), and a massive highway construction programme. The budget support for National Highways Development Project has been increased from \$2.1 billion to \$2.2 billion.

Equally remarkable about this year's budget exercise is what has been left unsaid. There is no revenue expected from disinvestment in the public sector, and only \$3.4 billion has been provided for the landmark rural employment guarantee scheme instead of the estimated \$8.9 billion that will be needed each year. These would require to be tackled at a later date. 🌈