

Public Finance

The Economic Survey (ES) presented in Parliament on February 27, 2006, a day before the presentation of the Union Budget 2006-07 (UB 2006-07), says that although the economic growth has been strong this year, in order to sustain this, speeding up of economic reforms is needed. The ES says that the hardening of risks of inflation, interest rate, and fiscal deficit are obstacles to achieve sustained economic growth. The ES has pitched for

unburdening the Indian industry from high level of taxes and distortive exemptions that provide perverse incentives, levying user charges, cutting unwanted subsidies, a transparent and hassle-free tax administration. The ES has identified power shortage as the single-most obstacle to growth and pegged losses to GDP due to power shortage at Rs 3,00,000 crore. It wants India to liberalise FDI regime for captive mining, especially coal, because of

The Economic Survey has identified power shortages as the worst obstacle to growth

Table PF.1: Budget at a Glance (Rs Crore)

Budget Heads	2004-05	2005-06 (BE)	2005-06 (RE)	2006-07 (BE)
Revenue Receipts	306013	351200	348474	403465
- Tax Revenue	224798	273466	274139	327205
- Non-tax Revenue	81215	77734	74335	76260
Capital Receipts	191669	163144	160231	160526
- Recoveries of Loans	62043	12000	11700	8000
- Other Receipts	4424	...	2356	3840
Total Receipts	497682	514344	508705	563991
Non-Plan Expenditure	365406	370847	364914	391263
- On Revenue Account	296857	330530	326142	344430
- Interest Payments	126934	133945	130032	139823
- On Capital Account	68549	40317	38772	46833
Plan Expenditure	132276	142497	143791	172728
- Revenue Expenditure	87495	115982	114153	143762
- Capital Expenditure	44781	27515	29638	28966
Total Expenditure	497682	514344	508705	563991
- Revenue Expenditure	384351	446512	440295	488192
- Capital Expenditure	113331	67832	68410	75799
Revenue Deficit	78338	95312	91821	84727
Fiscal Deficit	125202	151144	146175	148686
Primary Deficit	-1732	17199	16143	8863

Source: Budget at a Glance, Union Budget 2006-07

its importance to power generation. The ES stresses on the public-private partnership for infrastructure development, and states that a substantial share of investment for infrastructure development should come from private sector.

Central Finances in 2005-06

Thanks to the robust economic growth in general, and industry in particular, the budgeted deficit targets for FY 2005-06 are likely to be met (Table PF.1). More importantly, the revised estimates for 2005-06 are lower than the budget estimates. However, the credit for meeting deficit targets in 2005-06 goes to better expenditure control rather than revenue buoyancy. Although, the revised estimates of net tax revenue are higher than the budget estimates, they are lower than it was hypothesised a year ago for union excise duties and corporation tax collection. On the other hand, customs and service tax collections during the year have been more than the budget estimates. The non-tax revenue collection has been lower than the budgeted, resulting in a shortfall of around Rs 3,000 crore in revenue receipts. On the other hand, the revised estimate of total expenditure is lower than the budget estimate by around Rs 6,000 crore and it originates entirely from the revenue expenditure. Despite hardening of interest rates, its payments contributed 69 per cent of the decline in expenditure; decline in external debt could be the main reason for it.

Union Budget 2006-07

It was widely expected that the UB 2006-07 would address issues and concerns expressed by the ES and provide a roadmap of future reforms to achieve a sustained growth of more than 8 per cent. Although, the finance minister addressed some of the concerns raised in the ES, the UB 2006-07 mainly restricted to housekeeping aspects,

social sector spending and infrastructure development in rural areas, due to lack of political space.

The major effort, which would have far-reaching impact, is the increased allocation for development of human resources; it is increased by 31.5 per cent and 22.0 per cent for education, and health and family welfare respectively. India can reap the benefit of huge economically-active population only if human resources are properly endowed. The budgetary provisions are recognition of these imperatives. The budget 2006-07 aims at reducing disparity between the two nations exist within the country - Bharat and India. In line with the announcements made in the National Common Minimum Programme (NCMP) and Bharat Nirman, the budget proposals revolved around infrastructure development and rural areas. Continuing with the statements of the ES, the UB also laid focus on power sector. The captive consumption definition is proposed to be amended for coal mining by producers with firm supply contracts with steel, cement and power companies. To tackle shortage of coal for power sector, 20 billion tonnes of reserves are proposed to be de-blocked. The telecommunication sector is provided with Rs 1,500 crore from the universal services obligation fund in 2006-07 and target of 250 million connections by December 2007 has been set. For road sector, the National Highways Authority of India (NHAI) will be restructured to handle large number of projects in public-private partnership (PPP) mode. There have been announcements for port and urban infrastructure sectors also.

The rural development has been one of the thrust areas of the present government. Some attempts have been made in this budget for majority of rural population and dependent on agriculture, who look towards sky for rain for a good harvest. The interest rate on short-term credit at 7 per

The Union Budget also focussed on power sector

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cent with upper limit of Rs 3,00,000 on principal is extended to farmers. The spending on programmes under Bharat Nirman such as accelerated irrigation benefit programme, accelerated rural water supply project, rural roads, rural houses, rural electrification and rural telephony along with north-east component has been increased by 54 per cent. Allocations for other flagship programmes such as Sarva Siksha Abhiyan, Mid-day Meal Scheme, drinking water and sanitation, National Rural Health Mission, integrated child development services, National Rural Employment Guarantee Scheme, urban renewal mission etc. have been substantially increased.

The other measures include small and medium enterprises (SMEs) in the services sector, recognised at par with SMEs in the manufacturing sector, national manufacturing competitiveness programme, development of 15 tourist destinations, increasing FIIs and mutual fund investment limits and converting government's non-tradable special securities provided to banking sector into tradable SLR Government of India dated securities.

The tax proposals were in line with the general expectations of stability in rates. This clearly reflects a roadmap on direct tax front as laid out by the Kelkar task force with minor aberrations. The corporate tax rate under the minimum alternate tax (MAT) has been increased from 7.5 per cent to 10 per cent and long-term capital gains arising out of securities have been added in the calculation of book profits. Co-operative banks other than primary agriculture societies and primary co-operative agricultural and rural development banks are taken out of the scope of section 80P of the Income Tax Act. The Security Transaction Tax (STT) rate has been increased by 25 per cent, and changes in fringe benefit tax have been proposed.

On indirect tax front, the peak cus-

tom duty rates are declined from 15 per cent to 12.5 per cent. However, a CVD of 4 per cent is imposed on all imports with few exceptions. In the case of excise duty, relief has been given to certain sectors, however, the major change in excise duty structure is for aerated drinks and cars. Additional excise duty of eight per cent has been removed from these two items. Cess on the domestically-produced crude petroleum has been increased from Rs 1,800 per metric tonne to Rs 2,500 per metric tonne. In line with the growth of service sector, scope of the service tax has been both broadened (12 more services are under the ambit of service tax) and deepened (increased from 10 per cent to 12 per cent) in this budget. Similar to last year's budget announcement of adoption of state level value added tax (VAT) regime, this budget has made an announcement towards national level goods and services tax (GST) from April 1, 2010. In our opinion, this announcement has given policy direction for indirect tax. The roadmap, as far as service tax is concerned, is clear; service tax rate would gradually go up and align with the highest CENVAT rate of 16 per cent, and one can expect an average of service tax rate increase of one per cent per annum. Once, the scope of service tax is increased to all services and aligned with the highest CENVAT rate, its contribution to the exchequer would be similar to GDP. However, few services that are growing in leaps and bounds in the last few years, are still outside the service tax net. The private final consumption expenditure (PFCE) on medical care and health services has grown at an annual rate of 16.5 per cent during 1999-00 to 2004-05, highest for nine broad categories of PFCE. Leaving doctors out of service tax net implies that a major possible source of service tax revenue is out of the net at a time when the government is focussing on widening the tax net and garnering higher tax collections.

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The budget has pegged gross tax and net tax revenue growth (2006-07 BE over 2005-06 RE) at 19.5 per cent and 19.4 per cent respectively in 2006-07, which is 1.5 percentage points and 2 percentage points lower than the growth achieved last year (2005-06 RE over 2004-05) for gross and net tax revenue respectively.

The corporation tax is budgeted to grow at 28.4 per cent compared to 25 per cent last year. The two major assumptions behind high budgeted growth of corporate tax collection seem to be continued growth of both manufacturing and services sector at a rate higher than the current year (9 per cent for both industry and services sector) and larger collection from the increased rate of MAT. Surprisingly, income tax collection rate is budgeted to grow only at 16.9 per cent compared to more than 30 per cent last year. On the back of 4 per cent CVD, custom duty collection is budgeted to grow at 20 per cent and excise at 6.3 per cent. Service tax is budgeted to grow at 50 per cent against more than 60 per cent last year.

On aggregate, budgeted growth of 19.4 per cent for net tax collections and 19.5 per cent for gross tax collections seems plausible if the current growth buoyancy continues in the next year. However, at sectoral level, revenue growth target for corporation tax and custom duty collection appear optimistic and the income tax and excise duty targets seem pessimistic. With both widening and deepening of service tax and growth momentum of services sector, service tax growth targets are also pessimistic.

With these proposals, the good news is that the fiscal consolidation mode is back. As per the budget estimates for 2006-07, fiscal deficit, revenue deficit and primary deficit are expected to be 3.8 per cent, 2.1 per cent and 0.2 per cent of

GDP respectively. While calculating these ratios, implicitly, current GDP at market price is assumed to grow at 12 per cent and with the kind of assumptions made for corporate tax collection to be true, growth of current GDP at market price will be more than 12 per cent. This could mean that next year, fiscal and revenue deficits might be lower than the budgeted. If this happens, it would be good for the government to achieve FRBM norms of wiping out revenue deficit by 2008-09 and reduce fiscal deficit to GDP ratio at 3 per cent. As per the medium-term fiscal policy statement, the rolling targets for revenue deficit for 2007-08 and 2008-09 are 1.1 per cent and 0 per cent respectively. It is very difficult to reduce revenue deficit by more than one percentage point in a year with committed expenditure on programmes such as the National Rural Employment Guarantee Scheme (NREGS), Bharat Nirman, and increased allocation for education and health to achieve commitments made in the National Common Minimum Programme (NCMP). However, the rolling target for fiscal deficit of 0.4 percentage point of GDP in the next two years seems feasible.

Prognosis

What are the implications of this budget for growth? With lowering of excise duty on certain items, and reducing peak customs duty on non-agriculture products, the consumption growth is unlikely to have adverse effect. Although, CVD of 4 per cent is levied on all imports with a few exceptions, full credit for this duty should be given to manufacturers of excisable goods. This measure won't put extra burden on prices of manufactured products. Although there are no direct tax measures to promote investment, the budgetary allocations for infrastructure

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development would crowd in private investment.

Over the last couple of years, there has been considerable fiscal consolidation. Though fiscal consolidation at central level is on track, much have to be done at state level. The most important fact for this fiscal is that the RBI will not

be subscribing to the Government of India bonds or in other words, the government is going to stop borrowing from the RBI. The borrowings would be done from the market and unless the government improves its fiscal position, the borrowing would be at higher coupon rate, which may deteriorate its fiscal position further.