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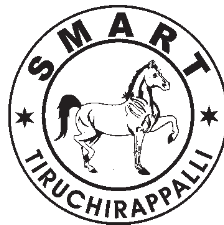

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UNION BUDGET 2005-06: MEASURING UP TO THE CHALLENGES

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The Union Budget 2005-06 was presented by the Finance Minister, P.Chidambaram, on Monday, the 28th of February 2005, in the Lok Sabha. It has been a case of coercive politics because it has been vehemently fought out in the open public and in closed circles, be it political, industrial or administrative, the debates, allegations and questions, regarding the new proposals in the budget. The previous budget was marred by the controversies relating to the imposition of Securities Transaction Tax [STT] of 0.15 per cent on purchases of securities on stock exchanges. But the present one is a revisit to the rate and its administration to accommodate a proactive response towards the general sentiments of the financial markets. It is insane enough to expect some sort of wizardry from the Finance Minister on budget proposals, yet such high expectations are the ones which drive the economic growth momentum. It is difficult to present a perfect budget in the context of the Indian economy being in a resurgent mood with a GDP growth rate of 6.9 per cent this year on the back of an 8.5 per cent growth in the previous period, particularly owing to the high growth rates in the most segments of the manufacturing industry, 23 per cent increase in exports and the low level of inflation. Yet there are too many social and developmental issues that need to be prioritised. Economic growth would no doubt be required to be pushed up through reform measures but pre-emptive action should be called in for the eradication of poverty, unemployment, ill health and illiteracy in the social sector. It is an act delicate enough to combine both the priorities on the social and developmental front, considering the limited outlays and the burgeoning interest payments and defence expenditure. Political aspirations within the government is another constraint, considering the divergent views of the coalition partners, not to forget the priorities assigned in the National Common Minimum Programme [NCMP].

The pre-budget Economic Survey Report for the period 2004-05,which is required for a valid consideration of post-budget analysis, notes a bullish trend in the Indian economy. The Report notes that recovery of the agricultural and allied sector and the strong and improved performance of the industrial and service sectors have resulted in the performance of the Indian economy for 2004-05 to exceed the expectations. Not only that the survey has pointed out the lacklustre fiscal performance, being higher than targeted, but also has provided justification for increased tax collection, emphasising on a tax-to-GDP ratio. Fiscal consolidation, through adequate tax reforms including the phased removal of exemptions, has been laid out as a priority in the Report. Infrastructure investment, irrigation investment, higher Foreign Direct Investment as well as Foreign Institutional Investments is also emphasised. In fact, the Economic Survey Report has provided a stage well set for the new budget.

As regards the previous 2004-05 Budget, estimates for revenue receipts were Rs. 3,09,322 crores, and capital receipts were Rs. 1,68,507 crores, estimates being later revised to Rs. 3,00,904 crores and Rs.2, 04,887 crores

respectively. Revenue deficit for the period was estimated to be Rs. 76,171 crores, later revised to Rs. 85,165 crores and fiscal deficit for the same was estimated to be Rs.1,37,407 crores, which was revised to Rs.1,39,231 crores. The current budget for 2005-06 estimates the revenue receipts at Rs. 3,51,200 crores, capital receipts at Rs. 1,63,144 crores, the revenue deficit at Rs. 95,312 crores, and the fiscal deficit at Rs. 1,51,144 crores. The revenue deficit works out to 2.7 per cent of the GDP while the fiscal deficit works out to 4.3 per cent. Sector–wise, the central plan outlay for the budget period represents a substantial increase over the previous fiscal. Plan outlay for rural development including rural housing amounts to Rs.13,992 crores, industry and minerals to Rs.11,998 crores, agriculture and allied activities to Rs.6,425 crores and social services to Rs. 53,384 crores.

The major policy initiative of the budget is the reforms in the taxation laws. The proposals include the progressive adaptation of the Kelkar Committee Report on the Income Tax legislations. Income tax slabs are rationalised and though the exemptions through deductions under Section 80L and rebate under Section 88 are removed, the proposals provide a major tax relief to the taxpayers and yet, the proposals are expected to mop up Rs. 6,000 crores per annum. The basic tax exemption limit is raised to Rs.1,00,000 while through the introduction of a novel concept of 'gender-budgeting', women are entitled to a higher exemption limit of Rs.1,25,000 and senior citizens to a limit of Rs.1,50,000. Slabs are rationalised to a three-tier structure, with a first slab of Rs. 1.0 lakh to Rs. 1.5 lakhs annual income having to pay a lower tax of 10 per cent. Second slab of Rs.1.5 to Rs. 2.5 lakhs invite a tax liability of 20 percent and 30 per cent tax will be paid by assesses having annual income of above Rs. 2.5 lakhs. A 10 per cent surcharge is levied only on income above Rs. 10 lakhs. A consolidated allowance for deduction of Rs. one lakh under a new Section 80C in lieu of the standard deduction would not hamper the tax savings potential. In fact, the comparison of the existing tax liability with the new tax liability would reveal an enhanced savings potential. The new proposals eliminate the complexities and distortions in computations caused by the differential tax treatments of the numerous savings schemes. Such rationalisation is a signal of the move towards international practice of taxing financial savings under the EET [Exempt-Exempt–Tax] method, where contributions to savings schemes are exempt from tax [E], accumulations to it are exempt [E], but the withdrawals, including the benefits, are taxed [T].

Revamping the excise duty structure to attract a 16 per cent duty for almost all goods, and other selective relief are still expected to be revenue neutral. Increase in the Securities Transaction Tax on day traders would bring in more revenue to the exchequer.

The National Common Minimum Programme [NCMP] of the ruling alliance had prioritised the agricultural sector, where the government would ensure public investment in agricultural research and extension, rural infrastructure and irrigation. The programme also promises to double the flow of rural credit in the next three years, to introduce a special programme for dryland farming, to implement minimum wage laws for the farm sector, and to ensure adequate protection to farmers from imports etc. Likewise, the new budget allocation to the agriculture and food sector is essentially linked to reforms. The proposal to create employment opportunities by bringing one lakh hectares under irrigation and the creation of standardised markets, not only pursues the NCMP, but also would provide impetus to the

agricultural sector, which quite regrettably had grown only by 1.1 per cent in the year 2004-05, even on the back of a 9.6 per cent growth in the year 2003-04. That this downward trend has to be reversed is beyond doubt, though to achieve it would require increased investments in the sector to bring more area under irrigation and cultivation, better water management, agricultural research and diversification. It has to be considered that though the sector had achieved only a marginal growth, there was vitality in the agricultural exports in the recent years. Increased allocation to the sector would definitely help to provide further momentum. Though the proposal to create additional one crore employment over a period of five years through irrigation in one crore hectares might seem unrealistic in the present context of the sector. But in the long run, such targets would be reachable, since it requires much more hard realities to drive in more effectiveness to developmental efforts. Creating agricultural markets and marketing infrastructure through subsidies to private and cooperative sectors would provide relief to the largely unorganised farming community to market their produces. It is undeniably a commendable effort that the Finance Minister has made the proposal to disburse Rs.1,08,500 crores, exceeding the targets, to the cooperative banks despite their below par performance. The intention is to double the flow of agricultural credit as has been promised in the NCMP.

The special attention in the budget to water resources, including enhancing supply of potable water and sanitation facilities in rural areas is laudable. Increased outlay for the Accelerated Irrigation Benefit Programme, support assurance for the Baglihar hydropower project in the Doda district of Jammu and Kashmir, plan outlay for flood management and erosion control etc. are the major proposals. Outlay of Rs. 100 crores for the national project on renovation and restoration of water bodies, to be launched in March of this year in nine states is expected to bring about 20,000 hectares of land under irrigation. One of the major health hazards and deficiencies of rural households has been the lack of sanitation facilities. Only 30 per cent of the rural households have access to safe sanitation facilities. In addition to the proposal to provide 630 crores to sanitation, it is also proposed that the coverage of Total Sanitation Campaign [TSC] to all districts from the 452 at present would be realised.

Industrial sector was largely excluded from substantial treatments because of the demands from the sector itself that it be left free to grow on its own, outside the bureaucratic interventions and controls. Plan outlay for the sector for the period amounts to Rs. 11,998 crores, substantially higher than the previous allocation of Rs.7,833 crores. A financial package for the revitalisation of the sugar industry was also included. It would benefit the companies because the corporate tax rates are brought down from 35 to 30 per cent, though the surcharge has been raised to 10 per cent from 5 per cent. Additional benefits would accrue from the reduction in import duties of capital goods. But reduction in the depreciation allowance from 25 per cent to 15 per cent can cause difficulties to those who have invested in substantial amounts in expansion.

Reform measures in the proposals include major changes in the Banking Regulation Act, 1949. It is worth noting that though the roadmap for reforms has been prepared by the Reserve Bank of India, the implementation of these reforms would be by the banks on its own authority. It is to be expected that these reform measures would assist the RBI to ensure the consolidated supervision of the banks and their subsidiaries. India's largest bank, the State

Bank of India ranks a very lowly 82nd position in the world in terms of business and no wonder, expectations should be on the high from the sector to allow them to function with comparatively more autonomy and competence. But the pre-budget opposition to the banking sector reforms by the Left parties caused the domestic investors to turn to heavy sellers. The accusation by the parties was that the government was deliberately meddling with the independent role of the RBI in fixing norms on the FDI and voting rights in the private sector.

Under the new proposal, the RBI would also prepare a road map for the presence of foreign banks in Indian financial market. Also it would study the feasibility of an agency model for banks to provide agricultural credit.

It is also proposed to convert Mumbai into a Regional Financial Centre. London and Tokyo being the pulse centre of global finance, and Mumbai being located in between these two centres, would significantly increase its potential. Such measures would assist Mumbai to transform itself into a point of such significance as it is enjoyed by the likes of Singapore and Hong Kong.

The proposal for the dereservation of 108 items from the small-scale sector might come as a blow to the existing units since their capability to withstand competition from a bigger competitor would always be in jeopardy. But where the identified items are set for rapid growth, especially the textile sector, following the dismantling of the quota regime, it is essential that operations be carried on a much larger scale. Further , the textile sector is going to benefit from the new proposals to reduce customs duty on select items of raw materials and machinery.

It is worthy of note that the way in which the budget was prepared does reflect not only the economic context in which it was prepared, but also the political context to which it was subjected. It is exactly why the reason contrary to the tradition, the budget was free from intense controversies, though it did attract protests, regrettably enough from political circles itself against the proposal to introduce tax on withdrawals from bank exceeding Rs.10, 000. Responding to the criticisms, the Finance Minister later showed the delicacy of providing the much-needed clarification that the proposal was not meant to have any revenue objective, but rather was to prevent the abuse of cash withdrawals, where large amounts were transferred through the banks for no ostensible purpose and where it was administratively impossible to keep track of those outflows. The delicacy with which the budget was prepared and presented, without any attempt on radical measures is enough evidence of the pressure under which the function was carried out. Even an increased defence allocation caused such charges that the government was following a policy of militarisation of the economy. Hence it is better that restraint be exercised on radical measures.

An expert opinion would not consider this budget as an economic exercise, but rather as a political one. That the potentially contentious issues relating to the policy measures and initiatives on the Foreign Direct Investment allowance in critical sectors as well as disinvestments has not been subjected to treatment, would suffice itself to be considered that the Minister was playing it safe. Probably, these would reasonably be expected to be treated at a later phase, since these are measures linked to liberalisation, and it would not be paranormal if the Left Front were to surface their contention over it. Obviously, the allowance of higher FDI limits in critical areas in the previous budget, and the subsequent opposition from the

Left Front should have forced the Finance Minister to offer a marked deviation from the usual procedure, and instead to decide to open a dialogue on issues relating to mining, retail trade and managing pension funds. But the intentions are made very clear from the quotations made by the Finance Minister about the example of China, having received US $ 500 billion in FDI since its economy was opened up. Dialogues on FDI might even turn around to become a test on the capability of the government to pursue the economic reforms.

The rising fiscal deficit is a worry at 4.3 per cent of the GDP. It is one area where the budget has failed. The decline of the fiscal deficit from the previous of 4.4 per cent to 4.3 per cent is marginal and quite contrary to the promise of the previous budget. The Fiscal Responsibility and Budget Management Act binds deficit reduction as a goal to ensure responsible government measures and stable economic environment. But where the social sector responsibilities weaved into rural development through health care, education, sanitation, drinking water etc. demands substantial outlays, it is no surprise that the budget should fall short of the targets. Moreover, the recommendations of the Twelfth Finance Commission require additional transfers to be made to the States. But, in fact, the substantial increase in the social sector spending should have been the responsibility of the states. Where Rs.25,000 crores are devolved for pursuing the NCMP promises, it should be the prerogative of the Planning Commission to confirm that the promised outlays are actually transformed into outcomes.