

Indian Budget 2006-2007 Highlights

No spokes in the wheel, as economy never keel

Finance Minister Mr. P Chidambaram has stayed away from any big ticket fiscal measures while preparing the 2006-07 budget. Therefore, there are no surprises in this year's budget, except for a few tweaks in last year's template. There is an emphasis on stimulating growth into public infrastructure, without losing track of fiscal targets. Corporate tax rates have not been changed, and customs duties have been reduced, but service tax rates have been increased and expanded to include a larger range of business services.

There has been an encouraging response to the budget, reflected in a 200-point gain in the Sensex, barometer of India's stock markets.

State of the Economy

Economic growth remained buoyant, with 8.1% GDP growth in 2005-06, with manufacturing and services sectors performing impressively. The **industrial sector** registered an impressive growth of **9%**, driven by growth in manufacturing and construction, and the **Services sector** grew by 11.1%. **Agriculture** GDP grew by a satisfactory 2.3%, compared to 0.7% the previous year.

Inflation remained in the range of 3-5% during the financial year, and was 4% in February 2006. Fuel, power and lubricant prices accounted for the main part of price rises during the year. However, the modest inflation disguises the continuous government intervention in public sector companies (which dominate India's petroleum products sector) to retain market prices of refined products, despite huge increases in crude oil prices. As a result, all government owned refineries posted huge losses in 2004-05, while refineries elsewhere reported booming profits.

External Sector

The year 2004-05 saw a reversal in current account trends, showing a deficit after being surplus for three years. This was mainly on account of huge merchandise trade deficit in the first half (April- Sep), owing largely to the escalating oil bills (current account deficit of \$3.3 bn) and merchandise imports rising much faster (46%) than exports (22%) during the year. The trade deficit for the first nine months of 2005-06 was around 2.6 percent of GDP.

The Capital account continued to show surplus due to steady growth in non-debt creating foreign investment inflows. **Continued gains in services and strong remittances resulted in a comfortable level of reserves which were around US\$140 billion in Feb 2006.** The rupee strengthened against major currencies in 2005-06. India's external debt, at US\$124 billion, rose modestly in the year, due to short term borrowings.

Selected indicators of external sector

S.No.	Item/Year	99-00	00-01	01-02	02-03	03-04	04-05	Apr-Sept 05	2005-06
1.	Growth of exports BOP%	9.5	21.1	-1.6	20.3	23.3	23.9	29.5	21.9
2.	Growth of imports BOP%	16.5	4.6	-2.8	14.5	24.1	48.5	38.3	48.4
3.	Exports/Imports BOP%	67.8	78.5	79.4	83.4	82.9	69.2	71.3	58.6
4.	Import cover of FER (no. of months)	8.2	8.8	11.5	14.2	16.9	14.3	13.9	11.2
8.	Exports	8.3	9.9	9.4	10.6	11.0	11.8		
9.	Imports	12.3	12.6	11.8	12.7	13.3	17.1		
10.	Trade balance	-3.9	-2.7	-2.4	-2.1	-2.3	-5.3		

11.	<i>Invisible balance</i>	2.9	2.1	3.1	3.4	4.6	4.5		
12.	<i>Current account balance</i>	-1.0	-0.6	0.7	1.3	2.3	-0.8		
13.	<i>External Debt</i>	21.9	22.4	21.1	20.4	17.8	17.3		

Source: Economic Survey 2005-06

Government Performance

Taxes are the main source of revenues, and account for nearly 10.5 % of India's GDP. Taxes account for 65% of central government revenues. However, the central government also resorts to borrowings to meet its resource requirements. In recent years, government debt has been worrying, with interest accounting for almost 21% of government expenditure— even higher than the plan expenditure. Subsidies and defence are the two major heads of government expenditure other than interest payments. Fiscal and revenue deficits have been causes for concern, and some steps have been taken to tighten government performance to contain these.

Rupee Comes from	%	Rupee goes to	%
Borrowings and other liabilities	22	Interest	21
Excise duty	18	Central Plan expenditure	19
Customs duty	11	Defence	13
Corporation tax	20	State share of taxes and duties	17
Income tax	11	Subsidies	7
Non-debt capital receipts	2	State & UT Plan assistance	6
Servicetax & other taxes	5	Non-plan assistance to states	5
Non-tax revenue	11	Other non-plan expenditure	12

The Fiscal Responsibility and Budget Management Act (FRBM) enacted in 2003 requires a reduction in revenue deficit by at least 0.5% and fiscal deficit by 0.3% of GDP each year. However, the government is way off target in this respect. Revenue deficit, at 2.6%, was higher than the previous year's 2.5%. Fiscal deficit at 4.1% in 2005-06, was as targeted although higher than 4% in 2004-05, despite tax revenue increases of over 21%. A notable aspect is that almost 33% of tax revenues foregone by government, by way of exemptions and concessions, are almost 50% of the amounts collected: in 2004-05, nearly Rs 1587 billion in tax revenues were foregone, against gross tax revenues of Rs 3060 billion.

	2004-05	2005-06	2005-06	2006-07
	Actuals	BE	RE	BE
1. Revenue receipts	3060.13	3512.00	3484.74	4034.65
2. Tax revenue (net to centre)	2247.98	2734.66	2741.39	3272.05
3. Nontax revenue	812.15	777.34	743.35	762.60
4. Capital receipts (5+6+7)	1916.69	1631.44	1602.31	1605.26
5. Recoveries of loans	620.43	120.00	117.00	80.00
6. Other receipts	44.24	-	23.56	38.40
7. Borrowings and other liabilities	1252.02	1511.44	1461.75	1486.86
8. Total receipts (1+4)	4976.82	5143.44	5087.05	5639.91
9. Nonplan expenditure	3654.06	3708.47	3649.14	3912.63
10. On revenue account of which	2968.57	3305.30	3261.42	3444.30

11. Interest payments	1269.34	1339.45	1300.32	1398.23
12. On capital account	685.49	403.17	387.72	468.33
13. Plan expenditure	1322.76	1434.97	1437.91	1727.28
14. On revenue account	874.96	1159.82	1141.53	1437.62
15. On capital account	447.81	275.15	296.38	289.66
16. Total expenditure	4976.82	5143.44	5087.05	5639.91
17. Revenue expenditure	3843.51	4465.12	4402.95	4881.92
18. Capital expenditure	1133.31	678.32	684.10	757.99
19. Revenue deficit (17-1)	783.38	953.12	918.21	847.27
As a percentage of GDP	2.5	2.7	2.6	2.1
20. Fiscal deficit	1252.02	1511.44	1461.75	1486.86
As a percentage of GDP	4	4.3	4.1	3.8
21. Primary deficit	-17.32	171.99	161.43	88.63
As a percentage of GDP	-0.1	0.5	0.5	0.2

Source: Budget 2006-07

Tax revenues are expected to rise by 15% in 2006-7, and expenditures by 9.3%, which could bring the fiscal deficit and revenue deficits on track. Revenue deficit is expected to be eliminated in 2008-9, and fiscal deficit is expected to come down to 3%. This is proposed to be attained through enhanced tax collection through greater compliance and coverage rather than through tariff increases, and without substantial disinvestments in government owned public sector entities. On the expenditure side, interest on borrowings accounted for over 37% of total revenue receipts. However, capital expenditure (plan and non-plan) represented only 13% of total expenditure.

Central Plan Outlay (Rs billion)

For 2006-07, outlays have been increased by 20% for various economic and social sectors. Subsidized farm credit and subsidized farm loans, flagship social schemes and energy have received higher increase in allocations.

Sectors	2005-06 (Revised Estimates)	2006-07 (Budget Estimates)
Agriculture and allied	59	74
Rural development	167	182
Energy	537	696
Industry and Minerals	100	145
Transport	404	486
Communications	175	198
Science, Tech and Environment	60	80
Social services	512	633
Others	37	44
Total	2053	2540

TAX PROPOSALS

Direct Tax

- Personal income tax and corporate income tax have not been changed from the 30% level. However, the Minimum Alternative Tax (MAT) rate-applying to profitable companies that enjoy tax exemptions-has been increased from 7.5% to 10%; long term capital gains arising out of securities is included in calculating book profits; and the credit period for MAT has been increased to seven years.
- The unpopular Fringe Benefit Tax (FBT) introduced last year shall see some changes:
 - FBT on 'tour and travel' reduced to 5%. - For airline companies and shipping industry, value benefit in the form of 'hospitality' and 'use of hotel boarding and lodging facilities,' at 5% instead of 20%.
- There is an increase of 25%, across the board, on all rates of Securities Transaction Tax (STT).
- Section 80IA of the Income Tax Act applies to infrastructure facilities; the terminal date for developing an industrial park extended to March 31, 2009 and for the power sector to March 31, 2010.
- Open ended and close ended equity-oriented schemes to be treated on par for exemption from dividend distribution tax.
- Exemption under section 10(23G) removed.
- Primary Agricultural Credit Societies and Primary Cooperative Agricultural and Rural Development Banks are still exempt from tax under section 80P; all other cooperative banks are excluded.
- Benefit of section 54ED withdrawn w.e.f. April 1, 2006; scope of section 54EC restricted to two institutions, viz., NHA and REC; for NABARD, SIDBI and NHB route of zero coupon bonds to raise low cost funds already opened.
- Donations to wholly charitable institutions to be taxed at the highest marginal rate; such donations to partly religious and partly charitable institutions/trusts to be taxed only if the donation is specifically for an educational or medical purpose.
- Banking Cash Transaction Tax (BCTT) to continue until the Annual Information Returns (AIR) system can capture all significant financial transactions.

Indirect Taxes

Goods

- Peak rates of Custom duties reduced from 15% to 12.5%. However, a 4% countervailing duty has been added to all imports. This would increase the overall duty to marginally above 15%.
- Excised duty has been reduced on several categories: man-made fibre yarn and filament yarn, small cars, ready-to-eat packaged foods and instant food mixes, condensed milk, ice cream, preparations of meat, fish and poultry, some price categories of footwear, compact fluorescent lamps, printing, writing and packing paper
- Excised duty will apply on packaged software.

Services

- Service tax rate increased to 12% from 10%. New services to be included like ATM operations, maintenance and management, share transfer agents, sale of space or time (other than print media), sponsorship of events (other than sport events), ship management, etc.

A common Goods and Service Tax (GST) is proposed to be implemented by April 1, 2010 .

SECTOR PROPOSALS

Agriculture

Irrigation: outlay of 2006-07 increased to Rs. 71 bn; 20,000 water bodies of 1.47 million hectares identified, renovation and restoration cost estimated Rs. 45 bn.

Credit: increased to Rs. 1750 bn in 2006-07; 5 mn farmers will benefit. Farmers will receive short term credit at 7% with upper limit of Rs. 300,000 on the principal amount.

Sanctions under Rural Infrastructure Development Fund to increase to Rs. 100 bn.

Telecommunication:

- Target is to reach 250 million connections by December '07.
- 50 million rural connections to be rolled out in three years over.

Power:

- 5 ultra megapower projects of 4,000 MW each to be awarded before December 31, 2006.
- Rs. 6 bn provided for non-conventional energy resources
- 10,000 villages in 2005-06 and 40,000 more to be electrified in 2006-07.

Coal:

- 45 coal blocks have been allotted for captive consumption to power, cement and to the steel sectors and to the State Governments.
- Reserves of 20 billion tonnes to be de-blocked for power projects.
- A comprehensive review of coal is underway.

Petroleum:

- Rs. 220 bn investment expected in the refinery sector in next few years.
- **Road Transport:** National Highways Development Programme enhanced to Rs. 100 bn in 2006-07. Allocation of Rs. 550 crore for North Eastern region.
- 1,000 km of access controlled Expressways to be developed on Design, Build, Finance and Operate (DBFO) model.

Capital Market:

- Limit on FII investment in Government securities to be increased to \$2 billion from \$1.75 billion.
- Limit to FII investment in corporate debt to be \$1.5 billion from \$0.5 billion
- Ceiling on aggregate investment by mutual funds in overseas instruments is to be raised to \$2 billion from \$1 billion with removal of requirements of 10% reciprocal shareholding.

Services Sector

Tourism

- Development of 15 tourist destinations and circuits to be undertaken;
- 50 villages with core competency in handicrafts and other related work to be identified and developed.
- 4 new institutes of hotel management to come up in 4 states: Uttaranchal, Chhattisgarh, Haryana and Jharkhand.
- Plan allocation of Rs. 8 bn.

Manufacturing

Employment: 5 industries, namely textiles, food processing, petroleum, chemicals and petrochemicals, leather and automobiles, with employment opportunities identified in the manufacturing sector.

Textiles: Fund allocation for Technology Upgradation Fund (TUF) enhanced to Rs. 5 bn; Rs. 189 crore allocated for Scheme for Integrated Textiles Parks (SITP); Jute Technology Mission to be launched; a National Jute Board to be established.

Handlooms: 100 more clusters to be added to Cluster Development; a 'handloom' mark to be launched.

Food Processing Industry NABARD to create a refinancing window with a corpus of Rs. 1,000 crore. National Institute of Food Technology Entrepreneurship and Management to be set up.

Information Technology Hardware manufacturing: manufacture of semi-conductors and other high technology IT products including wafer, flat LCD/Plasma panel displays and storage devices.

Small and Medium Enterprises (SMEs) 180 items identified for de-reservation; corpus of Credit Guarantee Fund to be raised to Rs. 25 bn in five years; Credit Guarantee Trust for Small Industries to be proposed to reduce guarantee fee from 2.5% to 1.5% for all loans.

The above texts have been taken from the official budget document and related publications