

Budget Overview **Arjun Gupta****No Frills, No Fuss**

Palaniappan Chidambaram surprised critics by delivering absolutely nothing in the third budget of his tenure as Union Finance Minister. Yet what's right with this year's budget is a continuation of his earlier policies—low tax rates, fiscal prudence, plans for indirect tax reform, increasing spend on the National Common Minimum Programme (CMP), and addressing India's infrastructure needs.

GDP growth. Target 10 per cent; 2005-06 estimate, 8.1 per cent. Growth has averaged over 7.5 per cent over the last 3 years. With manufacturing and services growing at 9.4 per cent and 9.8 per cent respectively, the challenge is to boost the 2.3 per cent growth rate in agriculture—a 43 per cent higher outlay in the CMP with higher lending to the farm sector can help lift this. Still, much more needs to be done for India to achieve her 10 per cent target.

Fiscal deficit. Down from 4.1 per cent to 3.8 per cent in 2006-07, in line with the FRBM Act, where the government has to reduce the deficit by 0.3 per cent a year. A better tax/GDP ratio (up from 9.2 per cent in 2003-04 to 11.5 per cent in 2006-07) helped the reduction. If this continues, the government could be on its way to putting its fiscal house in order. We could expect an upgrade from global rating agencies, resulting in lower borrowing costs for India Inc.

Taxes. In line with the commitment to maintain a low tax regime, there were few changes, but the most far-reaching announcement was that of a uniform nationwide tax on goods and services, to be introduced by April 2010. Toward this objective service tax rates were raised 2 per cent to 12 per cent. Expect a 1 per cent increase in the service tax rate every year until 2010.



Union Budget 2006 maintains established policies

Infrastructure. Plan expenditure is up from 26.6 per cent in 2004-05 to 30.6 per cent of total government expenditure in 2006-07; more government resources are being spent on India's future, notably in areas of shortage, like power and roads. The infrastructure sector is expected to remain buoyant.

What wasn't addressed. Labour market reforms, further PSU divestment, opening up the insurance sector, oil sector reforms, and subsidy alleviation. To ensure true price discovery in the economy, these areas need to be addressed urgently. Political opposition to these key reforms is hard, unfortunately.

Where does this leave investors?

Equities: In the 1980s GDP growth averaged 5.5 per cent a year, which improved to 6.0 per cent in the 1990s. It has averaged 7.5 per cent over the last three years. If India does manage to increase this to 10 per cent a year we could expect equity markets to remain buoyant. Key reforms in the pension sector will increase the long-term flow of funds into equity markets. Meanwhile, the 25 per cent increase in the securities transaction tax is expected to have a minimal impact on equity markets.

Fixed income: The FII limit in government and corporate debt was increased by \$1.25 billion, to \$3.5 billion, deepening the market. Also planned: structural reforms in the corporate bond market.

A wider tax net should reduce the fiscal deficit over time. This bodes well as the government will borrow less from the market leaving more funds for private investors to borrow. Increasing private sector participation should lift India's growth rates even further. ■

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