



## **The Indian Budget 2004-05**

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### **Reforming under chains!**

The first budget of the UPA government has **at its heart social issues** of agriculture, education and employment but gives **due importance to reforms, fiscal consolidation and maintaining a growth rate of 7-8%**.

Finance Minister P. Chidambaram is clearly looking from a **long term perspective and trying to strengthen the foundation of the economy** by provisioning for quality basic **education, health**, harnessing **water** resources, generating **employment**, promoting **investment** and focusing on agriculture and **infrastructure** because it's the people that make the country.

### **State of the Economy:**

Real **GDP is estimated to have grown by 8.2% in 2003-04**, buoyed by a strong agricultural recovery of 9.1% from the drought affected previous year. Apart from agriculture, the Industry and Services sector also surged to 7.1% and 8.4% respectively maintaining the growth momentum, according to the revised estimates released by Central Statistical Organisation (CSO). **The economy has recovered** and growth was also observed in Mining and Quarrying, electricity, gas and water supply, trade, hotels, transportation and communication and financing, insurance, real estate and business services.

The growth recovery was accompanied by continued maintenance of relative stability of prices. Inflation measured by the WPI (Wholesale Price Index) was 4.6% at end March 2004 over end March 2003, and 5.5% on average.

The Reserve Bank of India (RBI) in its Annual Policy Statement for 2004-05 has placed the inflation rate on a point to point basis at around 5% in 2004-05.

The downward trend in interest rates continued in 2003-04. RBI reduced the Bank rate from 6.25% to 6% from the close of business on April 29, 2003. Also the Cash reserve ratio was reduced by 25 basis points to 4.5% in June 2003.

### **External Sector**

The Balance of Payments position was further strengthened by foreign exchange reserves (including gold, SDRs and Reserve position in IMF) increasing by a unprecedented US\$36.9 billion in 2003-04. The level of reserves crossed the US\$ 100 billion mark on December 19, 2004 and stood at US\$119.3 billion as of May 31, 2004.

This accretion is attributed to the doubling of the capital and current account surplus on one hand and valuation gains from steady appreciation of Euro and Pound Sterling against the US dollar on the other.

FII (Foreign Institutional Investors) investment witnessed a sharp recovery from US\$ 0.3 billion in 2002-03 to US\$ 7.2 billion in April to December 2003. According to SEBI (Securities and Exchange Board of India), FII investment in full year 2003-04 amounted to US\$ 10 billion, two thirds of which occurred in the second half of the year.

### Selected indicators of external sector

S.No.	Item/Year	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04*
1.	Growth of exports-BOP %	5.6	4.5	-3.9	9.5	19.6	0.0	16.9	12.5
2.	Growth of imports-BOP%	12.1	4.6	-7.1	16.5	7.0	-2.8	13.5	20.8
3.	Exports/Imports-BOP%	69.7	69.7	72.1	67.8	75.8	78.0	80.3	74.2
4.	Import cover of FER (no. of months)	6.5	6.9	8.2	8.2	8.6	11.3	13.8	16.2
5.	External assistance (net) /TC(%)	10.6	9.7	10.4	8.3	5.1	11.6	-19.1	-10.3
6.	ECB (net)/TC (%)	27.3	42.6	55.4	2.9	47.7	-11.0	-18.2	-21.2
7.	NR deposits/ TC (%)	32.1	12.0	12.2	14.2	27.6	26.5	23.2	19.9
8.	Short-term debt/ FER (%)	25.5	17.2	13.2	10.3	8.2	5.1	6.0	5.7
9.	Debt service payments as % of current receipts	21.2	19.0	17.8	16.2	17.3	14.1	15.8	18.1
		GDP	at	Current	Market	Price			
10.	Exports	8.9	8.7	8.3	8.4	9.8	9.4	10.3	
11.	Imports	12.7	12.5	11.5	12.4	13.0	12.0	12.8	
12.	Trade balance	-3.8	-3.8	-3.2	-4.0	-3.1	-2.6	-2.5	
13.	Invisible balance	2.7	2.4	2.2	3.0	2.6	2.9	3.3	
14.	Current-account balance	-1.2	-1.4	-1.0	-1.1	-0.5	0.3	0.8	
15.	External Debt	24.5	24.3	23.6	22.1	22.4	20.9	20.2	
16.	Debt Service Payments	3.2	2.7	2.6	2.5	2.9	2.4	2.9	

\*calculated on the basis of figures upto Apr-Dec 2003-04

TC: Total capital flows (net); ECB: External Commercial Borrowings; FER: Foreign Exchange Reserve

As the total capital flows are netted after taking into account some capital outflows, the ratios against item no. 5,6 and 7 may, in some years, add up to more than 100%.

Rupee equivalent of BOP components are used to arrive at GDP ratios. All other percentages shown in the upper panel of table are based on US Dollar values.

Source: Economic Survey 2003-04

### India's External Debt Outstanding

Period	1998	End-1999 (US \$)	March 2000 (Million)	2001	2002	2003	End-2002R	Dec 2003P
Long-term Debt	88485	92612	94327	97504	96012	100301	101476	106357
Short-term Debt	5046	4274	3936	3628	2745	4569	3837	5773
Total External debt	93531	96886	98263	101132	98757	104870	105313	112130
External debt % to GDP	24.3	23.6	22.1	22.6	21.1	20.2	-	-

R: Revised P:Provisional; \*Figures for end Dec relate to the period Apr-Dec only

Source: Economic Survey 2003-04

### Government Performance:

The provisional unaudited accounts indicate that the fiscal outcome in 2003-04 is better than that estimated. **Fiscal deficit turned out to be lower at 4.6% than the Budget Estimate (BE) of 5.6% mainly on account of higher than budgeted revenue receipts and lower than budgeted revenue expenditure.**

Corporate tax revenue increased by Rs121.09bn over the Budget estimates and more than offset the shortfall in revenue from other taxes. Non tax revenue also exceeded the BE by Rs. 63.02bn on account of higher dividends from public sector enterprises. Capital receipts exceeded by Rs 240.76bn on account of prepayment of high cost debt by states (hence loans recovery increased to Rs 669.28bn against a budgeted Rs.180.23bn. Most significantly net market borrowings were lower at Rs. 888.60bn (budgeted: Rs.1071.94 bn).

However **expenditure management remains a worrisome aspect** as the aggregate expenditure was higher than the budgeted by Rs.331.41bn. Moreover fiscal management of the states continue to alarm as **combined deficit of centre and state is estimated to be 9.6%.**

### Budget at a glance (In Rs billion)

	2001-02 Actual	2002-03 Actuals	2003-04 Budget Estimates	2003-04 Provisional	2004-05 Budget Estimates
<b>1. Revenue receipts</b>	2014.49	2317.48	2539.35	2630.00	3093.22
<i>Tax revenue (Net to Centre)</i>	1336.62	1594.25	1841.69	1869.32	2339.06
<i>Non-tax revenue</i>	677.87	723.23	697.66	760.68	754.16
<b>2. Capital receipts</b>	1610.44	1686.48	1848.60	2089.36	1685.07
<i>Recoveries of loans</i>	164.03	341.91	180.23	669.28	271.00
<i>Other receipts</i>	36.46	31.51	132.00	160.48	40.00
<i>Borrowings / liabilities</i>	1409.55	1313.06	1536.37	1259.60	1374.07
<b>3. Total receipts (1+2)</b>	3624.53	4003.96	4387.95	4719.36	4778.29
<b>4. Non-plan expenditure</b>	2612.59	2889.42	3178.21	3497.87	3322.39
<i>On revenue account,</i>	2399.54	2680.74	2893.84	2827.71	2936.50
<i>of which interest payments</i>	1074.60	1178.04	1232.23	1242.61	1295.00
<i>On capital account</i>	213.05	208.68	284.37	670.16	385.89
<b>5. Plan Expenditure</b>	1011.94	1114.55	1209.74	1221.49	1455.90
<i>On revenue account</i>	616.57	715.54	768.43	785.37	918.43
<i>On capital account</i>	395.37	399.01	441.31	436.12	537.47
<b>6. Total Expenditure (4+5)</b>	3624.53	4003.96	4387.95	4719.36	4778.29
<i>Revenue Expenditure</i>	3016.11	3396.28	3662.27	3613.08	3854.93
<i>Capital expenditure</i>	608.42	607.69	725.68	1106.28	923.36
<b>7. Revenue deficit</b>	1001.62	1078.80	1122.92	983.08	761.71

8. Fiscal deficit	1409.55	1313.06	1536.37	1259.60	1374.07
9. Primary deficit	334.95	135.02	304.14	16.99	79.07
<i>Memo items (per cent of GDP)</i>					
Revenue deficit	4.3	4.4	4.1	3.6	2.5
Fiscal deficit	6.1	5.3	5.6	4.6	4.4
Primary deficit	1.5	0.5	1.1	0.1	0.3

- Revenue deficit (Revenue expenditure-Revenue receipts) *Source: Economic survey 2003-04*
- Fiscal deficits (revenue deficit +capital expenditure-capital recoveries from loans/ disinvestment and other recoveries)
- Primary Fiscal deficit (Gross fiscal deficit – Interest payments)

Total expenditure as a proportion of GDP had risen to a alarming 16.2% in 2002-03 but more than the level of expenditure, which by international standards is not very high, it is the **quality of expenditure that is a major concern.**

Interest payments accounted for about 30% of total expenditure and 35% of Revenue expenditure. **The effect of lower interest rates on the total interest burden of the Central government is not visible because of growth in outstanding debt.**

The increasing trend in government debt is alarming as with over three fourths of the fiscal deficit being accounted for by the revenue deficit, there is very **limited scope to use the borrowings in a productive manner.** Gross market borrowings of the Central Government were budgeted at US\$1398.87bn and net market borrowings at US\$ 1071.94 bn in 2003-04. However a large receipt on account of debt swap scheme enabled the Government to **prepay external debt of US\$ 3753.56 million in 2003-04**

### Expenditure Allocation

Rupee Comes from %		Rupee goes to %	
Borrowings and liabilities	24	Interest	23
Excise duty	19	Central Plan expenditure	16
Customs duty	10	Defence	14
Corporation tax	16	State share of taxes and duties	15
Personal tax	9	Subsidies	8
Non debt capital receipts	6	State Plan assistance	10
Other taxes	3	Non plan assistance to states	3
Non-tax revenue	13	Other non plan expenditure	11

## TAX PROPOSALS

### Direct Taxes

- Income tax exemption limit has been increased to Rs 100,000, freeing 14 million of the presently 27 million taxpayers from taxation, and resulting in a revenue loss of Rs 17 billion.
- Long-term capital gains have been abolished
- Short-term capital gains tax reduced from 30% to 10%.
- Service tax has been hiked **from 8 to 10%** and has been extended to 13 more services apart from the existing 58.
- Interest on Non Resident (External) Account and NRI deposits in forex no longer exempt from tax
- There is no change in interest rates on small savings including PPF, GPF and SDS. However, senior citizens have been promised a savings scheme offering 9% interest.

### Indirect taxes:

- **A 2% education cess** has been levied on income tax, corporation tax, excise and custom duties.
- VAT is to be implemented by April 2005.
- The CENVAT component (16%) of excise duty has been removed on textiles and handlooms.
- The whole of excise duty (16%) has been removed on tractors, sickles, spades, hand tools, dairy machinery, computers and ambulance vans, wheel chairs and artificial limbs
- Counter Vailing duty (CVD) exemption on specified items withdrawn
- Import duty on platinum cut from Rs 550 per 10 gm to Rs 200.
- Custom duty on metals, minerals, refractories and catalysts has been reduced to 15% and on specified textile and garment making machinery reduced from 20% to 5%.
- Customs duty on non alloy steel reduced from 15 to 10 percent but excise duty raised from 8 to 12%.
- Abolition of special additional duty
- Auto industry is entitled to 150% deduction of expenditure on in house R&D
- Import duty on platinum cut from Rs 550 per 10 gm to Rs 200
- 15% transaction cost on the value of all security transactions in the stock exchanges has been imposed

### **Subsidies**

- National Institute of Public Finance and Policy to prepare blue print for better targeting subsidies.
- US\$ 420.21bn earmarked for Subsidies 61% of which has been set aside as food subsidy amounting to US\$ 258 billion (2% more than last year). Other subsidies include US\$ 81.43bn for urea fertilisers, US\$4.73bn for imported urea, US\$ 40.46bn towards payment to manufacturers and importers of fertilisers and agencies and US\$ 35.59bn has been set aside as petroleum subsidy

## **SECTOR PROPOSALS**

### **Agriculture and Rural Economy**

- Doubling **agricultural credit** in 3 years, accelerating the completion of **irrigation** projects and investing in rural **infrastructure** (provision of US\$ 28bn for irrigation and US\$ 80bn for infrastructure)
- Providing farm **insurance** and livestock insurance
- Full tax holiday for agro processing industry
- **Restoring Water Bodies** (repair, renovate and restore ) directly linked to agriculture beginning with 5 districts, National water Resources Development project to be launched
- Nationwide **Water Harvesting Scheme** to be launched to cover 1lakh irrigation units at a average cost of Rs 20000 per unit and easy loans from NABARD
- Rs 30 crore allocated to **flood control**
- Allocation of Rs 1000 crore to **Research and Development**
- Improving agricultural product markets and promoting agri-businesses. National Horticulture Mission to be launched to double horticulture production by 2011-12, government to facilitate farmers to diversify into oilseeds.

### **Education and Health**

- The 2% cess on Union taxes and duties to yield Rs 4000-5000 crore to be earmarked for education including cooked midday meal
- Programme to be launched to upgrade 500 Vocational training Institutes over the next 5 years
- Universal Health Insurance Scheme to be redesigned and made exclusive for persons and family below poverty line.
- A new Group Health insurance scheme to be introduced through public sector for members of Self Help groups and credit linked groups
- Allocation of Rs 259 crore for prevention and control of HIV/AIDS

## Infrastructure

- Airports, Seaports and tourism would be the focus of growth
- Inter Institutional Group (IIG) formed by IDBI, IDFC, ICICI Bank, SBI, LIC, Bank of Baroda and Punjab National Bank to ensure speedy conclusion of loan agreements and implementation of infrastructure projects.
- All drinking water schemes to be brought under the umbrella of the Rajiv Gandhi Drinking Water Mission. Allocation of US\$ 26bn for Accelerated rural water supply programme and US\$1.51bn for Urban water supply.
- Construction of an International Container Transshipment Terminal(ICTT) in Kochi
- **Rural Housing:** Allocation for Indira Awas Yojana raised by Rs 537 crore to Rs 2247 crore, reduction in rate of refinance by National Housing Bank ,RBI has agreed to revise the norms of repayment for rural loans as per crop cycles. Target of 2,50,000 rural housing units per year

## Industry

- A National Manufacturing Competitiveness Council to be set up
- Companies doing Research on Biotechnology to get 100% tax exemption for 10 years
- **Investment Commission** to be formed
- 85 items removed from **Small Scale Industry** reserved list and ceiling for loans raised to 10 million, rate of subsidy raised from 12% to 15%
- **Public sector:** equity support of US\$ 141.94 and loans of US\$ 21.32 bn to central Public sector enterprises (PSE) including Railways in 2004-05,Board of Reconstruction of PSEs (BRPSE) to be established, financial support for restructuring Hindustan Antibiotics Limited

## Foreign Investment

- Sectoral cap for FDI raised from 49% to 74% for **Telecommunications** , from 40% to 49% for **civil aviation** and from 26% to 49% in **Insurance**
- **Investment ceiling for FIIs in debt funds raised** from \$1 billion to \$1.75 billion
- **Procedures for registrations** and operations of FIIs in the capital market to be **simplified**
- FIPB to be made a one stop service

<b>Foreign Investment Inflows</b>		<b>(in US \$ million)</b>		
	<b>2000-01<sup>(a)</sup></b>	<b>2001-02<sup>(p)</sup></b>	<b>2002-03<sup>(p)*</sup></b>	
<b>A. Direct Investment</b>	4029	6131	4660	
<b>1. Equity</b>	2400	4095	2700	
<b>SIA/FIPB</b>	1456	2221	919	
<b>RBI</b>	454	767	739	
<b>NRI</b>	67	35	-	
<b>Acquisition of shares</b>	362	881	916	
<b>Equity capital of Unincorporated</b>	61	191	126	
<b>2. Re invested earnings</b>	1350	1646	1498	
<b>3. Other capital \$</b>	279	390	462	
<b>B. Portfolio investment</b>	2760	2021	979	
<b>GDRs/ADRs #</b>	831	477	600	
<b>FII's **</b>	1847	1505	377	
<b>Offshore funds &amp; Others</b>	82	39	2	
<b>C. Total (A+B)</b>	6789	8152	5639	

- Acquisitions by non-residents; # Raised from Global and American Depository Receipt; Foreign Institutional Investors
  - P Provisional R Revised \$ data pertain to inter company debt transactions of FDI entities \*April to December
- Source: RBI

## Our Analysis

Mr.Chidambaram's budget attempts to redistribute India's shine, and appease the sections of the Indian population which were bypassed by the 'India shining' phenomenon of the past few years.

The leniency toward lower-income classes of tax payers and the elderly citizens, and the expenditure focus on agriculture and rural infrastructure, are reflective of the pro-poor assurances under the UPA manifesto. At the same time, the budget seeks to extract retribution from the higher-income groups and the services sectors (which have done impressively in the last three years) by way of an addition to the service tax and a special cess in the name of education, a proposed turnover tax and increase in the dividend tax rate.

The expectation of improved tax collections and a settlement of disputed arrears appears to be major tools for bridging the revenue and fiscal deficits. Meanwhile, the

disinvestments targets have been scaled down by nearly two-thirds (from Rs 110 bn to Rs 40 bn) in deference to the communist members of the alliance. On another front, the government is keeping its overall expenditure in check (a modest rise of 1.2%) and plans to reduce non-plan expenditure by more than 5%, without any specific elaboration on how this is proposed to be effected.

The biggest assumption gamble of the Budget is that agriculture will prosper from this budget. However, the cautious messages from the Met departments are already rocking this basic premise of the budget. If a poor monsoon takes away the advantages being meted out to agriculture, there would be ballooning of subsidies and ad hoc relief measures for the affected areas, which will exert pressure on non-plan expenditure. With food stocks near the low level of 30 million tones, failed monsoons this time around will push up consumer prices, unlike the previous monsoon failure when we had a 64 million tonne food reserve to intervene in all affected areas and contain price rises. A poor faring by agriculture would also reduce savings, depress industrial demand, and dilute tax revenues, as a result of which GDP growth targets could go awry.

All said, the UPA now needs a new ally-Indra, the rain god, and pronto!

S.V.Divvaakar