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India’s Budget Aims to Maintain Growth

Increased spending on poor, infrastructure will crimp ability to cut fiscal deficit

By Jay Solomon and Eric Bellman

Bombay – India moved to keep growth and economic changes on track, as the government announced a budget that increases spending on the poor and on infrastructure as well as new guidelines for foreign investment in banking.

Higher spending likely will mean that New Delhi fails to meet a target to trim the country’s fiscal deficit for the year ending March 31, 2006, Finance Minister P. Chidambaram told India’s Parliament, raising concerns at credit-rating agencies like Standard & Poor’s Rating Service.

Some financial analysts and investors voiced disappointment that the government yesterday didn’t announce concrete plans to sell more state-owned assets or to open other economic sectors to more foreign investment.

Still, investors drove Indian stocks to near all-time highs, buoyed by Mr. Chidambaram’s plans to cut corporate-tax rates and some tariffs. They also welcomed the central bank’s announcement of long-awaited guidelines for foreign ownership of Indian banks. Analysts said billons of dollars in new investment might go into India’s banking industry now that the rules on mergers and acquisitions have been clarified.

“The budget has no bells and whistles, but is still very, very nice,” said Jon Thorn, manager of the $160 million India Capital Fund in Hong Kong. “You have a much clearer idea of what the future holds” for India.

The Bombay Stock Exchange’s benchmark Sensex index rose 2.2% to close at 6713.86.

Mr. Chidambaram, presenting his second budget since the Congress party’s victory in May, said his government would focus in the coming fiscal year on job creation and improving infrastructure and social programs for the rural poor. The Congress party came to power on the back of voter disaffection with government policies seen as pro-middle class and overly focused on cities. The finance minister said his government is seeking to rectify this imbalance.

The new budget allocates more than 240 billion rupees, or about $5.5 billion, for social spending, with 110 billion rupees for food-for-work programs. It also commits 140.4 billion rupees of fresh capital for India’s state-run companies. The finance minister said some of India’s $133 billion in foreign-exchange reserves would be used to build roads, ports and airports.

However, Mr. Chidambaram acknowledged that this spending will crimp the government’s ability to cut its fiscal deficit, which stands at 4.5% of economic output, excluding the finances of India’s states. Under a parliamentary act, New Delhi has to reduce its fiscal deficit by 0.3 percentage points per year. Mr. Chidambaram said India would meet the target for the current fiscal year but was projected to miss it by 0.1 percentage point for the coming year.

“I was left no option but to press the pause button vis-à-vis” meeting these financial targets, Mr. Chidambaram said. “I may add that we perilously close to limits of fiscal prudence.”

S&P said in a statement it was concerned New Delhi wasn’t meeting its deficit target at a time when India’s strong economic growth provided it the fiscal space to do so. “It must give rise to worries concerning India’s future fiscal performance should growth rates become less favourable,” credit analyst Ping Chew said.

The Finance Ministry projected India’s economy to grow 6.9% this fiscal year and more than 7% in the year that begins April 1st.

Corporate India welcomed the government’s plan to reduce tariffs and to restructure and widen India’s tax base. Mr. Chidambaram said the top customs duty on nonagricultural projects would be reduced to 15% from 20%. India also lowered its effective corporate-tax rate to 33% from 35%.

The Finance Ministry said it would make up for the revenue losses by improving compliance and widening taxes on services and tobacco. It also is preparing to implement a nationwide value-added tax April 1st.

Analysts had expected the finance minister to announce a target as high as 100 billion rupees from the sale of stakes in government companies. And the Finance Ministry’s annual Economic Survey, released Friday, suggested New Delhi might move quickly to raise investment levels in the insurance, retail and mining sectors.

However, the finance minister’s speech only mentioned that there were “opportunities” to attract investment in these fields. And Mr. Chidambaram didn’t signal any plans to change India’s notoriously rigid labor laws.

The minister said his government needs further consultation with its Communist Party allies before moving ahead in these politically sensitive areas.

Still many economic analysts said they remained optimistic that reforms are progressing. “The economy has been liberalized quite a bit so the budget is becoming less relevant that the other announcements that are made outside” of it, said Sukumar Rajah, chief investment officer in Bombay for Franklin Templeton Asset Management (India) Ltd.

India’s central bank outlined its policy on foreign bank ownership and expansion just hours after the budget announcement Global financial institutions, including HSBC Holdings PLC and Standard Chartered PL have been placing on hold their investment plans in India for months awaiting clarification of these ground rules.

Under the new guidelines, foreign banks will be allowed to buy stakes in banks ìidentifiedî by the central bank for restructuring, the Reserve Bank of India said. The acquisitions will be allowed in a phased manner and subject to the central banks approval. The green-lighted foreign banks will be given management control equivalent to their shareholdings.

Under previous regulations, management control of Indian banks was capped at 10%, even if the foreign bank’s shareholding was higher.

ìIt was released on the same day [as the budget], which shows the kind of urgency the government is placing on banking reform, î said Neel Chatterjee, senior vice president at Standard Chartered Group in Bombay. “It’s indicative of the direction the government wants to take the financial sector, which is very positive and encouraging.”