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Shaving India’s budget deficit

By Andrew Atkinson

SALES TAX MAY BE BROADENED TO RAISE FUNDS FOR INFRASTRUCTURE

New Delhi Plumbers, barbers and other service providers in India may be required to pay a 10 percent tax as Finance Minister P. Chidambaram seeks to cut borrowing.

Chidambaram will probably widen the number of businesses that must pay a sales tax in his Feb. 28 budget, said Jon Thorn, who manages the $150 million India Capital Fund in Hong Kong. Services, which account for half of the economy, contribute 5 percent of tax revenue.

India needs to increase revenue to pare a $31 billion budget deficit and fulfill a pledge to spend $150 billion in the next decade to upgrade roads, power lines and telephone networks. The projects are meant to foster development in a nation where 800 million people live on less than $2 a day and help India vie with China for overseas investment.

”India has to get something done about infrastructure, and fast,” said Thorn. “The drive is to raise more revenue and we can be reasonably sure that the government will cast a wider net over services.”

Increasing revenue from service tax may help Chidambaram reduce the budget deficit to 4.1 percent of gross domestic product in the year starting April 1 from 4.4 percent this fiscal year, according to the median forecast of seven economists surveyed by Bloomberg.

India has plenty of scope to raise taxes. Total tax revenue, including levies on income, imports and sales, amounts to less than 10 percent of GDP. In China, the figure is 20 percent, and among the members of the Organization for Economic Cooperation and Development it averaged 37 percent in 2001.

Chidambaram is targeting service companies because the tax they pay is low. Tax revenue from services will come to 141.5 billion rupees, or $3.2 billion, in the year ending March 31, the Indian government forecast in July. By contrast, the excise tax on manufacturers, which account for less than a quarter of the economy, will come to 1.09 trillion rupees.

“The service sector is way undertaxed,” said Ping Chew, director of sovereign and international public finance ratings at Standard & Poor’s in Singapore.

Chidambaram plans to add 30 services to the sales tax net, bringing the total to 101, according to a Feb. 17 report in the Hindustan Times, which did not say where it got the information.

Revenue from the service tax would rise by two-fifths to 200 billion rupees in the coming fiscal year.

Total tax revenue next year will probably rise by a fifth to 3.8 trillion rupees, according to Shuchita Mehta, an economist at Standard Chartered Bank in Mumbai. Economic growth and improved tax collection will also help increase revenue, economists said.

A lower deficit may help India win a higher debt rating, paring borrowing costs and spurring foreign investment. The central government uses a quarter of its $109 billion budget to pay interest on debt, which was estimated at 17.2 trillion rupees as of last March 31, or more than three-fifths of GDP.

“The ratings have a chance to be upgraded” if India accelerates efforts to cut borrowing, Chew at Standard & Poor’s said.

Standard and Poor’s in 2002 reduced its rating on India’s local currency debt to BB+, the highest non-investment grade, citing concerns about the deficit, which reached 6.2 percent of GDP by March that year. Moody’s Investors Service has maintained its Ba2 rating, two levels below investment grade, since 1998.

Indian manufacturers are pushing for a reduction in corporate tax rates of almost 36 percent. Singapore’s corporate tax rate is 20 percent.

Lower taxes “would increase companies’ capital expenditure, boost capacity and improve their efficiency,” said M. L. Pachisia, managing director of Orient Paper & Industries, which makes cement, paper and electric fans.

India has to upgrade its infrastructure if it is to achieve a government target of sustaining economic growth of as much as 10 percent a year, said Thorn of the India Capital Fund. The government forecasts growth of 6.9 percent this fiscal year.

Since 1979, when the economies of India and China were about equal, China’s GDP has grown to $1.4 trillion, more than twice the size of India’s. China last year attracted a record $61 billion of foreign investment, 14 times as much as India.

Electricity output in China is double that in India, and China had six times as many telephone lines per 1,000 people in 2002, according to the World Bank.

The Chinese government “means business and it makes doing business in China more comfortable for foreign investors,” said Amit Bhalla, an accountant who joined Huawei Technologies, China’s biggest phone-equipment maker, two years ago.

“China’s companies have been able to compete with any in the world,” said B. Hariharan, finance director at Ballarpur Industries, India’s largest maker of writing and printing paper. “If that kind of situation is created in India then the sky is the limit.”