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India to Raise Limit on Foreign Investing

Budget Also Includes Plans to Boost Rural Spending, Increase Taxes, Cut Deficit

By Jay Solomon

New Delhi — India's new Congress party-led government unveiled a budget that lifted foreign-investment limits in three top industries, and made good on a campaign pledge to significantly increase rural spending through infrastructure development, cheaper farm credit and subsidies.

To calm India's skittish financial markets, Finance Minister P. Chidambaram said the new government will raise the ceiling on the amount that foreigners can invest in the telecommunications, insurance, and civil-aviation industries, and he said New Delhi remains open to selling stakes in state-owned companies.

Mr. Chidambaram also said that his government, despite its alliance with leftist and communist parties, would move to reduce New Delhi's fiscal deficit in coming years through larger tax receipts, better managed subsidies and a strengthening partnership wit the private sector.

For the year ending March 31, 2005, the government pledged to reduce its fiscal deficit to 4.4% of India's total economic output from 4.6% the previous year. New Delhi also said it would reduce its revenue deficit, the gap between taxes raised and spending, to 2.5% of gross domestic product from 3.6%. The government said it would seek to sustain annual economic growth at 7% to 8%.

"We will considerably enhance investments in all aspects of the economy,î Mr. Chidambaram said Thursday in a speech to India's Parliament. ìHowever, fiscal prudence and financial discipline will remain the overarching objectives."

Mr. Chidambaram also said the government is abolishing a capital-gains tax on securities sold after 12 months. But the Bombay Stock Exchange's benchmark 30-company Sensitive Index closed down 2.3% at 4843.84 Thursday on news that the government would impose a 0.15% tax on securities transactions. Still, many market participants said they still viewed the budget as a positive long-term development for India.

Standard & Poor's Rating Service said a better fiscal performance by the government could boost India's local and foreign currency ratings, both of which are below investment grade. "This budget marks the new government's attempt at balancing demands from its coalition and presenting itself as fiscally responsibleî the ratings company said.

"Regarding the fiscal deficit, I think India's now in pretty good shape," said Jon Thorn, who runs the $110 million India Capital Fund in Hong Kong. "I think people are focusing on the wrong things."

Financial markets swooned in May when the Congress-led coalition came to power on fears that leftist and Communist party allies would seek to derail economic overhauls while pushing through massive social spending programs. The new government's immediate abolishing of the privatization ministry and its lowering of the foreign-investment cap in a top infrastructure sector were seen as bad initial signals.

But Mr. Chidambaram said Thursday that his government would seek to court foreign and private investment as top instruments for growth. "Foreign direct investment has the potential to add a competitive edge, especially in the industrial sector," the finance minister said. "FDI will continue to be encouraged and actively sought."

Higher Investment Ceiling

Mr. Chidambaram said New Delhi would raise the cap on foreign equity in Indian telecommunications companies to 74% from 49%, and to 49% for insurance and civil-aviation companies, from 26% to 40%, respectively. Finance Ministry officials also said New Delhi would continue to raise funds from the sale of state-owned companies and committed to government to divesting itself of stakes this year in Maruti Udyog Ltd., the country's largest car maker, Bharat Aluminum Co., and National Thermal Power Corp.

The principal theme of the budget, though, was Prime Minister Manmohan Singh's plan to significantly increase investments targeted at India's rural population, a critical constituent behind Congress's electoral victory. In particular, Mr. Chidambaram said his government immediately would increase spending on infrastructure programs, irrigation systems, and health care and education for the poor.

The finance minister announced extra spending for the current fiscal year of 100 billion rupees, or about $2.2 billion, for these projects and said a 2% surcharge would be levied on all taxes to raise 40 billion to 50 billion rupees for education spending. Mr. Chidambaram said New Delhi would seek to double credit to the farm sector over the next three years and would establish a fund of 80 billion rupees to develop rural infrastructure. Food subsidies totaling 252 billion rupees will be included in the budget.

A major source of revenue for the funding of these social programs will be significantly larger tax revenue, Mr. Chidambaram said. The Finance Ministry plans to increase taxes on India's booming services sector, which accounts for half of India's economic output, to 10% from 8%.

Efforts to revitalize India's rural areas widely are being welcomed by corporate India. Many businessmen acknowledge that India's recent economic boom, which registered growth of more than 8% last fiscal year, has been disproportionately centred on India's middle class and high-technology zones. Wealthier farmers will strengthen corporate earnings, these businessmen say.

New Customers

"Even marginally increasing incomes [in the rural sector] will result in a large number of new customers," said Sunil Mittal, chief executive officer of Bharti Tele-Ventures Ltd, one of India's main telecommunications companies.

Still, analysts said New Delhi faces fiscal risks by underwriting so many social programs. The central government is running a fiscal deficit of 10% of GDP, the broadest measure of economic output, when the budget shortfalls of its state governments are consolidated with that of the national government. Economists said India's financial position could deteriorate further if economic growth and tax revenue don't grow at the heady rates the government is projecting.

"There are certain risks on the fiscal side," said Subir Gokarn, an economist at Crisil Ltd., a New Delhi-based credit-rating concern. "The government's revenue forecasts could be a bit optimistic."