What's In Chidambaram's Bag?

There are great expectations all around. But given his political and economic constraints, the FM will have to walk the tightrope between good economics and good politics. By Amit Mukherjee

P. Chidambaram: Another tightrope walk, but expect some populist stance

These are the best of times for Finance Minister Paliniappan Chidambaram. The economy is galloping ahead at 9.2 per cent, the booming stock market is spreading cheer all around and most projections forecast more of the same in the months and years ahead. These are also the worst of times to be in his shoes. The inflation rate has been rising relentlessly, eating into household budgets; interest rates have gone up in tandem, making loans-the lifeblood of middle class aspirations-more expensive, and the economy is showing early signs of overheating. And as B-day draws closer, he is acutely aware of the economic constraints that he will have to tide over. "Several steps are being taken to see that the monetary situation remains under control," he says.

On the political side, he will be under pressure from his Left allies and sections of his own party to go easy on necessary, though unpopular, reforms. Congress President and UPA Chairperson Sonia Gandhi has already written to the government expressing reservations over the proposal to allow foreign retailers to enter the country and the contentious SEZ policy. But happily, there are signs that the Left is coming to terms with the limits on its ability to influence key decisions. "The government has, by and large, ignored our views on most issues, but we will still vehemently oppose any move to bring in measures that go against the interests of the common man," says CPI(M) MP Nilotpal Basu.

THE LEFT CHARTER

Surprise! The Left hasn't made too many subversive demands.

Increase Plan allocations to meet NCMP commitments. **LIKELY TO BE ACCEPTED.**

Raise resources by increasing tax rates for corporates and the rich. **NOT LIKELY TO BE ACCEPTED.**

Increase public investment in agriculture and irrigation. Expedite completion of ongoing irrigation works. **LIKELY TO BE ACCEPTED.**

Reduce interest rate on loans for farmers to 4 per cent. Provide debt relief to all debt-stressed farmers. **MAY BE PARTIALLY ACCEPTED.**

Check price rise in essential commodities. Strengthen procurement and increase agricultural production. Universalise the PDS by increasing food subsidy. **MAY BE PARTIALLY ACCEPTED.**

Bring down prices of petrol and diesel by restructuring the duty structure on petroleum products. **ALREADY DONE.**

Extend NREGA to 200 more districts. Allocate more funds for the rural employment and infrastructure development. **LIKELY TO BE ACCEPTED.**

Increase expenditure on education from 3.8 per cent to 6 per cent of GDP. Increase education cess to fund expansion of education at all levels. **MAY BE PARTIALLY ACCEPTED.**

Allocate funds to initiate social security scheme for unorganised workers. **LIKELY TO BE ACCEPTED.**

Reintroduce standard deduction for salaried employees. **MAY BE PARTIALLY ACCEPTED.**

So, what exactly does India Inc. expect from Budget 2007? Prime Minister Manmohan Singh has indicated that the tax regime will be simplified. "Our tax regime should not have too many exemptions that make tax administration an unnecessarily complex exercise vulnerable to misuse," he has said recently. The apex chambers are comfortable with this idea, provided "the corporate tax rate is cut from 33.66 per cent to 25 per cent". This, they feel, will enable them to compete more effectively in the global marketplace. Multinationals can also expect some relief. There is a strong possibility that they will be taxed at the same rate as their Indian counterparts from the coming financial year. MNCs currently pay an effective corporate tax of 41.8 per cent.

The Left and several UPA constituents agree that exemptions should go, but they also advocate raising the tax rate to 35 per cent. "Profits are rising 40-50 per cent in most cases. There can, thus, be no rationale for such mollycoddling," says CPI(M)'s Basu. The Left parties claim that total exemptions to the corporate sector add up to Rs 57,000 crore. "This amount alone can take care of the deficit and fund a number of welfare schemes," he adds.

Industry, understandably, is less than enthusiastic about the Left agenda. "Collections are buoyant this year; so, there is no need to increase tax rates or bring more services under the tax net. Rather, the corporate tax structure needs to be rationalised further," says Siddhartha Roy, Chief Economist, Tata Sons. The consensus is that India Inc. will have to live with fewer exemptions. Will this be accompanied by lower corporate tax rates? Opinion is divided on this.

THE 10 CORPORATE EXPECTATIONS

Thrust on infrastructure: Development of basic infrastructure in power, roads, ports and airports will receive a boost.

Lowering of corporate taxes: Even the Prime Minister has hinted at it. Most corporate leaders feel this is a given.

Rationalisation of tax exemptions: Companies in India enjoy a range of exemptions like tax holidays for software technology parks, EoUs, infrastructure service providers and units set up in backward areas. These are likely to be phased out.

Rationalisation of indirect taxes: Rationalisation and lowering of indirect taxes is another demand that is likely to be accepted, at least partially.

Abolition of surcharges/cess: Surcharges are usually levied to raise resources for situations caused by natural disasters or military emergencies. Given the buoyancy in revenues and the comfortable fiscal situation, industry expects surcharges to go.

Rationalisation of FBT: The most contentious levy imposed by the government. The FM may tinker with it and exempt some legitimate business actitivities, but outright abolition seems unlikely.

Better and simplified tax administration: This is part of the government's stated policy; so expect something on this front.

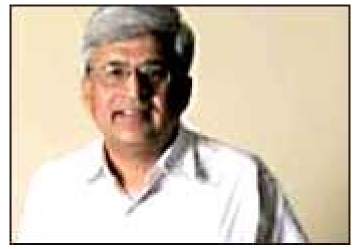
Thrust on education and health: Given Congress President Sonia Gandhi's personal interest in this issue, the FM will have to deliver.

Boost to agriculture: This is the only sector in the economy that is not on steroids; yet some 65 per cent of the country's population depends on it. The consensus is that Chidambaram will definitely allocate a major chunk of resources to agriculture to bring it up to scratch and touch that magical 10 per cent growth figure.

Fiscal responsibility & accountability: The government is mandated by law to cut its coat according to its cloth. The FM will almost definitely ensure that the government continues to live within its means. Not doing so can result in severe long-term damage to the economy.

Other items on India Inc.'s wish list are: rationalisation of surcharge, abolition of fringe benefit tax, reduction in duties in select areas and increased capital expenditure, especially in the agri sector. Will these wishes be granted? "We believe the Budget will continue with the FBT while making an attempt to further exempt genuine business expenditure from the tax net. We also think that the stock investor may have to shoulder some additional burden," says a senior Kotak Securities executive.

Finance Ministry officials are tightlipped on what the Budget holds, but Business Today learns that it is fairly certain that Chidambaram will announce a Rs 2,200-crore package for small-scale industries. He is also expected to reduce customs duty on machinery imports for sectors such as leather, footwear, textiles & clothing and sports goods.



Prakash Karat: Tax the rich to raise resources

Then, India Inc. can expect tax relief on reinvested profits, though short-term capital gains tax on stocks may rise from 10 per cent to 15 per cent. "We also want the tax on distribution of dividends to go," says a top executive in a multinational company. Customs duties is another area that is bothering industry. At present, sectors such as metals, minerals and heavy machinery, among others, face an inverted duty structure, i.e., the tax regime is skewed against domestic manufacturers. "It makes no sense to pay more for raw materials than finished products as such duties only make foreign players more competitive," says Tata Sons' Roy.

Finance Ministry officials say Budget 2007 will provide a significant amount of support to projects with political overtones. Among them, the biggest beneficiaries are likely to be the Jawaharlal Nehru Urban Renewal Mission, the National Rural Health Mission (NRHM), and the National Rural Employment Guarantee Scheme. Also on the anvil are massive investments in agriculture and education.

The Left feels the government can mobilise additional resources for these welfare measures by reintroducing capital gains tax, increasing the securities transaction tax from 20 per cent to a higher level and by raising the wealth tax rate from 1 per cent to 3 per cent. The consensus: Chidambaram is unlikely to give in on any of these.

Inflation is a huge and legitimate concern. "The spurt in the Wholesale Price Index from 5.58 per cent to 6.12 per cent is indeed a matter for concern," the fm admitted recently. It has since risen to 6.73 per cent. The Finance Minister will need to device a multi-pronged strategy to cage this monster. The most likely measures: a further rationalisation of duties on petroleum products and, possibly, the reintroduction of standard deduction for salaried people.

Will all these grand expectations bear fruit? We'll find out on February 28.