

## **Fiscal Reforms in India**

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**Abstract:** *Fiscal Policy assumes a central place in the overall macroeconomic framework. As government sector and private sector compete for resources and for consumption in the economy, fiscal policy needs to be designed in a framework where an increase in government activity would result in net gains to the economy even when it may negatively impact in private sector activity, or reduce foreign exchange reserves or increase the monetary base. The specific objectives of the research are as to addresses the vital area of reforms, viz. fiscal reforms, to evaluate the impact of fiscal reforms on the public finances of the Union and state governments to analyze the outcome of the different tax measures and public expenditure, .to form a view of the effectiveness of fiscal reforms. Fiscal reforms have initiated a right kind of approach to maintain fiscal discipline in the Indian economy and the Indian economy has met it successfully at the national level however there has been some problems at the state level. Fiscal reforms have brought a new vision and mission for the government both central and state towards competitiveness and efficient mode for managing the economy The research work has analyzed the work of specialized institutions/ organizations of the govt. of India and RBI. The data are mostly sourced from budget documents of govt. of India , articles on central govt. finance published by RBI, finance accounts of govt. of India, handbook of statistics on the Indian economy published by RBI Compared the performance of the fiscal variables in the post reform decade to the extent possible subject of availability of data & put them in simple tabular form The policy simulation results revealed that fiscal deficit, in general, resulted in widening the current account deficit if it is money- financed. In this case, the price and income effects reinforce each other, leading to the deterioration in the external balance both in the short-run and in the long-run. Thus, the recourse to deficit financing to promote public investment and growth involves a loss of control on inflation The study will have an important implication in development programmes and public policies*

**Key –Words:-** *Fiscal reform, Critical study, Indian economy, Fiscal discipline, Govt. policies*

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### **I. Introduction**

In the post-independence years, with the gradual abatement of political and economic uncertainty, stimulating and accelerating growth was one of the primary objectives of fiscal policy. In a nascent economy where the income levels and financial savings were low, the fiscal assumed the responsibility of creating the capital base in the form of infrastructure to stimulate growth. Thus, India embarked on a planning process since 1950 which assigned a large role to the public sector and taxation was made the mainstay of public finances. Early empirical literature on the operation of fiscal policy in India since independence was, thus, skewed more in favor of taxation reflecting its significance in the strategy of resource mobilization for planned development. With the public sector assuming the 'commanding heights' of the economy during the plan era, studies on public expenditure were closely associated with the performance of the five-year plans.

Fiscal policy focused on achieving greater equity and social justice during the 1970s and both taxation and expenditure policies were employed towards fulfilling this objective. High marginal tax rates did not yield the necessary revenue to support the envisaged public expenditure. The growth in receipts thus lagged behind the surge in disbursements despite substantial amount of resources mobilized through additional taxation and hike in the administered prices. Thus, during the 1980s Indian public finance was in a state of disarray with the fiscal pattern destabilizing the relationship between the economy and the budget. This resulted in persistently large deficits which were seemingly intractable. Therefore, the decade of 1980s could be called the decade of fiscal deterioration which, in turn, raised the question of sustainability of fiscal stance of the Government. Empirical research thus, took cognizance of alternative concepts of deficit to analyze its impact on the economy. The fiscal semblances of the 1980s spilled over to the external sector resulting in the macroeconomic crisis of 1991. Another disquieting feature of the fiscal system was the large size of monetized deficit which exerted inflationary pressures. The persistent and burgeoning revenue deficit which became endemic in the system pre-empted the borrowed resources, reducing the availability of resources for capital investment. The structural adjustment programme and the consequent economic reforms gave a fresh dimension to empirical analysis of fiscal policy which focused not only on the various instruments of fiscal policy and issues of debt but also on the overall fiscal sustainability in the context of an open economy framework. Although the first half of the 1990s witnessed some fiscal correction, its retraction

during the second half of the decade underlined the need for a consistent and sustainable fiscal consolidation process.

## **II. Economic Conditions at the time of Reforms**

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### *Taxation*

In the planned economy model adopted since Independence, taxation was used as an instrument for reducing private consumption and transferring resources to the Government to enable it to undertake large-scale public investment in an effort to spur economic growth. Taxation was also used to reduce inequalities through progressivity in respect of income and wealth, particularly during the 1970s. The non-integrated and complex nature of the indirect tax structure and the problems it created in terms of multiplicity of levies and the resultant cascading effects received attention in the mid-1980s. Preliminary steps to reform the tax structure were taken in the form of introducing the modified value added tax (MODVAT). Tax reforms received a boost in the early 1990s under the structural adjustment programme initiated in the wake of the economic crisis of 1991. Since then, reforms in the tax structure, both direct and indirect, have been a continuous process.

### ***Phase I: 1947-1968***

In the post-independence era, taxation policy was geared towards achieving the economic objectives of promoting employment through grant of tax incentives to new investment; reducing inequality through progressive taxes on income and wealth; reducing pressure on balance of payments through increase of import duties; and stabilizing prices through tax rebate in excise duties on consumption goods. Given the narrow tax base, the tax policy relied more on indirect taxes. The first comprehensive attempt at reforming the tax system was by the Taxation Enquiry Commission (TEC)-1953-54 (Chairman: John Matthai). The first major official study on the incidence of direct and indirect taxation was brought out by the Matthai Commission. This was followed up by similar studies during 1961 and 1969 which employed derivatives of the original study. Shifting of corporate income tax incidence in India was studied by Lall (1967) and Laumas (1966). Major thrust was given on tax system. Taxation policy was geared to promote employment by providing incentives & tax holidays, reduce inequality of income through progressive taxation, reduce pressure on balance of payment through increase of import duty, stabilizing prices through tax rebate in excise duty on consumption goods, tax policy more relied on indirect tax.

### ***Phase II: 1969-1980***

During this phase, in addition to promoting economic growth, fiscal policy was also used as a means to reduce income inequality. Taxation was used as a prime instrument to achieve this objective during the initial years. To meet its objective of alleviating poverty and bringing about greater social justice, the Government raised the income tax rates to substantially high levels during the 1970s - marginal rate of taxation moved up to 97 per cent and, together with the incidence of wealth tax, crossed 100 per cent. Wealth tax, estate duty (on inherited wealth) and gift tax (on transfer of wealth) were imposed. Indirect taxes were hiked on goods considered luxuries or inessential.

### ***Phase III: 1981-90***

This phase began with a grim economic situation characterized by low economic growth, high inflation and deterioration in balance of payments due to sharp increase in prices of crude oil imports. The Government sought to

reduce its deficit through tax increases. New tax savings instruments were introduced to enable financing of the large plan expenditure. Tax concessions were also given to non-residents to encourage flow of foreign exchange remittances to address the balance of payments problem. Customs duties were hiked to contain growth in imports, augment revenue and protect the domestic industry. The Long-term Fiscal Policy announced by the Government of India in 1985 presented for the first time a long-term perspective for fiscal policy in which the Central Government recognized the deteriorating fiscal position as the most important challenge of the 1980s and set out specific targets and policies for achieving fiscal turnaround. It indicated a direction of change in tax policy required to promote growth, increase built-in elasticity of the tax system, secure better tax compliance and move towards a more equitable distribution of the burden of financing the Plan. A modified system of Value Added Tax (MODVAT) was introduced in 1986 in a phased manner to reduce the distortionary effect of tax on production, minimize tax cascading and increase progressively. Reforms in customs duty focused on increased reliance on tariff system rather than on quantitative restrictions to regulate imports in order to yield more revenue. This phase marked the first real effort towards a long-term perspective for tax reform, which in turn was spurred by the realization on the part of the policy makers that (a) the economic effects of taxation have to be considered to ensure against distortions in resource allocation and adverse effect on economic growth; (b) the administrative implications and the possible behavioral response of both tax administrators as well as tax payers have to be considered while designing the tax structure. Thus, considerable importance was given to the issue of tax evasion and the factors which determined

#### ***Phase IV:1991 onwards***

Tax reform efforts prior to 1991 focused on enhancing revenue productivity to finance large developmental plans and promoting equity. Tax reforms since 1991 were initially undertaken as a part of the structural reform process following the macroeconomic crisis of 1991 (Box 1). The reforms aimed at augmenting revenues and removing anomalies in the tax structure through restructuring, simplification and rationalization of both direct and indirect taxes drawing mainly from the recommendations of the Tax Reforms Committee 1991 (Chairman:Dr.Raja J. Chelliah). The key tax reforms include lowering the maximum marginal rate on personal income tax; widening of the tax base by way of a series of steps including introduction of presumptive taxes, adoption of a set of six (one-by-six) economic criteria for identification of potential tax payers in urban areas and taxation of services; reducing the corporate tax rate on both domestic and foreign companies; unification of tax rates on closely held as well as widely held domestic companies; rationalization of capital gains tax and dividend tax; progressive reduction in the peak rate of customs duty on non-agricultural products and rationalization of excise duties it.

### **III. Fiscal Reforms In India At Central Level**

Macro-economic imbalances characterized by high fiscal deficits and a growing revenue deficit continued to remain a major source of concern for the Government during the past few years. These concerns were compounded by the impact of the Gulf Crisis during 1990-91. Aggregate resources of the Central Government including internal and extra budgetary resources of Central Public Enterprises were estimated to increase by 15.0 percent in 1990-91. Aggregate disbursements, on the other hand, were estimated to increase by 9.4 per cent in 1990-91, thereby indicating some reduction in the relative side of the gap between income and expenditure of the Central Government. This also applied to the combined Budget Estimates (BE) of the Centre, States and Union Territories for 1990-91, which estimated a deficit of Rs. 8,999 crore compared with the Revised Estimates of Rs, 12,149 crore in 1989-90

The Annual Plan for 1990-91 provided for a total outlay of Rs. 64,717 crore for the Centre, State and Union Territories implying an increase of 12.4 per cent over that the terminal year of the Seventh Plan. The allocation for the Central Plan was Rs 39,329 crore. The Budget for 1990-91 laid stress on containment of the budget deficit through strict monitoring of Government expenditure and revenues. The Budget provided for a deficit of Rs 7,206 crore amounting to about 1.4 per cent of GDP as against the deficit of Rs 10,592 crore amounting to 2.4 percent of GDP in 1989-90.

***Long term fiscal policy was launched in coherence with 7th plan in 1985-1990 i.e. on 19th dec. 1985***

#### **Approach & Objectives of LFTP**

Restoring fiscal equilibrium  
Reforming tax structure  
Promoting socially desirable activities  
Market oriented development

#### **Steps taken in LFTP**

Stability in tax laws  
Simplification of income tax  
Reduction of secrecy in budget  
No change in personal income tax rates more than once in 5 year

Introduction of MODVAT  
Merging several excise duties into basic duty  
Abolition of surcharge on profits.

Performance of LFTP

Tax revenue was better  
Non tax revenue also performed better non plan expenditure was high  
Borrowings & budget deficit was high  
Contribution of public enterprise fell short  
Assistance to state & union territories was high  
Shows growing imbalance  
Govt. announced series of austerity measures i.e. rationalize major subsidies on exports, food, fertilizers, Curtailing plan & non-plan budgetary support to public enterprises, Improve tax compliance, Stop further accumulation of debt, Strategic investment in infrastructure and human resource, Look after weak & less privileged.

**Govt. of India constituted committee under chairmanship of Dr .Raja .J.Chelliah to examine structure of direct and indirect taxes through are solution on 29th aug. 1991**

Terms of reference of committee

- Methods of increasing revenue through direct & indirect tax
- Make tax system fairer
- Rationalization of tax system
- Identify new areas of taxation
- Improving compliance of direct & indirect tax & strengthening enforcement
- Simplification & rationalization of custom tariff & excise duty
- Scope of extending MODVAT
- Reducing tariff in order to promote international competitiveness

Major recommendation of Interim report

- Revision of income tax exemption of Rs28000
- Reduction of no. of income tax slabs
- Lowering tax rate with an entry rate of 20% & max. 40%
- Introduction of presumptive tax on small retail traders whose annual turnover is below Rs 5 lakhs
- Imposition of wealth tax of 1% of the value of non-financial asset exceeding the exemption limit of Rs 15 Lakh
- Allowance exempted from tax limit to 10% of salary
- Limiting rent free residential accommodation to 20% whose salary exceeds Rs 36000 to 20% or actual expenditure whichever is less
- Gradually switching to VAT to services & commodities
- Reduction of multiplicity of rates of excise duty to 3 rates (10,15,20)percent
- Selective excise duty on non- essential commodities or commodities injurious to health at higher rate of 30%, 40%, 50%
- Enlargement of tax base by including services like telephone, brokers non life insurance

Major recommendation of final report

- Revenue audit
- Improvement in tax administration
- Reduction of general level of tariff
- Simplification of tariff system
- Reform s in domestic indirect taxes

This all decision taken leads to decline in fiscal deficit from 8.4% to 5% , increase in tax revenue. However there was high current act deficit in balance of payment was needed to be reduced & promote export also Revenue shortfalls in indirect taxes & rise in public expenditure was seen. To overcome this subsidies were rationalized, zero based budgeting was used in finding out expenditure prioritization, focus on ongoing project rather starting new one. No. of initiatives were taken in 97 -97 budget to strengthen infrastructure & social sector

- IDFC was set up
- 200crore were provided in budget to NHA
- Social programme aimed for primary education, drinking water, health centre, mid-day meal, rural development
- Guarantee scheme to cover dues of PSU's , NTPC, Coal India

- NABARD share capital augmented Rs 500crores
- One page return saral was introduced
- Tax holiday given for industrial activity in backward area
- Small scale exemption limit enhanced 30-50-lakh
- Various budget focus on infrastructure, hr development, weak sections of society, modernization of traditional industries

**Fiscal Responsibility & budget management Act was introduced in lok Sabah in Dec2000**

- Main aim is to provide legal and institutional framework to eliminate revenue and fiscal deficit & stabilize debt
- Eliminate revenue deficit and fiscal deficit to not more than 2% of GDP within a period of 5 financial year
- Prohibit certain type of borrowing from RBI
- Within a period of 10 financial year total liabilities would not exceed 50% of GDP
- Measure to control non- plan expenditure

**IV. Fiscal Policy And Medium Term Fiscal Plan Analysis**

A noteworthy development in the fiscal area was the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 by the Government of India (GOI). Five State Governments, viz. Karnataka, Punjab, Kerala, Tamil Nadu and Uttar Pradesh have also enacted similar legislations. In addition, Maharashtra has introduced the fiscal legislation bill in its State Assembly. It is important to note that the structure and content of these legislations go beyond the conventional fiscal legislation, i.e., setting the ceiling on the fiscal indicators. The legislations included enforcement mechanism as well as the supporting institutional mechanism to enable the observance of fiscal prudence. Furthermore, the legislations have combined fiscal transparency and provisions of medium-term fiscal policy framework, which have significant implications for budget integrity and accountability.

The FRBM bill was passed by the Lok Sabha in May, 2003 and by the Rajya Sabha in August, 2003. The institutional arrangements are being envisaged to achieve sound fiscal management through elimination of revenue deficit, reduction in fiscal deficit and a phased decline in Center's borrowings from the RBI. The Government of India legislation has been enacted in terms of the conventional golden principles of fiscal legislation, viz., deficit rule, debt rule and borrowing rule, budget management, medium-term fiscal plan, and evaluation of fiscal performance. The Rules under the Act have been notified on July 5, 2004. It may be noted that the terminal year for the elimination of the revenue deficit has been extended to the year 2008-09 through an amendment to the FRBM Act 2003 carried out in July 2004.

**Fiscal Legislations at the State levels** Broadly akin to the Centre's fiscal legislation, the main focus of State legislations is the deficit reduction targets in terms of key deficit indicators, particularly, elimination of revenue deficit in the medium term. In addition, fiscal targets aim at reducing GFD. The targets in respect of GFD-GSDP ratio varies from 2 per cent (Kerala) to 3 per cent (Karnataka and Uttar Pradesh).

The **Karnataka Fiscal Responsibility Act, 2002** aims at reducing GFD/GSDP to 3 per cent and revenue deficit to 'nil' by 2006. The Act has also set limit on total liabilities at 25 per cent of GSDP by 2015 and on guarantees within prescribed ceiling under the Karnataka Government Guarantees Act. The Act also specifies budget management through medium-term fiscal Plan, compliance through half-yearly review and enhancement of transparency.

The **Kerala Fiscal Responsibility (KFR) Act, 2003** has set GFD target of 2 per cent of GSDP and 'nil' revenue deficit by 2007. Since the Kerala Ceiling on Government Guarantees Act provides for an upper limit on outstanding guarantees at Rs.14,000 crore, no separate provision on guarantees has been made in the KFR Act. The KFR Act also provides for setting up of the Public Expenditure Review Committee which would submit a review report explaining, inter alia, the reasons for deviation from the fiscal target during the previous year.

The **Punjab Fiscal Responsibility and Budget Management Act, 2003** contains the rate of growth of GFD to 2 per cent per annum in nominal terms till GFD is below 3 per cent of GSDP and stipulates reduction in the ratio of revenue deficit to revenue receipts by at least 5 percentage points each year until revenue balance is achieved. The Act also limits debt to 40 per cent of GSDP by 2007 and caps outstanding guarantees on long-term debt to 80 per cent of revenue receipts of the previous year and limits guarantees on short-term debt to borrowings in respect of working capital or food credit. The Act provides for Medium-term Fiscal Plan and quarterly review of performance and measures for fiscal transparency.

The **Tamil Nadu Fiscal Responsibility Act, 2003** aimed at containing GFD at 2.5 per cent of GSDP and the ratio of revenue deficit to revenue receipts at 5 per cent by 2007. The Act also caps outstanding guarantees at 100 per cent of the total revenue receipts in the preceding year or at 10 per cent of GSDP,



whichever is lower. In addition to Medium-term Fiscal Plan and measures for transparency, the Act also states that an independent external body would carry out periodic review for compliance. The Act has since been amended in 2004, wherein the terminal year for the target of reduction of revenue deficit to revenue receipts and fiscal deficit to GSDP has been deferred by a year to 2008. Further, the terminal target for fiscal deficit has been raised from 2.5 per cent to 3.0 per cent. The risk weighted guarantees have also been capped at 75 per cent of the total revenue receipts in the preceding year or at 7.5 per cent of GSDP, whichever is lower.

The **Uttar Pradesh Fiscal Responsibility Act, 2004** stipulates limiting GFD to a maximum of 3 per cent by 2009. Revenue deficit would decline to nil over the same period. Total liabilities would be capped at 25 per cent of GSDP by 2018.

The **Maharashtra Fiscal Responsibility and Budget Management Bill, 2002** specifies that the revenue expenditure shall not exceed revenue receipts after a period of five years from the appointed day. The expenditure would be adjusted as per the latest revenue estimates and the amount of risk due to guarantees would be contained within 1.5 per cent of the expected revenue receipts.

## V. Revenue Reforms And Their Implications

In 1950-51, gross central taxes accounted for 4.08 percent of GDP. With the widening and deepening of the tax net to raise resources for development projects, the percentage started increasing with every passing decade. It increased to 5.21 in 1960-61, to 7.02 in 1970-71 and stood at 9.17 in 1980-81.

In 1990-91, when the proves of economic reforms was initiated, gross central taxes accounted for 10.12 percent of GDP. However, as a result of tax reforms introduced since then, this percentage started falling and it became as low as 8.20 in 2001-02. Stating the reasons for this fall of more than 2 percentage points, the Twelfth Finance Commission noted, "The impact of these reforms on direct and indirect taxes was diametrically opposite. While the direct taxes showed, even with the lower rates, a rising tax-GDP ratio, this ratio for the indirect taxes kept sliding down. The indirect taxes had a larger share in the total tax revenues of the centre and the fall in the indirect tax to GDP ratio could not be compensated by a rise in the direct taxes. As a result, the overall central tax-GDP ratio fell."

In the wake of reforms initiated in early 1990s rates of both corporate and personal income tax were substantially reduced. Following better compliance, the decline in the relative share of direct taxes has been reversed. Direct taxes as a percentage of Center's total tax collection rose from 19.2 percent in 1990-91 (pre-reform period) to 34.7 percent in 1997-98. The figure stood at 47.9 percent in 2007-08.

### Main recommendations of the Task Force on Direct Taxes, 2002

At the time of presenting the first batch of supplementary demands for grants to Parliament in July 2002, the Finance Minister had proposed setting up of two task forces to recommend measures for simplification and rationalization of direct and indirect taxes. Accordingly, two task forces were set up in September 2002 under the chairmanship of Vijay Kelkar, Adviser to Minister of Finance and Company Affairs.

The Task Force on Direct Taxes presented its consultation paper to the Government on November 2, 2002. The discussion paper on indirect taxes was presented on November 25, 2002. These consultation papers were made public to facilitate an informed discussion on tax policy.

The main recommendations on direct taxes relate to rising of exemption limit of personal income tax, rationalization of exemptions, abolition of concessional treatment to long-term capital gains, and abolition of wealth tax. In respect of indirect taxes, the main recommendations relate to widening of the tax base, removal of exemptions, expansions, expansion in the coverage of service tax etc.

The Task Force on Direct Taxes was assigned the following Terms of Reference.

- Rationalization and simplification of the direct taxes with a view to minimizing exemptions, removing anomalies and improving equity;
- Improvement in taxpayer services so as to reduce compliance cost, impart transparency and facilitate voluntary compliance,
- Redesigning procedures for strengthening enforcement so as to improve compliance of direct tax laws; and
- Any other matter related to the above points.

**Personal Income Tax:** The Task Force recommended a two rate schedule for personal income tax.

Rate Structure of Personal Income tax Recommended by the Task Force on Direct Taxes

Income level	Tax rate
Below Rs 1,00,000	Nil
Rs 1,00,000-4,00,000	20 percent of the income in excess of Rs 1,00,000
Above Rs 4,00,000	Rs 60,000 plus 30 percent of the income in excess of Rs 4,00,000

It recommended the abolition of surcharge on income tax. It recommended that residents but not ordinarily residents must be subjected to tax on their global/world-wide income at par with residents. It recommended that standard deduction under section 16(1) of the Income Tax Act should be eliminated. However, the exemption of conveyance allowance subject to a ceiling of Rs 9,600 should be continued. It recommended the elimination of the tax incentives for savings under section 88, section 80L, section 10(15)(i), section 10(15)(iib), section 10(15)(iic), section 10(15) (iid), section 10(15) (iv)(h) section 10(15)(iv)(i) of the Income Tax Act. It insisted that these benefits must be immediately withdrawn and not through a sunset clause.

It recommended that the basic exemption limit for senior citizens should be Rs 50,000 more than the exemption limit for the general class of individual taxpayers. To put it differently, the exemption limit for senior citizens should be Rs 1, 50,000 as against Rs 1, 00,000 for the general category of individual taxpayers. It further recommended that the exemption limit for senior citizens should be revised as and when the exemption limit for the general category of individual taxpayers is revised. Still further, it recommended that this benefit of higher exemption limit should also be extended to widows.

**Corporate Tax reforms:** The Task Force on Direct Taxes made the following recommendations for the reform of corporate income tax:

- Reduction in corporate tax rate from the existing levels of 36.75 percent to 30 percent for domestic companies and to 35 percent for foreign companies.
- Exemption of dividend from taxation in the hand of the shareholders. There will also be no tax on distribution of dividends by a company.
- Exemption of long-term capital gains on listed equity.
- Elimination of Minimum Alternate Tax under section 115JB.
- Removal of the distinction between unabsorbed depreciation and unabsorbed business loss.
- Removal of the following deductions under section 10 and Chapter VIOA of the Income Tax Act with immediate effect and not be a sunset clause

**Capital Gains:** The Task Force on Direct Taxes recommended that concessional treatment of long-term capital gains through a reduced scheduler be aggregated with other incomes and subjected to taxation at the normal rates.

**Wealth Tax:** In view of the meager revenue and problems of administration and compliance, the Task Force recommended the abolition of wealth tax.

**Expenditure Tax:** The present tax on expenditure in hotels is in the nature of a consumption tax. It was introduced as a separate tax in the absence of a tax on services. Since tax on services has since been introduced, it is only appropriate that they levy is merged with the service tax

**Main Recommendations of the Task Force on Indirect Taxes, 2002**

As a Policy, multiplicity of levies must be reduced. Accordingly, it is recommended that there should be only three types of duties, viz. Basic customs duty, additional duty of customs (or countervailing duty) and anti-dumping (safeguard duties). All other duties should be removed.

Import Duty Structure Recommended by the Task Force on Indirect Taxes

0 percent	For items like life-saving drugs and equipments, sovereign imports (defence and security related goods) and imports by RBI.
For other goods by 2004-05	10 percent for raw materials, inputs and intermediate goods. 20 percent for consumer durables.
By 2006-07	5 percent for basic raw materials like coal, ores and concentrates, xylems etc. 8 percent for intermediate goods which will be used for future manufacture (capital goods, basic chemicals, metals etc). 10 percent for finished goods other than consumer durables. 20 percent for consumer durables.

As regards customs exemptions, the Task Force on Indirect Taxes recommended, "As a policy, all exemptions must be removed except in case of:

- Life-saving goods.
- Goods of security and strategic interest.
- Goods for relief and charitable purposes.

- International obligations including contracts.”

**Excise Duties:** The Task Force on Indirect Taxes recommended the following excise duty structure.

Excise Duty Structure Recommended by the Task Force on Indirect Taxes

0 percent	For life-saving drugs and equipments, security items, food items, necessities and the like, and agricultural products
6 percent	For processed food products and matches.
14 percent	Standard rate for all items not mentioned against other rates.
20 percent	For motor vehicles, air-conditioners and accreted water
Separate rates for tobacco products and their substitutes (like pan masala)	

As regards duty exemption for the small scale sector, the Task Force on Indirect Taxes recommended Duty exemption should be extended to only small units with a turnover of Rs 50 lakh.

Duty exemption limit for the larger SIS units should be gradually brought down to Rs 50 lakh as per the following time frame: from Rs 100 lakh to Rs 75 lakh by the year 2004-05 and from Rs 75 lakh to Rs 50 lakh by the year 2005-06.

**.Value Added Tax (VAT):** The Task Force on Indirect Taxes unanimously acknowledged that VAT is a major reform in the indirect tax system of India. For a smooth and speedy implementation of VAT at the level of Centre and States. The introduction of VAT should be on the basis of floor rather than uniform rates to avoid loss of revenue, preserve tax autonomy, and minimize need for compensation. Eliminating the tax on inter-state exports should be done regardless of VAT introduction; Taxation of services should be transferred to the states, and integrated with the VAT.

## VI. Expenditure Management In India

Public expenditure in India assumed significance in the context of the mixed economy model adopted since Independence whereby the primary responsibility of building the capital and infrastructural base rested with the Government. The concerns regarding equity and poverty alleviation, particularly since the 1970s, added another important dimension to public expenditure in terms of redistribution of resources. The inadequate returns on the huge capital outlays over the years as well as the macroeconomic crisis of 1991 stemming from high fiscal imbalances led to a shift in the focus from mere size to efficiency in public expenditure management so as to facilitate adequate returns and restore macroeconomic stability. The cutbacks in capital outlay undertaken as part of the expenditure management in the first half of the 1990s, however, raised concerns over the inadequate infrastructural investment and the repercussions on the long-term growth potential. The upward movement in Government's revenue expenditure was partly responsible for fiscal deterioration which set in during the latter half of 1990s. With a renewed commitment towards fiscal consolidation since 2003-04, re-prioritization of expenditure and emphasis of outcomes rather than outlays are the guiding principles of public expenditure management.

Apart from the emphasis on undertaking large-scale capital outlay, expenditure policy was also geared towards promotion of equity and social justice through public expenditure on social welfare and poverty alleviation schemes. Rural development received special attention in terms of larger outlays and directed lending by the newly nationalized banks. Several employment schemes were inaugurated and small-scale industry, which was touted to promote employment, was given special privileges. Exchange control and industrial licensing were tightened during this period. Strong fiscal measures were taken to reign in inflation during 1974-76

### Public Expenditure commission 1979

Appointed by Shri Charan Singh the deputy PM and FM in 16 Mar 1979 in lok sabha

#### Committee has following terms

- Identify overlapping function between state & central govt. & rationalizing it.
- Containing expenditure on staff within reasonable limits
- Review of existing arrangement for planning, executing, monitoring, & evaluation of major projects & program.
- Review arrangement of sanctioning & controlling expenditure. & suggest how they can improved
- Downsizing govt. abolishing secretary level post in 1april 1999

### **Restructuring of Government expenditure Suggested by the Eleventh Finance Commission**

The Eleventh Finance Commission examined at length the pattern of public expenditure at the level of Central and State Governments and made a number of suggestions to rationalize it in order to control budgetary deficits. It observed, “Alongside revenue augmentation, restructuring of public finances will require structural changes on the expenditure side as well. While the thrust should be on compression, the composition of expenditure would need to be restricted in favor of priority sectors like elementary education, primary health



care, water supply, sanitation, roads and bridges and other infrastructure. Items that would require a tight rein are salary and pensions, interest payments and subsidies. There has to be a radical changes in the method of financing the plan expenditure as well.

### **Restructuring of Government Expenditures suggested by the Twelfth Finance Commission**

After examining in detail the structure of expenditure at the levels of Central and State Governments, the Twelfth Finance Commission recommended its restructuring on the following lines. "In restructuring expenditures, there is need to make reference to the basic objectives of government intervention in economic activities, as also to the basic objectives for assignment of responsibilities as between central and sub-national governments. It is also important to relate government expenditures to outcome in terms of the quality, reach, and impact of government services. This would be facilitated if governments focus more on their primary responsibilities rather than spreading resources thinly in many areas where the private sector can provide the necessary services. The primary role of government is to provide public goods like defence, law and order, and general administration. The role of governments extended to merit goods and services with large positive externalities like education and health. The services should be assigned to the central government if the scope of public goods is nation-wide like defence. The services get assigned to state governments if the scope of the public good is limited regions or if externalities are more local in character like the health services. There is a felt need to examine whether the central government is not partaking in many responsibilities that legitimately belong to the domain of the states. To conclude expenditure reforms in the context of liberalization have two aspects (a) consolidation so as to reduce the quantum of expenditure and (b) restructuring with a view to changing the composition of government expenditure, i.e. shift towards growth-inducing expenditure on infrastructure and human resource development and reduction in unwarranted subsidies.

A successful expenditure control policy should include the following : (a) subjecting all ongoing schemes to zero-based budgeting, (b) assessment of manpower requirements of government departments, (c) review of all subsidies, (d) introducing cost-based user charges wherever possible, (e) review of budgetary support to autonomous institutions, and (f) greater commercialization of the operations of public sector enterprises

## **VII. Debt Reforms In India**

Public debt is a method by which governments obtain money. Public debts are incurred through public loans. A loan may be either voluntary or compulsory. A government may raise loans either internally or externally. Clearly, external loans are voluntary in nature. Public loans may be for short, medium or long period. Short-term loans are also known as floating debt. Long term loans are also called funded debt. Debt requirements of a government may be classified on the basis of purpose also. A government may resort to borrowings for productive or unproductive purposes. **Rationale for Government Borrowings** -Long-term borrowing by a government are justified when the benefits of a capital project undertaken by it are likely to be reaped over a long period of time, i.e. by more than one generation of taxpayers. The financing of such projects should place the repayment burden on the present as well as future generations. If long-term capital projects are financed out of current revenues and/or short-term borrowings, the future generations would enjoy free riding. Thus, it is both fair and efficient that projects with long-term benefits are financed through long-term borrowings

### **Constitutional Provisions Pertaining to Public Borrowings in India**

Under Article 292 the executive power of the centre extends to borrowing, either within or outside India, upon the security of the Consolidated Fund of India, within such limits, if any, as may from time to time be fixed by Parliament/ However, the borrowing power of a State (Article 293) is subject to a number of restrictions: (i) it cannot borrow outside India; (ii) it can borrow within the territory of India subject to the following conditions (a) limitations as may be imposed by the State Legislature, (b) consent of the Union Government to raise fresh loan if the Union has guaranteed an outstanding loan of the State, (c) consent of the Union to raise fresh loan if a Union loan to the State remains outstanding. Since all the States are in debt to the Centre, they have to obtain Center's permission for raising loans

### **Instruments of Government Borrowings in India**

The Government of India borrows heavily both internally and externally. Internal borrowings of the Government are chiefly meant to meet budgetary deficit. External borrowings are meant to meet deficit in the balance of payments.

The main sources of internal borrowings are: individuals, commercial banks, financial institutions and the Reserve Bank of India. Borrowings from the RBI are through ways and means advances (WMA).

Another important instrument of Government borrowing is the Statutory Liquidity Ratio (SLR). Under this system, commercial banks and other financial institutions are required to invest prescribed proportions of their assets/liabilities in Government securities. The Committee on Financial Reforms (Chairman: M Narasimhan) 1991 had suggested the gradual lowering of this ratio to 25 percent. Government also raises loans from the general public through regular flotation of securities and bonds like Kisan Vikas Patras and various other small saving schemes.

The major sources of external borrowings are the international agencies like the IMF and the World Bank, foreign governments, and foreign private sources. Short-term borrowings from abroad are mainly used to meet balance of payments requirements. Long-term foreign borrowings are needed to finance development projects under the Five Year Plans.

#### States' Indebtedness

The mounting debt and debt-servicing liabilities of the States have attracted considerable attention in recent years. The non-Plan revenue gap of the States is looked after by the Finance Commission while the Planning Commission takes care of the Plan gap, both on revenue and capital accounts. Another reason for the high and growing indebtedness of the States is the composition of Central assistance for Plans given under the Gadgil Formula. The existing pattern of assistance has a loan-grant ratio of 70:30. The problem of States indebtedness is not new though it has aggravated in recent years. Debt-related relief to the States may be provided in various forms, viz. Write-offs, rescheduling of the loans with a view to shifting the timing of repayments, consolidation of past loans on common terms, and reduction of interest rate. The Second Finance Commission was asked to examine this problem and make suitable recommendations to reduce States debt burden. The Commission recommended, inter alia, the postponement of repayments but it did not help to tackle the problem on a long-term basis. The matter was again referred to the Fourth Finance Commission which expressed its inability to make a thorough investigation of the problem and suggest lasting solutions in a short period of time at its disposal. Fifth Finance Commission recommended that the Central Government should repay the amount of States unauthorized overdrafts to their Reserve Bank of India by adjusting the amount against the grants payable to the concerned States. Sixth Finance Commission recommended moratorium on the repayment of certain Central loans and writing off a few old loans of small amount. The Eighth and the Ninth Finance Commissions recommended debt relief of Rs 2,285 crore (for the period 1984-89) and Rs 494 crore (for the period 1990-95) respectively.

The Tenth Finance Commission noted the following disturbing features of the debt profile of States and its management, "(i) diversion of borrowed funds for meeting revenue expenditure, (ii) use of loans in unproductive enterprises, or enterprises which are potentially productive but are beset by poor performance, and currently yielding low or even negative returns, (iii) non-provision for depreciation or amortization funds

#### **Recent Trends in Central Government Liabilities**

India's internal and external debt has reached alarming proportions. The country is virtually caught in a debt trap. Moreover, the budgets of Central and State Governments are showing huge deficits of chronic nature. The fiscal policy has failed to contain budgetary deficits with the result that deficit financing has to be resorted to on a large scale. Had the debt servicing burden been contained, there could have been larger amount of resources spared for sectors of the economy

#### **12th finance comm. Recommendation**

- Debt swap scheme
- Define borrowing limits of states
- Debt restructuring programmes for the state
- Enactment of fiscal responsibility legislation
- FRBM act 2003 enactment
- Prioritizing ECB
- LIBOR based ceilings on int. rate
- Control on short term debts
- Retiring/restructuring, of more expensive external debt
- Incentives & schemes to promote export
- Build up foreign exchange reserve to provide effective insurance against external sector uncertainties

To conclude, the empirical studies on issues pertaining to public debt in India received considerable attention in the post-1991 period. The various dimensions of government debt analysed included studies on the methodology and estimation of public debt of the country and the issue of solvency and sustainability of the public debt.

### VIII. Conclusion & Suggestions

In India, fiscal policy has played a pivotal role since independence, contributing significantly to the socio-economic development process of the country. Reflecting this, a large, growing and erudite body of literature has emerged over the years.

Over the years, various instruments of fiscal policy *viz.*, taxation, public expenditure and public borrowings have been employed, with varying degrees of importance, to achieve higher economic growth and stability, efficient resource allocation and equitable distribution of income. Furthermore, in India, as in many developing countries, fiscal policy does not operate in isolation as it has close macroeconomic linkages with real, monetary and external sectors. Thus, the macroeconomic impact of fiscal policy is critical for achieving the broader economic goals. Indian public finance today has reached a turning point. The future course of public finance would critically hinge upon the following developments. First, fiscal policy can be a powerful tool for accelerating growth, provided resources are raised efficiently without causing distortions and utilised for delivering public goods and services, including physical and social infrastructure and helping the underprivileged. Total government expenditure as proportion of GDP needs to be maintained, and raised at the State level, in order to ensure the maintenance of existing infrastructural facilities and create new ones. This calls for a change in the composition of expenditure. Second, adherence to fiscal legislation, both at Centre and State level, is critical for macroeconomic, financial, external sector and budgetary sustainability. Third, fiscal empowerment *i.e.*, expanding the scope and size of revenue flows into the budget, through tax reforms appropriate user charges and restructuring of public sector undertakings assumes critical importance. Fourth, as the Indian economy becomes more open and integrated with the rest of the world, fiscal policy would have to face greater challenges. Fifth, the approach to fiscal federalism, both in terms of addressing the vertical and horizontal imbalances, would have to focus on institutional reforms which align needs with revenue capacities. Sixth, the changing demographic profile would make designing an appropriate fiscal policy more complex

### IX. Suggestions:

- The Central Assistance to State Plans should increasingly take the form of project-specific assistance. The existing schemes like the Accelerated Irrigation Benefit Programme (AIBP) and Rural Infrastructure Development Fund (RIDF) administered by NABARD may be made more effective. To enhance the scope of project-based assistance, another fund might be created for providing assistance for infrastructure other than irrigation, particularly roads, bridges and power projects.
- Allocation from non-lapsable funds for North-Eastern States should be accounted as part of the State Plans. This will give a boost to States' Plan size to which they attach a lot of political importance.
- States should be encouraged to utilize more of the external assistance.
- Another fund might be created for providing assistance for infrastructure particularly for roads, bridges, power projects
- Allocation from non-lapsable funds for North Eastern states should be accounted as part of state plans. This will boost plan size to which they attach a lot of political importance
- States should be encouraged to utilize more of external assistance especially to help weaker states
- Today there is both need & scope to raise resources through levying reasonable electricity tariffs & irrigation
- Tax competition among states to attract private investments should be stop as its harmful for states, decreases tax revenue
- Extension of guarantee to the borrowings of state-level public enterprise is adversely affecting the credibility of states and their credit ratings.
- There is a urgent need for genuine devolution of political, administrative and financial powers to panchayati raj institutions.
- Innovative & bold decision which marks a complete break with existing mind set in present way of doing things is required
- Successful implementation of medium term reform programme by the states would put country firmly on the path of sustained and equitable growth
- State must augment their tax and non tax revenues
- Non tax revenue can be substantially increased by revision of user charge on public services
- Control fast growing subsidized
- Non tax revenue can be increased by cutting implicit subsidies on variety of economic & social services of a non merit nature through appropriate user charges are substantial Dire need of stopping populist measures rather govt. should improve and implement prudent measures

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