

## Outlook

2.52 Despite significant progress on tax front encompassing reduction and rationalisation of duty rates, the tax base continues to be narrow and porous. The rates remain saddled with numerous exemptions which affect efficacy of tax administration. Direct taxes which have been lowered to internationally comparable levels are beset with exemptions, allowances, deductions and incentives to achieve a variety of social and economic objectives. Customs tariff remain high in comparison to rates prevailing in East Asian Countries. Considerable progress has been made in restructuring central excise system. A major medium term challenge remains coordinating CENVAT with the State level VAT. At the same time progress of VAT among states have to be harmonised to avoid inter state tax disputes. Service sector has been one of the fastest growing sectors of the national economy, but largely remains untaxed. To raise tax/GDP ratio it would be imperative to widen the scope of service taxes.

2.53 Expenditure needs to be restructured with focus on quality. However, the task of expenditure restructuring is constrained by preponderance of contractual or committed nature of expenditure which includes interest payments, pensions, wages and salaries, statutory transfers to state etc. In recent years efforts have been made to restrain growth in expenditure on subsidies. Subsidies need to be better targeted, transparent, for finite duration and should serve strict economic objectives. During the current year some incipient signs of improvement in Central Public finances are

discernible. Tax collections have been better and growth in expenditure lower compared to the last year.

2.54 The upward trend in combined (Centre & States) fiscal deficit to GDP ratio in recent years needs to be reversed. This has led to accumulation of public debt which ultimately leads to high interest rates, adversely affects private investments, increases servicing cost of public debt which crowds out not only public investment but also social expenditures leading to lower growth. This is an outcome which is untenable. The current primary balance (*i.e.* GFD net of interest outgo) which is in the negative has to be reduced and eventually transformed into a surplus. The combination of nominal growth rate being higher than nominal interest rate, provides a leverage for debt sustainability.

2.55 The introduction of Fiscal Responsibility and Budget Management Bill, 2000 in Lok Sabha in December, 2000 is a historic step in our fiscal history. It shifts the emphasis of fiscal management from a purely short term perspective to a longer time horizon for conduct of prudent and accountable fiscal policy. Introduction of rule based budget management practices will also enable the economic agents and the community at large to take informed decisions. Besides, its enactment is likely to be seen as a demonstration of our country's resolve to maintaining macro economic stability. Placing limits on the Central Government borrowings, debt and deficits and emphasising greater transparency in fiscal operations would also greatly facilitate effective conduct of monetary policy.