Outlook

2.66 Significant improvement has been effected over time in the Union tax structure, but much needs to be done in the domain of domestic commodity taxation and import tariffs. A comprehensive CENVAT that allows full credit for all inputs with a few duty rates may adversely affect revenue in the short-run but may be considered necessary in the interest of eliminating distortions. Reduction of customs tariffs must be persevered with to bring them to internationally comparable levels for increased competition and global integration. Removal of multiple and complex exemptions can go a long way in improving revenue buoyancy in the indirect taxes. Besides, it is imperative to expand the ambit of tax on domestic goods to include the services sector as well. Introduction of a broad based VAT by April 2003 is a significant step towards reforming domestic trade taxes. However, the issue of taxation of inter-state trade under State level VAT has to be addressed, otherwise VAT will remain primarily on intra-state trade. On the direct tax front, income tax and corporate tax rates have been brought down to internationally comparable levels. However, the Income Tax Act continues to be beset with tax concessions which manifest in the form of full or partial exemptions, deductions and tax holidays etc. Since the marginal tax rates have been reduced over the years it would be imperative to expand the tax base by plugging the loopholes. Tax incentives by their very nature represent a revenue cost for the Government. Besides, tax incentives introduce complexity and element of discretion into the tax system. They only impose greater taxpayer compliance burden and administrative costs.

2.67 One central feature of the Central Government finances during the 1990s has been the decline in both the share of taxes and expenditure in the GDP. The latter has been brought about through compression in capital expenditure rather than revenue component of expenditure. The erosion in tax-to-GDP ratio has to some extent prevented fiscal adjustment on a sustained basis. Therefore, erosion in tax-GDP ratio needs to be reversed. The potential for increase in tax GDP ratio does exist. This is reflected in a rising share of non-agriculture GDP which augurs well for a higher overall tax-GDP ratio. Besides, resumption in overall growth and particularly industrial growth in future is likely to bring in higher corporate tax collections and excise revenues. Also a concerted effort would be required to tax untapped potential of direct taxes through improvement in direct tax administration by focussing on measures to foster increased compliance and widespread computerisation. Despite the growing share of services in GDP only a small fraction is captured under the tax net. To augment tax-GDP ratio it is essential to move away from selective approach to a comprehensive approach in the domain of service taxation.

2.68 The trends in the Central Government finances during the current year show considerable slippage on the revenue side due to the slowdown in the economy and industry in particular. Government has responded to slowdown by cutting down the tax rates in both the direct and indirect taxes. The slower economic growth not only leads to revenue shortfalls but also puts pressure for fiscal stimulus. As a deliberate policy, the Government has avoided cutting or compressing capital expenditure. In the backdrop of economic slowdown, the issue of quality rather than quantum in fiscal adjustment assumes importance. Higher Government spending with low capital expenditure content may not translate into much needed higher aggregate demand to stimulate the economy. A major feature of the inter-temporal profile of Government expenditure has been the erosion of capital expenditure. Capital expenditure, which has been crowded out in both Central and State Government budgets needs to be restored by budgetary allocation and higher Internal and Extra Budgetary funding . As a result we are not investing enough for future. Further, such expenditure would have to be in growth augmenting infrastructure sectors. Government investment and reforms should focus on leveraging private sector participation in these sectors rather than for furthering the objective of ownership. Besides, the composition of revenue expenditure has to shift to socal sectors like education and health.