Outlook

2.61 Fiscal consolidation is a critical component of economic reforms programme for two main reasons. First, it has a direct bearing on economic growth by improving the quality of Government expenditure with higher outlays on infrastructure and social sectors. Second, it reduces pre-emption of private savings by the Government and creates more space for the private sector, thus indirectly promoting growth. The deterioration in the fiscal situation since 1997-98 has not resulted in any fiscal crisis so far because of the relative stability of the revenues, an increase in the average maturity period of Central Government loans, a low proportion of external debt to total debt, high credibility of the Government's fiscal consolidation plans and the subdued demand for non-food credit in recent years. While the reduction in interest rates has helped at the margin, its effect in terms of reduction in the average cost of Government debt is yet to be felt. For this to happen, interest rates should remain at a lower level for a number of years. With fiscal deficit remaining high and signs of a pick up in the flow of credit to the commercial sector, the possibility of interest rates moving northwards cannot be ruled out. Government has taken a number of initiatives as discussed above to address the problem. These initiatives, however, need to be stepped up. While reforms can be designed better when the economy is doing well and there is no crisis, mobilising popular support for such reforms is a challenge in the absence of an impending crisis. Though the growth of the Indian economy has improved from an average of 2.9 per cent in the seventies to 5.8 per cent in the nineties, the per capita income in India remains very low in comparison with a number of East Asian countries, particularly China, which had the same level of per capita income as India in the seventies. To achieve the targeted annual average growth of 8 per cent, the Tenth Five-Year Plan envisaged an acceleration in the investment rate from 24.4 per cent in the base year to 32.3 per cent in 2006-07, the terminal year of the Plan. Of the 7.9 percentage point increase in the investment rate envisaged in the Plan, 2.6 percentage increase would have to come from the public sector. Without fiscal consolidation, such a step up in public investment cannot be attained.

2.62 In the process of fiscal consolidation, with a low tax-GDP ratio, tax revenue augmentation should be the prime concern. The Kelkar Task Force has outlined the road map for re-engineering business processes in both direct and indirect taxes. A number of measures have been taken in pursuance of this and a lot more remains to be done. There is a clear need to overhaul the regime of exemptions, reduce the number of notifications, simplify procedures and move towards a paper-less and transparent administration, anchored on trust. It is equally important to establish a rigorous penal and enforcement mechanism that takes care of those who violate the trust imposed, as is the practice in countries with low rates, simple tax laws and procedures. The crux of business process re-engineering of tax administration lies in moving from the present officer based assessment to a system of self-assessment, random validation and enforcement. This process is likely to be hindered by the presence of large-scale evasion-prone cash transactions. Innovative tax laws and procedures need to be evolved in consultation with major stake holders and a strict penal mechanism put in place.

2.63 The enactment of the FRBM Act provides an institutional framework and binds the Government to adopt prudent fiscal policies. As the economy is doing well now, the adjustments required to eliminate revenue deficit by March, 2008, as stipulated in the Act need to be front loaded. The limitation of the FRBM Act is that it applies only to the Central Government. Fiscal consolidation remains incomplete without the involvement of States. The burden of fiscal adjustment has to be borne both by the Centre and the States. Though a few States have enacted fiscal responsibility legislation, the majority of States are yet to follow suit. There is greater need to involve all the States to effect overall fiscal consolidation and strengthen the growth momentum with macroeconomic stability.