

Outlook

2.69 Fiscal consolidation has remained intractable despite initiatives of successive budgets at reducing deficits, primarily because of lack of accountability in fiscal marksmanship. One of the major factors that necessitated Parliamentary scrutiny of fiscal responsibility through a legislative framework was the fact that in a business-as-usual scenario, fiscal marksmanship would, in view of the large pressures for funds in an emerging economy, is seldom achieved without institutional accountability. The outlook on the fiscal front very much depends on how the credibility of the budgetary process is enhanced. In the medium term, adherence to FRBM targets, given the limitations of expenditure compression, critically hinges upon the success in raising the tax-GDP ratio. The continuance of the growth momentum witnessed in manufacturing and services and deepening of the tax reforms are likely to facilitate this process and thereby help reinforce growth with macroeconomic stability through fiscal consolidation.

2.70 The current year marks the beginning of fiscal adjustment mandated under the FRBM Act. The medium-term fiscal adjustment requires a quantum jump in tax revenues. The Budget for 2004-05 aims at an ambitious front-loaded reduction in revenue and fiscal deficit, beyond the mandated minimum reductions. The fiscal adjustment path shown by the Kelkar Task Force is primarily revenue-led. The Kelkar Task Force has arrived at the balance required under the FRBM Act in 2008-09 through progressive increases in the tax-GDP ratio from 9.2 per cent in 2003-04 (Prov.) to 13.17 per cent in 2008-09. Given the near stagnant tax-GDP ratio in the last few years due to tax restructuring, the task appears daunting, but not impossible. Sustaining the reform process in tax and expenditure regimes is a sine quo non for achieving the targets set under the FRBM Act. The tax base needs to be widened through increase in the share of services in tax revenues, removal of exemptions that do not conform to the established principles of tax policy, and an enforcement mechanism that is non-discretionary, transparent and effective. The

present tax system needs to be further simplified and streamlined. The higher tax revenues have to be realised not through increasing tax rates, but through innovative changes in policies, procedures, laws and dispute settlement mechanism that help overcome the problems associated with the present complex system. Fiscal consolidation cannot be sustained without the active involvement of States, which account for about 39 per cent and 56 per cent of combined revenue receipts and expenditure, respectively. Fiscal reforms at the Centre and States should be complementary. In this context, harmonization of fiscal reforms at the Centre and States assumes critical importance. The TFC has provided a firm basis for such harmonization through linking debt relief for States to fiscal consolidation through FRBM type legislation. While the consensus reached for the proposed introduction of State-level VAT is a welcome step in the move towards harmonizing tax structures across States, establishing a national common market for goods and services for the country as a whole would require carrying forward this process of co-ordination.

2.71 The fiscal adjustment envisaged under the FRBM Act also is critically dependent on sustaining expenditure reforms through containing unproductive expenditure. While it is essential to increase the level of expenditure in social sectors and in building productive capacity in the economy, it is equally important to transform the outlays into better outcomes. The way forward is in fulfilling the NCMP objective of targeting subsidies sharply at the poor, carrying on with pension reforms, maintaining a benign interest regime through lower Government borrowings, effecting a shift in the composition of expenditures in favour of Plan capital expenditure, and reforms in public service delivery. Capacity development of the civil society organisations and civil service reforms, which facilitate a paradigm shift in public service delivery from the current hierarchical model to a more participatory one, are the demand and supply side governance pre-requisites for converting the enhanced outlays into sustained developmental outcomes.