

**India's Fiscal Matters by Parthasarathi Shome, Oxford University Press, New Delhi, 2002, pages 260, Price Rs. 495**

The fiscal situation across a wide spectrum of countries poses formidable challenges in public policy making. The way the author has handled these challenges marks his wide experience in this area. The author relies on his analysis of cross-country experience to identify the issues and address them in the Indian context. The book highlights that the prevailing issues and emerging challenges for the fiscal policy in India demand a medium-term fiscal strategy. An efficient and implementable system of taxes, a rational and affordable level of expenditure, role of public and private sectors in economic activities, and an appropriate level of decentralisation should be the essential elements of the medium-term fiscal strategy. The appropriate fiscal strategy would help to move an economy like India towards a higher growth path without high inflation or inter-generational transfers of the burden of public debt.

The book under review attempts to provide inputs in developing a comprehensive medium-term fiscal strategy for India. With the objective of charting out the strategy, it reviews the fiscal performance of the Indian economy during the 1990s when liberalisation of the economy essentially began. While some initial improvement in fiscal health, particularly for the Centre took place, size of the gross fiscal deficit especially from 1997-98 has become difficult to contain both at the Centre as well as State level. The significant growth in expenditure was not matched by similar growth in revenues. Revenue expenditure like interest payments, pensions, wages and salaries triggered the growth in expenditure. On the other hand, capital expenditure registered a marked decline, having adverse implications for the growth process of the economy. Overall, worsening of the combined fiscal position of Centre and State Governments has resulted in voluminous debt and debt service obligations.

The book tries to ascertain the optimal degree of fiscal decentralisation for India in the light of international experience. The theoretical developments on fiscal decentralisation underline its usefulness in optimal utilisation of resources through enhanced local participation in decision making. However, the opposing views point towards lack of efficiency and equity whereby decentralisation could lead to problems in macro-economic management. Issues like corruption and fiscal transparency and their association with fiscal decentralisation are also discussed at length. The international experiences, particularly of Argentina and Brazil reveal that broad based revenue productive taxes such as income and consumption taxes are usually subject to revenue sharing. As revenue share from shared taxes has tended to increase for lower level of governments, federal governments have devised non-sharable taxes that are often inefficient such as tax on financial transactions that appears to have become increasingly popular in Latin America. Besides, there has been hardly any specific rule on distribution of tax revenue, and changes have usually favoured lower level government shares mainly in support of further decentralisation. While rules have to be clear and simple with a minimum of objectives, experience shows that even that is not sufficient if different tiers of government cannot be persuaded to carry out their responsibility adequately. In this connection, only cooperative not competitive federalism will ultimately achieve the desired results in terms of efficient economic growth, fiscal consolidation and equitable vertical and horizontal distribution.

The book provides a comprehensive historical perspective on Indian fiscal arrangements at the local level from the early 20<sup>th</sup> century right up to the 73rd and 74th amendments to the Constitution, empowering the local governments. It is felt that there is a need to give more taxing power/tax bases, in view of the want for development of social and economic

infrastructure at the lower tiers of governments. Further, these governments should make efforts towards setting their tax structure broad-based and efficient in tax collections with user charges and emphasis on productive expenditure. The empirical tests for India cited in the book conclude that decentralisation of expenditure is supportive of higher growth and lower fiscal deficit. It is indicated that decentralised expenditure responsibilities can improve growth and fiscal performance so long as resource availability is ensured at lower level of government.

The book assesses various measures initiated for improvement in revenue performance during the 1990s, particularly with reference to the Central taxes: reduction in individual and corporate income tax rate, scaling back of custom duties, and rationalisation of excise tax structure. The focus of the on-going tax reform remained on simplification and rationalisation of both direct and indirect taxes. However, the measures have not been accompanied, by and large, by expansions in the tax base. The existing tax incentives in income taxes, exemptions in indirect taxes and omission of a feasible expansion of the tax base through taxation of consumption of services have continued. The various exemptions have also affected the quality of tax administration and revenue performance. For a couple of decades, services sector has grown rapidly and now represent more than half of the GDP. In view of its increasing role in GDP, the taxation of service sector assumes importance. It is imperative to introduce comprehensive taxation of services at the Central level and the selected services should also be seriously considered for appropriate assignment for taxation to the States and local bodies. On taxation of services, India can draw important lessons from Brazil, which was one of the first country to introduce a comprehensive Value added tax (VAT) on both goods and services in the mid-1960s.

In order to enhance the revenue performance, tax reforms have also assumed importance at State level. States have made various efforts to enhance their revenues over the last decade. The taxation policy of many States has been gradually rationalised to make the tax structure simpler, transparent and easy for compliance, and to render support to both trade and industry. It was recognised that competitive sales tax reductions by States aimed at attracting investments had led to revenue losses without commensurate gains. It is in this context, the book has discussed at length the applicability of VAT in India. The VAT has become popular across the world. More than 100 countries have introduced VAT though most of them have introduced at the level of Central government as has been the case with India. The introduction of VAT at the Central level is not as much challenging as at the State level. Brazil and Canada have introduced VAT even at the State level, while Argentina and India are in the process of doing the same. In India, preparations for a State level VAT have been going on since the early 1990s. Some States have already made efforts to introduce VAT, covering a few items. Recently, with a view to harmonising the inter-state taxes and ultimately switching over to State level VAT, States have introduced uniform floor rates for different groups of taxable commodities during 2000. Currently, preparations are underway for introduction of VAT at the State level as envisaged in the Union Budget, 2003-04. Once introduced, it is expected to increase revenue buoyancy, as the coverage expands to value addition at all stages of production and distribution chain. The issues and challenges ahead in introducing the VAT also assume importance. First, given the floor rates agreed to by the States, it would be difficult to design a VAT that is single rated or even double rated, by any particular State. Thus, there is a need to come to an agreement regarding new floor rates in case any particular State introduces a VAT before others. Secondly, when States introduce a comprehensive VAT, the treatment of inter-state trade under such a VAT has to be resolved and revenue compensation to losing States needs to be considered.

Overall, in view of the sluggish growth in revenue, a broad tax base needs to be developed. Having a broad tax base enables lower average tax rate for generating the same tax revenue. Emphasis should be given to minimise the exemptions from the VAT, deductions from the individual income tax and other incentives given to boost some economic activities like exports. Further, there is a need to maintain a close link between tax policy formulation and tax administration practices. The strategies focusing on rationalisation of tax rates, better tax compliance, improved efficiency in tax administration and review of tax exemptions/incentives would be helpful in improving the revenue performance.

The book has emphasized the importance of fiscal transparency and suggested that proper economic management should be based on a clear fiscal framework, which needs to be developed. In the case of India, though the Five Year Plans do provide a broad framework for conduct of fiscal policy, the medium-term macroeconomic forecasts are rarely used for fiscal policy planning and budgeting. Countries such as Argentina and Brazil have drawn up guidelines for fiscal responsibility in line with the IMF guidelines.

It may be concluded that the book is very timely and pertinent to Indian fiscal affairs. The issues of tax administration, expansion of tax base through more services in tax net, introduction of transparency in fiscal matters and channelisation of expenditure along productive lines are well recognised. Several measures have already been initiated in India during 1990s covering most of these areas. Further, the book provides very useful insights on the optimal level of fiscal decentralisation for India. The discussion on VAT is very relevant and will provide valuable inputs to the policy makers in India to facilitate the smooth implementation of VAT at State level. However, issues like rigidities in bringing expenditure to a lower level or in channelising it towards productive lines apart from sustainability of public debt, which continue to pose problems for the on-going process of fiscal consolidation could have been addressed adequately. Nevertheless, the book remains an important contribution to India's fiscal matters.

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