**UNIT: 1**

**FISCAL REFORM MEASURES IN THE CONTEXT OF INDIA’S**

**NEW ECONOMIC POLICY**

INTRODUCTION:  
The fiscal trend of 1970s suggests that this was a period of moderate growth in public expenditure in line with revenue flows. Thus the fiscal situation of central government remained comfortable till 1980. But there was a significant deterioration in the fiscal situation in 1980’s, especially by the second half, which was marked by high and persistence fiscal deficits accompanied by large fiscal deficits. This large fiscal deficit had some spill-over effects on the external sector which was reflected in the widening of current account deficit in the early 1990s. Therefore, Indian policy makers realized the need to start the process of fiscal reforms as a part of economic reform measures in 1991-92. Fiscal sector reforms were the integral and the most critical part of the macro-economic stabilization and reforms programme taken by the government after 1991 crisis.

FISCAL SECTOR REFORMS IN INDIA:

Under fiscal policy the government uses fiscal instruments to achieve desirable objectives. In other words, fiscal policy deals with instruments like taxation, expenditure and borrowing decisions of the government. Therefore, Fiscal position of the central government is determined through its taxation policy, growth and pattern of the public expenditure and process of public borrowing. Fiscal reforms thus encompass tax-reforms, expenditure reforms and reforms in the borrowing process of the central government

1. **Tax Reforms:**

In order to augment public revenue, the main focus has remained on taxation reforms. The first comprehensive attempt at reforming the tax structure was made by the Taxation Inquiry Commission (TEC) appointed by the Government of India under the chairmanship of John Matthai. The commission made several recommendations regarding income tax, some of which dealt with the broad structure while others related to matters like inclusion and exclusion of certain categories of income from taxation, grant of concessions to promote objectives of economic policy and so on. On March 2, 1970, the Government constituted the Direct Taxes Enquiry Committee with Justice K.N. Wanchoo as the chairman. The committee considered, inter alia the problem of tax evasion and suggested various measures to fight the evil of tax evasion. To give effect to the recommendation made by the Committee, the government of India enacted the Taxation Laws (Amendments) Act, 1975. The Indirect Taxation Enquiry Committee was set up by the Government of India on July 19, 1976, under the chairmanship of Shri L.K.Jha to review the existing structure of indirect tax system. The Committee recommended the introduction of Value Added Tax (VAT) at the manufacturing stage, called MANVAT, to tackle adverse effect of excise taxation. However, it was not implemented until 1986-87. A wide ranging and systematic effort to minimize the incidence of taxation was undertaken, through the introduction of Modified Value Added Tax System (MODVAT) in 1987. It was introduce in a limited manner on a few commodities and the coverage was gradually extended over the years. Further, the Government of India constituted a Committee of experts under the chairmanship of Raja J. Chelliah to examine the structure of direct and indirect taxes through its Resolution dated August 29, 1991. The Committee submitted interim report in December 1991 and final report in January 1993. For the smooth and proper administration of the tax law and also to improve the tax collections, two task forces were setup by the Finance Minster in September 2002 under the chairmanship of Vijay Kelkar, Adviser to Minister of Finance and Company Affairs. The task force had given its recommendations on the aspects relating to direct and indirect taxes such as: (a) doubling the exemption limit for personal income tax, (b) abolishing taxes on equity capital gains and dividends received by individuals, (c) moving to dual rate structure in excise and custom duties, (e) abolition of minimum alternate tax. This was implemented in 2003-04. For an efficient and harmonized consumption tax system in the country the Goods and Service Tax (GST) was introduce in 2010-11. GST is proposed to be comprehensive indirect tax levy on manufacturing, sales and consumption of goods as well as services at the national level. GST is aimed at giving India a world class tax system and improving tax collections. The changeover to GST will be a game-changing tax reform measure which will significantly contribute to the buoyancy of tax revenues, acceleration of growth and generation of many positive externalities.

1. **Expenditure Reform:**

To carry the process of reducing the growth in non-development expenditure, the government set up an Expenditure Reform Commission in 2000. The main Areas identified by the Expenditure Reform Commission included the creation of the nation-  
al food security buffer stock and minimization of fertilizers subsidies through dismantling of controls in a phased manner.

According to Eleventh Finance Commission, alongside revenue augmentation, restructuring of public finances will requires structural changes on the expenditure side as  
well. While the thrust should be on compression, the composition of expenditure would need to be restricted in favour of priority sectors like elementary education, primary health care, water supply, sanitation, roads and bridges and other infrastructure. Items that would  
require a tight rein are salary and pensions, interest payments and subsidies. There has to be a radical change in the method of financing the plan expenditure as well.

1. **Borrowing Reforms:**

After the fiscal crisis of 1991, the monetary policy of April 1992 heralded a new approach to internal debt management by introducing market operation in regard to absorption of Government of India dated rupee securities and longer term Treasury Bills and this was to be  
facilitated by overall reduction in the borrowing programme in 1992-93. These were in the line with the recommendation of the Chakravarty Committee and Narsimah Committee. Another noteworthy reform in process of borrowing was the reduction of the differences between the interest rate on market borrowing and other internal liabilities i.e. small savings, provident funds etc. in 1993-94. Further in 1994-95, there was inclusion of loan in conversion  
of maturing treasury bills and Zero Coupon Bonds and increase in the rate of interest on ‘other internal liabilities’.

1. **Fiscal Responsibility and Budget Management Act (FRBM Act) :**

The deterioration of fiscal situation and high fiscal deficit of Govern- ment of India by the latter half of the 1990s renewed the urgency for  
improving public finances at both Centre and State level. Government of India set up Committee under chairmanship of Dr. E.A.S. Sarma in  
2000. Based on the recommendations of the Sarma Committee, the government introduced the Fiscal Responsibility and Budget manage- ment bill in December 2000. In this Bill numerical targets for various fiscal indicators were specified. The Bill was referred to the Standing Committee on Finance of the Parliament. With the approval of the Parliament and clearance from the Standing Committee on Finance,  
the President of India gave his assent on the Bill on August 26, 2003. The Fiscal Responsibility and Budget Management Act, 2003 (FRBM Act, 2003) came into force from July 5, 2004.FRBM Act is all about maintaining a balance between Government revenue and government expenditure. The intention of the **Fiscal Responsibility and Budget Management Act was**to bring:’

* fiscal discipline.
* efficient management of expenditure, revenue and debt.
* macroeconomic stability.
* better coordination between fiscal and [monetary policy](https://www.clearias.com/monetary-policy/).
* transparency in the fiscal operation of the Government.
* achieving a balanced budget.

**Objectives of the FRBM Act:** The main objectives of the act were:

1. to introduce transparent fiscal management systems in the country.
2. to introduce a more equitable and manageable distribution of the country’s debts over the years.
3. to aim for fiscal stability for India in the long run

Additionally, the act was expected to give the necessary flexibility to Reserve Bank of India (RBI) for managing inflation in India.

**Initial FRBM Targets (to be met by 2008-09)**

1. **Revenue Deficit Target** – revenue deficit should be completely eliminated by March 31, 2009. The minimum annual reduction target was 0.5% of GDP.
2. **Fiscal Deficit Target** – fiscal deficit should be reduced to 3% of GDP by March 31, 2009. The minimum annual reduction target was 0.3% of GDP.
3. **Contingent Liabilities** – The Central Government shall not give incremental guarantees aggregating an amount exceeding 0.5 per cent of GDP in any financial year beginning 2004-05.
4. **Additional Liabilities** –  Additional liabilities (including external debt at current exchange rate) should be reduced to 9% of the GDP by 2004-05. The minimum annual reduction target in each subsequent year to be 1% of GDP.
5. **RBI purchase of government bonds** – to cease from 1 April 2006. This indicates the government not to borrow directly from the RBI.

## Latest FRBM Targets

The latest provisions of the FRBM act requires the government to limit the fiscal deficit to **3%** of the GDP by **March 31, 2021,** and the debt of the central government to **40%** of the GDP by **2024-25**, among others.

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