

# Fiscal Policy, Tax Policy and Fiscal Federalism Implications

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# Fiscal Policy

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- Background: Need to continue the stimulus;
  - Higher expenditure level of 2008-09 continues.
  - Fiscal Deficit at 6.8 per cent and Revenue deficit at 4.8 per cent is above the comfort level.
  - With relaxation of States' borrowing to 3.5% of GDP (4 per cent of GSDP), the total borrowing is 10.3%. Significant proportion being financed through OMO.
  - Pressure on the interest rates; Crowding out private investment?
  - During the course of the year, disinvestment could be used to contain the deficit.
  - Quality of the budget: No hidden expenditures; realistic projection of revenues and expenditures; attempt to increase capital expenditures; Direct transfer to district/state level bodies is Rs. 95567 Crore or almost 1.6 percent of GDP. Underlines the need to strengthen the delivery system.



# Policy Reform Initiatives

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- Expenditure expansion to combat the slowdown.
- Infrastructure thrust with IIFCL enabled to refinance 60% of commercial bank lending to PPP projects.
- Higher Capital Expenditures (26.8%) and plan expenditures (14.9%); plan outlay (15.4%).
- Fertilizer subsidy regime.
- Committee to examine the pricing policy for petroleum and diesel.

# Tax Policy Changes

- Tax system reform: Desirable directions – minimising the three costs.  
Multiplicity of objectives have complicated the tax system.

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  - Promise of a simpler broad based tax system.
  - Promise of Direct Taxes code:
  - Reiteration of GST in April 2010.
  - Removal of FBT and CTT, but STT remains.
  - Exemption limit increased and surcharge removed;
  - Some rationalization of excise.
- Selective tinkering of tax rates continues:
  - Investment linked incentives for selected industries.
  - MAT raised.
  - Selective reduction of customs duties on LCD panels and set top boxes.
  - Selective exceptions to 8 per cent modal rate:
    - Food items (unprocessed food is exempt any way).
    - Items of mass consumption pressure cookers, bulbs etc.
    - Power driven pumps – uncontrolled exploitation of ground water!
- Service tax: Selectivity: railway freight; lawyers.

# Growth Impulses

	Growth Of Expenditures			Growth in 2009-10 over 2008-09
	Per Cent of GDP			
	2007-08	2008-09 RE	2009-10 BE	
Total Expenditure	15.2	16.6	17.3	13.30
Non- Plan Expenditure	10.8	11.4	11.8	12.60
Plan Expenditure	4.4	5.2	5.5	14.90
Capital Expenditure	2.5	1.8	2.1	26.80
Interest payment	3.6	3.5	3.8	17.00
Defence (Rev+Cap)	2.0	2.1	2.4	23.70
Revenue Deficit	1.1	4.4	4.8	
Fiscal Deficit	2.70	6.00	6.80	
Primary Deficit	-0.90	2.50	3.00	

# Expenditure on Major Schemes

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## Outlay on Major Flagship Schemes

	2008-09 RE	2009-10 BE	Rs. Crore Percent increase in 2009-10 over 2008-09
Rural Wage Employment	37500	37778	0.7
Indira Awas Yojana	7019	7912	12.7
Rural Rioads	7225	8609	19.2
Rural development	56710	58840	3.8
Sarva Shiksha Abhiyan	11940	11934	-0.1
NRHM	7388	8704	17.8
JNURM	10448	11619	11.2



# Fiscal Federalism Issues

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- Direct Transfer of central Plan Assistance to State/District Level Autonomous Bodies (1.6%)
- Tax devolution lower by 0.2 points (3% in 2008-09 and 2.8% in 2009-10); Marginal increase (0.12 point) in non-plan Grants. Overall not much of a difference in transfers.
- Asymmetric treatment of states: Task force to examine providing relief to farmers in Maharashtra borrowing from money lenders.



# GST: Feasibility by April 2010

- Commitment to introduce GST is appreciable. Are we ready to change the regime by April 2010?

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- However, implementation without proper preparedness could create a chaotic consumption tax system.
- However, Considerable preparation is necessary:
  - Legal/ Constitutional changes;
  - Policy/Institutional changes:
    - Inter-state appropriation of service tax revenue;
    - Decision on rates: revenue neutral.
    - Individual state revenue implications and compensation formula;
    - Mechanism to relieve the inter-state tax.
    - Information system on Inter-state transactions
    - Taxpayer education and training for tax officials.
    - Unification of the rates by the centre.
    - Unification of the rates by the states.
    - System to resolve inter-State and centre-State problems.
- Is April 2010 a realistic target?
- What could be done?
  - Unify CENVAT rates ;
  - Convert service tax from being selective to general in the forthcoming budget;
  - Unify the two taxes by having a common threshold April 2010. This will be a GST at the manufacturing stage.
  - Complete the preparations to introduce the dual GST at the retail level in April 2011.

# Concluding Remarks

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- ❑ Fiscal situation is far from being comfortable.
- ❑ Fiscal consolidation will be a major challenge from next year.
- ❑ The budget seems to be a holding up operation. No much of reforms is seen except statements. However, despite the claims, there has been some control over expenditure expansion.
- ❑ Forcing GST implementation without preparedness could create a chaotic consumption tax system.