Annex 2

Implementation of the Reddy Committee Recommendation

The Finance Minister, in his Budget Speech for 2002-03 said that:

"Last year I had announced the setting up of an Expert Committee headed by Deputy Governor, RBI to suggest rationalization of administered interest rates. The Committee has given its report, which has been examined by the Government. Accordingly, I propose to take the following measures:

- Administered interest rates will now be benchmarked to the average annual yields of government securities of equivalent maturities in the secondary market. Accordingly, most administered interest rates are being reduced by 50 basis points from March 1, 2002. Such adjustments will henceforth be made annually on a non-discretionary automatic basis. The benefit of reduction in interest rates on small savings deposits will be fully passed on to the States.
- A corresponding reduction of 50 basis points will be made in the interest rate applicable to Government of India Relief Bonds. Further, a ceiling of Rs.2 lakh per year is being put on investment in these bonds.
- The entire net proceeds of small savings will be transferred to State Governments beginning April 1, 2002, up from the current transfer of 80 per cent. Consequently, additional loan assistance of about Rs.10,000 crore will be available to the States along with the benefits of a lower interest rate.
- State Governments will be enabled to pre-pay their high cost debt of the past from these additional resources which would be at a lower interest rate. Modalities of this pre-payment of small savings debt of State Government will be worked out in consultation with them and the Reserve Bank of India.
- The interest rate on the loans portion of Central assistance to State plans is being reduced by 50 basis points.

- Alignment of interest rates on GPF by the State Governments with the reduced GPF interest rates at the Centre will further reduce the interest burden of State Governments.
- Revisions are being made in the tax treatment of small savings, which will be outlined in Part B of my speech.

The implementation of this long sought reform in the treatment of small savings and administered interest rates is another step forward in the deregulation of interest rates in the economy that has been carried out in phases over the last 10 years. This should help in reducing the interest burden on the government and private sector alike in future."

The state of implementation of various recommendation of the Reddy Committee is set out below.

Issues	Recommendation of the Committee	State of Implementation
Medium-Term Vision	The medium-term objective of the Central Government should be to spell out a well conceived fully funded long-term saving schemes managed independently and professionally and aimed at promoting growth and meeting genuine investment demands in the economy. Toward this end, the PPF may be integrated into the Pension Funds system that emerges along the lines of action taken towards the reform of GPF, EPF and other old age security schemes.	Pension reform proposed. Decision to integrate it with PPF awaited.
Benchmarking	The average secondary market yield on Government Securities as the appropriate benchmark.	Accepted.
	After arriving at the benchmarking option, the Committee felt that the spread over the benchmark yields for fixing the interest rates on the small saving schemes may have to be suitably calibrated subject to a maximum of 50 basis points to arrive at the actual interest rate.	Accepted in principle. However, rates are yet to be consistent with the benchmark.
	The investors should have the option to choose between the fixed rates or floating rates at the time of entry, excepting investors in provident funds (PPF, GPF and EPF) who would have the option of floating rates only.	No change of status quo

	The Committee felt that the periodicity of revision in interest rates should be annual, at the beginning of the financial year, which may be reviewed at a later date.	Accepted.
	The NSSF must continue as the conduit for mobilisation of small savings as well as repayment to the investors.	Accepted.
Federal Finance	The entire net proceeds from small savings collected after March 31, 2002 should be transferred to the State Governments.	Accepted.
	The Central and State Governments should jointly repay the outstanding small saving liabilities as of March 2002, apportioned in accordance to their respective shares.	Debt swap scheme launched.
	As the Central Government would have no share from the fresh collections after March 2002, the market-borrowing programme of the Central Government may be enhanced to the extent of its annual liabilities.	Market borrowing programme is drawn up without any reference to Reddy Committee.
	If the net collection available for distribution among the States comes down since 2002-03 because of growing repayments obligation, each State Governments may be allowed additional market borrowings to maintain its budgetary resources.	Net small saving collection had actually gone up since 2002-03.
	In utilising the additional resources (on account of 100 per cent transfer of the net proceeds from small savings), the State Governments should mandatorily prepay their liabilities to the Central Government ahead of the schedule, as it would be beneficial for them to replace their high cost liabilities of the past with low cost borrowings in a softening/stable interest rate environment.	Accepted.
	In case, some State Governments do not wish to have a share in small savings, they may be given the choice to opt out of the scheme. The net proceeds from such States may form a corpus with the NSSF to be used for investment in Central or other State Government securities.	All State Governments seems to be willing to garner resources from small savings.
	The Central Government will have to deduct a portion of gross collection to cover actual operational expenses, before transferring the net collections.	Previous practice continuous.

Taxation	The tax concession at the time of accrual may be provided for long-term savings scheme under Section 88 of IT Act, providing tax rebate at a rate of 20 per cent on investment up to Rs.60, 000.	Government seems to have adopted a gradual process of phasing out tax concessions.
	Considering the social structure of the Indian economy and inadequate social safety provisions, it is proposed that the rate of income tax at the time of withdrawal may be kept lower than the rate at which the tax concession was conferred on contribution. It is accordingly proposed that all withdrawals at the time of maturity could be uniformly taxed at a rate of 10 per cent.	The recommendation of the Reddy Committee has been forwarded to the Central Board of Direct Taxes.
	The introduction of new tax system, with immediate effect, will make all the existing long-term savings taxable. The incidence of tax on existing long-term savings would fall with retrospective effect. With a view to correcting this situation, all the existing long-term saving schemes may be categorized into 'old' and 'new' schemes. While the fresh accretions into 'old' scheme would stop with immediate effect, the existing tax benefits exempting withdrawals from taxation may continue till the redemption of that scheme. The 'new' schemes for long-term savings should be subjected to proposed tax regime with immediate effect.	Direct tax proposals are made which are different from those proposed by the Committee.
Institutional Mechanism	The existing rates of commission paid to the agents may continue.	No change in status quo.
	A National Small Savings Authority (NSSA) may be constituted at the Centre to administer the NSSF with regard to all fresh flows.	Not Accepted.