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AN ANALYSIS OF FISCAL REFORMS IN INDIA

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Abstract: *At the time of independence in 1947, India inherited an economically stagnant economy. The framers of the Indian Constitution tried to build a strong united India, both to ensure the cohesiveness of a vast country and to build a sound fiscal system of government. So a modest attempt is made in this paper to redesign the fiscal reform process relating to revenue mobilization, expenditure restructuring and debt reforms in future.*

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INTRODUCTION

At the time of independence in 1947, India inherited an economically stagnant economy. The framers of the Indian Constitution tried to build a strong united India, both to ensure the cohesiveness of a vast country and to build a sound fiscal system of government. So India adopted federal structure with the union of a central and the state governments to actualize and uphold the values of national unity, cultural diversity, regional autonomy and rapid socio-economic transformation.

Indian fiscal system with a constitutional division of the revenue powers, expenditure functions and the powers of borrowing between the centre and state governments is not free from the problems. Though the tax powers are distributed clearly among centre and state governments under Article 246 and Seventh Schedule of the Indian Constitution but the division of tax powers based on efficiency considerations and scientific principles creates the problem of gap in the revenue resources and requirements of the states. Since 1980s, economists (like Bhargava, 1984; Mohan, 2003; Singh, 2004) have observed that the states have been assigned limited tax powers as compared to the central government.

In the case of distribution of expenditure powers, the main functions of the central government are those which are necessary to maintain macro-economic stability, international trade and relations. The major sectors assigned to the states comprise public health, agriculture, irrigation, education, industries and minerals, which require huge funds.

So far as another important instrument of fiscal system i.e., the borrowing powers of the centre and state governments are concerned, it is regulated by Articles 292 and 293 of the Constitution. While there are no restrictions on the central government but limited borrowing powers of the states can be said ‘a knotty problem’ of the fiscal system.

The Constitution recognizes that its assignment of tax powers and expenditure functions would create imbalances between expenditure 'needs' and abilities to raise revenue of the state government. To correct this imbalance, the Constitution provided statutory fiscal transfers from the centre to the states through the instrument of the Finance Commission. The main function of the Finance Commission is to recommend allocations of central taxes, grants and loans to the states. In addition, the Planning Commission also gives assistance to the states on the basis of an established formula (Gadgil formula).

Under such a fiscal system, the fiscal performance of both the centre and state governments 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 persistent fiscal deficits. This large fiscal deficit had some spill-over effects on the external sector which was reflected in the widening current account deficit in the early 1990s. The need to start the fiscal reform process as a part of economic reforms in 1990-91 was realised. As such a comprehensive fiscal reform programme at the central government level was initiated in 1990-91. The primary objective of the fiscal reforms programme was to achieve a reduction in the size of deficit and debt in relation to GDP.

A major reform in the Indian federal structure was made in 1992, when a two-tier structure was transformed into three tier structure. In the 73rd and 74th constitutional amendments, rural and urban local bodies, which till then functioned as agencies of the state governments, got statutory recognition to provide an enabling environment for decentralized provision of public services.

No doubt, Indian fiscal reform programme is based on the policy of gradualism and evolutionary transition rather than rapid restructuring 'shock therapy' (Mathur, 2001) but now a period of two decades is over, so it seems important to anlayse and assess the usefulness of the reforms. Such an analysis will provide insights to redesign the fiscal reform process relating to revenue mobilization, expenditure restructuring and debt reforms in future. Therefore, a modest attempt is made in this paper with the following objectives in mind:

- to assess the impact of fiscal reforms on fiscal performance of the central government.
- to compare revenue and expenditure position of the central government in pre and post-reform period.

The fiscal performance of the central government for the period of 1975-76 to 2007-08 has been analysed. The paper is divided into three sections. Section I presents the details of the reforms undertaken. Section II reveals the comparative picture of fiscal performance of the central government during pre and post-reform period. The conclusions of the study are given in the last section.

SECTION I

In this section an attempt is made to anlayse the fiscal reforms undertaken by the central government of India. Fiscal reforms have been analysed under the broad heads of: (i) Revenue reforms, (ii) Expenditure reforms, and (iii) Reforms in borrowings process.

(i) Revenue Reforms

In order to augment public revenue as a measure to tackle fiscal crisis, the main focus has remained on taxation reforms and non-tax revenue front was totally neglected till the mid of 1990s.

(A) Pre-Reform Period

Since independence a number of attempts have been made at improving the tax structure in the sphere of direct as well as indirect taxes. The central government of India embarked upon the reforms process during pre-reform period mainly on the basis of recommendations made in Taxation Enquiry Report (1953-54), Report of Direct Taxes Enquiry Committee (1971), and Report of Indirect Taxes Enquiry Committee (1977).

Many remedial measures were taken for various aspects of direct taxes from time to time. In the case of personal income tax, the attempt to achieve the desired state of redistribution caused the policy makers to design the income tax system with confiscatory marginal rates. This led the Direct Taxes Enquiry Committee in 1971 to recommend significant reduction in marginal tax rates. On the recommendation of the Direct Taxes Enquiry Committee, the highest marginal tax rate was brought down from 97.7 per cent in 1973-74 to 66 per cent in 1976-77 and to 50 per cent in 1985-86 to raise revenue.

In the case of corporation taxes, the rate of surcharge on corporation tax was increased from 5 per cent in 1975-76 to 7.5 per cent in 1979-80. It was further reduced to 2.5 per cent in 1981-82 with a view to improving financing from their own internal resources. In 1983-84, the rate of surcharge was increased to 5 per cent. In line with the Long Term Fiscal Policy (LTFP), the surcharge on corporate tax was discontinued in 1985-86.

As regards the wealth tax rate, the highest wealth tax rate was reduced from 8 per cent in 1974-75 to 5 per cent in 1979-80 and further to 2.5 per cent in 1985-86 and made applicable to net wealth over Rs. 20 lakh (Economic Survey, 1975-76 and 1985-86).

However, on the indirect taxes side, a major simplification exercise was attempted by the Indirect Taxes Enquiry Committee (Government of India, 1977) in 1972. As the excise system

had no built-in-checks against evasion, it recommended the introduction of input tax credit to convert the tax into a manufacturing stage value added tax (MANVAT), but it was not implemented until 1986-87. Then to minimize the incidence of taxation on inputs Modified Value Added Tax System (MODVAT) was introduced in 1987. As a result, availment of MODVAT credit for payment of duty had gone up appreciably over the years.

The tariff rates were extremely high by the middle of 1980s. In line with the LTFP, the tariffs were raised to augment revenue and the weighted average rate increased from 38 per cent in 1980-81 to 87 per cent in 1989-90 (Rao, 2005).

(B) Post-Reform Period

The main focus of the fiscal reforms process during 1990s was again on the taxation front only. A process of simplification and rationalization of both direct and indirect taxes was started on the basis of recommendations of the Chelliah Tax Reforms Committee (1991) and Report of the Task Force on Direct and Indirect Taxes (2002a and 2002b). Since then many remedial steps are being taken to simplify various aspects of direct taxes.

As regards the personal income tax, many changes have been made since 1991. The maximum marginal rate was reduced from 56 per cent in 1990-91 to 30 per cent in 1997-98 to augment revenue. “A new scheme called "one by six" was introduced to widen the tax net during 1998-99. This scheme was introduced in 12 districts in 1997-98 and was extended to 133 districts in 2000-01." (Gupta and Kaur, 2004). By 2003-04, it was applicable throughout the country. This scheme was abolished in 2005-06.

Significant reforms were also carried out in the area of corporate tax which aimed at increasing the generation of internal resources. By the year 1991-92, widely held and closely held (foreign and domestic) companies were taxed at 40 and 50 per cent, respectively. Following the recommendations of Tax Reforms Committee (TRC), 1991, the tax rates of closely and widely held companies were unified at 40 per cent in 1993-94 (Rao, 2005). However, the rates in 1997-98 were 35 per cent and 48 per cent in case of domestic and foreign companies, respectively. In 2002-03, the rate of tax for foreign company was further reduced to 40 per cent while the rate of tax for domestic company remained at 35 per cent. The corporate income tax for domestic companies was reduced to 30 per cent in 2005-06. Further, there has been no change in existing rates of corporate tax.

In the case of wealth tax, on the recommendations of the Chelliah Committee, it was charged at the flat rate of 1 per cent since 1992-93 with a basic exemption of value of Rs. 15 lakh on taxable items of wealth. However, a major relief was provided in 2004-05 in the form of abolition of tax on long-term capital gains and reduction in tax on short-term capital gains. In 2005-06, a new tax i.e., fringe benefit tax was introduced, but was abolished after realization of its considerable compliance burden in 2009-10.

Measures have also been taken in the area of indirect taxes to improve the efficiency of these taxes. The reform impetus on Excise duties came with the implementation of the recommendations of the Tax Reforms Committee, 1991. In 1999-00, almost eleven major advalorem duty rates were merged into three. In order to bring further simplification in the rate structure, the three rates were further merged into a single rate of 16 per cent in 2000-01 to be called a central Value Added Tax (CENVAT), along with three special additional excises of 8, 16, and 24 per cent for a few commodities. In 2008-09, the general CENVAT rate on all goods and services was reduced to 14 per cent.

Import duties were more than 300 per cent prior to reform process undertaken. A phased reduction in the peak rate of custom duty has been undertaken since 1991 and accordingly the peak rate of custom duty was reduced to 110 per cent in 1992-93 to 40 per cent in 1997-98 and to 30 per cent in 2002-03. It was further reduced to the level of 15 per cent in 2005-06 and to 10 per cent in 2007-08 with a few exceptions (Economic Survey, 2007-08).

It was realised only in mid-1990s that the structural transformation taking place in favour of service sector but services out of tax-net coverage was an important reason of declining tax revenue. So, in order to broaden the base for domestic indirect taxes, a modest beginning was made in 1994-95 with the introduction of selective tax on services. This tax was charged at the rate of 5 per cent on the amount of telephone bills, the net premium charged by insurance companies and the brokerage charged by stock brokers in relation to their services. In 2002-03, the coverage of service tax was extended to 60 services at the rate of 5 per cent. The rate of service tax was raised to 10 per cent and number of services was raised to 84 in 2005-06. In 2007-08, the coverage of service tax was extended to 100 services at the rate of 12 per cent (Economic Survey, 2008-09).

A comprehensive indirect tax reform in the country is going to take place in April 2011 with the implementation of a dual Goods and Service Tax (GST), levied concurrently by the centre

as Central Level GST (CGST) and the states as State Level GST (SGST). GST would be further improvement over the VAT. This new system, which is being steered by an Empowered Committee of State Finance Ministers and the central government will replace state level VAT and CENVAT. In case of Central GST, central excise duty, additional excise duty, service tax, additional custom duty (countervailing duty), special additional duty, surcharge and cesses would be subsumed with CGST which are at presently levied separately on goods and services by central government. In case of State GST, VAT/sales tax, entertainment tax, luxury tax, taxes on lottery, betting and gambling, state cesses and surcharges, and entry tax except for stamp duty, toll tax, passenger tax and road tax would be subsumed with SGST which are at present levied separately on goods and services by state government. This will mark a major step in unifying the tax regime across the country and do away with tax arbitrage that currently disturbs investment decisions.

(ii) Expenditure Reforms

Continuously growing public expenditure mainly a high rate of growth of non-developmental expenditure is the main reason for deteriorating fiscal condition of the central government.

(A) Pre-Reform Period

The problem cropped up in the mid-1970s as public expenditure grew at a higher rate as compared to the growth rate of public revenue. To control the growing rate of public expenditure, a Commission was set up by a resolution of the Government of India on May 29, 1979. But it was wound up on January 31, 1980. In January 1984, a package of measures was taken by the central government with a view to restraining the growth of expenditure. "Plan expenditure was to be reduced by 5 per cent including supplementary grants. Non-plan expenditure (excluding interest payments and transfers to States) was cut by 3 per cent" (Economic Survey, 1983-84).

Recognizing the gravity of the expenditure problem, a system of zero-base budgeting was initiated in the course of the formulation of the budgets of all central government departments for 1987-88 (Economic Survey, 1986-87).

(B) Post-Reform Period

Efforts were made by the government in 1990-91 to curb built-in–growth in expenditure and to bring about structural changes in the composition of expenditure and effecting

economy in non-plan expenditure. Emphasis was also laid on curtailing unproductive expenditure by undertaking a number of measures. These include "monthly budgeting of expenditure in all the departments, cut in the expenditure on staff cars, electricity and telephone bills, and a complete ban on the purchase of new vehicles" (Economic Survey, 1990-91).

The government initiated various measures to correct the fiscal imbalance during 1991-92. Such measures mainly were reduction in the fertilizer subsidy, abolition of Cash Compensatory Support for exports, abolition of subsidy on sugar. Further, the government had also "imposed 5 per cent cut on the expenditure of all Ministries/Departments. Only a few items of expenditure, such as, statutory grants to state governments, block grants and loans for state Plan schemes, interest payments and pension payments were exempted from the expenditure cut" (Economic Survey, 1991-92).

The problem of high rate of growth of non-developmental expenditure persisted for a long time, but the reforms on this front started very late with the beginning of the process of downsizing the government. It was only in the end of the last decade of 20th century and one decade later than tax reforms process was initiated, i.e., on February 29, 2000 an Expenditure Reforms Commission was constituted.

The measure to improve the quality of expenditure includes subjecting all existing schemes to zero-based budgeting and only those that were demonstrably efficient and essential were decided to be retained from 2001-02. The central government has also brought about pension reforms by introducing a new pension scheme with effect from January 1, 2004 for central government employees by replacing the existing defined benefit pension system.

Further in 2006-07, government took a series of initiatives for fiscal reforms like "avoiding rush of expenditure through releases in a time sliced manner and simplification of procedures" (Economic Survey, 2006-07).

(iii) Reforms in Borrowing Process

Growing debt burden and aggravating fiscal crisis have both way cause and effect relationship. Only a few changes in the process of central government borrowings have been made as a part of the fiscal sector reforms.

(A) Pre-Reform Period

During 1976-77, long-term borrowings and debentures were excluded from the capital base. A new National Savings Annuity Scheme was introduced to promote small savings from April 1, 1976. For canalising the unaccounted money for productive purposes, the Government of India announced the Scheme of Special Bearer Bonds on January 15, 1981.

Other important reforms undertaken by the government were the introduction of Investment Bonds in June 28, 1982 and long-dated securities with a maturity of 30 years in 1984-85. The system of ad-hoc treasury bills was replaced by a system of Ways and Means Advances (WMA) in 1987.

(B) Post-Reform Period

On the recommendations of the Chakravarty Committee and Narasimham Committee, internal debt management policy was introduced in market operation in 1992 relating to absorption of Government of India dated rupee securities and longer term Treasury bills. In addition to this, government introduced 364-days treasury bills and 91-days Treasury bills on an auction basis from April 1992 and December 1992, respectively. Moreover, auctions of repurchase agreements (REPOS) of dated securities were introduced from December 1992. However, it was realised that these developments might lead to discipline in use of borrowed funds at relatively high rates of interest. Besides, they would import liquidity as well as flexibility to investors.

Another noteworthy reform in process of borrowing was the reduction of the difference between the interest rate on market borrowings and 'other internal liabilities' (small savings, provident funds, etc.) in 1993-94. Further in 1994-95, there was inclusion of loans in conversion of maturing treasury bills and Zero Coupon Bonds and increase in the rate of interest on 'other internal liabilities'.

In 1999-00, there was conversion of other liabilities into central government securities which led to the sharp increase in internal debt and corresponding decline in 'other internal liabilities'. Thereafter, the most notable outcome of external debt management has been the control over short term debt.

SECTION II

In this section, an attempt has been made to compare the fiscal performance of the central government in pre-reform period with that of post-reform period.

The Fiscal Situation of the Central Government

The fiscal situation of the central government represented by the various deficit indicators has worsened since the mid-1980s (Table 1). The latter half of the 1980s saw fiscal deficits in the range of 7-8 per cent of GDP and gross primary deficit and revenue deficit were also in the ranges of 4-5 per cent of GDP and 2-3 per cent of GDP respectively. Fiscal consolidation was hence a major focus of the reform process introduced in 1991-92.

Table: 1 Deficits of the Central Government (As per cent of GDP at current market prices)

Year	Gross Fiscal Deficit	Gross Primary Deficit	Revenue Deficit	Revenue Deficit as per cent of Fiscal Deficit
1975-76	3.60	2.14	-1.05	-29
1976-77	4.19	2.55	-0.33	-8
1977-78	3.58	1.98	-0.42	-12
1978-79	5.13	3.35	-0.26	-5
1979-80	5.23	3.36	0.57	11
1980-81	5.71	3.92	1.40	25
1981-82	5.07	3.20	0.23	5
1982-83	5.56	3.50	0.68	12
1983-84	5.86	3.70	1.14	19
1984-85	6.99	4.59	1.69	24
1985-86	7.77	5.10	2.09	27
1986-87	8.37	5.43	2.47	30
1987-88	7.56	4.41	2.55	34
1988-89	7.28	3.92	2.48	34
1989-90	7.31	3.67	2.44	33
1990-91	7.84	4.06	3.26	42
1991-92	5.55	1.49	2.48	45
1992-93	5.34	1.21	2.47	46
1993-94	6.96	2.72	3.78	54
1994-95	5.68	1.34	3.05	54
1995-96	5.05	0.86	2.49	49
1996-97	4.84	0.53	2.37	49
1997-98	5.82	1.53	3.04	52
1998-99	6.47	2.03	3.82	59
1999-00	5.36	0.74	3.46	65
2000-01	5.65	0.93	4.05	72
2001-02	6.19	1.47	4.40	71
2002-03	5.91	1.11	4.40	74
2003-04	4.48	-0.03	3.57	80
2004-05	3.99	-0.04	2.49	62
2005-06	4.08	0.38	2.57	63
2006-07	3.45	-0.19	1.94	56
2007-08	2.68	-0.93	1.11	41

Note: 1. Negative (-) sign indicates surplus in deficit indicators.

2. Revenue deficit is the difference between revenue expenditure and revenue receipts.

3. Gross fiscal deficit (GFD) is aggregate disbursements (net of debt repayments) less revenue receipts, non-debt capital receipts and recovery of loans and advances. Since 1999-2000, it excludes States' share in small savings as per the new system of accounting.

4. Gross primary deficit is defined as GFD minus interest payments.

Source: Various issues of Handbook of Statistics on the Indian Economy.

As a result, 1990s have seen varied performance on the deficit indicators. The period 1991-92 to 1996-97 with the exception of 1993-94 has seen a decline in the fiscal deficit and other deficit indicators as a percentage of GDP through a combination of an increase in revenues coupled with a reduction in expenditure.

From 1997-98, expenditure started rising once again and by the year 2001-02, all the major deficit indicators, viz., revenue deficit, fiscal deficit and primary deficit rose to levels higher than those prevalent at the beginning of the reform process. With the implementation of Fiscal Responsibility and Budget Management Act (FRBMA) 2003, not only the fiscal deficit as a proportion of GDP declined since 2003-04, but this was also accompanied by a commensurate decline in the revenue deficit leading to a marked improvement in the quality of fiscal deficit. This decline in fiscal deficit of the central government since 2003-04 has been achieved on the strength of higher revenues. Success in containing or managing expenditure has been limited.

It is also clear from the table that the ratio of revenue deficit to fiscal deficit of the central government, which indicates the extent to which borrowings are used to meet current expenditure, increased from 11 per cent in 1979-80 to 34 per cent in 1988-89. The revenue deficit, which constituted 42 per cent of fiscal deficit in 1990-91, accounted for 80 per cent of fiscal deficit in 2003-04. This is reflective of the fact that a larger portion of fiscal deficit goes to finance public consumption expenditure. Since FRBMA mandated a reduction in revenue deficit with the reduction in fiscal deficit resulted in a decline in the proportion of revenue deficit to fiscal deficit by 39 percentage points in four years. It was 41 per cent in 2007-08 implying a “progressively better utilization of borrowed resources towards asset creation” (Economic Survey, 2007-08).

The Trends in Receipts of the Central Government

Graph 1 shows some of the disquieting features of the receipts of the central government of India. It shows that during 1975-76 to 2007-08, the total receipts of the central government increased almost sixty-six times witnessing a growth rate of 14 per cent (i.e., from Rs. 10512 crore in 1975-76 to Rs. 697298.42 crore in 2007-08). Along with the increase in total receipts of the central government, the revenue receipts stepped up from Rs. 7848.64 crore in 1975-76 to Rs. 52091.5 crore in 1989-90 – showing an increase of six times during pre-reform period.

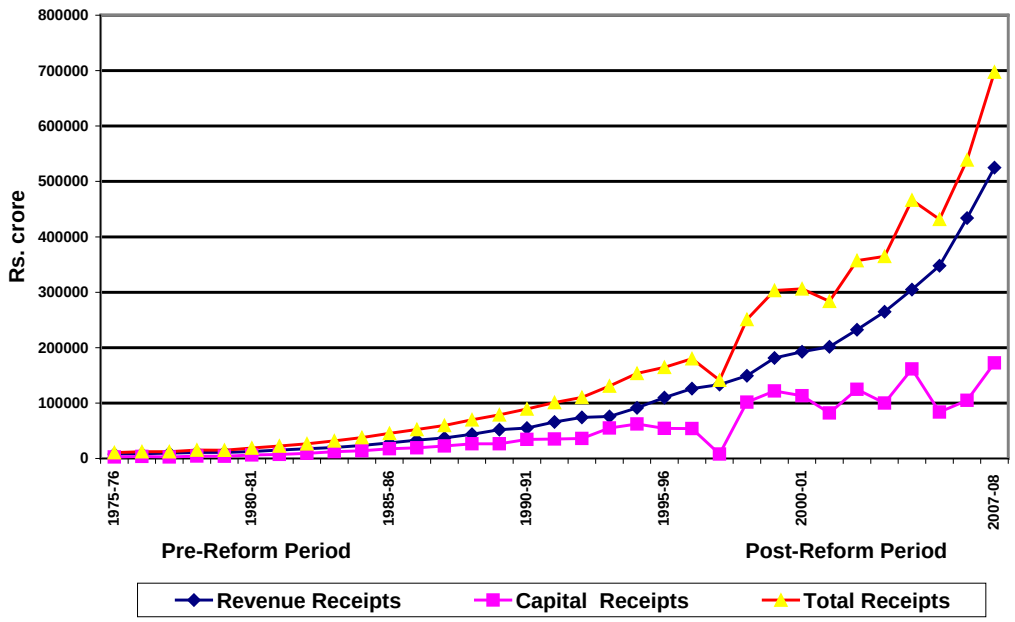
Table 2: Growth Rate of Receipts of the Central Government

	1975-76 to 1989-90	1991-92 to 2005-06	1975-76 to 2005-06
Revenue Receipts	15	13	14
Capital Receipts	20	11	14

Source: Computed on the basis of data compiled from various issues of Indian Public Finance Statistics.

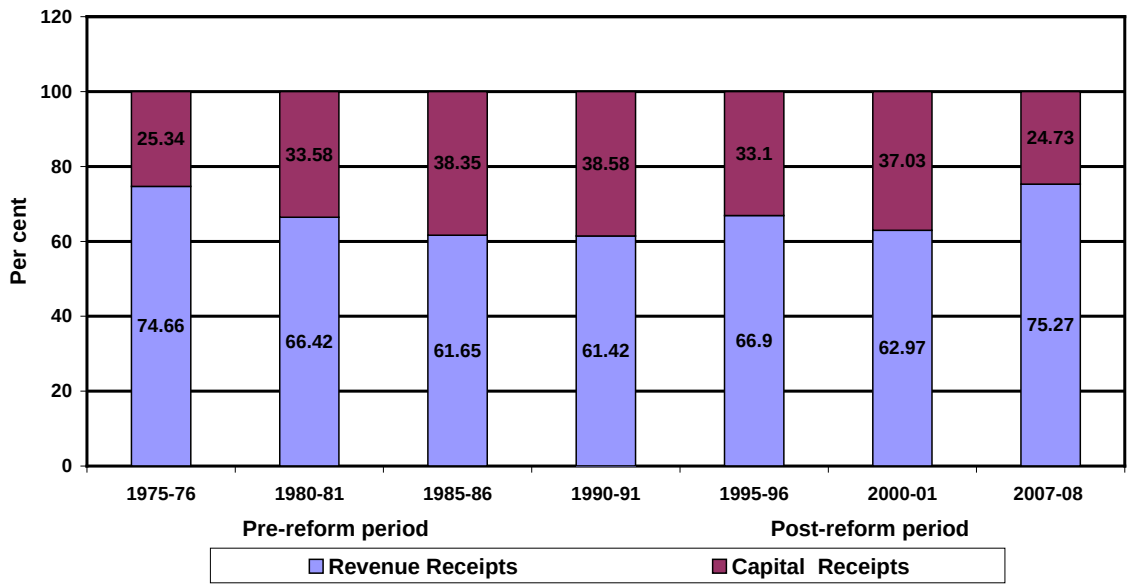
During the post-reform period, revenue receipts increased from Rs. 54989.97 crore in 1990-91 to Rs. 524889.68 crore in 2007-08 (R.E.) – i.e., an increase of nine times. Revenue receipts contributed higher growth rate of 15 per cent in pre-reform period as compared to 13 per cent in post-reform period.

Graph 1: Trends in Total Receipts of the Central Government



Looking at revenue receipts as a proportion of total receipts of the central government, it was three-fourth of the total receipts in 1975-76 (Graph 1.2). The government undertook various policy initiatives even before 1990 to raise revenue which included an overhaul of the excise tax structure through the introduction of Modified Value Added Tax (MODVAT), the launching of a simpler and more growth-oriented scheme of excise duty concessions for small scale units, simplification and rationalizations of taxation provisions relating to gifts and capital gains, and systematic steps to curb tax evasion (Economic Survey, 1986-87). Despite these fiscal policy initiatives taken by the government, the share of revenue receipts declined and dipped to the level of 62.31 per cent in 1988-89.

Graph 1.2: Share of Revenue and Capital Receipts in Total Receipts of the Central Government



The fiscal situation had assumed a crisis by the beginning of the fiscal year 1991-92. To cope with the situation, the government aimed at augmenting revenue and a number of measures targeting tax revenue were announced in 1991-92. Along with those mentioned earlier, these included the announcement of the Voluntary Deposits Scheme, reduction of rate of tax on dividend income received from such investment, extension of the scheme of tax deduction at source, limiting the ad-valorem rates of custom duty, rationalization of auxiliary duties, and raising of special excise duty (Economic Survey, 1991-92). As a result of which there was substantial increase in revenue receipts of the central government and it rose to 70.03 per cent in 1996-97. Thereafter in 1997-98, reduction in personal and

corporate tax rates brought a substantial increase in the share of revenue receipts which reached to the highest level of 94.46 per cent of total receipts of the central government. A number of remedial measures were further undertaken in the regime of taxation which included reduction in the peak rates of custom duties, rectifying anomalies like inverted duty structure, rationalizing excise duties with a movement towards a median CENVAT rate, relying on voluntary tax compliance through tax payer facilitation. These tax reforms in Indian fiscal system could not help to maintain such a higher share of revenue receipts of the central government. Since 1998-99, it has been fluctuating between 60 to 75 per cent.

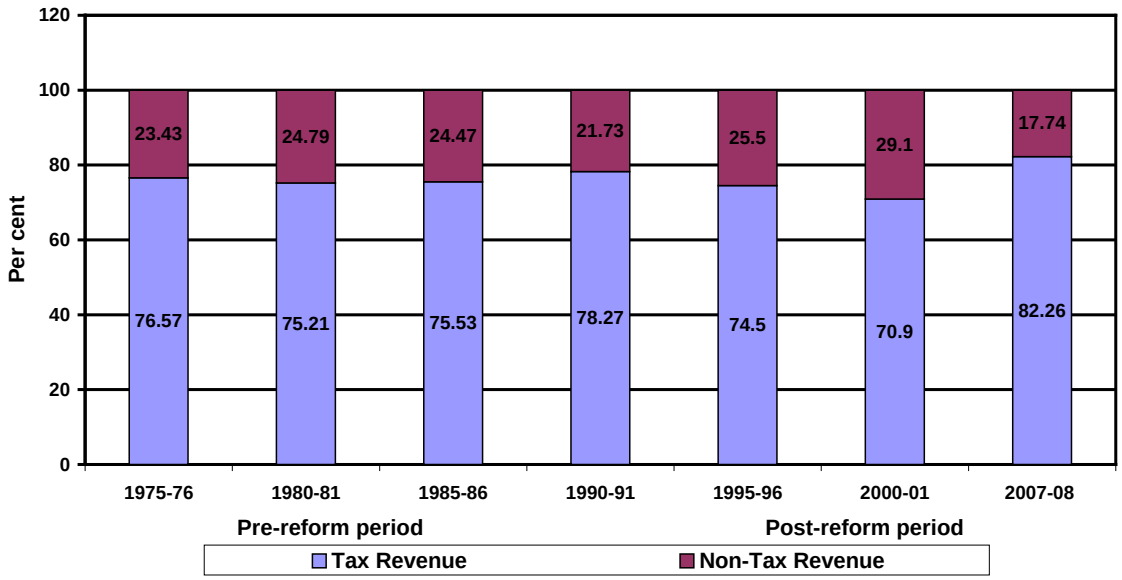
Further, a higher share of capital receipts constituting market borrowings, external debt, small savings, state and public provident funds, special deposits of non-government provident funds, special securities and miscellaneous capital receipts implies a greater burden of liabilities on the central government. In the pre-reform period, capital receipts showed significant increase from Rs. 2663.36 crore in 1975-76 to Rs. 26629.88 crore in 1989-90 - registering an increase of ten times. In the post-reform period 1990-91 (Rs. 34541.68 crore) to 2007-08 (R.E.) (Rs. 161676.46 crore), it shows an increase of five times only. It registered a growth rate of 20 per cent in the pre-reform period as compared to the post-reform period i.e., 11 per cent (Table 2). Looking at capital receipts as a proportion of total receipts of the central government, it consisted of 25.34 per cent of the total receipts of the central government in the year 1975-76. This percentage rose to 38.06 per cent in 1983-84 and further declined marginally to 37.83 per cent in 1989-90. During the post-reform period, the sharp decline in the share of capital receipts in 1997-98 was due to decline in state provident funds, special securities and miscellaneous capital receipts. Again, it rose to the level of 34.98 per cent in 2002-03 and could be reduced to 19.47 per cent of total receipts in 2006-07.

Trends in Components of Revenue Receipts

Graph 2 shows the detail study of revenue receipts of the central government during the pre and post-reform period. Looking at the share of tax revenue and non-tax revenue in the revenue receipts of the central government, it is found that the main source of revenue of the central government is tax revenue which remained 70 to 80 per cent of the total revenue receipts for most of the period under study. The graph clearly shows that the relative share of non-tax revenue remained between 21 per cent to 26 per cent in the pre-

reform period. As a proportion of total revenue receipts, it hovered between 25 to 30 per cent and was increased to 33 per cent by 2001-02. Thereafter, it started declining and reached to 17.74 per cent in 2007-08 (R.E.). This decline in relative share of non-tax revenue

Graph 2: Share of Tax and Non-Tax Revenue in Total Revenue Receipts of the Central Government



was mainly due to reduction in interest receipts, debt swap scheme and a softening interest rate regime (Report of Twelfth Finance Commission, 2005-10). Another reason for such decline was that the central government did not pay proper attention to non-tax sources for revenue generation. This issue was raised in the Ninth Five Year Plan when it observed, "Sufficient attention has not been paid to realization of non-tax revenues. Areas from where non-tax revenues can be augmented are irrigation charges, royalties on minerals and revision of user charges on services rendered by the government".

The Trends in Expenditure of the Central Government

Graph 3.1 presents the amount of revenue expenditure, capital expenditure and total expenditure of the central government. It is evident from the graph that total expenditure of the central government has been continuously growing and it has increased 64 times (i.e., from Rs.11010.73 crore in 1975-76 to Rs. 704667.47 crore in expenditure which created serious imbalances in the fiscal sector of 2007-08) during the study period.

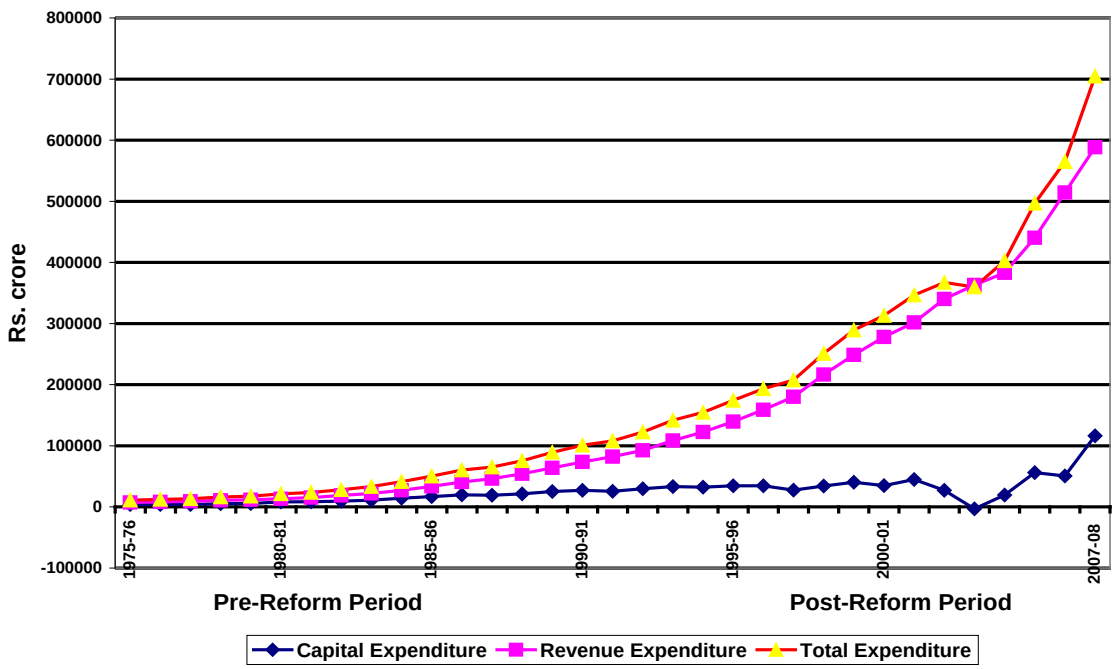
Table 3: Growth Rate of Expenditure of the Central Government

	1975-76 to 1989-90	1991-92 to 2005-06	1975-76 to 2005-06
Revenue Expenditure	17	13	15
Capital Expenditure	16	20	13

Source: Computed on the basis of data compiled from various issues of Indian Public Finance Statistics.

This sharp increase in the total expenditure is mainly because of continuous increase of revenue the economy. Along with the increase in total expenditure of the central government, revenue expenditure increased by nine times (from Rs. 7094.45 crore in 1975-76 to Rs 64005.68 crore in 1989-90) during pre-reform period. Such expenditure during the period 1990-91 to 2007-08 moved up little less than eight times (from Rs. 73551.33 crore to Rs. 588378.05 crore). The rate of growth of revenue expenditure was more in the pre-reform period (17 per cent) as compared to the post-reform period (13 per cent). It is clear from the graph 3.2 that revenue expenditure of the central government remained significantly higher and recorded a growth rate of 15 per cent during 1975-76 to 2007-08.

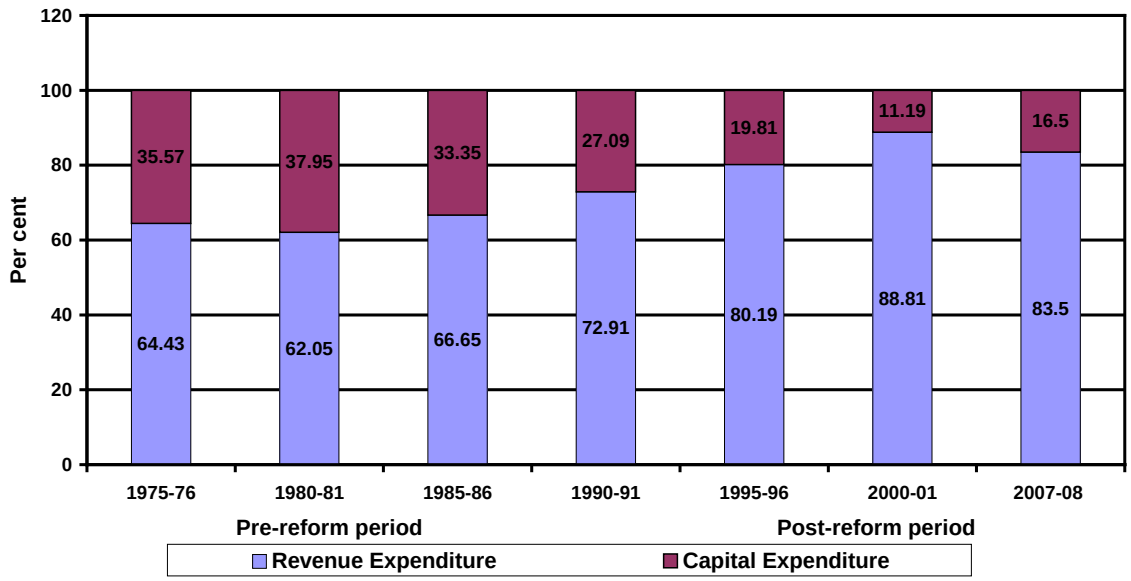
Graph 3.1: Trends in Total Expenditure of the Central Government



It constituted more than 60 per cent and even reached to 100 per cent of the total expenditure during 2003-04. This increasing trend was because of the rise in interest payments and the sharp escalation in salary bills (pay and allowances) and pension payments. Another reason behind this growing public expenditure on revenue account was the measures designed by the government for the welfare of poor, especially for those in rural areas.

A tremendous increase in the share of expenditure on revenue account of the central government was accounted for by the decline in the share of capital expenditure in the pre-reform period. Capital expenditure moved up from Rs. 3916.28 crore in 1975-76 to Rs. 25309.71 crore in 1989-90 – showing an increase of six times. It constituted 35.57 per cent of the total expenditure of the central government in the year 1975-76. This percentage decreased to 34.57 per cent in 1984-85 and further declined to 28.34 per cent in 1989-90. There is a secular fall in the share of capital expenditure, which is mirrored in the rise in the share of revenue expenditure in the post-reform period too. Capital expenditure of the central government went up from Rs. 25309.71 crore in 1990-91 to Rs. 116289.42 crore in

Graph 3.2: Share of Revenue and Capital Expenditure in Total Expenditure of the Central Government



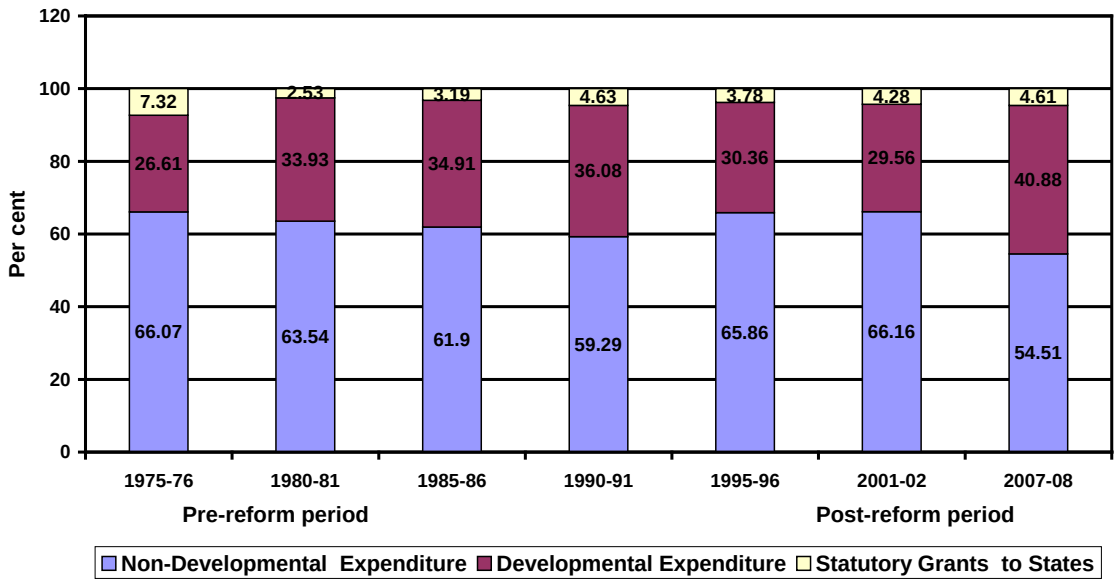
2007-08 (R.E.) - recording an increase of little less than five times during the post-reform period. Capital expenditure registered a higher growth of 20 per cent in the post-reform period as compared to the 16 per cent in the pre-reform period. Looking at capital expenditure as a proportion of total expenditure of the central government, the share of

capital expenditure has been on the decline in the post-reform period and reached to 8.96 per cent in 2006-07. This is due to the fact that expenditure compression has been brought about since 1990-91 mainly through cut in capital expenditure. This fiscal correction through reduction in capital expenditure is often cited as one of the causes for economic slowdown.

Trends in Components of Revenue Expenditure

From the share of non-developmental and developmental expenditure in total revenue expenditure of the central government (Graph 4), it can be observed that a significant proportion of the revenue expenditure is made on non-developmental expenditure. But the increase in non-developmental expenditure (eight times) in pre-reform period was more than the increase in the post-reform period (seven times). The reason behind this fall (however it is very less) is the significant measures introduced by the government on the expenditure front. One among them was regarding pension reforms. A new pension programme based on defined contributions was envisaged for those entering central government services after October 1, 2001. The quality of expenditure is not improving as developmental expenditure recorded an increase of nine times in the post-reform period as compared to the increase of thirteen times in the pre-reform period.

Graph 4: Share of Non-developmental and Developmental expenditure in Total Expenditure of the Central Government



On the other hand, statutory grants to states have shown an increase of seven times in post-reform period in comparison to the increase of three times in pre-reform period reflecting the impact of the Twelfth Finance Commission award.

SECTION III

The findings that came out from the review of India's fiscal reforms can be summed up as follows. One, with the initiation of fiscal reforms process, the immediate impact was the sharp reduction but thereafter there was a steady reduction and the reduction was sharper after the enactment of the Fiscal Responsibility and Budget Management Act (FRBMA), 2003 in both the revenue and fiscal deficits of the central government. This improvement in the fiscal position of the central government has been achieved on the strength of higher revenues. Two, there has been a significant increase in receipts of the central government as a result of tax reforms. The revenue receipts as compared to the capital receipts of the central government have registered a substantial increase throughout the study period but the increase in revenue receipts (nine times) in the post-reform period was more than the increase in the pre-reform period (six times). Whereas capital receipts recorded an increase of five times in the post-reform period as compared to the pre-reform period (ten times).Third, the increase in tax (ten times) and non-tax revenue (eight times) is more in post-reform period than the pre-reform period (six times and seven times, respectively). The improvement in tax revenue can be attributed to tax reforms made by the centre, however, the non-tax revenue side has remained neglected. So, more efforts need to be made to increase non-tax revenue also. Four, due to lesser efforts being made to compress expenditure during the first decade of economic reforms process, expenditure continuously increased and grew by sixty-four times during the study period. What is more disturbing is that revenue expenditure shot up only at the cost of capital expenditure. It constituted more than 60 per cent and even reached to cent per cent of the total expenditure of the central government. While capital expenditure of the central government constitutes merely 4 to 37 per cent of the total expenditure during pre as well as post-reform period. So there is an urgent need to restrain the growth in revenue expenditure. Five, the increase in non-developmental revenue expenditure of the central government in the pre-reform period was more (eight times) than the increase in the post-reform period (seven times). The reason behind this fall was the significant reforms introduced by the government in

expenditure. Similarly, developmental expenditure recorded an increase of nine times in post-reform period as compared to thirteen times in the pre-reform period. This could have been brought down only after the implementation of FRBMA, 2003. No doubt fiscal reforms process has started bearing fruits, but main emphasis should be on reduction in non-developmental expenditure on revenue account.

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