CHAPTER-5

ANATOMY OF FISCAL DEFICITS- RECEIPTS SIDE

Fiscal deficit is an outcome of expenditure and receipts movements over a period of time. Unfortunately, unsustainable growth of public expenditure of the Government seems to have received more attention than poor growth of non-debt resources. It may be because spending squeezes especially on capital account are easier to achieve in the short run when there is strong sense of urgency to scale down fiscal deficit.

International experiences also suggest that fiscal consolidation programme that focused mainly on expenditure reduction had more successful outcomes than those focusing mainly on revenue side.[1] The predominant response to fiscal crisis has been to place greater emphasis on reducing expenditures than on raising revenues. However, this applies mainly to developed countries where tax revenue as a share of GDP is generally higher than in developing countries. Therefore fiscal consolidation in developing countries like India should be a more balanced mix of revenue enhancement and expenditure reduction.[2]

A narrow tax base, growing diversification of the economy, untapped potential sources of taxation like large part of services sector, low productive efficiency of public sector enterprises and low user charge in case of many publicly provided goods point to the fact that through proper planning and better economic management receipts side of the budget can be made to grow in a sustained manner.

Government budgeting is typically about fitting competing demands

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1 IMF, *World Economic Outlook*, Washington D.C. May 1996, p.61.

2 United Nations, *World Economic and Social Survey 1997*, New York. Bookwell Publishers, New Delhi, p.64.

into a spending package that is deemed affordable. The limit to government expenditure i.e. fiscal envelope is determined by maximum sustainable borrowings and the revenue raising capacity of the fiscal system. If the non-debt receipts of the budget can be made to yield more income it would relax the envelope restrictions on the expenditure and also reduce recourse to borrowings. A lasting solution to the problem of fiscal deficit over medium and longer term can come about only when there is adequate mobilization of non-debt receipts of the government, so that borrowings get entirely translated into investment and are not utilized for meeting current expenditures. This will reduce the strain on fiscal situation.

Revenue and Capital Receipts

5.1 **Revenue receipts** are receipts on the revenue account and constitute the largest proportion of non-debt receipts of the Centre. These include Tax and Non-Tax Receipts.

The **Tax Revenue** is the income that is gained by Government because of taxation of the people. It comes from three main sources viz. taxes on personal incomes and corporate tax, taxes on wealth, capital and property transactions, & t axes on commodities and services.

Non-Tax Revenue includes revenue from currency & coinage and mint and other fiscal services, Interest receipts, profits and dividends and receipts from various charges, fee and penalties imposed by the government.

5.2 **Capital Receipts** are receipts on capital account and include net recoveries of loans and advances to state governments, union territories and public sector undertakings, net market borrowings (gross borrowings minus repayments),net small savings collections (gross savings minus states share) and other capital receipts like remittances, PSU disinvestment proceeds, provident funds, reserve funds and contingency funds. Of these net recoveries of loan and proceeds from PSU disinvestments are two components which are treated as **non-debt capital receipts**. Rest all are liabilities which have to be serviced. These carry long term obligations in the form of interest payments and payment of principal whenever it falls due. Present borrowings increase future servicing obligations thereby increasing the revenue expenditure on non-plan account in coming years.

5.3 Trends in Total Receipts, Revenue Receipts and Capital Receipts.

Total receipts of the Central Government showed massive increase over the period 1990-91 to 2003-04. In absolute terms they grew from Rs 89537 crores in 1990-91 to Rs 471368 crores in 2003-04 i.e. by 5.26 times though the trend has been erratic and has shown large fluctuations over this period. The growth in receipts has been higher in the second half of the period (1997-98 to 2003-04) when it grew by 3.33 times, than in first half when it grew about twice (**Table 5.1**). During the years 2003-04 to 2009-10, it grew about twice from Rs 471368 crores to Rs. 968514 crores.

Revenue receipts in absolute terms grew from Rs. 54995 crores in 1990-91 to Rs 263878 crores in 2003-04. These receipts grew by almost 4.7 times. This growth has been largely due to growth of tax revenue. The annual average growth rate for this period was 13 per cent. In the post FRBM period also, the revenue receipts continued to increase and reached Rs 602935 crores in 2008-09 before declining to Rs 562173 crores in 2009-10.

Table 5.1 and Figure 5.1 show the trends in revenue receipts, capital receipts and total receipts during the period 1990-91 to 2009-10.

Table No 5.1

RECEIPTS

Year	Revenue Receipts			Capital Receipts			Total Receipts	
	Amount (A)	% Change over Previous Year	Percent to Total Receipts	Amount (B)	% Change Over Previous Year	Percent to Total Receipts	Amount (A+B)	% Change Over Previous Year
1990-91	54995.42	-	61.42	34541.68	-	38.58	89537.1	-
1991-92	66029.87	20.06	65.35	35017.78	1.38	34.65	101047.65	12.86
1992-93	74117.32	12.25	67.25	36087.97	3.06	32.75	110205.29	9.06
1993-94	76871.83	3.72	57.13	57688.93	59.86	42.87	134560.76	22.10
1994-95	91317.89	18.79	59.42	62362.49	8.10	40.58	153680.38	14.21
1995-96	109983.41	20.44	66.90	54428.05	-12.72	33.10	164411.46	6.98
1996-97	126186.74	14.73	70.03	54004.03	-0.78	29.97	180190.77	9.60
1997-98	133547.71	5.83	94.46	7828.33	-85.50	5.54	141376.04	-21.54
1998-99	149441.16	11.90	59.54	101536.03	1197.03	40.46	250977.19	77.52
1999-00	181272.75	21.30	59.78	121944.14	20.10	40.22	303216.89	20.81
2000-01	192741.63	6.33	62.97	113358.63	-7.04	37.03	306100.26	0.95
2001-02	201612.37	4.60	71.07	82078.63	-27.59	28.93	283691	-7.32
2002-03	231748	14.95	55.96	182414	122.24	44.04	414162	45.99
2003-04	263878	13.86	55.98	207490	13.75	44.02	471368	13.81
2004-05	305991	15.96	61.41	192261	-7.34	38.59	498252	5.70
2005-06	347077	13.43	68.63	158661	-17.48	31.37	505738	1.50
2006-07	434387	25.16	74.46	149000	-6.09	25.54	583387	15.35
2007-08	541925	24.76	76.03	170807	14.64	23.97	712732	22.17
2008-09	602935	11.26	64.16	336818	97.19	35.84	939753	31.85
2009-10 (BE)	562173	-6.76	58.04	406341	20.64	41.96	968514	3.06

Source: Compiled from Indian Public Finance Statistics, Ministry of Finance, 2003-04 and Economic Surveys, 2003-04 and 2004-05.

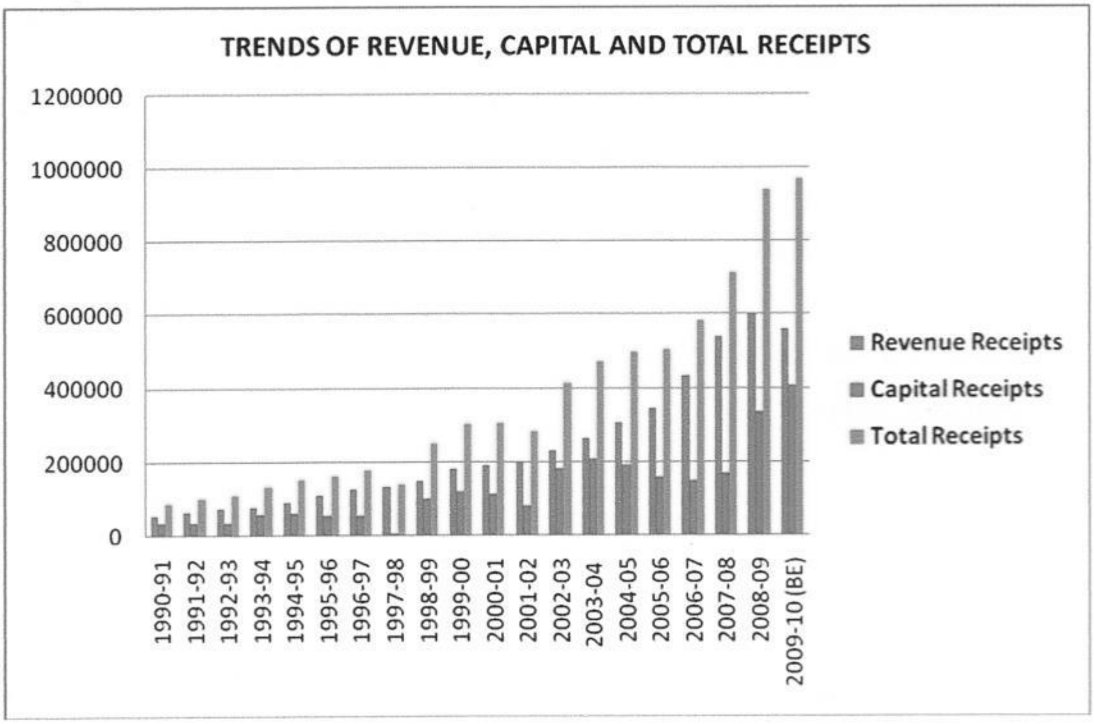

Figure 5.1

The Capital receipts over the period 1990-91 to 2003-04 grew by about 6 times, in absolute terms from Rs. 34541 crores to Rs. 207490 crores, showing an increase of 500 per cent the figures declined to Rs 170807crores in 2007-08 but rose thereafter to Rs 406341 crores in 2009-10(BE) The rate of growth has been non linear with large fluctuations over certain years. Though relative share of debt creating capital receipts has declined lately, they still remain a major source of financing fiscal deficit of the Central Government. Only market borrowings accounted for 70 per cent of financing of the fiscal deficit in 2003-04.

5.4 Tax and Non-Tax Revenue

Table 5.2 and Figure 5.2 give the pattern of tax and non tax revenues over the period, 1990-91 to 2009-10 (BE)

The Tax Revenue (net of state's share) grew from the Rs 43041 crores in 1990-91 to Rs 186981.84 crores in 2003-04 and Rs 474217.57 crore in 2009-10 (BE). **(Table 5.2).** The credit goes to tax reforms process which focussed on rationalisation of rate structure, elimination of exemptions, tax base widening and improved compliance.Higher GDP growth coupled with better tax administration and introduction of new taxes such as the 'fringe benefit tax', resulted in higher growth of tax revenues. The non tax revenue rose steadily from Rs. 11948 in 1990-91 to Rs 77801 in 2003-04 and RS.135804 in 2009-10(BE)

Table 5.2

Year	Tax Revenue	Non-Tax Revenue	Total
1990-91	43041.70	11948.27	54995.42
1991-92	50164.37	15865.50	66029.87
1992-93	54114.31	20001.36	74117.32
1993-94	54505.81	22365.67	76871.83
1994-95	67454.43	23862.50	91317.89
1995-96	81938.83	28044.54	109983.41
1996-97	93731.08	32455.62	126186.74
1997-98	95672.49	37875.22	133547.71
1998-99	104652.24	44788.92	149441.16
1999-00	128271.17	53001.58	181272.75
2000-01	136658.56	56083.07	192741.63
2001-02	133661.72	67950.60	201612.37
2002-03	159424.59	72788.67	232213.00
2003-04	186981.84	77801.16	264783.00
2004-05	224798.24	79894.17	304692.41
2005-06	270264.23	77738.75	348002.98
2006-07	351182.27	82909.34	434091.61
2007-08	439547.12	101542.55	541089.67
2008-09	465970.00	93018.59	558988.59
2009-10 (BE)	474217.57	135804.70	610022.27
Source: Indian Public Finance Statistics 2002-03, 2006-07,2009-10 Ministry of Finance, Govt of India			

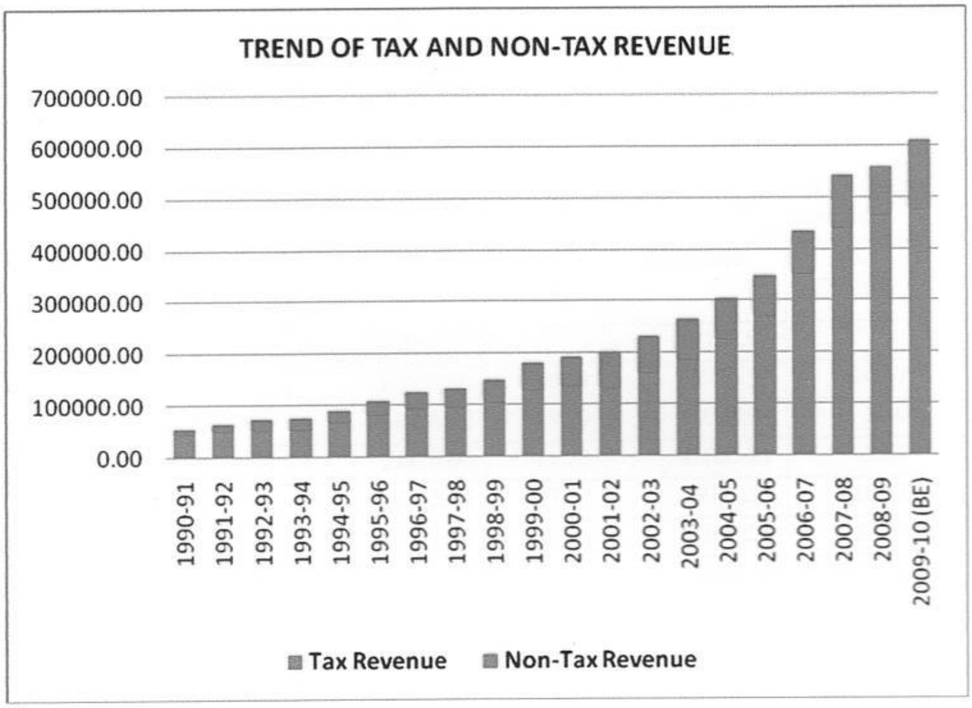

Figure 5.2

In absolute terms, the direct taxes rose from Rs 6908.77 in 1990-91 to Rs 132183.05 crores in 2004-05 from where it rose steadily to Rs 363956.00 crores in 2009-10. The receipt on account of indirect taxes rose from Rs.36132.93 crores in 1990-91 to Rs. 277123.34 crores in 2009-10. (Table 5.3). The high buoyancy of **direct tax revenues** may be attributed substantially to improvement in tax compliance following the institution of the Tax Information Network (TIN) in January 2004 and its implementation by the National Securities Depository Ltd (NSDL). According to the report of the Comptroller and Auditor General of India (C&AG), in 2002-03 almost 80 per cent of the assessees for tax deduction at source (TDS) did not file returns. With the setting up of TIN, tax compliance has gone up significantly. The share of income tax in gross tax revenue of the Centre witnessed a marginal increase from 16.27 per cent to 17.20 per cent in the period from 2003-04 to 2008-09.

TABLE -5.3

TAX REVENUE RECEIPTS OF CENTRAL GOVERNMENT*

(Rs. Crore)

Year	Direct Tax Revenue		Indirect Tax Revenue	
	Revenue	% Change	Revenue	% Change
1990-91	6908.77	-	36132.93	-
1991-92	10248.46	48.34	39915.91	10.47
1992-93	12083.32	17.90	42030.99	5.30
1993-94	13440.60	11.23	41065.21	-2.30
1994-95	18413.29	37.00	49041.14	19.42
1995-96	22291.32	21.06	57647.51	17.55
1996-97	25382.68	13.87	68348.40	18.56
1997-98	27182.57	7.09	68489.92	0.21
1998-99	32121.74	18.17	72530.50	5.90
1999-00	41437.57	29.00	86833.60	19.72
2000-01	49651.71	19.82	87264.24	0.50
2001-02	47707.66	-3.92	86510.95	-0.86
2002-03	83090.12	74.17	133175.98	53.94
2003-04	105091.35	26.48	149256.89	12.07
2004-05	132183.05	25.78	172774.49	15.76
2005-06	162337.49	22.81	203814.12	17.97
2006-07	225045.23	38.63	248467.22	21.91
2007-08	312220.49	38.74	280926.64	13.06
2008-09	338905.81	8.55	289043.19	2.89
2009-10	363956.00	7.39	277123.34	-4.12

Source: Indian Public Finance statistics 2000-01, 2003-04 , 2009-10,, Govt of India, Min of Finance, New Delhi.

In the case of indirect taxes, while the share of custom duties in gross tax revenue declined marginally by nearly two percentage points between 2003-04 and 2008-09, the share of Union excise duties witnessed a sharp decline largely on account of rate cuts, and in recent years, on account of the slowdown in the growth of the manufacturing sector. The share of indirect taxes would have fallen further but for the buoyant revenue from service tax. Service tax improved its share from 3.10 per cent in 2003-04 to 10.35 per cent in 2008-09. The increase in the share of service tax was on account of an increase in both coverage as well as tax rates.

Tax/GDP Ratio

Table 5.4 gives data on Tax/GDP ratios during 1990-91-to 2009-10.

TABLE - 5.4

Tax/GDP Ratio of Central Government

(Gross Tax Revenue)

Year	Direct	Indirect	Total
1950-51	1.75	2.27	4.02
1960-61	1.68	3.46	5.14
1970-71	1.88	5.05	6.93
1980-81	2.06	7.00	9.07
1990-91	1.94	8.17	10.11
1991-92	2.34	7.94	10.29
1992-93	2.41	7.51	9.92
1993-94	2.34	6.4	8.75
1994-95	2.66	6.43	9.09
1995-96	2.82	6.52	9.33
1996-97	2.82	6.59	9.41
1997-98	3.16	5.95	9.12
1998-99	2.66	5.55	8.21
99-2000	2.97	5.83	8.8
2000-01	3.25	5.72	8.97
2001-02	3.04	5.17	8.21
2002-03	3.4	5.4	8.8
2003-04	3.82	5.42	9.23
2004-05	4.08	5.33	9.41
2005-06	4.38	5.5	9.88
2006-07	5.25	5.8	11.05
2007-08	6.31	5.68	11.99
2008-09(RE)	6.08	5.19	11.26
2009-10(BE)	5.84	4.45	10.29

Source: Indian Public Finance Statistics 2009-10, Min of Finance Govt of India New Delhi. The ratios to GDP at market prices are based on CSO's national account 2004-05 series and prior to 2004-05 on old series of CSO's national account 1999-2000

The gross tax revenue of the Central Government as a percentage of GDP dropped from 10.11 per cent in 1990-91 and 9.33 percent in 1995-96 and further to 8.21 per cent by 1998-99. The tax reforms process failed in making any significant dent in fiscal deficit during this period, in so much as it has not been successful in pulling up a stagnant tax/GDP ratio. It somewhat revived to 9.03 per cent in the year 2000-01 only to fall again to 8.09 per cent in 2002-03 in the following two years. In the post FRBM period, the gross tax-GDP ratio went up by over three percentage points in a span of four years, from 9.23 per cent in 2003-04 to 12.56 per cent in 2007- 08 , but showed a downward trend in 2008-09 and 2009-10(BE) and declined to 10.29 percent in 2009-10(BE) the figures in 1991-92.

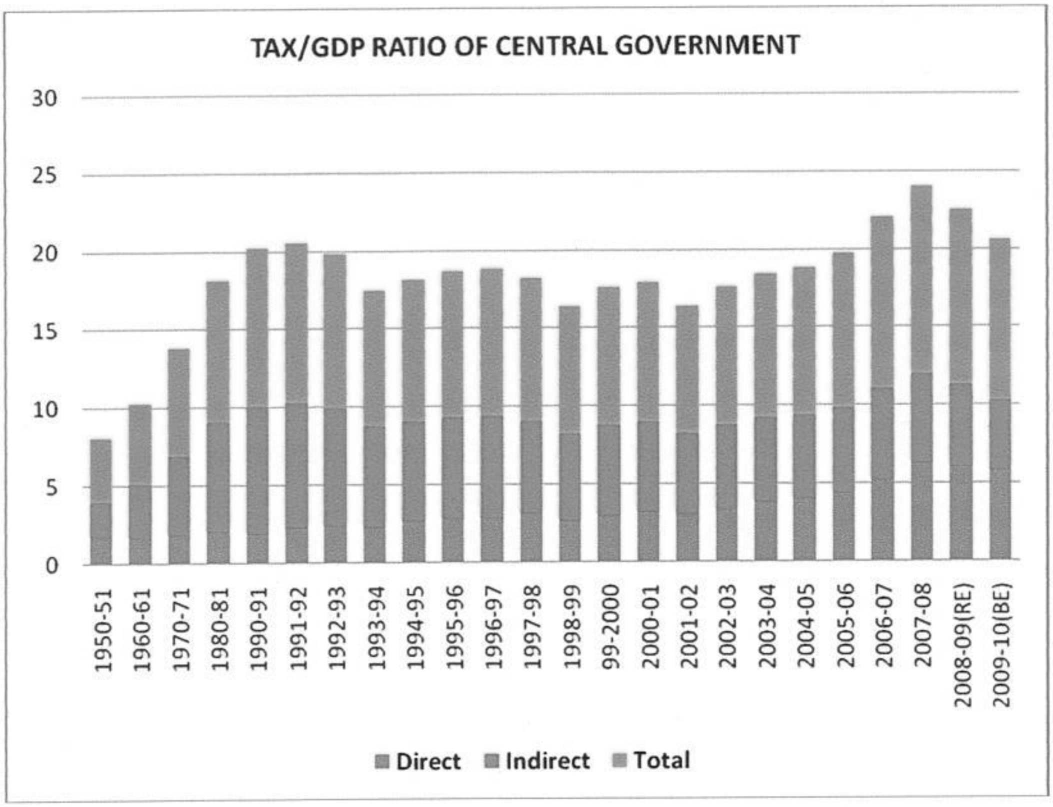

Figure 5.3

The improvement from 2001-02 to 2008-09 (RE) came largely from the buoyancy of direct taxes, particularly corporation tax, reflecting the increasing profitability of the Indian corporate sector. In fact, indirect tax-GDP ratio remained stagnant between 5 and 6 per cent since the late nineties.

Despite efforts at tax reforms, improvement in tax/GDP ratio is constrained by a shift in the composition of GDP in favour of services sector which is contributing about half of GDP but has yielded very little by way of tax collection.[3] Moreover since 1990-91 there has been a conscious effort to reduce the rates of commodity taxes, both customs and excise as a part of trade liberalization. The lower tax to GDP ratio is attributable to a fall in indirect tax to GDP ratio from 7.9 per cent in 1990-91 to 5.1 per cent in 2001-02 though it has shown some improvement by reaching 5.4 per cent in 2003-04 **(Table 5.4).** The tax GDP ratio rose to 6.32 in 2009-10 for the direct taxes but declined to 4.36 for indirect taxes in the same year. The key factors responsible for this low tax/GDP ratios are low revenue base due to exemptions, implementation issues, and inadequate use of IT.

Tax Structure-A Compositional Shift In Favour Of Direct Taxes

The most important accomplishment of this period has been in the area of direct taxes where the collections rose sharply from 16 per cent of total tax revenue (net of state's share) in 1990-91 to 41.67 per cent in 2003-04 (BE). In the period between 2004-05 and 2009-10, the share of direct taxes increased from 43.53 percent to 57.72 percent **(Table 5.5)** while the share of indirect taxes declined from 56.47 percent to 42.28 percent. The share of direct taxes in total tax revenues increased from 16 percent in 1990-91, to over 57 per cent in 2009-10. This change in favour of direct taxes has been sharper in the last four years of this period. Higher growth of direct taxes, **has also resulted in a shift in the composition of gross tax revenues of the Centre**. For the first time in the history of public finances in India, in the year 2007-08, direct tax have overtaken indirect tax collections. This is a healthy development as direct taxes are more progressive than indirect taxes. Table 5.5 shows the trends in growth of direct and indirect taxes.

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3 Government of India, *Economic Survey- 2001-02,* Ministry of Finance, New Delhi, p.41

TABLE-5.5

Relative Share of Direct and Indirect Tax

			(In Per cent)
Year	Direct Tax Revenue	Indirect Tax Revenue	Total Tax Revenue Net of State's share
1990-91	16.05	83.95	100
1991-92	20.43	79.57	100
1992-93	22.33	77.67	100
1993-94	24.66	75.34	100
1994-95	27.3	72.7	100
1995-96	27.2	72.8	100
1996-97	27.08	72.92	100
1997-98	28.41	71.59	100
1998-99	30.7	69.3	100
99-2000	32.3	67.7	100
2000-01	33.33	66.67	100
2001-02	35.7	64.3	100
2002-03	39.7	60.3	100
2003-04	41.67	58.33	100
2004-05	43.53	56.47	100
2005-06	45.12	54.88	100
2006-07	48.61	51.39	100
2007-08	52.63	47.37	100
2008-09	55.48	44.52	100
2009-10	57.72	42.28	100

Source: Indian Public Finance Statistics, 2003-04, and 2009-10, 2009-10, Ministry of Finance, New Delhi.

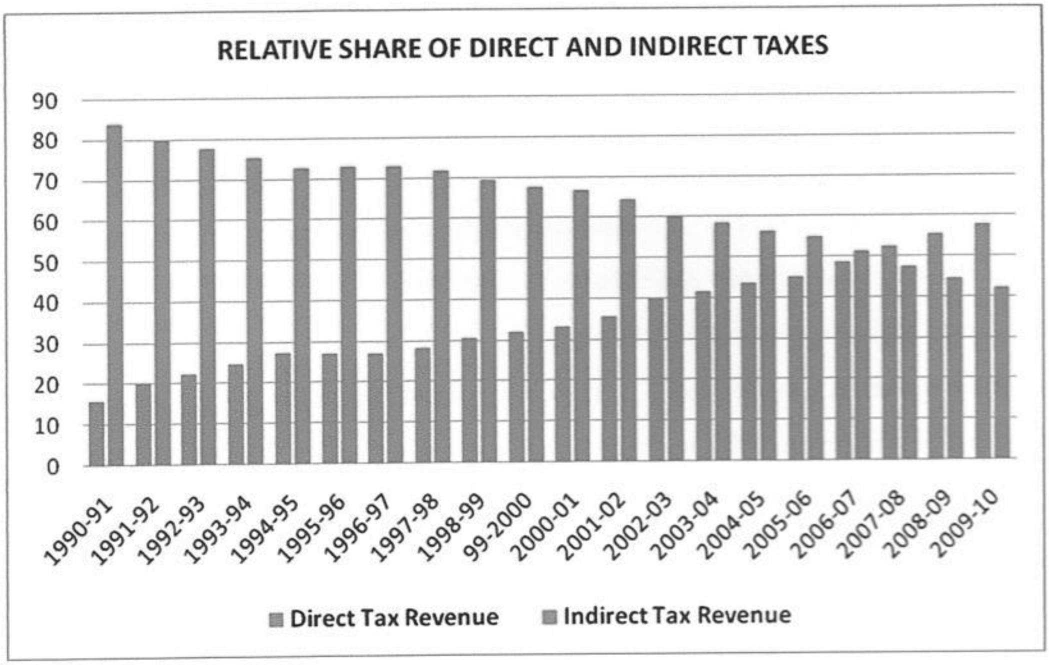

Figure 5.4

Tax Reforms and Fiscal Deficit

The need to create a tax system that would increase revenue buoyancy, make administration mere simple and efficient and increase equity between economic sectors with respect to tax burden was unanimously recognized and the consensus on tax reforms had evolved much before the economic crisis broke out in 1990. Actually the Long Term Fiscal Policy (LTFP) contained important aspects of tax reforms. It clearly stated a broader base of taxation.... combined with moderate rates of taxes and strict enforcement can yield better revenue results." It also espoused clearly the ideal of a uniform custom duty.[4] Recognising that stabilization in the ultimate analysis can be achieved only through a buoyant revenue system[5] the Government set up a high powered committee on tax reforms under the chairmanship of Dr. Raja J. Chelliah (1991).The Chelliah Committee advocated simplification of the tax structure and adoption of limited number of simple broad based taxes with simple rate structure and very few exemption and deductions which formed the basis of major changes in the tax system between 1990-91 to 2003-04 .

These tax reforms though comprehensive and of far reaching consequences, have not been of much help in greater tax revenue realisation for the Centre. The growth of tax revenues should be of an order which is sufficient to bring down the revenue deficit to a zero level so that capital receipts could be entirely utilized for investment. Unfortunately this has not happened in India yet. The data clearly establishes the fact that growth of tax revenue decreases fiscal deficit, as poor growth of tax revenue has invariably resulted in high growth of Gross fiscal deficit. The GFD/GDP ratios were 6.4 percent 4.8 per cent, 6.2 per cent and 6.5 percent of GDP respectively for these fiscally difficult years 1993-94, 1997-98, 2001-02 and 2009-10 respectively, in which the fiscal consolidation process received serious setbacks.(Table 5.6)

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4 Acharya, Shankar,*Milestones in Tax Policy*, Economic Times, Feb. 7, 2001.

5 Chelliah, Raja J. Towards Sustainable Growth: *Essays in Fiscal and Financial Sector Reforms in India,* OUP, New Delhi, 1996, p.89

Table-5.6

Centre's Tax Revenue and Fiscal Deficit Trends

Year	Tax Revenue(Rs. Crore)	Tax Revenue (As Percent of GDP)	Fiscal Deficit(Rs. Crore)	Fiscal Deficit (As Percent of GDP
1993-94	54505.81	8.75	55257	6.4
1997-98	95672.49	9.12	73204	4.8
2001-02	133661.72	8.21	140955	6.2
2005-06	270264.23	9.88	146435	4.0
2007-08	439547.12	11.99	126912	2.6
2009-10	474217.57	10.29	400996	6.5

Source: Compiled from Indian Public Finance Statistic, Ministry of Finance, New Delhi, 2003-04.and 2009-2010 and Economic Survey 2004-05 and 2009-10.

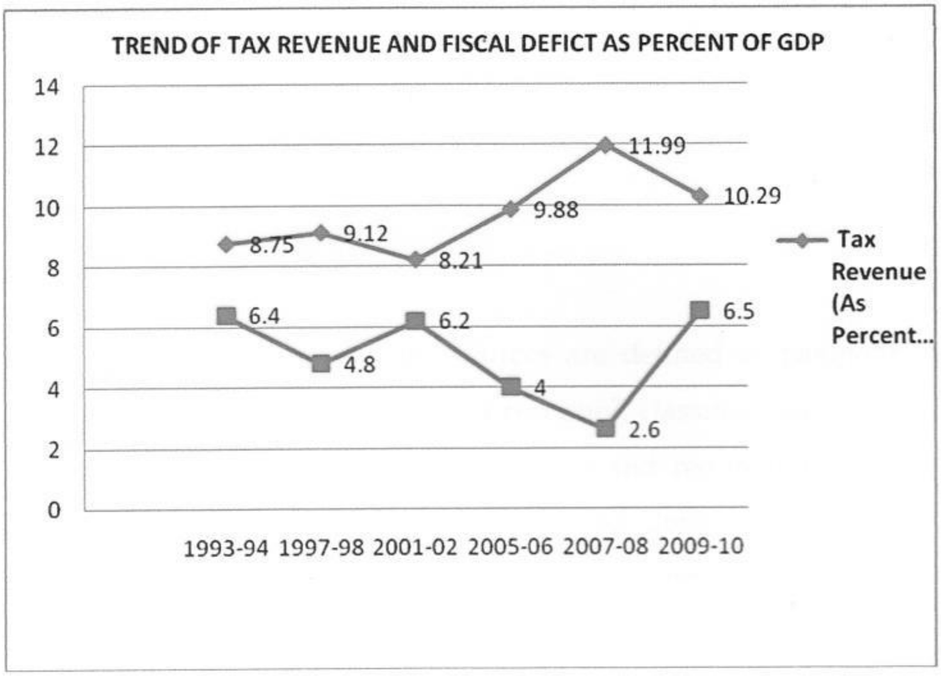

Figure 5.5

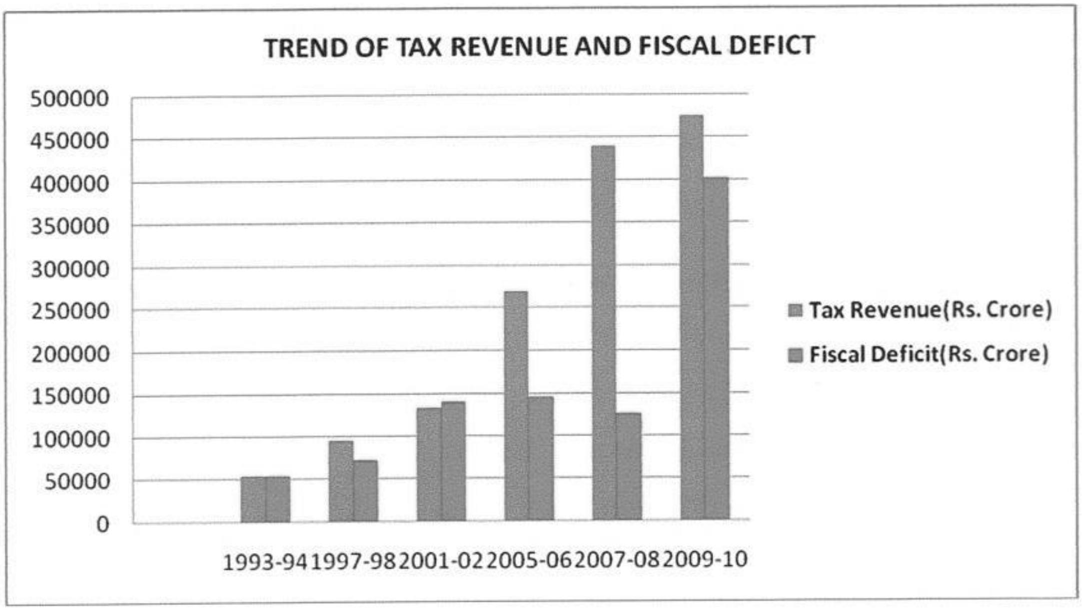

Figure 5.6

Service Tax

The service sector has been an extremely fast growing area, now accounting for half of the GDP. Hence it was very important to add services to the tax base.[6] Service tax improved its share from 3.10 per cent in 2003-04 to 10.35 per cent in 2008-09 and 10.14 percent in 2009-10. The increase in the share of service tax was on account of an increase in both coverage as well as tax rates.

Non-Tax Revenue

Non Tax Revenue: Non tax sources are defined as payment to the Government for which there is no quid pro quo[7], classified into three broad categories, viz sources which are compulsory and requited payments like penalties, voluntary and unrequited receipts like donations, voluntary and requited payments including revenue earned from resources owned by the

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6 Rao, M.G. Tax Reforms in India: Achievements and Challenges, *Asia-Pacific Development Journal 7(2), 2000*, p.59

7 Purohit Mahesh C and Purohit Vishnukant. *Non-Tax Sources in India, Issues in pricing and delivery of services.* Foundation for PEPR, New Delhi

Government, like forests, marine habitats and riparian rights etc.

Mobilising resources through nontax sources serves the twin purpose of rationalizing non tax structure and generating greater means to achieve economic growth.[8] Table 5.2 shows the trends in tax and non tax revenues.

Non-tax revenue of the Centre mainly comprises interest receipts, dividends and profits from public sector undertakings including banks, and receipts from economic services. Augmentation of non-tax revenues by way of enhancement of user changes and returns of Government investments through a restructuring of PSUs, was a key objective of the economic reforms process. From a low base of Rs. 11948 crores in 1990-91 non-tax revenues grew to a level of Rs 77801 crores in 2003-04. This 6.5 times increase in non-tax revenues has been largely due to increase in interest receipts, net contribution of PSUs, profits of RBI which includes dividends/profits of nationalised banks and other Government financial profits from light houses and lightship. (Table 5.2) In the post FRBM reforms period, it increased to 101542 crores in 2007-08, declined to 93018 crores in 2008-09 before rising again to 135804 crores in 2009-10(BE). As a proportion of GDP, non tax revenue recorded on improvement from 2.1 per cent in 1990-91 to 2.79 per cent in 2003-04 after which it declined to 1.81 per cent in 2008-09 (TFC). The share of interest receipts in the non-tax revenues of the Centre declined from over 50 per cent in 2003-04 to less than 20 per cent in 2008-09. Now the predominant share in non-tax revenues is accounted for by dividends and profits and economic services.

The major areas of low recovery of cost of delivery in case of non-tax revenue are **social and community services** and **economic services** which account for a very small percent of total non-tax revenue.

Serious underpricing of scarce inputs like water encourages its overuse

8 Ibid .

and misuse. [9] On the one hand Government agencies spend crores of rupees on save water advertisement campaigns and on the other hand people waste water because it comes too cheap for them.

Similarly, the subsidies going to Economic Services which include agriculture, rural development, energy industry and minerals, irrigation and flood control etc. are very high with low recovery rates. There is immediate need of a close scrutiny of such subsidies and for raising user charges for large farmers whose paying capacity has grown substantially since green revolution.

SAVINGS: The gross savings rate rose from 32.2% in 2004-05 to 36.4% in 2007-08, before falling to 32.5% in 2008-09. The fall in 2008-09 was because of a fall in public sector savings, possibly as a result of the implementation of the sixth pay commission's recommendations. A structural change was a shift in the source of savings in the economy away from the household to the corporate sector. Thus, the period witnessed a sharp rise in private savings, which largely came from the corporate sector.

This performance on the front of savings has been mainly sustained by the buoyancy of household savings and to some extent by the private corporate sector's savings. The performance of public sector savings has been dismal and it has not been conducive either to overall savings rate or to the growth performance of the economy. Thus the public savings which are calculated from budgetary data and are composed of budgetary surpluses on current account of Central and state governments, current surpluses of various government departments and retained profits of government undertakings need to be generated in order that the same could contribute to strengthen infrastructure development. Since the government alone cannot

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9 Shome, P. Sen, Tapas and Gopalakrishnan K. Public Expenditure Policy and Management in India: A consideration of issues, *NIPFP Working Paper no.8,* New Delhi, June 1996, p.11.

shoulder the responsibility due to financial and resource constraints, the role of private sector savings for investment becomes crucial to help in execution of government projects in areas like national highways, power, transport, airports and seaports and to involve builders and NGOs (non-governmental organizations)and other experts to jointly execute such infrastructure development projects.