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Trends and Composition of Central Government Finances of India: Pre and Post-Reform Analysis

KEYWORDS: Revenue Policy, Expenditure Policy, Fiscal Measures, Government Finances

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ABSTRACT *In India the public expenditure and revenue policies has been assigned a key role in the economic development and growth process.However, theycould also have detrimental ramification if obscurely managed. Thus, the nature and degree of this expenditure and revenue pattern determine the overall quality of the government finances in India. This paper examines the trends and compositional changes in expenditure and revenue pattern of the central government of India during 1970-71 to 2010-11. This period is further divided into in the pre-reform and post-reform period.Study concluded thatas a result of reform measures, expenditure has grown at a lower rate in the post reform period than pre-reform period. However, on the revenue side reforms measures have not resulted into significant improvement in the revenue receipt as the growth of revenue receipts in the post-reform period has remained less than the pre-reform period.*

1. Introduction

In the post-independence years India followed the policy of planned growth and for that it pursued conservative policies. The public sector was given a predominant role and was made the main instrument of growth. The private sector with limited capital flow was required to contribute to the country's development in ways envisaged by the Indian planner. These conservative policies continued for decades, but it was noticed as early in the 1980s that there were excess of consumption and expenditure over revenue resulting in heavy government borrowing. Later this resulted in fiscal crisis at the beginning of 1991-92. Since 1991, central government carried out number of fiscal sector reforms. The overall impact of these reforms on expenditure and revenue policy has been quite encouraging for the few years of the first half of the 1990s. However, the rising share of expenditure in GDP through the late 1990 and early 2000s, without commensurate increase in revenue share of GDP reduce the overall quality of the government finances. Given the serious concern expressed on the fiscal position in the country, the government passed the Fiscal responsibility Management Act (FRBM Act) in 2003. However, the government has continuously failed to achieve the targets of the FRBM Act.In this context to measure the overall quality of the government finances following sections examine the trends and composition of expenditure and revenue pattern of the central government of India.

2. Trends and Composition of Expenditure Pattern of the Central Government

Total expenditure of the central government of India comprises of revenue and capital expenditure. Revenue expenditure is expenditure incurred for the purpose other than creation of assets of the central government. It is the expenditure incurred on civil administration, defence forces, public health and education, maintenance of government machinery etc. This type of expenditure is of recurring type which is incurred year after year. On the other hand, that expenditure of the government which led to the reduction in recurring financial liabilities falls under the category of capital expenditure. Such expenditure pertain to payments on acquisition of assets and loans and advances, expenditure on durable assets like highways, multipurpose dams, irrigation projects, buying machinery and equipment etc. They are non-recurring type of expenditure in the form of capital expenditure. Such expenditures are expected to improve the productive capacity of the economy.

Table 1 presents the compound annual growth rate (CAGR) of the total expenditure of the central government and its components. Since 1970's the main concern of the central government was to increase the development of the country by revamping public expenditure policy in direction of poverty alleviation, employment generation, and rural development.

Table 1: Compound Annual Growth Rates (CAGR) of Total Expenditure of the Central Government and its Components

Year	Whole period 1970-71 to 2010-11	Pre-reform Period 1970-71 to 1990-91	Post-reform Period 1991-92 to 2010-11
Total Expenditure	14%	16%	13%
Revenue expenditure	16%	17%	14%
Capital Expenditure	11%	14%	9%

Source: Data Compiled and Computed from Handbook of Statistics on Indian Economy, Reserve Bank of India, 2011-12.

To achieve these objectives the total expenditure of the central government stepped up drastically. In the pre-reform period total expenditure of the central government recorded a growth of 16percentper annum. This sharp increase in total expenditure is mainly due to continuous increase in revenue expenditure, which was recorded a growth of 17 percent per annum in pre-reform period. On the other hand there has been continuous decline in the share of capital expenditure in total expenditure in the pre-reform period. Capital expenditure recorded the growth of 14 percent per annum in the pre-reform period of 21 years.

Since 1990s the government undertook number of measures to curb expenditure growth and to bring about changes in the composition of expenditure. Expenditure reform commission set up by the government suggested a host of measures to curb built-in-growth in expenditure and some of these measures have been implemented by the government. These included subjecting all ongoing schemes to zero-base budgeting, reduction of the posts at various levels and introduction of Voluntary Retirement Scheme (VRS) for surplus staff, review of all subsidies and encouraging to PSUs to

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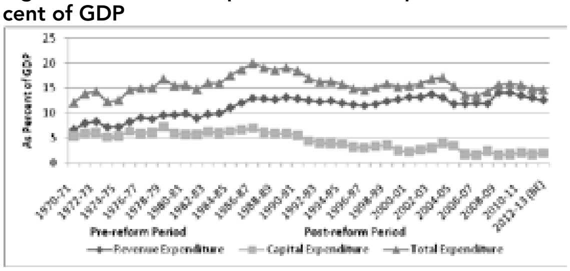
maximize generation of internal resources. Despite these numerous measures taken by the government, the expenditure continuously increased during the post-reform period which was the main contributory factor in the fiscal crisis.

In the post reform period, total expenditure of the central government has grown at a lesser rate of 13 percent per annum as compared to the pre-reform period.The reason behind increase in the total expenditure was sharp increase in the revenue expenditure of the central government. Revenue expenditure during the post-reform period has registered the growth of 14percent per cent per annum.Reasons behind the increasing share of revenue expenditure in total expenditure in the post-reform period was the rise in interest payment, sharp increase in salary bill, pension payments, government schemes for the welfare of the poor, agriculture schemes like debt relief for agricultural loans, introduction of an employment guarantee scheme.On the other hand, there is a sharp fall in the share of the capital expenditure. Capital expenditure of the central government recorded 9 percent growth rate per annum during the post-reform period.Therefore, in spite of all these reforms, the decline in the share of capital expenditure in the post-reform period is almost same as the decline in this share in pre-reform period. Overall it is clear that the share of the revenue expenditure as compared to the capital expenditure of the central government remains significantly higher during the period 1970-71 to 2010-11.

Figure 1: Revenue, Capital and Total Expenditure as Percent of GDP



Source: Data Compiled and Computed from Handbook of Statistics on Indian Economy, Reserve Bank of India, 2011-12.

B.E. = Budget Estimates

Figure 1 reveals the overall picture regarding total expenditure, revenue expenditure and capital expenditure as percent of GDP of the central government for the period 1970-71 to 2012-13. Revenue expenditure as percent of GDP was very high and continuously increasing in the pre-reform period and the gap between revenue and capital expenditure started widening in the mid-eighties. During post-reform period revenue expenditure was much higher than capital expenditure and the gap between these two widened extremely up to mid-2000s.

3. Trends and Composition of Revenue Pattern of the Central Government

Total receipts of the government are classified into revenue receipts and capital receipts. Revenue receipts include revenue received in the form of tax and non-tax revenue. On the other hand, receipt on capital account is composed of market borrowing, small saving, provident fund, special deposit, recovery of loans, disinvestment receipts, and external loan.

All receipts which are non-redeemable may be termed as revenue receipts. These include revenue from taxes and non-taxes sources of revenue such as proceeds of taxes and other duties levied by the center, interest and dividend on investment made by the government, fees and other receipts for services rendered by the government, income from the public sector undertaking like post and telegraph, railways etc. Those receipts of the central government which create liability and reduce financial asset may be called capital receipts. These include loans raised by the government from public which are called market loans, borrowing by the government from Reserve Bank of India and others through sale of Treasury Bills, loans received from foreign governments and bodies and recoveries of loans granted by the central government to state and union territory governments and others. It also included proceeds from disinvestment of government equity in public enterprises.

Table 2 shows the compound annual growth rates (CAGR) of receipts of the central government and its components. In the pre-reform period total receipts, revenue receipts and capital receipts of the central government of India are showing an increasing trend. Total receipts of the central government have been continuously increasing since 1970-71 expect for the year 1979-80.

Table 2: Compound Annual Growth Rates (CAGR) of Receipts of the Central Government and its Components

Year	Whole period 1970-71 to 2010-11	Pre-reform Period 1970-71 to 1990-91	Post-reform Period 1991-92 to 2010-11
Total Receipts	14%	15%	14%
Revenue Receipts	15%	15%	14%
Capital Receipts	14%	16%	13%

Source: Data Compiled and Computed from Handbook of Statistics on Indian Economy, Reserve Bank of India, 2011-12.

The deterioration in 1979-80 was due to the decline in interest receipts, shortfall in recoveries of loans and advances and lower receipts under external assistance than originally anticipated (Economic Survey, 1979-80). Significant measures were taken by the government to augment revenue such as reduction of maximum marginal rate of personal income tax on the recommendation of the Direct Taxes Enquiry Committee, 1971 (Economic Survey, 1980-81). Consequently there was a rapid increase in the total receipts of the central government recorded the growth of 15 percent per annum during the pre-reform period. Total receipts showed an increasing trend and registering the growth of 14percent per annum in the post reform period. It was due to the reforms undertaken by the central government in the tax system.

The revenue receipts of the central government have also witnessed a sharp rise in the pre-reform period. Such receipts recorded the growth of 15 percent per annum during pre-reform period. This was due to increase in taxes on income, interest receipts and receipts from general services (Report on Currency and Finance, 1978-79). The government undertook various policy initiatives to raise revenue which included an overhaul of the excise tax structure through the introduction of Modified Value Added Tax (MODVAT), the lunching of a simpler and more growth oriented schemes of excise duty concessions for small scale units and rationalization of taxation provisions relating to gifts and capital gains and systematic steps to curb tax evasion (Economic Survey, 1986-87).

There was a fiscal crisis by the beginning of the fiscal year 1991-92. To deal with the situation the government announced a number of measures targeting tax revenue in 1991-92. These included the announcement of 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 ad-valorem rates of custom duty rationalization of auxiliary duties, and rising of special excise duty (Economic Survey, 1991-92). As a result there was substantial increase in revenue receipts of the central government. Thereafter, reduction in personal and corporate tax

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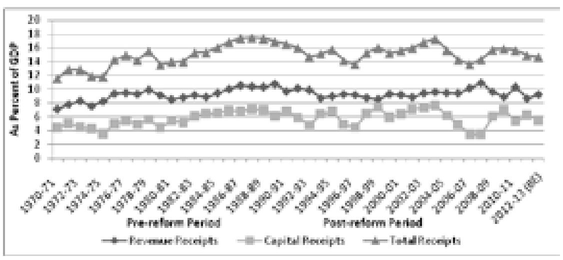
rates have brought a substantial increase in the share of the revenue receipts in 2007-08 recorded a growth rate of 14% per annum in the post-reform period.

Capital receipts of the central government recorded a growth rate of 16percent per annum in the pre-reform period. Capital receipts increase mainly on account of larger market borrowing, state and public provident funds and receipts under the Special Bearer Scheme (Economic Survey, 1981-82). During post reform period capital receipts registered a lower growth rate of 13percent per annum. There was a sharp decline in capital receipts which was mainly on account of the discontinuance of the debt swap scheme (Economic Survey, 2005-06).

Conclusively, revenue receipts recorded lower growth (15 percent per annum) as compared to capital receipts (16 percent per annum) during the pre-reform period. But the rate of growth of revenue receipts (14 percent per annum) was higher than the rate of growth of capital receipts (13 percent per annum) in the post-reform period.

Figure 2: Revenue, Capital and Total Receipts of the Central Government as Percent of GDP



Source: Data Compiled and Computed from Handbook of Statistics on Indian Economy, Reserve Bank of India, 2011-12.

B.E. = Budget Estimates

Figure 2 reveals the overall picture regarding revenue, capital and total receipts of the central government as percent of GDP. As proportion of GDP, total receipts of the central government, comprising of revenue and capital receipts, had risen significantly in 1990-91 due to large number of reforms to raise revenue. Further during the post-reform period, revenue has shown a declining trend.Hence reduction in number of slabs of personal income tax (Economic survey, 1985-86), introduction of MODVAT (Economic Survey, 1986-87), rationalization of custom and excise duties (Economic Survey, 1987-88) and enactment of direct Tax Law Bill (Economic Survey, 1989-90) were the major measures undertaken by the government.

However, revenue receipts as percent of GDP had not grown significantly. During the post-reform period too, no improvement has been seen in revenue receipts as percent of GDP. It may be noted that the introduction of an additional refinements to MODVAT has resulted in the reduction in revenue receipts of the central government. The improvement in the revenue receipts in 2007-08 owes to the macro-economic policy frame which facilitated the implementation of some of the key point in the fiscal agenda in the Kelkar Task Force Reports on direct and indirect taxes (Economic Survey, 2008-09). Capital receipts of the central government have been shown fluctuation during 1970-71 to 2012-13.

4. Conclusion

From a look at the trends in expenditure at the central level, it is concluded that total expenditure of the central government has been rapidly growing and it increased at the rate of 14 percent per annum throughout the study period. The main reason behind this increase in the total expenditure is the continuous increase in the share of the revenue expenditure which created serious fiscal imbalance in the economy. As a result of reform measures, revenue expenditure has grown at a lower rate in the post reform period than pre-reform period. Capitalexpenditure on the other hand has recorded a higher growth in the post-reform period than the pre-reform period.

On the revenue side, total receipts, revenue receipts as well as capita receipts of the central government have grown at the rate 14 percent, 15 percent, and 14 percent respectively throughout the study period. The analysis reveals that the reform measures undertaken by the central government have not resulted into significant improvement in the revenue receipt as the growth of revenue receipts in the post-reform period has remained less than the pre-reform period. On the other hand, the capital receipts of the central government recorded a lower growth in the post-reform period as compared with the pre-reform period.

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