INDIAN STREAMS RESEARCH JOURNAL

ISSN: 2230-7850
IMPACT FACTOR : 4.1625(UIF)
VOLUME - 6 | ISSUE - 12 | JANUARY - 2017

STUDY OF GOVERNMENT FINANCES OF INDIA

Mr. Hashmat Mehdi Ali Khan
Research Scholar, Swami Ramanand Teerth Marathwada University, Nanded

ABSTRACT

Fiscal Policy in India – Public Expenditure of Government – Receipts by the Government – Ways and Means Advances – Nature of Government Budget - Tax Reforms – Indirect Taxes – Direct Taxes – Increase in Tax Rate – Increase in Tax Base – Ensuring Tax Compliance.

KEYWORDS: *Government Finances , Increase in Tax Rate , Fiscal Policy .*

INTRODUCTION OF FISCAL POLICY IN INDIA:

The government does not perform any business so it cannot earn money to spend. Hence the government has to raise the money from the economy to enable it to spend that money in terms of requirements and national priorities. The government raises money primarily through 'taxes' and the spending known as public expenditure'. A policy which affects either the manner in which the government raises resource or spends is known 'fiscal policy'. The objectives of any fiscal policy of a country are as follows:

(1) To ensure that the expenditure in an economy is in terms of national priorities, boost growth for the welfare of the people.
(2) Expenditure being incurred should not lead to a price rise situation.
(3) There should be efficiency in the way of resources that are raised and spent.
(4) Efforts are to be made to avoid wasteful expenditure in the economy.
(5) Resources being raised by the government through taxes should not create burden the common man.
(6) Taxation should be 'just' and helpful in reducing income inequalities.
(7) The policy should aim for overall improvement of the welfare of the economy.

In India, there is no fiscal policy by the name; however, the objectives of those are be achieved by the annual financial statement popularly known as the budget which tabled in the parliament. Hence, budget is not merely the details of expenditure and taxes but is also a policy tool to sub-serve objectives of a fiscal policy. The budget, thus, is more than a balance sheet of government receipts and expenditures

presented to parliament.

PUBLIC EXPENDITURE OF GOVERNMENT:

Public expenditure is spending by the central government. Broadly, there are two kinds of expenditure—one is plan expenditure, which is expenditure ear marked for investment in different areas, in the five-year plans for various sectors of the economy. These could be either capital or revenue in nature. Capital expenditure represents creation of as in an economy and is thus desirable for growth. For example, money spent for set up power plant is a capital expenditure. Revenue expenditure is recurring in nature, for maintenance, etc.

The other is the non-plan expenditure which is an expenditure not covered in the five- year plan but yet has to be incurred and could again be either revenue or capital. In India, non-plan expenditure is 70 per cent of the total expenditure whereas plan expenditure is only 30 per cent. The highest expenditure is non-plan revenue expenditure accounting for 63 per cent of total expenditure.What are the components of non-plan revenue expenditure? The first is the interest payments (servicing of the loans taken by the central government both internal and external) accounting for over 25 per cent of the total expenditure. Secondly, subsidies (food, fertilizers and retail petroleum goods). Thirdly establishment expenses of defense. Fourthly, loans to state governments/UT, establishment expenses of central government, pension to defence/central government retired personnel. Expenditure on these heads would account for over 90 per cent of non-plan revenue expenditure. These expenses are also known as consumption of the government as no assets are created.

Receipts by the Government:

The expenditure in an economy is met out of receipts by the government through various sources. The receipts could be revenue (which do not create any interest liability for the government, regularity in their receipts and not representing borrowings) and the other as capital (either creating a liability for the government or less certain of their receipt or borrowings). Of the total receipts, 90 per cent is revenue and 10 per cent is capital receipts. The primary source of revenue receipts is tax revenue (84 per cent of total receipts). Taxes could be either direct or indirect.

How to distinguish direct tax from indirect tax? Direct tax is a tax where the subject on whom the tax has been levied is identifiable, who has to pay the tax and the tax burden cannot be shifted. Examples can be income tax, corporate taxes, wealth tax, etc. In case if the subject is not identifiable or if the burden can be shifted it is an indirect tax. Common examples are excise duty (payable by companies on manufacturing activities), customs duty (duty on import of goods), service tax (tax on services being rendered by service providers), etc.

Fifty-five per cent of the tax revenue arrives through direct taxes while 45 per cent of the revenue is from indirect taxes. The base on which the tax is applied for indirect taxes could either be on value (ad valorem) or specific on a particular attribute (length of staples in cotton). India primarily follows an ad valorem indirect tax structure.

Certain taxes are levied by the central government and at the same time it is also collected by the central government (income tax, customs duty, excise duty and service tax), certain taxes levied by the central government but collected by the state governments (central sales tax levied on inter-state movement of goods). A few other taxes are levied and collected by the respective state governments (sales tax, octroi, municipal taxes, road tax, entertainment tax and agriculture tax).

The basis of sharing the tax revenue between the centres and the states are decided by the finance commission. The thirteenth finance commission under the chairmanship of Shri Vijay Kelkar has since submitted its report and is effective from 2010 to 2015.

There are two additional taxes—one is the surcharge which is imposed for additional revenue

VOLUME - 6 | ISSUE - 12 | JANUARY - 2017

considerations by imposing an additional percentage on the absolute amount of tax payable. Suppose surcharge on a tax is 5 per cent and the tax payable is Rs.100 then the total tax liability including surcharge would be Rs. 105.

The other is cess which is similar in application as the surcharge except that the amount collected by way of cess is meant solely for specific funding/cause like education cess, the amount collected would go for funding of education only.

Components of revenue receipts other than taxes are dividends received by the government from public sector, payment of interest by the state governments etc. Similarly, capital receipts of the government comprises of recoveries of loan, grants, assistance received by the government etc.

WAYS AND MEANS ADVANCES:

An interesting characteristic of expenditure and the receipts of an economy is that, all the receipts come with a lag over a period of time like direct taxes would be by the end of each quarter while committed expenditure as to be incurred immediately.

That is, for example, if there is a temporary mismatch between government s receipts and expenditure in a financial year and to meet this mismatch the Reserve Bank of India provides temporary overdraft to the government through the 'ways and means advances'.

This overdraft facility is for a time period of 90 days and the amount of overdraft is Rs. 20,000 crores during April to September and Rs 6000 crores during October to March.

NATURE OF GOVERNMENT BUDGET:

Thus, so far we have discussed the expenditure and receipts. What happens if expenditure exceeds receipts? It would result in a deficit or otherwise in a surplus and if both match then balanced.

What is good for an economy—a deficit, surplus or a balanced budget? To answer this question, a few aspects should be understood. There is a difference between personal and government budget and that being in a personal budget, spending is strictly in accordance with income. However, in a government budget, it is important to understand that expenditure is seen first and the reason for receipt is because of the need for spending in the economy. That is, a government budget by its very structure is deficit-oriented. Only in an economy where receipts surpass spending can there be a surplus or the government scales-down spending to match the receipts. This could drag down growth as lesser expenditure is taking place. More so in India, given the inflexibility to bring down non-plan expenditure, any reduction in expenditure would imply lesser capital expenditure and expenditure on social sector.

A balanced budget is good only if the budget is seen as a balance sheet or a statement of accounts of the government of India. A better thing can be a balanced budget multiplier which is an incremental increase in expenditure in any given year is met out of incremental increase in receipts in a given year.

Nature of Deficits:

Different components of expenditure and receipts are explained for a better understanding of deficits in the budget.

	Receipts	Rs in Crores		Expenditure	Rs in corores
1.	Revenue Receipts	90,000	4.	Non-Plan revenue expenditure a) (interest Payment)	90,000 (50,000)
2.	Capital Receipts (of which market borrowings of the government)	(10,000)	5.	Non-Plan Capital expenditure	25,000
			6.	Plan capital expenditure	50,000
			7.	Plan revenue expenditure	10,000
3.	Total receipts (1+2)	1,00,000	8.	Total revenue expenditure (4+7)	1,00,000
			9.	Total Capital expenditure (5+6)	75,000
			10	Total expenditure (8+9)	1,75,000

From the above example, we acquire to know various kinds of deficit.
(1) Budgetary deficit is total receipts (3) less total expenditure (10) Rs. 75,000 crores).
(2)Fiscal deficit is total receipts (but excluding government market borrowings) less total expenditure (Rs. 85,000 crores).
(3)Revenue deficit is revenue receipts (1) less revenue expenditure (8) (Rs 10,000 crores).
(4)Primary deficit is fiscal deficit less interest payments (4a) (Rs.35,000 crores) (A negative sign before the deficit would indicate surplus).

Since economies have begun targeting the fiscal deficit, usage of budgetary deficit has been discontinued. Of the remaining three, fiscal, revenue and primary which can be said to being potentially most dangerous? 'It is not the fiscal but the revenue deficit'. As revenue deficit implies borrowing money for meeting the consumption of the government and not to create assets. Borrowings per se are not bad as long as assets get created and the assets can service the borrowings.

In India, 70 per cent of the fiscal deficit is accounted for by revenue deficit. The primary deficit, on the other hand, tests for the sensitivity of interest payments towards fiscal deficit or how far the interest payments are responsible for the fiscal deficit.

A high primary deficit would mean that fiscal deficit is on account of factors other than the interest payments and structural in nature. A low primary deficit indicates that the high fiscal deficit is on account of interest payments, which is the case in India.

Hence we started by saying that the nature of government budget is deficit-oriented but too much of deficit is also bad as it contributes to inflation. It is difficult to say as what could be the 'safe' level of fiscal deficit.

A basic thumb rule is it should be under 3 per cent of GDP with a balanced budget multiplier. There are various compulsions of the government which make expenditure control difficult especially given their responsibilities for socio-welfare schemes infrastructure development, etc.

Still the government in line with the above had set definite time frame for reducing the fiscal and revenue deficit under the Fiscal Responsibility and Budget Management Act (FRBMA) for gradual reduction of revenue deficit by 0.5 per cent every year to be brought down to zero by 2007-2008. In respect of fiscal deficit the aim was to reduce it by 0.3 per cent every year beginning from 2004 to 2005. Clearly, the targets have not beer, achieved.

The global crisis initiated during 2007 required a fiscal stimulus package to ensure that the Indian economy does not slip into a recession and a conscious decision taken to relax the FRBMA provisions until the situation is improved.

If the expenditure needs are inflexible and deficits have to be checked the only way a to augment the receipts and this is where the government has focused through tax reform with the taxes being a major source of receipts for the government as it offered great potential. There is a need to increase the tax to GDP

ratio which is presently around 11 per cent especially given the growth of the economy there should be proportionately large increase in tax revenue.

Tax Reforms—Indirect Taxes:

It was mentioned previously that indirect taxes contribute about 45 per cent of the tax revenue. A major source of indirect taxes is excise duty which is payable on value of manufacturing activities in the economy. Excise duty like other indirect taxes by it is inherent structure is regressive in nature.

For example, the excise duty on salt is 10 per cent on a factory price of Rs. 10 which means the retail price for a packet of salt is Rs. 11 with an excise of Rs. 1 per packet going to the government. The price of Rs.11 is being paid by a person who is earning Rs. 5000 per month and also even by a person whose earning is Rs. 1,00,000 per month. The tax burden is higher on the people with lower income and that is what is meant regressive.

Secondly, multiple excise structure with multiple rates giving rise to different interpretation on tax payable giving scope for evasion, litigations and revenue loss to the government.

The third issue in excise is the cascading effect of taxes. For example, Maruti buys tyres from MRF company. The purchase price of tyres from MRF would have a component of excise duty, which becomes the input price for Maruti and excise duty has to be paid on the full value of car. This is known as the cascading effect, that is, taxes increase manufacturing cost and get again taxed.

The government has tried to address the issue by reducing the slabs of excise duty only and lower excise duty on essentials or mass goods to minimize the regressive character. 'With regard to the cascading effect, the best way to prevent it is by introducing value added tax (VAT) which is a tax on the value additions at each stage of production rather than on the finished goods provided the federal structure both centre and state government VAT would have to be at both levels.

An initiation was made with the government by first introducing the modified value added tax (MODVAT) scheme which allowed partial adjustment of duties on capital goods purchased, however, it was restrictive in nature. The government replaced MODVAT with a wider scheme of input credit for the excise duties inputs (raw materials, capital goods and services) purchased for direct use in production known as central value added tax (CENVAT) at the central level during 2004.

A major reform has been at the state level with the replacement of sales tax with state VAT. The credit for this goes to Shri. Asim Das Gupta the then Finance Minister, West Bengal and can be hailed as a landmark in tax reforms.

'Why' it is a major reform? First to make all the state governments to agree for the replacement of sales tax with a state VAT. The sales tax regime was very complicated with different sales tax rates for same products in different states. A state VAT required 'one product one tax rate' across all states and to drive a consensus for this was herculean effort as some states would stand to gain and others would tend to lose.

If in a particular state sales tax was a high of say 24 per cent but the consensus under a state VAT was only 12.5 per cent for that good clearly there would be revenue loss for that state government.

State VAT made effective from 1 April 2005 has the following salient features:

(1)State VAT is not a new tax but only a change in the way of collecting tax from the final stage to the value addition stage.

(2)This allows for set-off of duties from the tax payable but against original invoices / challans of the tax paid on the inputs purchased.

(3)There would be a uniform 4 per cent state VAT on 270 mass-consumed goods across all states, a uniform VAT of 12.5 per cent on 280 goods and 1 per cent on gold and silver ornaments across all states.

(4)Those with a turnover of Rs, 5 lakh and less would not be liable for any VAT, from Rs, 5 to 50 lakh a composite tax but with no set-off. VAT is payable for turnover exceeding Rs, 50 lakhs.

The state VAT has helped in checking tax evasion by introducing a 'bill culture', transparency in tax

VOLUME - 6 | ISSUE - 12 | JANUARY - 2017

administration and collection, increased revenue for the state government. Further, as part of deeper reforms, the government is proposing to integrate taxing of goods and services at differential rate separately into one tax with one tax rate as goods and services tax (GST) with both the centre and states taxing concurrently as the central government GST (CGGST) and the state government GST (SGGST).

This would considerably simplify the indirect tax regime, enlarge the tax base for larger resource generation and thus lower GST rate resulting in lower prices does of goods and services but also in ensuring the revenue for the government not to suffer. The government proposes to implement the GST regime as soon as there is broad based consensus with the states and technology put in place. Reforms in indirect taxes are commendable and the government's proposal of propelling to GST would place India with an efficient indirect tax regime at par with other mature economies of the West

Tax Reforms—Direct Taxes:

Direct taxes as seen earlier contribute 55 per cent of the tax revenue and it is a better way of taxation as it is progressive in nature and based on 'ability to pay', higher income, progressively, more the tax rate leading to greater revenue with least burden on the masses or those with low income. Direct taxes particularly income tax is progressive and in contrast to other taxes which are regressive in nature.

The progressivity of income taxes in periods of inflation pushes people up the bracket, as pay packets get inflated due to inflation resulting in higher taxes paid reduced spending by the individuals. On one hand, the coffers of the government fill up because of people moving up the tax bracket and on the other there is a reduced spend This phenomenon is known as 'Fiscal drag'.

How many people do you think are tax payers in the economy?

At present, 3.5 per cent are tax payers in the Indian economy, about 31.5 million population of over one billion people. This number is low especially considering the fact that India in its growing economy, with increased income, rising middle class, the affluent class and large number joining the elite billionaire club. In comparison, the number of tax payers has only increased by 11 per cent.

What are the ways through which tax payers and tax revenue can be increased? There could be three ways through which it can be increased and are as follows:

(1)Increase in the direct tax rates.
(2)Increase in the tax base.
(3)Enforce tax compliance.

Increase in Tax Rate:

Any increase in tax rate is seen negatively and resented by the people. There is also a relationship between the direct tax rate and revenue generated. Starting from a low tax rate and gradually increasing it, is positively related and increases tax revenue. However, beyond a level, any increase in tax rates becomes counter-productive as it lowers tax revenue rather than in increasing it. This is popularly known as the 'Laffer curve'.

An economy being on the Laffer curve implies that any increase in tax rates would lower the tax revenue and on the contrary lowering of tax rate would lead to increased revenue for the government. It is widely believed that India is on the Laffer curve with limited prospects of raising taxes.

This is because high tax rates lead to tax evasion, non-disclosure of income and generation of black money (taxes not paid). All efforts are made to minimize the incidence of taxes legally and illegally. It serves as a disincentive in the economy leading to lowering of income and the output. Hence, raising tax rates is not an option available in India.

Increase in Tax Base:

Tax base refers to that threshold level of income on which taxes become applicable. India has an exemption level, that is, if income is less than Rs. 1.6 lakh (Rs. 1.9 lakh for women) per annum taxes are not

VOLUME - 6 | ISSUE - 12 | JANUARY - 2017

payable. So one way could be to lower the exemption level so that more people are drawn in the tax net and thereby an increase in tax payers and tax revenue.

At present, the exemption level is very low given the present inflation. Besides the inflation does not factor in cost of education, transport and property prices all of which have increased manifold in recent times creating hardships and making it difficult for the middle class to make both the ends meet. Lowering the exemption would further burden the middle class and more so by this way it may be possible to increase the number of tax payers' but 'not necessarily tax revenue' as many would be marginal tax payers.

The other way to increase the tax base is to bring in untaxed sectors under the tax net. All sectors with the possible exception of the agricultural sector are already under the tax net. Agriculture being a state subject can be taxed only by the state government and not by the central government. Thus, like increasing tax rate, even increasing tax base is not a feasible option for raising direct tax revenue in India.

CONCLUSION:

This is to ask the question that is every person who ought to pay taxes is paying his/her taxes in terms of existing laws and the second are the people who are not paying should actually be paying taxes. This is what is meant by tax compliance. The government has made an initiation by making the income tax return form user friendly and easy to fill up by an-individual and it is known as 'Saral'.

The problem in India is that of tax compliance with lot of leakages, large-scale tax evasion and black money. It is estimated that over 40 per cent of GDP is black money which is circulating in the economy on which no taxes are paid.

REFERENCES:-

1)" Indian Economy " by Rudar Dutt and Sundaram.
2)" Indian Economy " by Mishra and Poori
3)" The Economic Times of India " Mumbai.
4)" Economic Political Weekly"
5)" The Times of India", Mumbai
6)" Indian Economy" by Uma Kapila.
7)" The Hindu", Chenai
8)" The Indian Express", Mumbai.