

## CENTRES' RESOURCES : ASSESSMENT OF REVENUE AND EXPENDITURE

## Introduction

4.1 The resource position of the Central Government during the period 1995-2000 has been assessed in conformity with our terms of reference. These require us to assess the revenue receipts and non-plan revenue expenditure of the Central Government having regard to the demands on the Central Government for expenditure on civil administration, defence and border security, debt servicing and other committed expenditure or liabilities. The terms of reference emphasise the need for improving overall fiscal management consistent with efficiency and economy in expenditure so as to generate surplus for capital investment and reduce fiscal deficit.

4.2 Our assessment is based on an analysis of the forecast of receipts and expenditure submitted by the Ministry of Finance. The Ministry of Finance submitted a memorandum which provided the overall context for our reassessment. We also had the benefit of discussing the issues under consideration with representatives of the Ministry of Finance.

## Analysis of the Forecast

4.3 The Ministry of Finance first submitted a forecast in July, 1993 and revised it in May 1994 after the budget of 1994-95 was presented to Parliament. Our reassessment has been carried out on the revised forecast.

4.4 To put the forecast in perspective, Table 1 compares the projected behaviour of major fiscal and budgetary variables with their observed pattern in the past. It is evident that the current fiscal imbalance gets accentuated in the forecast submitted to us: revenue receipts as a percentage of GDP are declining while revenue expenditures are rising. The Central forecast shows that the revenue receipts as a percentage of GDP are estimated to be 13.28 per cent during 1995-2000 as against the actuals of 14.56 per cent during 1985-90. On the other hand, revenue expenditure as a percentage of GDP is forecast to rise from 13.94 per cent in 1985-90 to 14.53 per cent during 1995-2000. Non-plan revenue expenditure is also projected to increase to 11.44 per cent. Thus, non-plan revenue expenditure as a proportion of revenue receipts is estimated to rise from about 80 per cent during 1985-90 to about 86 per cent of revenue receipts in the forecast period.

Table 1

## Pre-Devolution Revenue Account of Centre

(per cent of GDP)

Item	1980/ 85 Actual	1985/ 90 Actual	1990/ 95 Actual/ Estimates	1995/ 2000 Fore cast
<b>REVENUE</b>				
I. Revenue Receipts	12.81	14.56	13.36	13.28
a) Gross Tax	9.96	11.22	10.21	10.26
b) Non Tax	2.85	3.34	3.15	3.02

(per cent of GDP)

Item	1980/ 85 Actual	1985/ 90 Actual	1990/ 95 Actual/ Estimates	1995/ 2000 Fore cast
<b>EXPENDITURE</b>				
II. Revenue Expenditure	11.17	13.94	13.67	14.53
a) Plan	2.17	2.75	2.93	3.09
b) Non-plan	9.00	11.19	10.74	11.44
Revenue surplus/deficit	1.64	0.62	-0.31	-1.25
Non-plan revenue surplus/deficit	3.81	3.37	2.62	1.84

4.5 We note with concern that the tax/gdp ratio is anticipated to stagnate at the levels achieved during 1990-95 which is lower than what has been achieved during 1985-90. The average tax/gdp ratio during the period 1985-90 was 11.22 per cent, while it has been forecast at 10.26 per cent by the Ministry. Non-tax revenues are also expected to register a decline. The net effect is that the revenue deficit as a percentage of GDP is projected to increase four-fold during the next five years. Non-plan revenue surplus is estimated to decline from 2.62 per cent of GDP to 1.84 per cent.

4.6 Thus the projections for 1995-2000 aggravate rather than reverse the trend of deterioration of fiscal balance which started in the the mid-eighties. We recognise that the stabilisation and structural adjustment initiated by the Government of India since mid 1991 might result in a temporary drop in revenues, but we are not convinced that this should persist over the medium term covered by our recommendations. In fact, the forecast appears to be at variance with the position taken by the Ministry in its memorandum where it is submitted that the Ministry would, over the forecast period, raise tax/gdp ratio by 1 percentage point.

4.7 The Ministry's forecast of revenue receipts and revenue expenditures and its memorandum present a scenario of extreme fiscal imbalance. The projections indicate that the Centre does not have adequate resources on the non-plan revenue account to meet its constitutional obligation of devolution at existing levels as indicated in the forecast. We find it difficult to accept the position as the assumptions underlying the forecast are unsustainable.

## Reassessment of Centre's Receipts and Expenditures

4.8 We have, as explained in our approach, confined ourselves to the non-plan revenue account informed by the view that substantial recurring surpluses on the non-plan account are the first requisite for ensuring a sound and stable fiscal balance.

4.9 The reassessment was carried out in two stages: arriving at the base year of 1994-95 and then forecasting for 1995-2000. The estimation of the base year is important in view of the sensitivity of forecast values to the base year estimates. The need

for estimating the base year rather than accepting the budget estimates for 1994-95 is reinforced by the fact that the budget estimates for 1994-95 are out of line with the past. There is no prescriptive element in estimating the base year. We have been guided solely by the consideration of what the Central Government would most realistically be able to achieve in 1994-95. As regards the forecast, we take into account the historical patterns of revenue mobilisation and expenditure behaviour, current trends and recent changes in the macro-policy framework and blend them with prescriptive or normative considerations as appropriate.

**4.10** We have estimated the trend rate of growth for the period 1983-84 to 1992-93 (the last year for which actuals were available) in the case of receipts and the trends for the period 1986-87 to 1992-93 for different categories of revenue expenditure. Having arrived at the trend rates of growth, these were applied to the actuals for 1992-93 to arrive at the base year figures. These were suitably moderated wherever necessary in the light of the budget estimates for 1994-95. Given the fact that the sample period 1986-87 to 1992-93 has been one of the most expansionary phases of government expenditure, the trend figures for expenditure categories in all cases were higher than the budget figures. We have accepted the latter. In the case of receipts, an exception was made for customs duties with a slight upward revision of the budget figures keeping in view the collection from customs in the first six months of the current year. For "other tax revenues", suitable adjustments have been made on account of the changed status of Delhi. However, the estimated receipts from new service taxes announced in the budget but not included in the budget estimates for 1994-95 have been taken into account.

### Revenue Receipts

**4.11** In the case of major taxes of the Centre, viz. income tax, excise duty, customs duty and corporation tax, the buoyancy coefficients have been estimated with respect to the GDP at current market prices for the sample period 1980-81 to 1990-91. It needs to be appreciated that these are historical buoyancies which reflect the responsiveness of taxes to the changes in GDP. Forecasting on the basis of these buoyancies would imply a continuation of the historical trends in the future. Such an assumption would not be valid in view of the significant changes in the economic regime. We have, therefore, used this information on buoyancy coefficients as the basis of forming our judgement regarding reasonable rates of growth of individual taxes during the forecast period.

**4.12** In this context, we have deemed it appropriate to stipulate a buoyancy coefficient of 1.2 for excise duty as against an estimated buoyancy of 1.004. This prescriptive revision has been carried out in the light of the expanding tax base, changing composition of GDP, the rates of growth projected by the Ministry of Finance and the evidence tendered by the representatives of the Ministry of Finance in their deposition before the Commission. On the other hand, in view of the fact that there has been substantial reduction in customs duties we have adopted for it a buoyancy coefficient lower than its historical value. The buoyancy coefficient of customs duties is reckoned to be 1.2 having regard to the recent rates of collection, the anticipated average rate of custom collection during the forecast period and the continuance of the process of liberalised import policy.

**4.13** In the case of income tax and corporation tax, the historical buoyancies have been revised as in the liberalised environment corporation tax is likely to be more buoyant and

lower rates and an expanding base for income tax are expected to yield higher revenues. For corporation tax the historical buoyancy has been enhanced to 1.35 and in the case of income tax 1.2.

**4.14** In the case of "other tax revenues" we have used the trend rate of growth as the buoyancy could not be estimated on account of a compositional change with the sales and other tax receipts of Delhi no longer being a part of the Central resource pool. As explained earlier in the chapter, we have lowered the base in the case of "other tax revenues" but used the historical trend rate.

**4.15** In general, we have followed a principle, both for the Centre and the States, that no revenue source should have a prescriptive buoyancy of less than unity and more than 1.35. Further, differential year wise growth rates have been used for major taxes following our basic assumption of a graduation in the profile of the growth rate of GDP and inflation as explained earlier in para 2.31. The buoyancy estimates and growth rates are at Annexure IV.1.

**4.16** Non-tax revenues of the Centre mainly comprise interest receipts on loans advanced by the Centre, dividends and profits from public sector undertakings (PSUs), fees and other receipts on account of the services rendered by the government and its agencies and other transactions of a commercial nature. We have not found it necessary to reassess the interest receipts of the Centre. The interest receipts of the Centre on its loans and advances to the States are consistent with the interest liability of the States to the Centre and we have provided matching amounts in the expenditure estimates of the States.

**4.17** The reassessed items of non-tax revenues are dividends and profits from PSUs and "other non-tax revenues". The estimates furnished by the Ministry on dividend and profits from PSUs imply a rate of return on equity as low as 1.82 per cent. According to the Advisory Group set up by us to assess an adequate rate of return on equity investment of the central PSUs it should not be difficult for these PSUs to give a return of 8-10 per cent. We have estimated the outstanding equity as on 1994-95 and prescribed a normative rate of return of 8 per cent to arrive at the estimates of dividends.

**4.18** In the case of "other non-tax revenues" we have accepted the Ministry's forecast on three specific items - grants from external sources, royalty from petroleum and revenues from forestry and wild life. This is in line with our approach to such items as discussed in Chapter III in the case of States. For the remaining non-tax revenues we have estimated the buoyancy with respect to GDP and grown these at the graduated rates of GDP growth.

**4.19** As a result of our reassessment, tax receipts of the Centre increase by Rs 62,858 crores and the non-tax receipts improve by Rs 27,782 crores for the five year period. The total revenue receipts of the Centre thus stand reassessed at Rs 9,25,040 crores. The reassessed position of revenue receipts is at Annexure IV.2. The tax/gdp ratio of 10.94 per cent in 1991-92 which is estimated to decline to 9.59 per cent in 1994-95 improves, in our reassessment, to 11.4 in 1999-2000. The average tax/gdp ratio of 10.26 forecast by the Ministry for 1995-2000 rises to 10.94 in our reassessment. Revenue receipts as a percentage of GDP are now reassessed to be 14.31 per cent of the GDP as against 13.28 forecast by the Ministry.

### Non Plan Revenue Expenditure

**4.20** For reassessment, non-plan revenue expenditure has been disaggregated into four major categories: interest

payments, defence expenditure, subsidies, and "other non-plan revenue expenditure".

**4.21** For estimating interest payments, the composition of capital receipts and the rate of interest provided by the Ministry of Finance have been accepted. However, we have taken into account the likely impact of our reassessment of the revenue receipts and non-plan revenue expenditure on the net borrowing requirements of the Centre.

**4.22** As regards defence expenditure we have increased the estimated expenditure submitted by the Ministry. This has been necessitated by a revision of the GDP growth profile. Defence expenditure as a percentage of the GDP has been kept at the same level as in the Ministry of Finance forecast.

**4.23** The aggregate subsidies have been kept at the same level as in the base year level in nominal terms. At a disaggregated level, this is sufficient to accommodate the Ministry's forecast on food subsidies while implying a gradual reduction in the others.

**4.24** For the "other non-plan revenue expenditure", we have:

- i) adopted a price elasticity of 0.75 which is applied to the assumed rate of inflation and
- ii) allowed for a real growth of 1.5 per cent per annum.

**4.25** The Ministry of Finance had built into their forecast an additional requirement of Rs 19,926 crores in anticipation of the expected recommendations of the Fifth Pay Commission. We also feel that the Finance Commission is not required to take such anticipated developments into account in assessment of non-plan revenue expenditure which has to be based on commitments already made. The terms of reference do not require such an exercise to be done either. As admitted by the representatives of the Ministry of Finance in their evidence before the Commission, they have no specific basis and methodology for making such an estimate except past precedents. In these circumstances, we have made no provision for pay revision for the Central Government as in the case of States. If pay revisions is taken up during the forecast period additional resources would have to be raised to meet the fresh liability.

**4.26** On the basis of the foregoing assessment, the total non-plan revenue expenditure during 1995-2000, as reassessed by us, is placed at Rs 6,56,640 crores as shown at Annexure IV.3.

Non-plan revenue expenditure as a proportion of GDP has been reassessed at 10.16 per cent as against 11.44 per cent as in the forecast.

**4.27** As a result of the reassessment of revenue receipts and the non-plan revenue expenditure the pre-devolution surplus of the Centre, which had been forecast at Rs 1,15,797 crores is now estimated to be Rs 2,68,400 crores.

**4.28** A comparison of the forecast submitted by the Ministry of Finance and the reassessed non-plan position of the Central Government is summarised in Table 2.

**Table 2**

	Ministry's Forecast		Reassessment	
	(Revised) Absolute	% GDP	Absolute	% GDP
I. Revenue Receipts	834400	13.28	925040	14.31
a) Tax Revenue	644553	10.26	707411	10.94
i) Income Tax	82326	1.31	85239	1.32
ii) Corporation Tax	94043	1.50	100115	1.55
iii) Union Excise Duty	292773	4.66	303710	4.70
iv) Customs	162012	2.58	198198	3.07
v) Other Tax Revenue	13399	0.21	20149	0.31
b) Non Tax Revenue	189847	3.02	217629	3.37
i) Interest Receipts	115937	1.85	115934	1.79
ii) Dividends & Profits	15363	0.24	29249	0.45
iii) Other Non Tax Revenue	58547	0.93	72446	1.12
II. Non Plan Revenue Expenditure	718603	11.44	656640	10.16
a) Interest Payments	368000	5.86	348138	5.38
b) Defence Expenditure	111773	1.78	115063	1.78
c) Other Non-plan Revenue Expenditure	238830	3.80	193439	2.99
III. Non Plan Revenue Surplus	115797	1.84	268400	4.15