2

PUBLIC FINANCE

The setback to the objective of fiscal correction suffered in 1993-94 proved temporary, with the 1994-95 budget restoring central finances to the path of fiscal balance. As per the budget estimates of 1994-95, the Central fiscal deficit is estimated to have declined by 2.3 per cent of GDP since the start of the programme of fiscal correction. This decline is due to a decline in subsidies and defence expenditure by 1.5 per cent of GDP and a decline of 1.2 per cent of GDP in net capital expenditure (defined as capital expenditure minus interest on debt). The earlier trend of a rising ratio of non-Plan to Plan expenditure has also been reversed, with the average growth in the former being less than in the latter, since 1991.

2. Gross dissaving of the Government, as a proportion of GDP, increased sharply in 1993-94 (RE). The dissavings are expected to be lower in 1994-95(BE). This mirrors the fall in the fiscal deficit. Despite this decline in Central Government savings, however, gross capital formation out of Central budgetary resources rose from 5.4 per cent of GDP in 1992-93 to 6.0 per cent of GDP in 1993-94 (RE). The recent declining trend in the Central Government's debt-GDP ratio, with a fall from 69.4 per cent in 1991-92 to 68.4 per cent in 1992-93, was also temporarily reversed in 1993-94 (RE), but is expected to resume in 1994-95 (BE). The structure of the Central Government debt and liabilities is of some interest. The Central Government's loans to States, UTs and Public Sector Enterprises (PSEs) aggregate to about 33 per cent of the 'marketable outstanding liability' of the Centre (i.e. excluding borrowings from RBI) in 1993-94 (RE). The book value of economic assets (i.e. assets in 'economic service') aggregate to 28 per cent of these liabilities. In other words, sale of 'economic' assets could in principle help repay at least 28 per cent of the specified liabilities. Thus, only 39 per cent of the 'marketable outstanding liabilities' are on account of social and administrative assets and expenditures.

3. The 1994-95 budget continued the reform thrust towards a simpler system of taxation with moderate rates, few exemptions and a wider tax base. The diverse corporate tax rates on domestic companies have been integrated into a single rate and the marginal rates of corporate and personal income tax reduced. In regard to both excise and customs, there has been a drastic reduction in the number of end use notifications and in the number and dispersion of rates. The reduction of the peak rate of customs duty from 85 per cent to 65 per cent was accompanied by an effort to reform the structure of duties. On the excise front, a significant switchover was effected from specific to ad valorem duties to ensure built in revenue elasticity. The system of MODVAT credit for taxes paid on inputs, was extended to cover petroleum and capital goods. Besides, a modest beginning was made in extending indirect taxation to services such as telephones, non life insurance and stock brokers.

4. These tax reforms have induced a structural shift in the composition of tax revenue. The earlier excessive reliance on foreign trade taxes, which by and large engender inefficiencies and distortions, has diminished. The overall collection rate for import duties has fallen from 47 per cent in 1990-91 to 30 per cent in 1993-94. These trends are indicative of, a reduction in costs of capital and intermediate goods for Indian industries and a fall in protection levels, which is helping to spur Indian industry to improve its efficiency and competitiveness. Concomitantly, the share of direct taxes in gross tax revenue has increased from 19.1 per cent in 1990-91 to 28.4 per cent in 1994-95. These changes are desirable from the point of view of both equity and economic efficiency.

Fiscal Deficit

5. The process of fiscal correction which started with a major contraction of 2.4 per cent of GDP in 1991-92, continued more gradually in 1992-93 (0.2 per cent of GDP), but suffered a temporary setback in

1993-94. The fiscal deficit (as per the revised estimates), rose sharply by 1.7 per cent of GDP to 7.4 per cent (Table 2.1). The rise was contributed both by a lower realization of receipts and higher expenditure. The 1994-95 budget sought to restore fiscal balance by bringing the deficit down to 6 per cent. Since 1990-91, the fiscal deficit will therefore have declined by 2.3 per cent of GDP. This decline is due to a reduction in expenditures. Subsidies and defence expenditures declined by 1.5 per cent of GDP. This was however partly offset by a 0.8 per cent (of GDP) decline in revenue collections. Capital expenditure, net of interest payments on past debt declined by 1.2 per cent of GDP. This decline in net capital expenditure is slightly less than the decline in subsidies and defence expenditures. Thus, both current expenditure and net capital expenditure have contributed substantially to a decline in the fiscal deficit, based on budget estimate for 1994-95.

Fiscal and Budgetary Developments in 1993-94

Central Government

6. Revenue receipts consisting of tax and non-tax rev-

TABLE 2.1
Receipts and Expenditure of the Central Government

	1980-81	1989-90	1990-91	1991-92	1992-93	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5	6	7	8
				(Rs crore)			
1. Revenue receipts (2+3)	11937	52296	54954	66031	74128	76166	86084
2. Tax Revenue (Net of States share)	9358	38349	42978	50069	54044	54473	62742
3. Non-Tax Revenue	2579	13947	11976	15962	20084	21693	23342
4. Revenue Expenditure	14410	64210	73516	82292	91702	110224	118811
of which							
(a) Interest Payments	2604	17757	21498	26596	31075	37500	46000
(b) Subsidies	2028	10474	12158	12253	12043	12400	9463
(c) Defence Expenditure	3273	9665	10874	11442	12109	14944	16169
5. Revenue deficit	2037	11914	18562	16261	18574	34058	32727
6. Capital Receipts	7642	30020	38997	38528	36178	58646	59615
(a) Recovery of loans	2096	4980	5712	6021	6356	6655	6700
(b) Other receipts				3038	1961	2500	4000
(c) Borrowing and other liabilities	5546	25040	33285	29469	27861	49491	48915
7. Capital expenditure	7646	28698	31782	29121	29916	33648	32888
8. Total expenditure	22056	92908	105298	111413	122618	143872	151699
of which							
(a) Plan expenditure	8994	27520	28365	30961	36660	46027	46582
(b) Non-Plan expenditure	13062	65388	76933	80452	85958	97845	105117
9. Fiscal Deficit	8445	35632	44632	36323	40173	58551	54915
As per cent of GDP				(Per cent)			
1. Revenue receipts (2+3)	8.8	11.4	10.3	10.7	10.5	9.7	9.5
2. Tax Revenue (Net of States share)	6.9	8.4	8.0	8.1	7.7	6.9	6.9
3. Non-Tax Revenue	1.9	3.1	2.2	2.6	2.9	2.8	2.6
4. Revenue Expenditure	10.6	14.1	13.7	13.4	13.2	14.0	13.1
of which							
(a) Interest payments	1.9	3.9	4.0	4.3	4.4	4.8	5.1
(b) Subsidies	1.5	2.3	2.3	2.0	1.7	1.6	1.0
(c) Defence expenditure	2.4	2.1	2.0	1.9	1.7	1.9	1.8
5. Revenue deficit	1.5	2.6	3.5	2.6	2.6	4.3	3.6
6. Capital Receipts	5.6	6.6	7.3	6.3	5.1	7.5	6.6
(a) Recovery of loans	1.5	1.1	1.1	1.0	0.9	0.8	0.7
(b) Other receipts	0.0	0.0	0.0	0.5	0.3	0.3	0.4
(c) Borrowing and other liabilities	4.1	5.5	6.2	4.8	4.0	6.3	5.4
7. Capital expenditure	5.6	6.3	5.9	4.7	4.3	4.3	3.6
8. Total expenditure	16.2	20.3	19.7	18.1	17.4	18.3	16.7
of which							
(a) Plan expenditure	6.6	6.0	5.3	5.0	5.2	5.9	5.1
(b) Non-Plan expenditure	9.6	14.3	14.4	13.1	12.2	12.4	11.6
9. Fiscal Deficit	6.2	7.8	8.3	5.9	5.7	7.4	6.0

Note: The figures may not add up to the total because of rounding approximations.

TABLE 2.2
Central Government Deficit
(per cent of GDP)

	Budget Deficit	Revenue Deficit	Gross Fiscal Deficit	Gross Primary Deficit
1	2	3	4	5
1975-76	0.5	1.1	4.1	2.5
1980-81	1.8	1.5	6.2	4.3
1981-82	0.9	0.2	5.4	3.4
1982-83	0.9	0.7	6.0	3.8
1983-84	0.7	1.2	6.3	4.0
1984-85	1.6	1.8	7.5	5.0
Average Sixth Plan	1.2	1.1	6.3	4.1
1985-86	2.0	2.2	8.3	5.5
1986-87	2.8	2.7	9.0	5.8
1987-88	1.7	2.7	8.1	4.7
1988-89	1.4	2.7	7.8	4.2
1989-90	2.3	2.6	7.8	3.9
Average Seventh Plan	2.1	2.6	8.2	4.8
1990-91	2.1	3.5	8.3	4.3
1991-92	1.1	2.6	5.9	1.6
1992-93	1.8	2.6	5.7	1.3
1993-94(RE)	1.2	4.3	7.4	2.7
1994-95(BE)	0.7	3.6	6.0	1.0

The budget deficit is the difference between total receipts and total expenditure, both revenue and capital. The revenue deficit denotes the difference between revenue receipts and revenue expenditure. The fiscal deficit is the difference between the revenue receipts plus certain non-debt capital receipts and the total expenditure including loans, net of repayments. The primary deficit is the fiscal deficit less interest payments.

enue, which increased by 20.2 per cent in 1991-92 and 12.3 per cent in 1992-93, registered a smaller increase of 2.7 per cent in 1993-94 (RE) (Table 2.1). These are estimated to increase by about 13.0 per cent in 1994-95 (BE). Total expenditure of the Central Government registered a higher increase of 17.3 per cent during 1993-94 (RE) against increases of 5.8 per cent and 10.1 per cent in 1991-92 and 1992-93, respectively. Revenue receipts declined from 10.5 per cent of GDP in 1992-93 to 9.7 per cent, as per the revised estimates of 1993-94.

7. For many years, the growth of non-Plan expenditure has been faster than the growth of Plan expenditure. Non-Plan expenditure, which was Rs 13062 crore in 1980-81, increased by approximately five times to Rs 65388 crore in 1989-90, against an increase of three times in Plan expenditure over the same period. During 1990-91, a further increase of 17.7 per cent was recorded in non-Plan expenditure, against 3.1 per cent in Plan expenditure. However, with the introduction of reforms this trend has been reversed. During the first two years of reform process, the increase in non-Plan expenditure was only 11.7 per cent against an increase of 29.2 per cent in Plan expenditure. As per the revised estimates of 1993-94, the growth in Plan expenditure at 25.6 per cent has been almost double the growth of 13.8 per cent in non-Plan expenditure. A check on the fast growth of non-Plan expenditure. has been possible as a result of a number of steps taken by the Government. These include reduction of posts at various levels, overall cut on consumption of petrol/diesel, reduction in expenditure on telephone and restrictions on purchases of additional vehicles. The strength of the staff of the Central Government, which was growing over the years, showed an estimated decline of about fifty thousand from 39.98 lakh in March, 1992 to 39.49 lakh in March, 1994.

8. In order to check the high level of fiscal deficit, it is necessary to further review expenditure under various Sectors/Ministries and explore areas where a reduction is possible or expenditures are more effectively financed through user charges.

Savings and Capital Formation

9. Gross savings of the Government, which showed distinct improvement during the first two years of fiscal reform , once again came under pressure during 1993-94 (RE). As per the Economic and Functional Classification of the Central Government's Budget, against the dissavings of Rs.8401 crore (-1.2 per cent of GDP) in 1992-93 , the revised estimates of 1993-94 show dissavings at Rs.19574 crore (-2.5 per cent of GDP) (Table 2.4). Consumption expenditure also increased from Rs.26865 crore (3.8 per cent of GDP) to Rs.32467 crore (4.1 per cent of GDP) (Table 2.3). The consumption expenditure at 4.1 per cent of GDP, though higher than that in the first two years of reforms, is still lower than 4.5 per cent in 1989-90 and 4.2 per cent in 1990-91 - years immediately preceding the initiation of reform.

10. The increase in the expenditure on gross capital formation out of budgetary resources by 0.6 per cent of GDP - from 5.4 per cent in 1992-93 to 6.0 per cent in 1993-94 (RE), is higher than the increase in consumption expenditure. Gross capital formation as a per cent of GDP in 1993-94 (RE) has also been higher than the gross capital formation of 5.7 per cent of GDP in 1991-92. Most of the increase has however, come in 'financial assistance for capital formation in the rest of the economy'. As a result, the share of physical assets in gross capital formation, which had risen from 24.5 per cent in 1990-91 to 26.3 per cent in 1991-92 and to 31.5 per cent in 1992-93, decreased marginally to 30.1 per cent in 1993-94 (RE).

Government Debt

11. Internal liabilities increased from 51.2 per cent of GDP in 1992-93 to 54.2 per cent of GDP in 1993-94 (RE) (Table 2.5). The increase in internal liabilities

TABLE 2.3
Economic Classfication of Total Expenditure of Central Government

	1980-81	1989-90	1990-91	1991-92	1992-93	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5	6	7	8
		(Rs.Crore)					
1. Consumption expenditure	5174	20784	22359	24466	26865	32467	33983
a) Defence	3571	14298	15319	16251	17403	21244	22726
b) Other Government administration	1603	6486	7040	8215	9462	11223	11257
2. Transfer payments(Current)	6912	37877	45134	51378	58518	67970	74580
a) Interest payments	2253	16525	19949	24955	29055	35263	43501
b) Subsidies	1912	10862	10728	10326	10479	11742	9738
c) Grants to States & UTs (including local bodies)	1810	5725	7664	8797	10030	11915	11404
d) Others	937	4765	6793	7300	8954	9050	9937
3. Gross capital formation out of budgetary resources	9012	33012	35058	35165	37649	47162	48353
a) Physical assets	1907	8136	8602	9259	11875	14193	15516
b) Financial assets	7105	24876	26456	25906	25774	32969	32837
4. Others	1397	3376	2422	1722	2895	1922	1829
5. Total expenditure	22495	95049	104973	112731	125927	149521	158745
As per cent of GDP		(Per cent)					
1. Consumption expenditure	3.8	4.5	4.2	4.0	3.8	4.1	3.7
a) Defence	2.6	3.1	2.9	2.6	2.5	2.7	2.5
b) Other Government administration	1.2	1.4	1.3	1.3	1.3	1.4	1.2
2. Transfer payments(Current)	5.1	8.3	8.4	8.3	8.3	8.6	8.2
a) Interest payments	1.7	3.6	3.7	4.1	4.1	4.5	4.8
b) Subsidies	1.4	2.4	2.0	1.7	1.5	1.5	1.1
c) Grants to States & UTs (including local bodies)	1.3	1.3	1.4	1.4	1.4	1.5	1.3
d) Others	0.7	1.0	1.3	1.2	1.3	1.2	1.1
3. Gross capital formation out of budgetary resources	6.6	7.2	6.5	5.7	5.4	6.0	5.3
a) Physical assets	1.4	1.8	1.6	1.5	1.7	1.8	1.7
b) Financial assets	5.2	5.4	4.9	4.2	3.7	4.2	3.6
4. Others	1.0	0.7	0.5	0.3	0.4	0.2	0.2
5. Total expenditure	16.5	20.8	19.6	18.3	17.9	19.0	17.5
As per cent of total expenditure		(Per cent)					
1. Consumption expenditure	23.0	21.9	21.3	21.7	21.3	21.7	21.4
a) Defence	15.9	15.0	14.6	14.4	13.8	14.2	14.3
b) Other Government administration	7.1	6.8	6.7	7.3	7.5	7.5	7.1
2. Transfer payments(Current)	30.7	39.8	43.0	45.6	46.5	45.5	47.0
a) Interest payments	10.0	17.4	19.0	22.1	23.1	23.6	27.4
b) Subsidies	8.5	11.4	10.2	9.2	8.3	7.9	6.1
c) Grants to States & UTs (including local bodies)	8.0	6.0	7.3	7.8	8.0	8.0	7.2
d) Others	4.2	5.0	6.5	6.5	7.1	6.1	6.3
3. Gross capital formation out of budgetary resources	40.1	34.7	33.4	31.2	29.9	31.5	30.5
a) Physical assets	8.5	8.6	8.2	8.2	9.4	9.5	9.8
b) Financial assets	31.6	26.2	25.2	23.0	20.5	22.0	20.7
4. Others	6.2	3.6	2.3	1.5	2.3	1.3	1.2

TABLE 2.4
Capital Formation by the Central Government and its Financing

	1980-81	1989-90	1990-91	1991-92	1992-93	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5	6	7	8
(Rs. Crore)							
I. Gross capital formation out of budgetary resources of Central Government	9012	33012	35058	35165	37649	47162	48353
(i) Gross capital formation by the Central Government	1907	8136	8602	9259	11875	14193	15516
(ii) Financial assistance for capital formation in the rest of the economy	7105	24876	26456	25906	25774	32969	32837
II. Gross Saving of the Central Government	3	-5142	-10502	-7802	-8401	-19574	-16493
III. Gap (I-II)	9009	38154	45560	42967	46050	66736	64846
Financed by							
a. Draft on other sectors of domestic economy	7339	34831	41794	36599	39812	61599	59203
(i) Domestic capital receipts	4762	24239	30447	29744	27500	52539	53203
(ii) Budgetary deficit	2577	10592	11347	6855	12312	9060	6000
b. Draft on foreign savings	1670	3323	3766	6368	6238	5137	5644
As per cent of GDP *(Per cent)*							
I. Gross capital formation out of budgetary resources of the Central Government	6.6	7.2	6.5	5.7	5.4	6.0	5.3
(i) Gross capital formation by the Central Government	1.4	1.8	1.6	1.5	1.7	1.8	1.7
(ii) Financial assistance for capital formation in the rest of the economy	5.2	5.4	4.9	4.2	3.7	4.2	3.6
II. Gross Saving of the Central Government	0.0	-1.1	-2.0	-1.3	-1.2	-2.5	-1.8
III. Gap(I-II)	6.6	8.4	8.5	7.0	6.6	8.5	7.1
Financed by							
a. Draft on other sectors of domestic economy	5.4	7.6	7.8	5.9	5.7	7.8	6.5
(i) Domestic capital receipts	3.5	5.3	5.7	4.8	3.9	6.7	5.8
(ii) Budgetary deficit	1.9	2.3	2.1	1.1	1.8	1.2	0.7
b. Draft on foreign savings	1.2	0.7	0.7	1.0	0.9	0.7	0.6
I. Gross capital formation out of the budgetary resources of the Central Government; increase over previous year	24.7	13.9	6.2	0.3	7.1	25.3	2.5

Notes: (i) *Gross capital formation in this table includes loans given for capital formation on a gross basis. Consequently domestic capital receipts include loan repayments to the Central Government.*

(ii) *Because of the revision in the series of GDP, the ratios given here may differ from those given in earlier issues of Economic Survey.*

was mainly because of the increase in internal debt, which rose from 28.3 per cent of GDP in 1992-93 to 30.9 per cent in 1993-94 (RE). 'Other internal liabilities' consisting of Small Savings, Provident Funds etc. registered only a small increase from 22.8 per cent of GDP in 1992-93 to 23.3 per cent in 1993-94 (RE) The share of market borrowings in total internal liabilities, which was 32.4 per cent in 1980-81 and has been declining over the years, reached 22.7 per cent in 1992-93. However, the share increased to 23.3 per cent during 1993-94 (RE) because of the inclusion of loans in conversion of maturing treasury bills and Zero Coupon Bonds.

12. The liabilities shown in the budget are at the historical rates of exchange. Since the value of the rupee has depreciated considerably over the years, the external liabilities expressed at the current year-end rates of exchange are much higher. External liabilities which, at the end of the year 1993-94 (RE), were Rs.45892 crore at historical rates, are actually Rs. 127798 crore at the current year-end exchange rates (16.3 per cent of GDP). Total outstanding liabilities consisting of internal and external (adjusted) liabilities of the Centre, which had shown a decline in 1992-93, registered an increase during the year 1993-94 (RE). Liabilities rose from 68.4 per cent of GDP in 1992-93 to 70.4 per cent in 1993-94 (RE).

Interest Rates

13. The average interest rate on borrowings has also been increasing over the years. On internal liabilities, the average rate of interest, which was 8.4 per cent during 1991-92 and 8.6 per cent during 1992-93, rose significantly to 9.3 per cent during 1993-94 (RE). The increase in the rate of interest during the three years

TABLE 2.5

Outstanding Liabilities of the Central Government

At the end of :

	1980-81	1989-90	1990-91	1991-92	1992-93	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5	6	7	8
		(Rs.Crore)					
1. Internal liabilities	48451	239849	283033	317714	359654	426027	483546
a) Internal Debt	30864	133193	154004	172750	199100	242729	277561
(i) Market borrowings	15676	62565	70565	78075	81751	99443	114143
(ii) Others	15188	70628	83439	94675	117349	143286	163418
b) Other Internal liabilities	17587	106656	129029	144964	160554	183298	205985
2. External debt (outstanding)[1]	11298	28343	31525	36948	42269	45892	49508
3. Total outstanding liabilities (1+2)	59749	268192	314558	354662	401923	471919	533054
4. Amount due from Pakistan on account of share of pre-partition debt	300	300	300	300	300	300	300
5. Net liabilities (3-4)	59449	267892	314258	354362	401623	471619	532754
6. Total assets	58999	209623	236740	261478	290963	326854	355536
7. Excess of liabilities over assets (5-6)	450	58269	77518	92884	110660	144765	177218
As per cent of GDP		(Per cent)					
1. Internal liabilities	35.6	52.5	52.9	51.6	51.2	54.2	53.2
a) Internal Debt	22.7	29.2	28.8	28.0	28.3	30.9	30.5
b) Other Internal liabilities	12.9	23.3	24.1	23.5	22.8	23.3	22.6
2. External debt(outstanding)[1]	8.3	6.2	5.9	6.0	6.0	5.8	5.4
3. Total outstanding liabilities	43.7	58.7	58.7	57.6	57.2	60.0	58.6
6. Total assets	43.4	45.9	44.2	42.4	41.4	41.6	39.1
7. Excess of liabilities over assets (5-6)	0.3	12.8	14.5	15.1	15.7	18.4	19.5
Memorandum items							
External Debt (Rs.crore)[2]	13479	54100	66314	109677	120979	127798	132199
(as per cent of GDP)	9.9	11.8	12.4	17.8	17.2	16.3	14.5
Total outstanding liabilities(adjusted) (Rs.Crore)	61930	293949	349347	427391	480633	553825	615745
(as per cent of GDP)	45.5	64.3	65.2	69.4	68.4	70.4	67.7
Outstanding liabilities (Non-RBI)[3] (Rs.crore)	48495	231884	275292	346504	387973	453434	509354
Outstanding liabilities (Non-RBI) (as per cent of GDP)	35.7	50.8	51.4	56.2	55.2	57.7	56.0

[1] *External debt figures represent borrowings by the Central Government from external resources and are based upon historical rates of exchange.*

[2] *Converted at current year end exchange rates. For 1980-81, the rates prevailing at the end of March,1981. For 1986-87, the rates prevailing at the end of March,1987 and so on. However, for 1994-95(BE), the rates pertain to end-September, 1994.*

[3] *This includes marketable dated securities held by the RBI.*

1990-91 to 1992-93 has been only 0.2 per cent per annum (Table 2.6). The increase in 1993-94 has been mainly due to an increase in the rate of interest on 'other internal liabilities' from 9.6 per cent in 1992-93 to 11.1 per cent in 1993-94 (RE). The rate of interest on market borrowings has also gone up from 10.4 per cent in 1992-93 to 10.8 per cent in 1993-94 (RE). Market borrowings and 'other internal liabilities' constituted 66 per cent of total internal liabilities. In contrast, the rate of interest on external liabilities declined from 4.2 per cent in 1991-92 to 3.3 per cent in 1992-93 and further to 3.1 per cent in 1993-94 (RE).

Assets

14. Against total liabilities (adjusted) of Rs. 553825 crore at the end of 1993-94 (RE), the assets created with the surpluses of revenue account and the borrowings over the years amount to Rs. 326854 crore. Thus, the liabilities are more than the assets, to the tune of Rs. 226971 crore (28.9 per cent of GDP). The excess of liabilities over assets, which were only Rs. 2931 crore (2.2 per cent of GDP) at the end of 1980-81, have been rising steadily. This comparison of assets and liabilities is, however somewhat misleading, since assets are shown at book value. The current value of assets created should be many times higher than the book value. This is because a substantial part of the assets is in the form of physical assets.

15. Despite the limitation of 'book value', it is useful to look at the distribution of assets across major economic classes. In 1993-94 (RE), 72 per cent of assets were in economic services, 25 per cent in general services and 3 per cent in social services (Table 2.7). The small proportion in social services is a reflection of the fact that Social Sectors are almost entirely under the State Governments. To some extent borrowings by the Central Government went into the acquisition of capital for the provision of economic services. It is therefore interesting to calculate how much of the debt would be retired by selling these assets. The book value of economic asset was about 28 per cent of total 'outstanding liabilities' (non-RBI) in 1993-94 (RE) and to the extent that assets include land, the proportion would be much higher. 'Outstanding liabilities' (non-RBI) are defined so as to exclude non-marketable special securities and ad hocs held by RBI, as these represent monetisation whose cost has already been borne by the public in the form of higher inflation.

16. At the end of 1993-94 (RE), capital 'outlay' formed 54.3 per cent of total assets (Table 2.7). The remaining 45.7 per cent of Central Government assets consist of loans advanced by the Central Government to State Governments, public sector enterprises and others. A part of the loans to PSEs and State Governments will also result in capital formation. It is interesting to look at the structure of loans given by the Central Government. States and Union Territory Governments accounted for 68.2 per cent of the total outstanding loans advanced and PSEs another 30.9 per cent in 1993-94 (RE). Viewed in terms of liabilities incurred, 22.5 per cent of outstanding liabilities (non-RBI) were on behalf of State Governments and Union Territories and 10.2 per cent on behalf of PSEs. In other words, the Central Government 'outstanding

TABLE 2.6
Interest on the Outstanding liabilities of the Central Government

	1980-81	1989-90	1990-91	1991-92	1992-93	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5	6	7	8
		(Rs.Crore)					
1. Interest on internal liabilities	2373	16241	19637	23892	27439	33625	41839
a) Internal debt	1369	8273	9814	11317	13542	15823	21331
i) Market borrowings	808	5368	6366	7355	8147	8809	10380
ii) Others	561	2905	3448	3962	5395	7014	10951
b) Other internal liabilites	1004	7968	9823	12575	13897	17802	20508
2. Interest on external debt	231	1494	1834	2704	3529	3875	4161
3. Gross interest payments	2604	17735	21471	26596	30968	37500	46000
4. Net interest payments	809	9269	12687	15674	18480	22962	30022
Average rate of interest		(Per cent)					
1. Internal liabilities	N.A.	8.0	8.2	8.4	8.6	9.3	9.8
a) Internal debt	N.A.	7.2	7.4	7.3	7.8	7.9	8.8
i) Market borrowings	N.A.	9.7	10.2	10.4	10.4	10.8	10.4
ii) Others	N.A.	4.9	4.9	4.7	5.7	6.0	7.6
b) Other Internal liabilities	N.A.	8.9	9.2	9.7	9.6	11.1	11.2
2. External debt	N.A.	5.8	6.5	8.6	9.6	9.2	9.1
3. Total liabilities	N.A.	7.7	8.0	8.5	8.7	9.3	9.7

Note: The interest liabilities indicated above are on cash basis and not on accrual basis.

TABLE 2.7
Assets of the Central Government
At the end of :

	1980-81	1989-90	1990-91	1991-92	1992-93	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5	6	7	8
		(Rs.Crore)					
1. Capital outlay	29162	108647	122016	135076	155291	177419	194036
(a) General services	5951	26050	31023	31686	37607	44809	52366
(b) Social services	1062	3409	3749	4088	4484	4896	5311
(c) Economic services	22149	79188	87244	99302	113200	127714	136359
2. Loans advanced by the Central Government	29837	100976	114724	126403	135672	149435	161500
(a) States and Union Territory Governments	17335	64242	74111	83529	91554	101923	111472
(b) Foreign Governments	261	1184	2103	1546	687	488	542
(c) Public Sector Enterprises	12040	35003	37877	40615	42639	46103	48403
(d) Government Servants	201	547	633	713	792	921	1083
3. Total Assets	58999	209623	236740	261479	290963	326854	355536
4. Outstanding liabilities	59449	267892	314258	354362	401623	471619	532753
5. Excess of liabilities over Capital Outlay and Loans advanced	450	58269	77518	92884	110660	144765	177218
As per cent of GDP		*(Per cent)*					
1. Capital outlay	21.4	23.8	22.8	21.9	22.1	22.6	21.3
(a) General services	4.4	5.7	5.8	5.1	5.4	5.7	5.8
(b) Social services	0.8	0.7	0.7	0.7	0.6	0.6	0.6
(c) Economic services	16.3	17.3	16.3	16.1	16.1	16.2	15.0
2. Loans advanced by the Central Government	21.9	22.1	21.4	20.5	19.3	19.0	17.8
(a) States and Union Territory Governments	12.7	14.1	13.8	13.6	13.0	13.0	12.3
(b) Foreign Governments	0.2	0.3	0.4	0.3	0.1	0.1	0.1
(c) Public Sector Enterprises	8.9	7.7	7.1	6.6	6.1	5.9	5.3
(d) Government Servants	0.1	0.1	0.1	0.1	0.1	0.1	0.1
3. Total Assets	43.4	45.9	44.2	42.4	41.4	41.6	39.1
4. Outstanding liabilities	43.7	58.6	58.7	57.5	57.1	60.0	58.6
5. Excess of liabilities over Capital Outlay and Loans advanced	0.3	12.8	14.5	15.1	15.7	18.4	19.5
As per cent of total		*(Per cent)*					
1. Capital outlay	100.00	100.00	100.00	100.00	100.00	100.00	100.00
(a) General services	20.41	23.98	25.43	23.46	24.22	25.26	26.99
(b) Social services	3.64	3.14	3.07	3.03	2.89	2.76	2.74
(c) Economic services	75.95	72.89	71.50	73.52	72.90	71.98	70.28
2. Loans advanced by the Central Government	100.00	100.00	100.00	100.00	100.00	100.00	100.00
(a) States and Union Territory Governments	58.10	63.62	64.60	66.08	67.48	68.21	69.02
(b) Foreign Governments	0.87	1.17	1.83	1.22	0.51	0.33	0.34
(c) Public Sector Enterprises	40.35	34.66	33.02	32.13	31.43	30.85	29.97
(d) Government Servants	0.67	0.54	0.55	0.56	0.58	0.62	0.67

liabilities' (Non-RBI) would be 32.7 per cent lower if State Governments, Union Territories and PSEs had borrowed directly, instead of through the Central Government. Foreign Governments (0.3 per cent) and Government servants (0.6 per cent) account for only minor share of total loans.

Interest Payments

17. The increasing burden of debt coupled with higher interest rates, has resulted in a significant part of the revenue expenditure being used for interest payments (Table 2.1). Interest payments during 1993-94 (RE) constituted over 32 per cent of total revenue expenditure. This is somewhat lower than the expenditure of 33.4 per cent during 1992-93 and 32.3 per cent during 1991-92, but higher than 27.6 per cent during 1989-90. The proportion of total revenues used to make interest payments has however, increased continuously from 40.3 per cent in 1991-92 to 41.9 per cent in 1992-93 and 49.2 per cent in 1993-94 (RE). Total debt servicing consisting of interest payments and repayment of debt, was 112.8 per cent of total revenue receipts in 1993-94 (RE). It may however be logical to include, on the receipt side, the receipts from the sale of the equity of Central Public Sector Enterprises (CPSEs) and recovery of loans. Total debt servicing then constitutes 100.7 per cent of total receipts.

States and Union Territories : 1993-94

18. The revised estimates of both the current revenue and total expenditure of the States and Union Territories including State Public Sector Enterprises (SPSEs)

for the year 1993-94 (RE) are marginally higher than the actuals of 1992-93. Total expenditure increased by 0.3 per cent of GDP, from 15.7 per cent in 1992-93 to 16.0 per cent in 1993-94 (RE). Current revenue increased by 0.4 per cent of GDP from 12.1 per cent to 12.5 per cent of GDP. As a result, the gap between current revenue and total expenditure declined from 3.7 per cent of GDP in 1992-93 to 3.5 per cent in 1993-94 (RE). Non-development expenditure continued to increase faster than development expenditure. Non-development expenditure increased by 20.5 per cent, whereas development expenditure increased by only 10.8 per cent in 1993-94 (RE). As a result, the proportion of non-development expenditure in total expenditure increased to 34.7 per cent, compared to 32.8 per cent in 1992-93 and 31.8 per cent in 1991-92.

19. Increase in current revenue has been contributed by increases in non-tax revenue and grants from the Centre. Receipts from Sales tax have increased marginally in 1993-94 (RE) from 3.1 per cent in 1992-93 to 3.2 per cent of GDP. However, the financial performance of SPSEs continues to be a matter of concern. Internal resources of these enterprises were a negative amount of Rs. 1114 crore as per the revised estimates of 1993-94 compared with the negative amounts of Rs. 1305 crore in 1992-93 and Rs. 1699 crore in 1991-92. Though there has been some reduction in losses, yet these losses continue to be a drag on the States' finances. Sale of loss-making enterprises would not only reduce these losses and make available this amount for maintenance of social and physical infrastructure, but the sale proceeds of the assets would provide a corpus of funds for development of basic rural and urban infrastructure.

Centre, States and Union Territories: 1993-94

20. The Current revenue of the Centre, States and Union Territories, including Public Sector Enterprises declined from 21.8 per cent of GDP in 1992-93 to 21.5 per cent in 1993-94 (RE) (Table 2.8). Tax revenue continued to decline as a proportion of GDP, reaching 15.5 per cent of GDP against the actuals of 16.2 per cent of GDP in 1992-93. Non-tax revenue continued to increase as a proportion of GDP, rising from 5.6 per cent in 1992-93 to 6.0 per cent of GDP as in 1993-94 (RE) This is significantly higher than the actuals of 5.0 per cent in 1991-92. Internal resources of Public Sector Enterprises have been fluctuating, but at 3.2 per cent of GDP, are higher than the actuals of 2.1 per cent and 2.7 per cent in 1991-92 and 1992-93 respectively.

21. Total outlay has also been fluctuating as a proportion of GDP. After declining from 32.4 per cent of GDP in 1991-92 to 32.0 per cent in 1992-93, it has risen to 33.2 per cent of GDP as per the revised estimates of 1993-94. As a result of lower receipts and higher outlay, the gap between the two rose sharply to 11.7 per cent of GDP. The growth in non-development expenditure has been faster. As a result of this, its share in total expenditure has increased to 42.1 per cent in 1993-94 (RE) from 40.5 per cent and 40.4 per cent in 1991-92 and 1992-93 respectively.

22. The pattern of financing of this gap through capital receipts has also changed with greater reliance on domestic capital receipts and less on external finance and budget deficits. The share of domestic capital receipts in meeting this gap has gone up from 74.1 per cent in 1992-93 to 82.1 per cent in 1993-94 (RE) The contribution of the budget deficit declined to 12.4 per cent compared to 17.5 per cent in 1992-93. Similarly, the down-trend in the share of external finance also continued, reaching 5.6 per cent of the total gap, against 9.4 per cent and 8.4 per cent in 1991-92 and 1992-93 respectively.

Central Government Budget: 1994-95

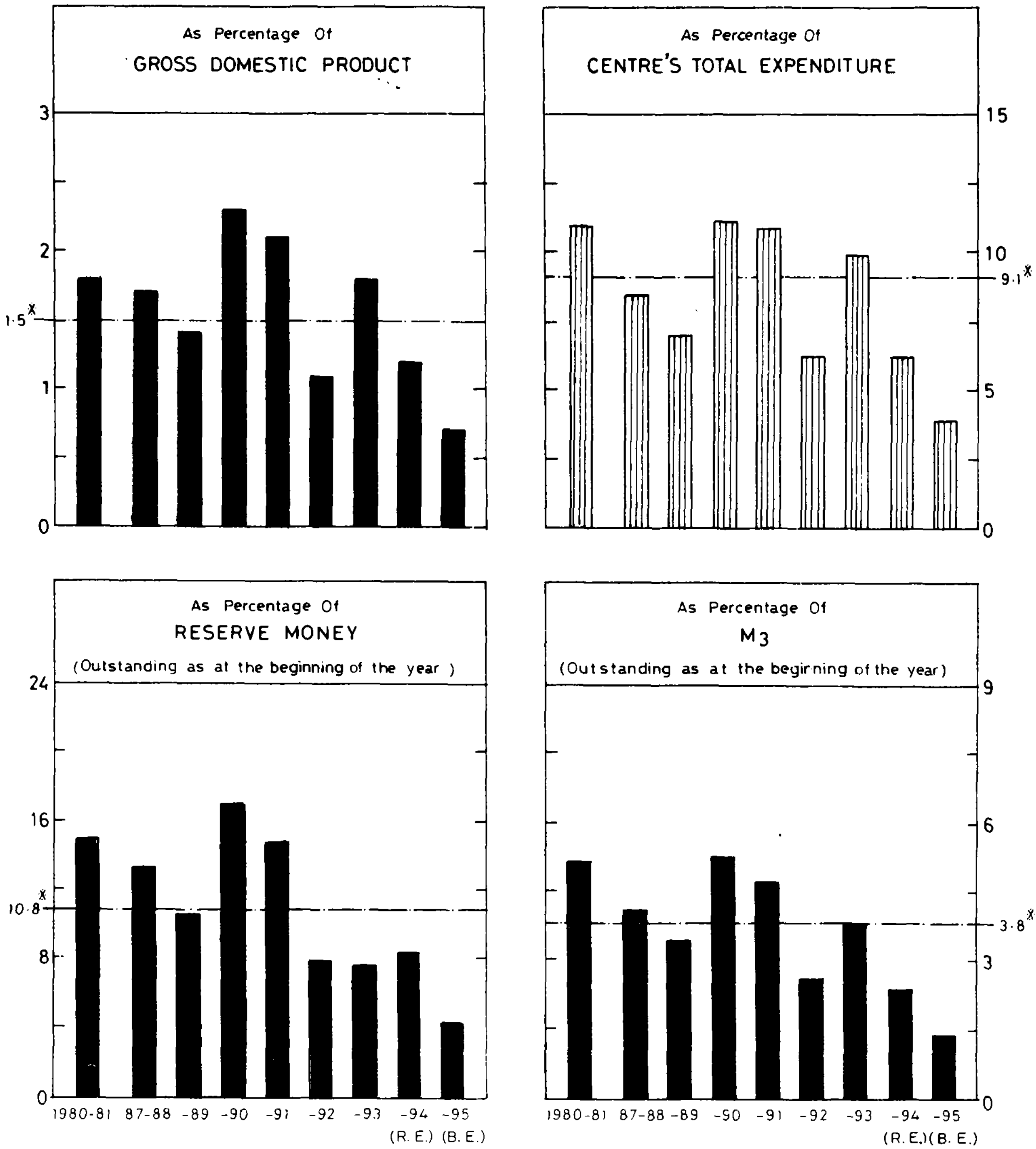
23. The budget for the year 1994-95 was formulated against the background of a slippage in the fiscal deficit during 1993-94 (RE). Correction of this slippage and restoration of fiscal balance was one of the main considerations in the current year's budget. Acceleration of industrial recovery, reforms in tax system and alleviation of poverty and unemployment were the other considerations which were important in the formulation of the current year's budget. Higher outlays were provided for important social sectors such as rural development, education, health & family welfare and welfare of scheduled castes, scheduled tribes and other backward classes.

Budget Deficit

24. The budget deficit (total receipts minus total expenditure, both revenue and capital) during the year 1994-95 is estimated to decline to Rs. 6000 crore, against deficit of Rs.9060 crore in 1993-94 (RE) and Rs.12312 crore in 1992-93. In the past, the actual budget deficit had been typically higher than the budget estimates. During the year 1993-94, the revised estimates of the budget deficit of Rs.9060 crore were more than double when compared with the budget estimates of Rs.4314 crore. In order to check this tendency, it has been agreed with the RBI that if the net issue of ad-hoc treasury bills exceeds more than Rs.9000 crore for more than ten continuous working days, RBI will automatically sell these bills in the market and reduce the level. It has also been decided to reduce this source of financing over the next two years and stop it completely by 1997-98. The weekly movement of the budget deficit during 1994-95 is shown in Fig.2.3. The budget was in surplus during the first four weeks. During the next 12 weeks, the budget showed a deficit once again. But

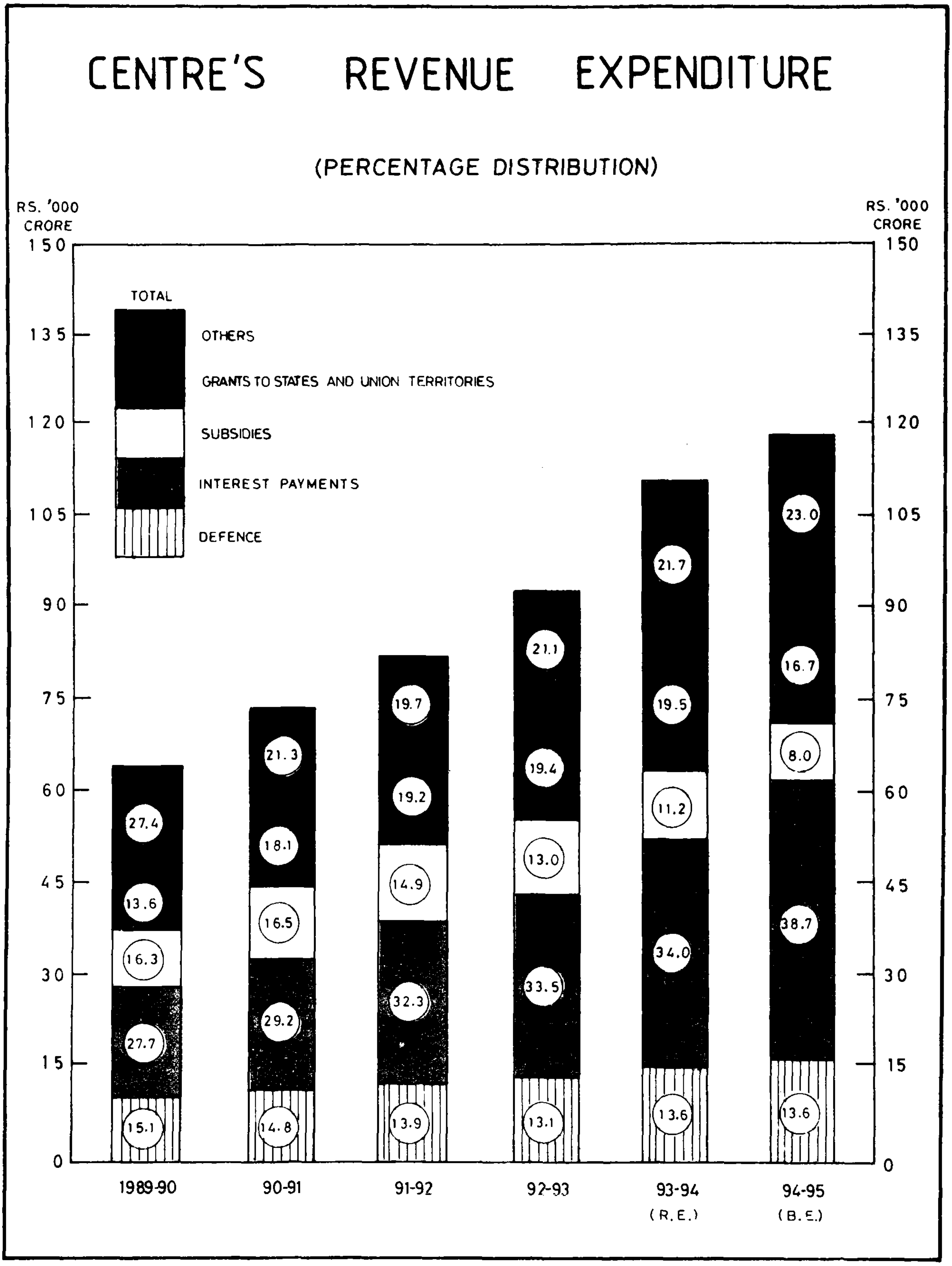
Figure 2.1

CENTRE'S BUDGETARY DEFICIT



* Average for the period 1980-81 to 1994-95

FIGURE 2.2



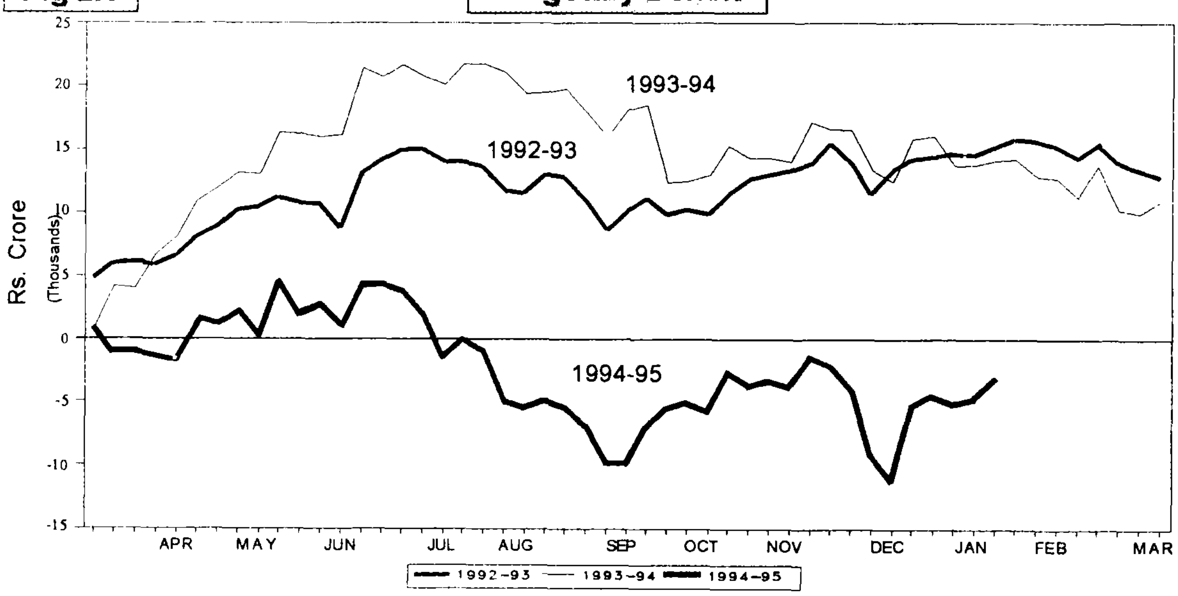
CENTRE'S REVENUE EXPENDITURE
(PERCENTAGE DISTRIBUTION)
RS. '000 CRORE
RS. '000 CRORE
150
135
120
105
90
75
60
45
30
15
0
TOTAL
OTHERS
GRANTS TO STATES AND UNION TERRITORIES
SUBSIDIES
INTEREST PAYMENTS
DEFENCE
27.4
13.6
16.3
27.7
15.1
21.3
18.1
16.5
29.2
14.8
19.7
19.2
14.9
32.3
13.9
21.1
19.4
13.0
33.5
13.1
21.7
19.5
11.2
34.0
13.6
23.0
16.7
8.0
38.7
13.6
1989-90
90-91
91-92
92-93
93-94
(R.E.)
94-95
(B.E.)

TABLE 2.8
Budgetary Transactions of the Central and State Governments and Union Territories (Including extra-budgetary resources of public sector undertakings for financing their Plans)

	1980-81	1989-90	1990-91	1991-92	1992-93	1993-94 (RE)	1993-94 (BE)	1994-95 (BE)
1	2	3	4	5	6	7	8	9
			(Rs.Crore)					
I. Total Outlay	36845	158107	176548	199370	224688	261224	258477	294960
(a) Developmental	24426	98501	105922	118715	134020	151154	153911	168233
(b) Non-developmental	12419	59606	70626	80655	90668	110070	104566	126727
II. Current revenue	24563	103115	110607	133834	153195	168885	178958	191932
(a) Tax revenue	19844	77693	87723	103198	114165	121930	131805	140945
(i) Direct taxes	3268	11165	12259	16656	19386	22470	22888	26682
(ii) Indirect taxes	16576	66528	75464	86542	94779	99460	108917	114263
(b) Non-tax revenue	4719	25422	22884	30636	39030	46955	47153	50987
III. GAP(I-II)	12282	54992	65941	65536	71493	92339	79519	103028
Financed by:								
(i) Domestic capital receipts	7161	40812	50192	52284	52969	75799	66428	88917
(ii) Net external assistance	1670	3567	4263	6171	5984	5136	6820	5644
(iii) Budgetary deficit	3451	10613	11486	7081	12540	11404	6271	8467
As per cent of GDP			*(Per cent)*					
I. Total Outlay	27.1	34.6	33.0	32.4	32.0	33.2	32.9	32.4
(a) Developmental	18.0	21.6	19.8	19.3	19.1	19.2	19.6	18.5
(b) Non-developmental	9.1	13.0	13.2	13.1	12.9	14.0	13.3	13.9
II. Current revenue	18.1	22.6	20.7	21.7	21.8	21.5	22.8	21.1
(a) Tax revenue	14.6	17.0	16.4	16.8	16.2	15.5	16.8	15.5
(i) Direct taxes	2.4	2.4	2.3	2.7	2.8	2.9	2.9	2.9
(ii) Indirect taxes	12.2	14.6	14.1	14.0	13.5	12.6	13.9	12.6
(b) Non-tax revenue	3.5	5.6	4.3	5.0	5.6	6.0	6.0	5.6
III. GAP (I-II)	9.0	12.0	12.3	10.6	10.2	11.7	10.1	11.3
Financed by:								
(i) Domestic capital receipts	5.3	8.9	9.4	8.5	7.5	9.6	8.4	9.8
(ii) Net external assistance	1.2	0.8	0.8	1.0	0.9	0.7	0.9	0.6
(iii) Budgetary deficit	2.5	2.3	2.1	1.1	1.8	1.5	0.8	0.9

Note: For clarification regarding the scope of some items in this table,see foot-note to Table 2.2 in the Statistical Appendix.

Fig 2.3 **Budgetary Deficit**



the level of the deficit was much lower than the deficit prevailing at the end of corresponding weeks of 1993-94 and 1992-93. Starting from the last week of July 1994, there has been a continuous budget surplus for weeks. This continuing period of surplus has been the longest such period in a decade and reflects a significant success in fiscal management during 1994-95.

25. The fiscal deficit, defined as the difference between the revenue receipts plus certain non-debt capital receipts and the total expenditure including loans, net of repayments, has also been at a lower level during 1994-95. It was Rs. 16792 crore at the end of June 1994, which is 14.7 per cent lower than the corresponding level last year. After this, there was some increase and the fiscal deficit rose to Rs. 23003 crore at the end of September, 1994. However, even at this level, the fiscal deficit is lower by 22.9 per cent compared with the fiscal deficit of Rs. 29832 crore at the end of September, 1993.

Savings and Capital formation

26. Gross savings of the Central Government, which came under pressure during 1993-94, are estimated to show an improvement during 1994-95(BE) as per the Economic & Functional Classification. The gross dissavings are estimated to decline from 2.5 per cent of GDP to 1.8 per cent of GDP in 1994-95 (BE). (Table 2.4). Consumption expenditure, excluding the consumption expenditure of Delhi, is estimated to decline from 4.1 per cent of GDP in 1993-94 (RE) to 3.7 per cent in 1994-95(BE) (Table 2.3). Transfer payments, on the whole, are estimated to decline from 8.6 per cent in 1993-94 (RE) to 8.2 per cent in 1994-95(BE). Subsidies and Grants to States and Union Territories are estimated to decline. Interest payments will however continue their irrevocable rise . 'Gross Capital Formation Out of Budgetary Resources' (Physical plus financial investment of Centre) is estimated to decline to 5.3 per cent of GDP from about 5.9 per cent, excluding Delhi, in 1993-94 (RE) This decline in investment is primarily due to a decline in financial 'assistance for capital formation in rest of economy' from 4.1 per cent to 3.6 per cent. The formation of physical assets has declined only marginally from 1.8 per cent to 1.7 per cent of GDP. Thus, the expected improvement in the fiscal position in 1994-95 is reflected in improved savings, but reduced investment in financial 'assistance for capital formation in rest of economy' out of budgetary resources.

Government Debt

27. The sharp increase in outstanding liabilities of the Central Government registered during 1993-94 (RE) is proposed to be checked during the current year. Total outstanding liabilities, including external liabilities converted at exchange rates prevailing at the end of September, 1994, are estimated to decline by 2.7 per cent of GDP to 67.7 per cent of GDP (Table 2.5). A major reduction shall come from a reduction in external liabilities from 16.3 per cent of GDP in 1993-94 (RE) to 14.5 per cent of GDP in 1994-95(BE). Internal liabilities are estimated to decline from 54.2 per cent of GDP in 1993-94 (RE) to 53.2 per cent in 1994-95(BE). The internal debt component of internal liabilities consisting mainly of market loans, special securities and Treasury Bills, will also decline from 30.9 per cent in 1993-94 (RE) to 30.5 per cent of GDP in 1994-95(BE). A decline of 0.7 per cent of GDP is estimated in other internal liabilities. Though outstanding liabilities as a proportion of GDP are estimated to decline, the absolute addition of Rs. 61135 crore to liabilities, coupled with rising interest rates is estimated to increase the total interest burden from Rs.37500 crore in 1993-94 (RE) to Rs.46000 crore in 1994-95(BE) (Table 2.6).

Supplementary Demands for Grants

28. The first batch of supplementary demand for grants for a total amount of Rs.343.3 crore was presented in August, 1994. The gross expenditure was matched by savings/recoveries or increased receipts to the extent of Rs.86.9 crore. Supplementary demands, therefore, involved a net cash outgo of Rs.256.4 crore. Payment to manufacturers/agencies under the scheme of sales of decontrolled phosphatic and potassic fertilizers with concessions to farmers involved Rs.250 crore. Other main items of expenditure are additional expenditure on the Delhi Milk Scheme and investment in share capital of Scheduled Castes Development Corporation.

29. The total expenditure as per the second batch of supplementary demand for grants presented in December, 1994, was Rs.5786.8 crore. The net cash outgo however, was only Rs.1961.8 crore since expenditure of Rs.3825 crore was matched by savings/recoveries or increased receipts. Additional release of Rs.2500 crore on account of small savings loans to States and Union Territories constituted over 43 per cent of total supplementary demands. Another 17 per cent was accounted for by additional Central assistance to States for externally-aided projects. Additional subsidy of Rs.500 crore on indigenous fertilizers (8.6 per cent), Rs.332 crore on imported fertilizers (5.7 per cent) and Central Government's share of expenditure of Rs.225 crore towards issue of photo identity cards (3.9 per cent) were some of other main items of expenditure.

Tax Measures and Reforms : 1994-95

30. Reform of the tax system has been an important element of structural reforms. The strategy has aimed at moving towards a simpler system of taxation with

moderate rates, few exemptions and a wider tax base. Earlier budgets had implemented these principles in direct taxes. The 1994-95 budget has continued to rely on these principles in direct taxes and undertaken major structural reform of indirect taxation, which continues to account for over 71 per cent of total tax revenue of the Centre. In regard to both excise and customs, there has been a drastic cut in the number of end use notifications, which will greatly reduce the possibility of disputes and the scope for discretion. Besides, the number of rate categories was sharply reduced, the peak rates were brought down and a significant switchover was effected from specific to ad valorem duties to strengthen built-in revenue elasticity. The system of credit for taxes paid on inputs, called MODVAT, was extended to cover petroleum and capital goods. These changes in commodity taxation have brought MODVAT closer to a VAT type system, and will facilitate the eventual introduction of a full fledged Value Added Tax. A modest beginning was also made in extending indirect taxation to services such as, telephones, non-life insurance and stock brokers. VAT principles do not however apply to these service taxes.

31. Tax reforms have induced a structural shift in the composition of tax revenue (Table 2.9). The share of direct taxes in the Centre's gross revenue jumped from 19.1 per cent in 1990-91 to 28.4 per cent in 1994-95 (BE), with a corresponding decline in the share of indirect taxes from 78.9 per cent to 71.3 per cent over the same period. Furthermore, the share of customs revenue in gross tax revenue dropped from about 36 per cent in 1990-91 to around 29 per cent in 1994-95(BE). The reduction in the general level of customs tariff is reflected in a sharp reduction of the collection rate from 44 per cent in 1991-92 to around 30 per cent in 1993-94. Overall, tax reforms since July 1991 have helped in correcting structural imbalances in the tax system, which by and large engender inefficiencies and distortions. Concomitantly, the share of direct taxes has increased, which is better from the point of view of both equity and economic efficiency.

TABLE 2.9
Sources of Revenue as Percentage of Gross Tax Revenue

	1990-91	1991-92	1992-93	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5	6
Direct Taxes[1]	19.1	22.6	24.3	27.6	28.4
Personal income tax	9.3	10.0	10.6	12.4	12.5
Corporation tax	9.3	11.7	11.9	13.7	14.3
Indirect Taxes[2]	78.9	75.5	73.7	71.0	71.3
Customs	35.9	33.0	31.9	29.3	28.9
Excise	42.6	41.7	41.3	41.4	42.1
Tax Revenue as Percentage of Gross Domestic Product					
Direct Taxes[1]	2.1	2.5	2.6	2.7	2.7
Personal income tax	1.0	1.1	1.1	1.2	1.2
Corporation tax	1.0	1.3	1.3	1.3	1.4
Indirect Taxes[2]	8.5	8.3	7.8	6.9	6.8
Customs	3.9	3.6	3.4	2.9	2.8
Excise	4.6	4.6	4.4	4.0	4.0

[1] *Includes expenditure, interest, wealth, gift taxes and estate duty.*
[2] *Includes other taxes and duties.*

Direct Taxes

Personal Income Tax

32. The process of moderation of personal income tax was continued in the Budget of 1994-95. The personal tax exemption limit was raised from Rs.30,000 to Rs.35,000. Besides, the surcharge of 12 per cent on non-corporate incomes was withdrawn. Personal tax rates were not changed, but there was a widening of tax slabs, as indicated below.

Tax rate	Income range in Rupees Old Slab	New Slab
Nil	0 - 30,000	0 - 35,000
20	30,001 - 50,000	35,001 - 60,000
30	50,001 - 100,000	60,001 - 120,000
40	Above 100,000	Above 120,000

33. With a view to grant relief to investors in units from lower or lower middle classes, units of Unit Trust of India and other approved mutual Funds are to be accorded long term capital gains treatment if they are held for more than 12 months as on the date of transfer.

34. A new provision was introduced to provide for separate assessment of income in the hands of a husband and wife, governed by the system of community property in the state of Goa and in the Union territories of Dadra and Nagar Haveli and Daman and Diu. The community income (except salary income) is to be equally apportioned between husband and wife.

Deductions

35. To help low income groups and the handicapped, further reliefs under the Income Tax Act were provided. Senior citizens (aged 65 years or more) are now entitled to a tax rebate of 40 per cent, against the earlier limit of 20 per cent. Concomitantly, the eligible income limit for claiming this deduction was raised from Rs.75,000 to Rs.100,000. To protect the erosion of post tax income of the handicapped child, such incomes were exempted from the provisions of clubbing, both under the income-tax and wealth tax Acts.

36. In computing income from self occupied

property; the deduction allowable in respect of interest payments on borrowed funds was raised from Rs. 5,000 to Rs .10,000 for purposes of income tax. The exemption limit for gifts made on the occasion of marriage of a relative was enhanced from Rs.30,000 to 100,000.

Non Resident Investments

37. As a measure of rationalisation and of encouragement to foreign investors, the varied rates of taxation of investment income (dividend and interest income) for non-resident individuals and non-resident companies were reduced to a uniform rate of 20 per cent.

Corporate Tax Simplification

38. A major reform of the corporate tax structure was taken in the Budget for 1994-95. This will help the corporate sector to save more, invest more and become more competitive. Previously, widely held and closely held domestic companies were taxed at rates of 45 per cent and 50 per cent respectively. The 1994-95 Budget removed the distinction between tax rates for widely held and closely held domestic companies and reduced the corporation tax on domestic companies to a uniform rate of 40 per cent. While a number of concessions to the corporate sector continued, the surcharge of 15 per cent for domestic companies with taxable income in excess of Rs.75,000 was also retained. Thus effective rate on domestic companies was reduced from 57.5 per cent (for closely held companies) and 51.75 per cent (for widely held companies) to a uniform rate of 46 per cent. Furthermore, the tax rate on companies incorporated abroad, but earning income in India (i.e. foreign companies) was reduced from 65 per cent to 55 per cent.

Base Broadening

39. As a part of the process of simplification and widening of the tax base, a new estimated income scheme for contractors with a turnover of up to Rs.40 lakhs and for truck owners who own up to ten trucks was introduced. In the case of contractors, the net profit is to be estimated at 8 per cent of gross receipts. In the case of truck owners, the income will be estimated at Rs. 2000 per month for heavy transport motor vehicles and Rs.1,800 per month for light commercial and medium vehicles. In both these cases, deductions on account of depreciation or interest or other expenses are deemed to have been already allowed and no further deduction is admissible. The above two schemes are optional. A system of rebuttal has been provided. The assessee will neither be required to maintain books of accounts, nor required to get his accounts audited. With a view to building an environment of trust and confidence and also to widen the tax base, the new simplified taxation procedure for small businessmen, etc., has been retained. The scheme which was in force initially for two assessment years, viz, 1993-94 and 1994-95, has now been made open ended, i.e. it will also apply to subsequent years.

40. An effective way of widening the tax base is to enlarge the scope of deduction of income tax at source. To this end, a new provision was introduced with effect from June 1,1994 to provide for withholding tax at the rate of 20 per cent (plus applicable surcharge) on rental payments above Rs.1,20,000 for any land and building in a financial year. However, rental payments made by an individual or a Hindu undivided family are excluded.

Incentives

41. Encouragement of exports has been accorded a high priority in the restructuring process. The existing tax exemption for income from commodity exports has been continued. Since there is a high potential for growth in exports of computer software, full tax exemption was extended to profits derived from exports of computer software for one more year, i.e. up to the assessment year 1995-96. With a view to encourage earnings from foreign tourists, the expenditure tax in hotels was reduced from 20 per cent to 10 per cent. The expenditure tax is levied in a hotel where the room charges for residential accommodation are Rs. 1,200 or more per day.

42. Investment in the development of human resources is an essential prerequisite for growth and progress. To this end, a new provision was introduced, which entitles an individual to claim a deduction from income of Rs.25,000 per annum on account of repayment of principal and payment of interest up to a cumulative total of rupees two lakh. This is applicable to loans borrowed from financial institutions for pursuing higher education in prescribed fields.

43. A weighted deduction of 125 per cent is allowed on payments made by an assessee to a National Laboratory for carrying out programmes of scientific research as approved by a prescribed authority. National Laboratory refers to scientific laboratories functioning under the aegis of the Indian Council of Agricultural Research, Indian Council of Medical Research or Council of Scientific and Industrial Research. The 1994-95 Budget has widened the ambit of National Laboratory to include scientific laboratories functioning at the national level under the aegis of Department of Electronics, Defence Research and Development Organisation, Department of Biotechnology and Department of Atomic Energy. Besides, this benefit was also extended to scientific laboratories undertaking scientific research in Universities and the Indian Institutes of Technology.

44. Changes have been made in the Income-Tax Act

so as to facilitate the adjustment in the labour force at a minimum cost and in a smooth manner, as a result of restructuring in the economy. The scope of the Income-Tax Act under section 10(10c), which provides tax exemptions under Voluntary Retirement Schemes, was expanded to include employees of universities and cooperative societies. Furthermore, to enable self employed people to contribute to a pension fund so as to provide for social security in the old age, the benefit of tax rebate under the Income-Tax Act was extended to cover contributions made to a pension fund established by Unit Trust of India.

45. Pollution control is a vital element in any strategy which fosters sustainable development. The Budget for 1994-95 has included pollution control among eligible projects entitled for concession under section 35 AC of the Income Tax Act. Hence, any person who makes a contribution to such a project can claim 100 per cent of such contribution as a tax deduction.

Revenue Impact of Reforms

46. The available data suggest that the strategy for reform of income taxes through simplification, reduction in marginal rates, rationalisation and administrative reforms is working. The reduction in income tax rates during the past four years has not led to a decline in revenue collections. On the contrary, average buoyancy as measured by the ratio of change in tax revenue to the change in the GDP at current prices, has shown an improvement. The reduction in personal income tax rates over the assessment years 1991-92 to 1994-95, from a marginal tax rate of 56 per cent on income above Rs. 1 lakh, to 40 per cent on income above Rs. 1.2 lakh, has not resulted in a reduction in revenue collections. The buoyancy of personal income tax revenues rose from an average of about 1 during 1987-88 to 1990-91 to around 1.4 during 1991-92 to 1994-95. Effective corporate tax rates have similarly been reduced, during the past four years, from a peak of 57.5 per cent for certain domestic companies to 46 per cent for all domestic companies. Despite this, the buoyancy has risen from an average of 0.8 during 1987-88 to 1990-91 to 1.7 in 1991-92 to 1994-95. This suggests that compliance has indeed improved.

Import Duties

47. The aim of import tariff reforms has been to reduce the costs of imported intermediates and capital goods to the economy and gradually lower the unduly high levels of protection provided to Indian industry, to promote competition, strengthen export competitiveness and benefit domestic consumers through better quality and lower cost goods. Customs duties, though lowered in the past three budgets, still remain much above the levels of our competitor countries. As consumer good imports are still restricted and therefore largely unaffected by tariff changes, the broad thrust of the tariff reductions has been to provide key imported raw materials and intermediates and capital goods at reasonable price to domestic industry. At the same time, the scale of duty reductions has been so calibrated as to ensure that it does not impose unreasonable pressure on domestic producers of similar products.

48. The key features of import tariff reforms in the Budget for 1994-95 are as follows. The process of reduction in peak rates was continued. The peak rate of customs duty was further reduced from 85 to 65 per cent, with the exception of dried grapes, almonds, alcoholic beverages, ball and roller bearings and passenger baggage. This was accompanied by decreases in duty rates on key raw materials and capital goods to boost investment.

49. A comprehensive reform of the structure of tariffs was initiated. This included rectification of anomalies resulting from higher levels of import duties on raw materials and components vis-a-vis finished products. An effort was made to unify rates on similar products with a view to reducing scope of classification disputes. A major pruning of notifications, including end use exemptions, was carried out, eliminating multiple rates and contradictory protection of the same commodity, and reduce discretionary power and possibilities of disputes.

Capital Goods

50. To promote investment and enhance competitiveness of the manufacturing sector in particular, a major restructuring of tariff rates covering the machinery and metals sector was undertaken. The basic customs duty on project imports and general capital goods was reduced from 35 to 25 per cent. The facility of project imports was extended to port development projects as well. This is expected to reduce the cost of investment and modernisation in Indian industry in a significant manner. The duty structure on machine tools was also simplified to two rates of 35 or 45 per cent from the existing varying rates of 40, 60, and 80 per cent. Besides, the customs duty on most parts, whether imported as parts of original equipment or as spares, was also reduced to 25 per cent.

51. The Tax Reforms Committee (TRC) had recommended that there should not be any exemption from Countervailing duty (CVD), as such an exemption discriminates against indigenous manufacturers of such items. In June/July 1993 the exemption from CVD in respect of 42 items was withdrawn and CVD was imposed, so as to equate non-protective duties (CVD and excise) and rationalise the MODVAT system. The

process was continued in the Budget for 1994-95, with the imposition of a CVD of 10 per cent on capital goods. Furthermore, by extending the benefit of MODVAT to capital goods, the full credit of excise duty paid on domestic capital goods or CVD paid on imported capital goods will be made available at one time.

52. Multiple exemptions governing import of medical equipment were eliminated. Rates were lowered to three distinct duty rates. Imports at zero rate were retained for imports of medical equipment by government hospitals, life saving equipment (83 items) and sight saving equipment. The import duty on specified medical equipment (list of 131 items) was reduced from 40 to 15 per cent, without any CVD. The import duty on "other medical" equipment was reduced from 85 to 40 per cent. In addition, components for their manufacture were allowed to be imported at 15 per cent customs duty. This differential is expected to help indigenous manufacturers of medical equipment.

Raw materials and Intermediate Goods

53. The reduction in import duty on capital goods was accompanied by reductions in the customs duty on metals, namely steel and non-ferrous. The customs duty on steel was reduced from a range of 75 to 85 per cent to 50 per cent. Besides, import duties on primary forms of major non-ferrous metals like copper, zinc and lead were unified at 50 per cent. During the course of the year, customs duty on unwrought aluminium was reduced from 25 to 10 per cent. These adjustments in tariff rates for metals, which are a vital input for the capital goods sector, will reduce anomalies faced by the domestic capital goods sector.

54. The reduction in the duty on raw materials and intermediates was continued further. The import duties on all ores and concentrates, melting scrap and iron ore pellets were reduced and unified at 10 per cent, to help make domestic metal production internationally competitive.

55. Significant changes in tariff structures for petroleum and coal were effected. The import duty structure on petroleum was simplified and replaced by ad valorem rates. A duty of 35 per cent on crude petroleum was prescribed, as against Rs.1500 per metric tonne before. Furthermore, import duty on LPG and petroleum gases was pegged at 15 per cent and those on other petroleum products at 30 per cent. However, the exemption from basic customs duty on naptha and kerosene was continued. There was a further reduction in the customs duty on coal. The import duty on coal and coke was reduced to 35 per cent and 25 per cent respectively, from the previous peak rate of 85 per cent.

Other Sectors

56. The tariff structure for electronics and telecommunications was rationalised. The customs duty on computer parts was reduced to 50 per cent and on application software to 20 per cent, from 80 and 85 per cent respectively. The duty on specified components and piece parts was reduced to 40 per cent and 30 per cent respectively. In order to promote the growth of the telecommunication sector, the import duty on non-electronic parts for the manufacture of telecom equipment was reduced to 40 per cent and that on optical fibres for manufacture of optical fibre cables (telecom grade) reduced to 40 per cent.

57. The overall dispersal of customs duty rates on chemicals was reduced, with the reduction of the peak rate to 65 per cent. In addition, the duties on DMT, PTA and MEG were further reduced from 70 to 60 per cent and on certain intermediates, the duty was reduced from 40 to 30 per cent.

58. In the pharmaceutical sector, the import duties on a large number of raw materials were lowered to two rates of 50 or 25 per cent from the existing rates of 85 to 50 per cent. In a few cases, there has been some upward adjustment in import duty, having regard to the need to protect the interests of domestic manufacturers of drug intermediates.

59. The domestic watch industry has a significant growth potential if it is made internationally competitive. To this end, the import duty on certain items of machinery for the industry were reduced from 50 per cent to 25 per cent. Besides, duties on specified components and specified raw materials for use in this sector were brought down from 70 and 50 per cent to 25 and 20 per cent respectively. This will also help to reduce smuggling of these small light but high value components.

Baggage

60. The general free allowance for passenger baggage was increased from Rs.3000 to Rs.4000. The concessional rate of import duty of Rs 220 per 10 grams for gold and Rs 500 per kilogram for silver was extended to such imports under special import licences.

Special Exemptions

61. During the course of the current year, some more duty exemptions were accorded to certain agriculture based items to ease pressure on domestic prices of such products. Refined sugar, crystal sugar and raw sugar were exempted from all customs duty and countervailing duty. Raw cotton was exempted from all customs duty. Besides, animal embryos were also exempted from customs duty. A uniform rate of customs duty was prescribed on almonds in shell at Rs.44/39 per kg for standard/preferential areas.

Collection Rates

62. Collection rates are better indicators of nominal

Box 2.1

Import Duty (excluding CVD) in per cent ad-valorem

Industry	TRC[1] Recommendation	Existing to date
1	2	3
1. Essential agricultural goods like wheat and rice	0	0
2. Other agricultural like oilseeds and pulses	10	65
3. Non-essential agricultural goods like almond and cashewnut	50	65[2]
4. Petrochemical building blocks	15	15 to 30
5. Organic and inorganic chemicals	20	15 to 65
6. Polymers	25	45 to 65
7. Textile fibres & yarn	25	25 to 65
8. Iron and Steel		
a. Pig iron	15	20
b. Semi & finished steel including stainless steel & other alloy steel	20	30 to 50
9. Copper	20	50
10. Aluminium	15	10
11. Nickel	15	30
12. Lead & Zinc	20	50
13. Tin	15	30
14. Wastes & Scrap & concentrates of ferrous & non-ferrous metals	10	10
15. Articles of iron & steel	30	50
16. Articles of non-ferrous metals:		
a. of copper, lead and zinc	30	50 to 60
b. of aluminium, nickel & tin	25	50
17. Machinery including machine tools	20	25 to 65
18. Electronics:		
a. Raw materials	20	20
b. Piece parts, components, sub-assembly & equipment	30	30 to 65
19. Instruments	30	40 & 60
20. Medical equipment	20	0 to 65

Note: Examples of petrochemical building blocks are ethylene, propylene, butadiene, benzene, ethyl-benzene and styrene. Polymers include LDPE/LLDPE, HDPE, PP, PVC, PS, polyesters, synthetic and natural rubber and the whole range of plastics and synthetic resins.

[1] Import duty structure recommended for 1997-98.

[2] Subject to specific duty as well in case of almonds.

tariff protection than the general (published) tariff rates. The collection rate is defined as the ratio of realised customs revenue (including auxiliary and countervailing duty) to the value of imports of a commodity. Because of numerous exemptions, the (published) tariff rates do not fully reflect the nominal level of protection. The actual incidence of duty is lower than that notified in the tariff schedule.

63. Table 2.10 shows customs duty collection rates during the period 1990-91 through 1993-94. The average collection rate has fallen by about 17 percentage points consequent to the reforms in the tariff regime, from 47 per cent in 1990-91 to 30 per cent in 1993-94. The drop in collection rates encompassed all major product groups except POL. The dispersion of rates, as measured by the range between the maximum and the minimum collection rates, though reduced, is still too wide. This distorts incentives and leads to misallocation of resources. The difference between the lowest and highest collection rates, after rising initially from about 75 percentage points in 1990-91 to about 96 percentage points in 1991-92, fell to 85 percentage points in 1992-93 and further to 59 percentage points in 1993-94.

64. During 1993-94, paper and newsprint, natural fibres and the "others" category had the lowest collection rates, ranging between 10 to 14 per cent. In particular, the low collection rate for the "others" category was due to the inclusion of items like fertilisers, precious stones etc. which attract low or nil duty. However, metals and chemicals continue to have collection rates in excess of 50 per cent. Moreover, the collection rate for metals at 69 percent is more than twice that for capital goods. This entails some disincentive for

TABLE 2.10

Collection Rates for Select Import Groups

(In Per cent)

S.No.	Commodity Groups	1990-91	1991-92	1992-93	1993-94
	1	2	3	4	5
1.	Food Products	47	27	12	19
2.	POL	34	31	31	36
3.	Chemicals	92	82	71	52
4.	Man-made fibres	83	63	45	18
5.	Paper & newsprint	24	23	18	13
6.	Natural fibres	20	21	20	14
7.	Metals	95	110	97	69
8.	Capital goods	60	64	53	31
9.	Others	20	14	13	10
10.	Non POL	51	49	39	28
	Total	**47**	**44**	**37**	**30**

S.No.1 Includes cereals, pulses, milk and cream, fruits, vegetable and animal fats.
S.No.3 Includes chemical elements and compounds, pharmaceuticals, dyeing and colouing materials, plastics and rubber.
S.No.5 Includes pulp and waste paper, newsprint, paperboards and manufactures and printed books, newspaper, journals etc.
S.No.6 Includes raw wool and silk.
S.No.7 Includes iron and steel and non-ferrous metals.
S.No.8 Includes non-electrical machinery and project imports, electrical machinery and transport equipment.

capital goods and possibly leads to negative protection as well. The Budget for 1994-95 has eliminated a large number of end use exemptions and undertaken rationalisation of the structure of tariffs with a view to remove anomalies and disincentive effects arising out of inverted tariff structures. This is expected to have a favourable impact on the capital goods sector and downstream industries in the chemical sector.

Excise Duties

65. A major reform of domestic commodity taxation was undertaken through the Finance Act, 1994, with the objective of simplifying and rationalising the excise-MODVAT system. This is expected to considerably reduce the transaction costs of administering the existing excise-MODVAT regime. Foremost was the drastic cut in the number of ad valorem rates to about half and a reduction in the dispersal of excise rates. It is noteworthy that the total number of ad valorem tax rates was reduced to about half the existing number. The process of lowering the rates where they were unduly high, was continued. In addition, there was a drastic phasing out of exemption notifications. Significantly, half the existing excise notifications were withdrawn. This is likely to bring many units under the excise net. Furthermore, this will do away with the cumbersome certification procedure which was required for claiming exemptions. This is expected to eliminate misuse and tax evasion. A massive switch over was also effected from specific to ad valorem rates to ensure built in buoyancy of revenues. The procedure for valuation of excise duty was simplified. Invoice of goods sold will be the basis, instead of the complicated price list procedure in vogue earlier.

VAT Principles

66. The ambit of MODVAT was extended to cover capital goods, petroleum products and spun yarn made from fibres. This will help in mitigating the cascading effect on textiles. In addition, investment activity will get a fillip with the lowering of acquisition cost of capital.

67. Modified Value Added Tax (MODVAT) was introduced with effect from 1.3.1986 through the 1986-87 Budget. Under the MODVAT Scheme, credit of duty is allowed on inputs which are used either for producing excisable finished products or intermediate products. Over time, the ambit of MODVAT has been extended to include more commodities/sectors. However, the transformation of existing MODVAT into a full fledged Central VAT up to the manufacturing stage is not yet complete. At present, the MODVAT scheme does not explicitly cover textile fabrics, tobacco products and matches. In addition, VAT principles of deduction/credit do not currently apply to all inputs. These include use of equipment/inputs in testing, research and development, quality control, pollution abatement, cleaning agents, and certain consumables. These are excluded as there is a lack of nexus between the input and output.

Rationalization and Simplification

68. The excise duty structure on petroleum products was rationalised and existing specific duty rates were replaced by an ad valorem rate of 10 per cent on all petroleum products, with the exception of motor spirit, on which an excise duty of 20 per cent was imposed. Furthermore, end use exemptions were virtually eliminated.

69. The various fibres and blended or spun yarns were subjected to a uniform excise duty of 20 per cent. In order to obviate the problems of classification and to make the excise duty neutral as between various fibres and yarn, a uniform excise duty of 20 per cent on all fibres and yarn was provided for, instead of complex and varying specific rates depending on the count of yarn. On cotton yarn, excise duty of 5 per cent was prescribed. As regards filament yarn, an ad valorem duty rate of 60 per cent was prescribed for polyester filament yarn, 30 per cent for nylon and polypropylene yarn and 15 per cent for viscose filament yarn. For industrial yarn, lower rates of 30, 20 and 10 per cent were put in place. As fabrics are not subject to excise

duty, the MODVAT chain is broken at this stage, leaving a wide dispersion of rates.

70. The existing rates of additional excise duty (in lieu of sales tax) for cotton and man-made fabrics which were a blend of ad valorem and specific rates, were converted to ad-valorem rates of 5, 10, and 20 per cent. The problem of cascading which arises from additional excise duties, can be solved by either transferring taxation of textiles back to the States and integrating it into State VATs, or by a comprehensive National VAT.

71. A uniform excise duty of 15 per cent was imposed on all metals except aluminium, for which an excise duty of 20 per cent was prescribed as against 25 per cent earlier. However, a low rate of 10 per cent was accorded to pig iron and certain other products of iron.

72. The excise duty structure for single formulation of Schedule-II drugs and branded drugs were unified at 15 per cent. However, excise duty at 10 per cent was imposed on branded ayurvedic and homeopathic medicines and medicines of other alternative systems. The excise duty on cosmetics was reduced from 70 to 50 per cent.

73. The duty structure for various chemicals and chemical based products was simplified and a uniform excise duty of 20 per cent was prescribed. This will reduce to a very significant extent, the onerous sampling and testing requirements which were required by the myriad rates for different chemicals. A uniform excise duty of 30 per cent was accorded to major bulk plastics, synthetic paints and detergents, as against 35 per cent earlier.

74. The excise duty structure for paper and paper board was unified at 20 per cent. The scope of exemption currently available to paper mills using unconventional raw materials, was enlarged. Subsequently, the excise duty on paper board or articles manufactured from pulp containing at least 75 per cent unconventional raw material, was reduced from 10 to 5 per cent

75. The specific excise duty rates on cigarettes were increased by about 12 per cent. However, in the non filter segment, the excise duty for up to the 60 mm category, was reduced from Rs.120 per thousand to Rs.60 per thousand to encourage higher off-take by the cigarette industry to help tobacco growers.

76. Subsequent to the presentation of Budget, excise reductions were made for a number of items of mass consumption and daily use. Soap made without the aid of power was exempted from excise duty. Excise duty exemption was also granted to footwear up to a value of Rs.50 per pair and to hawai chappals and parts thereof. Excise duty on pan masala not containing lime, katha or tobacco, was reduced from 50 to 20 per cent. Excise duty on insulated ware was reduced from 20 to 10 per cent.

77. Changes in excise duty rates after the budget provided significant reliefs to the woollen and jute industry. Full exemption was provided to woollen yarn in plain reel hanks and to made up articles of handloom fabrics. An excise duty of 10 per cent was prescribed on other woollen yarn. Excise duty on jute yarn, jute fabrics, jute twine, floor coverings of jute and bags of jute was reduced to 5 per cent. Laminated and fire resistant jute products and diversified jute products were exempted from excise duty. A uniform additional excise duty in lieu of sales tax at 10 per cent was prescribed on all knitted and crocheted fabrics. Corrugated boxes and cartons were exempted from excise duty.

78. Post budget changes were made for some segments of the consumer durable industry and intermediates. The excise duty on split air conditioners for use in buses was reduced from 60 to 30 per cent to eliminate any negative effect on tourism. Because of definitional and other changes, the excise duty on motor vehicles of Gross Vehicle Weight (GVW) not exceeding 2700 kg had gone up sharply. This was reduced from 40 to 25 per cent. The excise duty on medical, surgical, dental or veterinary furniture and their parts was reduced from 20 to 5 per cent. The excise duty on cement clinkers was reduced from Rs.250 to 185 per tonne. Compounded rubber was exempted from excise duty. In addition, compounded levy duty was prescribed on cold rolling machines utilised for cold rolling of stainless steel at Rs.10000 per cold rolling machine per month.

Service Tax

79. In line with the recommendations of the TRC, a service tax was introduced. This measure is expected to broaden the base for domestic indirect taxes as the services sector accounts for about 50 per cent of our GDP and has shown robust growth. Besides, there is no rationale for exempting services from taxation, when goods are taxed and many countries treat goods and services alike for taxation purposes. A modest beginning was made in the Budget for 1994-95 by bringing select services under the ambit of taxation. A service tax on services of telephones, non-life insurance and stock brokers was introduced. This tax is charged at 5 per cent on the amount of telephone bills, the net premium charged by insurance companies and the brokerage or commission charged by stock brokers in relation to their services. Given the difficulties of administration, the VAT principles have however not been applied to this tax.

Small Scale Sector

80. The Budget for 1994-95 seeks to promote the interests of the small scale sector by doing away with the full duty exemptions in most cases, while simultaneously expanding the coverage of items included in the general small scale industries (SSI) scheme for concessional duty. The past practice of exempting a particular product completely from excise entailed similar treatment to small and large units without providing any special fiscal advantage to the former. It is only when excise is levied on large units to the exclusion of small and tiny units that the latter are accorded a real fiscal advantage. Hence the removal of the full duty exemptions for a large number of product categories is likely to provide a competitive edge to tiny and small scale units over the comparatively larger units producing the same products.

81. The coverage of items included in the general SSI scheme for concessional duty was expanded to include a number of additional items in the 1994-95 budget. The scheme has been extended to various goods like rubber tyres and tubes, unbranded pan masala, unbranded chewing tobacco, conveyor beltings, monofilaments of HDPE and polypropylene, coated fabrics of cotton, certain specified products of ferrous and non-ferrous metals, woollen yarn, polypropylene spun yarn, acrylic spun yarn, narrow woven fabrics, textured filament yarn, gauze, rubberised textile fabrics etc. The SSI units have also been given the option to pay normal excise duty to enable them to avail the benefit of MODVAT credit. This will enhance the marketability of inputs manufactured in the small scale sector. The requirement of registration with the Directorate of Industries in the concerned States or Development Commissioner Small Scale Industries for availing small scale exemptions has been abolished. This measure is expected to help a large number of unregistered units.

82. The brand name provision in the general SSI scheme has been amended in order to plug certain loopholes whereby large companies were avoiding payment of excise duty by getting their brand name registered in the name of SSI units and obtaining the goods manufactured from a number of SSI units. The concession will no longer be available to the clearance of goods bearing the brand name of any other manufacturer. This will help small producers to promote their own brands. It has also been provided that in case SSI units manufacture parts/components for machinery to be used as original components by the purchaser of the goods, such branded components can be cleared without payment of duty up to Rs.30 lakh in a year under a simplified procedure, even though such parts and components bear the brand name of some other person. It has also been clarified that putting a code number, design number and drawing number will not be construed as a brand name.

83. Certain procedural facilities were also provided in the small scale duty exemption scheme in and after the presentation of the 1994-95 Budget. Small scale units are not required to maintain any extra records. Their own records with minor additional requirements are regarded as sufficient for excise purposes. Small and tiny units with clearances up to Rs.30 lakh are not required to file any formal declaration with the central excise department. Secondly, separate gate passes or other documents are also not required for clearance of such goods. Moreover, when the exemption limit of Rs. 30 lakh is crossed, the duty can be paid on the basis of bills or challans or invoices. Monthly returns have been replaced by simple quarterly statements to be filed with the excise department. SSI units will also be eligible to avail of MODVAT credit on the duty paid on capital goods, even if part of the clearances of a SSI unit are exempted. Small scale units which are fully exempted have been granted the facility of sending goods outside, without payment of duty for getting any job work done. The job worker in a small scale unit is also not required to pay any excise duty on job work. As a further facility, the clearance of such goods sent outside for job work will not be taken into account for determining the eligibility of the small scale unit. This scheme will grant substantial relief and flexibility to small scale units to upgrade their technology without losing the exemptions available. These measures will go a long way in reducing the transaction costs of doing business for small entrepreneur.

Reforms in Tax Administration

84. A number of measures were put in place to reduce the transaction time/cost incurred, especially by exporters/importers and income tax assessees. These are mainly in the nature of modernisation of the tax administration in certain areas pertaining to customs, central excise and income tax. Extensive computerisation of income tax has been initiated. Three computer centres, one each at Delhi, Madras and Bombay have been set up. A new PAN number has been devised and will be allotted to all income tax assessees. A number of changes were also made in the rules and regulations for speedy clearance of goods of exporters and importers. Exporters and importers will be able to clear their goods and pay their charges without their interface with custom officials through the computerised facilities provided at Delhi Palam Airport. Besides, in many cases, green channel clearance facilities were provided to manufacturer exporters. These have facilitated exporters in clearing their goods without any hindrance or problems at custom houses.

Revenue Performance 1994-95

85. In the Budget for 1994-95, it was indicated that the proposed changes in taxes would entail a conventional net revenue loss of Rs.3604 on Centre. This revenue loss was estimated on conventional lines, and did not give any credit due to simplification and rationalisation of the tax structure, which would help revenue collection. The consequence of postponing the tax reform, or of imposing additional taxes to offset the revenue loss as conventionally calculated, would have been completely unproductive in a situation where our economy was characterised by sizeable unutilized industrial capacity, record food stocks and comfortable foreign exchange reserves. It was felt that given considerable tax evasion, there was still scope for additional tax mobilisation even in the face of a reduction in tax rates, through improving tax administration and compliance. This conjecture has been proved right, as the trends on tax collections for the current year indicate. The data available for principal sources of direct and indirect taxes for the first seven months (April-October, 1994) of the current year are encouraging. In the case of direct taxes, collections from personal income tax and corporation tax at Rs.10243 crore were higher by 53.5 per cent over the same period of 1993-94. Collections from excise and customs were at Rs.34024 crore during April-October, 1994 and posted a growth of about 18 per cent. The extraordinary performance on corporate taxes may be partly due to changes in the advance tax payments schedule. Nevertheless, these trends do support the perceptions on which the Budget for 1994-95 was formulated

Overview of Tax Reform

86. Over the last few years a number of measures have been taken to simplify the tax structure and widen the tax base The task is not yet complete. However, there is a need to deepen the existing tax base through better enforcement and scrutiny. On the indirect tax front, significant changes have been brought about in import tariffs and excise duties. The lowering of custom duty has been gradual and calibrated in a manner so as to provide some cushion to domestic producers in the interim and at the same time remove the burden of excessive protection which has afflicted Indian industry for so long. The tariff reforms are geared to make Indian industry competitive in the long run. Extension of MODVAT to capital goods and the reduction in corporate taxes is expected to spur investment in the manufacturing sector. The reduction in personal income tax and excise duty is expected to stimulate domestic demand. There are unmistakable signs of strong industrial recovery. To a significant extent, this is the result of moves towards a tax structure which is transparent, simple, avoids multiplicity of rates and does not blunt incentives for agents, be they producers or consumers.

States and Union Territories: 1994-95

87. The current revenue of the States and Union Territories is budgeted to increase to Rs. 112015 crore (12.3 per cent of GDP), from Rs. 98401 crore (12.5 per cent of GDP) as per the revised estimates of 1993-94. Total expenditure is budgeted to increase from Rs. 126098 crore (16.0 per cent of GDP) in 1993-94 (RE) to Rs. 144076 crore (15.8 per cent of GDP). As a result of identical decreases in the ratio of current revenue and total expenditure to GDP, the gap between the two is also estimated to remain at the 1993-94 (RE) level of 3.5 per cent of GDP. The share of non-development expenditure in total expenditure is estimated to increase further to 36.0 per cent from 34.6 per cent in 1993-94 (RE) On the receipt side, realisation from sales tax are estimated to increase to 3.3 per cent of GDP against 3.2 per cent in 1993-94 (RE). But the grants from the Centre are estimated to decline to 2.5 per cent of GDP against 2.7 per cent in 1993-94 (RE) No significant improvement is expected in the financial performance of SPSEs.

Centre, States and Union Territories: 1994-95

88. The gap between the current revenue and total outlay is expected to decline from 11.7 per cent of GDP in 1993-94 (RE) to 11.3 per cent as per the budget estimates of 1994-95 (Table 2.8). Current revenue is estimated to decline marginally to 21.1 per cent of GDP from 21.5 per cent in 1993-94 (RE). A decline of 0.8 percentage points of GDP is estimated in the total outlay. However, the share of non-development outlay in the total outlay is estimated to increase still further to almost 43.0 per cent. The change in the structure of financing of the gap between current revenue and total expenditure is expected to continue as per earlier trends. The share of domestic capital receipts is estimated to increase to 86.3 per cent, while the share of external assistance declines marginally to 5.5 per cent. The contribution of the budget deficit will also decline from 12.4 per cent in 1993-94 (RE), to 8.2 per cent.

Annual Plan

89. The total outlay of Rs.112197 crore for the Annual Plan for 1994-95 for the Centre, States and Union Territories is 21.1 per cent higher than the revised outlay of Rs.92629 crore for the last year (Table 2.11). The Central Plan outlay of Rs.70141 crore accounts for 62.5 per cent of the total Plan outlay. The share of

TABLE 2.11
Annual Plan Outlay: Centre, States and Union Territories

Heads of Development	1993-94 (RE)	1994-95 (BE)	1993-94 (RE)	1994-95 (BE)
1	2	3	4	5
	(Rs.Crore)		(Per cent)	
1. Agriculture and Allied Activities	4913	5846	5.3	5.2
2. Rural Development	7013	8627	7.6	7.7
3. Special Area Programme	1328	1548	1.4	1.4
4. Irrigation and Flood Control	5006	6495	5.4	5.8
5. Energy	27044	32915	29.2	29.3
6. Industry and Minerals	10587	12566	11.4	11.2
7. Transport	13318	14909	14.4	13.3
8. Communications	6388	7194	6.9	6.4
9. Science,Technology and Environment	1318	1435	1.4	1.3
10. General Economic Services	956	1950	1.0	1.7
11. Social Services	14271	18048	15.4	16.1
12. General Services	487	664	0.5	0.6
Total	**92629**	**112197**	**100.0**	**100.0**

States and Union Territories at 37.5 per cent is higher than their share of 33.7 per cent during 1993-94 (RE). Sector-wise allocations show that there is an increase of 26.5 per cent in social services from Rs.14271 crore in 1993-94 (RE) to Rs.18048 crore in 1994-95 (BE), The allocation for rural development is estimated to increase by over 23 per cent.

90. The outlay of Rs.50064 crore for the annual Plan of the Central Public Sector Enterprises (CPSEs) for 1994-95 constitutes about 71.4 per cent of total Central Plan outlay. The estimated financing pattern of CPSEs' Plan shows that their internal resources will contribute 45.8 per cent. Another 39.8 per cent shall come from extra-budgetary resources, comprising bonds/debentures, external commercial borrowings and suppliers' credit etc. Budget support takes care of the remaining requirement of 14.4 per cent. Compared with the financing pattern as per the revised estimates of 1993-94, internal resources are estimated to improve from about 43.0 per cent to 45.8 per cent of the total plan outlay of CPSEs. Similarly, reliance on budget support is also estimated to decline from about 17.0 per cent in 1993-94 (RE) to 14.4 per cent of their Plan outlay in 1994-95 (BE).

91. It has been the policy to reduce budgetary support to CPSEs with a view to making them increasingly more self-reliant. The emphasis is now on generation of increased internal resources and borrowings from the market. Budget support, which was 23.5 per cent of the Plan outlay of CPSEs in 1991-92 declined to 17.9 per cent in 1992-93 and further to about 17.0 per cent in 1993-94 (RE). The Plan size of CPSEs could not be maintained at the original level of Rs.47235 crore and was reduced to Rs.43892 crore.

92. Domestic resources are estimated to contribute to 82.6 per cent of the aggregate resources, against 80.2 per cent in 1993-94 (RE). Net inflow from abroad accounts for 11.9 per cent and the remaining 5.6 per cent is estimated to come from deficit financing. Net inflow from abroad is higher than the revised estimates of about 10.0 per cent in 1993-94 (RE). But reliance on budgetary deficit is estimated to slide down from 9.8 per cent in 1993-94 (RE) to 5.6 per cent in 1994-95 (BE).

Performance of Departmental Enterprises

Railways

93. The gross traffic receipts of the Indian Railways increased from Rs.15688 crore in 1992-93 to Rs.18585 crore in 1993-94(RE), representing a growth of 18.5 per cent. In percentage terms, this growth in Gross Traffic Receipts is much higher compared to 1991-92 and 1992-93, when it was only 13.5 per cent and 14.3 per cent respectively. In 1993-94 (RE), the total working expenses (including appropriations to the Depreciation Reserve Fund and Pension Fund) have been estimated at Rs.15355 crore as against Rs.13980 crore in the previous year. The working expenses thus, show an increase of 9.8 per cent, which is well below the 11.1 per cent increase in 1991-92 and the 12.8 per cent in 1992-93. As a combined result of higher growth in gross traffic receipts and a comparatively lower increase in working expenses, the net traffic receipts of the railways show an increase from Rs.1708 crore in 1992-93 to Rs.3230 crore in 1993-94 (RE). The net Railway Revenue comprising the net traffic receipts and net miscellaneous receipts amount to Rs.3494 crore in 1993-94 (RE). The ratio of net revenue to Capital-at-Charge and investment from Capital Fund works out to 15.3 per cent in 1993-94 (RE) as compared to 8.7 per cent in 1991-92 and 9.7 per cent in 1992-93. The ordinary working expenses, forming a major part of the total working expenses, also registered a lower increase of 12.2 per cent in 1993-94 (RE). as compared to 13.8 per cent in 1992-93. After making provisions for payment of Rs.1299 crore as dividend to General Revenues, the 'Surplus' amounts to Rs.2195 crore, which partly meets the investment requirements of the Railways. The other sources of financing the Railway Plan are budgetary support and market borrowings through Indian Railway Finance Corporation, as also withdrawals from the Depreciation Reserve Fund. Given the great stringency in resources, contemplated and announced measures for privatisation of different services need to be implemented speedily.

Box 2.2
Highlights of Railway Budget 1994-95

- Classification of certain commodities revised upward both for wagon and train loads. Sub-classification of Iron and Steel divisions abolished and common rates to be charged. Classification of grains and pulses for other than public distribution system raised.
- Rebate for cement and chemical manure raised.
- Exemption to certain essential commodities to continue.
- No increase in Second Class Ordinary fares upto 100 km. Marginal increase ranging from Re.1 to Rs.5 beyond 100 km proposed. An increase ranging from Re 1 to Rs.20 in second class Mail/Express fares beyond 155 km proposed. Upper Class and AC Chair Car fares raised by 6 per cent. AC 3-Tier fares 25 per cent higher than AC Chair Car fares.
- Fares of Rajdhani, August Kranti and Shatabdi Express trains suitably revised.
- Sleeper Class fares 25 per cent higher than second class fares.
- Second class Monthly Season Ticket (MST) fares increased -Re.1 to Rs.9 for distance up to 90 km and Rs.11 to Rs.40 for distances beyond 90 km. First Class season tickets 4 times the second class season ticket fares.

94. The Railway Budget for 1994-95 envisages a surplus of Rs. 1970 crore, after providing for payment of dividend to General Revenues in full. The fare and freight rate increases in the Railway Budget for 1994-95 are shown in Box 2.2. They are expected to fetch additional revenue of Rs. 997 crore. The Railways' Plan outlay for 1994-95, the third year of the Eighth Five Year Plan, has been budgeted at Rs. 6515 crore, and budget support at Rs. 1150 crore. Market borrowings are estimated at Rs. 1050 crore. The rest of the Plan outlay of Rs. 4315 crore is to come from internal resources. In addition, the Konkan Railway Corporation is to raise Rs.450 crore through sale of tax-free bonds. In the Plan, priority has been accorded to gauge conversion, rolling stock and track renewals.

Posts

95. The gross receipts of Department of Posts in 1993-94 increased to Rs.1105 crore from Rs.1074 crore in 1992-93, mainly as a result of normal growth of traffic in the absence of any revision in the tariff. Gross working expenses were Rs.1867 crore, and net working expenses Rs. 1312 crore. There was therefore, a deficit of Rs.207 crore. During 1994-95, as per the Budget estimates, the gross receipts are expected at Rs.1170 crores and gross working expenses at Rs.1975 crore. With net working expenses at Rs. 1316 crore, the deficit is estimated at Rs.146 crore for 1994-95 (BE).

96. Department of Posts has been making losses continuously over the years. No dividend is being paid to the General Revenues, despite huge investments in buildings and other infrastructure. Modernisation activities initiated on large scale during the current Plan are likely to improve the performance. However, under-pricing of various services offered by the Department is an important reason for losses. The degree of underpricing is shown in Table 2.12. The degree of subsidy ranges from about 20 per cent on Insurance, Book-post rates, Money-orders and Parcels, to 90 per cent on Postcards. Registered letters have a subsidy of about 40 per cent,

TABLE 2.12
Cost and Revenue of Main Services of the Department of Posts

(Rupees)

Service	1991-92		1992-93		Subsidy during 1992-93	Subsidy as per cent of cost
	Cost	Revenue	Cost	Revenue		
1	2	3	4	5	6	7
1. Postcard	1.25	0.15	1.54	0.15	1.39	90
2. Printed Card	1.20	0.60	1.44	0.60	0.84	58
3. Letter Card	1.41	0.75	1.57	0.75	0.82	52
4. Letter	1.43	1.81	1.78	1.85	-0.07	-4
5. Parcel	18.51	14.31	22.11	17.02	5.09	23
6. Money Order	13.16	8.99	14.09	10.97	3.12	22
7. Registration	8.76	6.00	10.36	6.00	4.36	42
8. Insurance	12.66	18.12	13.76	11.01	2.75	20
Book Post						
9. Book and Sample Packet	1.78	2.42	2.28	1.79	0.49	21
10. Printed Books	2.25	2.26	2.94	1.52	1.42	48
11 Others	2.47	2.11	3.27	1.29	1.98	61

printed books and letter cards around 50 per cent and printed cards almost 60 per cent. Elimination of the subsidy on even a few items, such as parcels, registered letters, and a small rise in all others would eliminate the postal deficit or even convert it into a surplus. A word of caution is in order however. Not all differences between price and cost represent subsidies, as there is room for improvement in efficiency of some services. This is particularly true of urban and metropolitan services, where introduction of new technology and modernisation of systems and procedures will result in better service and lower costs.

Telecommunications

97. The network owned and operated by the Department of Telecommunications has been generating increased surpluses. Net Receipts estimated at Rs.2683 crore in 1993-94 (RE) against Rs.2195 crore in 1992-93 represent an increase of 22.2 per cent. These are estimated to be raised to Rs.3669 crore in 1994-95 (BE). The dividend to be paid to the general revenues was estimated to rise to Rs.263 crore in 1993-94 (RE) from Rs.257 crore in 1992-93. The operating ratio, which is a percentage of net working expenses (excluding the provision for redemption of bonds) to the revenue earned, has been proposed to be brought down to 50.50 in 1993-94 (RE) from 53.87 in 1992-93. The Plan outlay for Telecommunication services including outlay for Videsh Sanchar Nigam Limited, for the year 1994-95 (BE) is Rs. 7245 crore against Rs. 6470 crore in 1993-94 (RE), recording an increase of about 12 per cent. The entire outlay will be financed from the internal and extra budgetary resources of the Telecommunication sector. Internal resources (Rs. 5251 crore) account for the major part (72.5 per cent) of the total resources. This represents an increase in contribution of internal resources of 65.7 per cent in 1993-94 (RE).

98. In order to carry out the targets set out in the Eighth Five Year Plan, it was decided to expand the supply of value added services with the participation of private sector. The Government issued in May, 1994 the National Telecom Policy, with an aim of providing by 1997 telephones on demand. In order to carry out the ambitious targets of the new policy, even basic services have been thrown open to the private sector. Foreign equity participation in Indian Companies providing basic services, value added services, and manufacturing telecom equipment will also be encouraged.

Broadcasting

99. Total expenditure on Broadcasting as per the revised estimates of 1993-94 was Rs.788 crore. Against this, the receipts were Rs.439 crore. Thus, receipts could meet only 55.7 per cent of the total expenditure. Receipts from the commercial operations of Broadcasting have been lower than the expenditure in the earlier years as well. Television is a highly profitable business across the world. All India Radio and Doordarshan also have to provide a public service. This entails provision of education and information within the overall larger objectives of accelerating social and economic development of the country. In most countries of the world this is done through the provision of a public service TV channel and a few public service radio channels. All India Radio and Doordarshan have channels/time slots for entertainment oriented programmes with a view to earn commercial revenue. Similarly, even private television companies and private channels operated on a purely business motive can be subject to a code of ethics and required, as part of the licence, to provide specified social programming for a stipulated proportion of time slots. This could include education of the public on the importance of population control, personal hygiene and sanitation, public health and cleanliness, social and civic rights and responsibilities and functional literacy, all of which are woefully lacking so far. Keeping in view the pressure on Government finances, it is desirable that commercial receipts are stepped up, as for instance through market pricing of television advertising slots. All India Radio and Doordarshan have already taken some measures in this regard. As a result, commercial receipts have increased over the years. Commercial receipts which were 55.7 per cent of total expenditure in 1993-94 (RE) are a distinct improvement over their share of 36.4 per cent in 1989-90 and 44.5 per cent in 1990-91. This trend needs to be continued and further improved in the coming years.

Outlook

100. The policy reforms which are transforming the economy, will also change the transmission mechanisms through which fiscal policy affects economic activity. Two identifiable changes can have a profound affect on the link between the fiscal deficit and macro economic variables such as inflation and production. One is the opening of the economy to trade and capital flows. The other major development is the snapping of the link between the fiscal deficit and reserve money growth ('deficit financing'/'budget deficit'). To appreciate the profound effect of these changes, they have to be analysed at two levels.

101. The direct, immediate and short term effect of both these developments is to weaken the link between a rise in the fiscal deficit and inflation. To the extent that the economy is more open, excess demand created by the fiscal deficit will be met by imports and spill over more strongly into the current account. This will result in a stronger effect on balance of payments and a reduced impact on domestic inflation. This along with

a cut in the link between the fiscal deficit and monetisation will mean that the direct effect of the fiscal deficit on inflation will be reduced.

102. To conclude from this, that a gradual and sustained reduction in the fiscal deficit is no longer necessary, will be a serious misreading of economics and quite dangerous. Any rise in the fiscal deficit will place pressure on both the exchange rate and on interest rates paid by producers. An open economy is more sensitive to international prices, and a change in the exchange rate will have a greater impact on domestic inflation. Similarly, with market determined domestic interest rates, the costs of production will become more sensitive to changes in the fiscal deficit. Large fiscal deficits will lead to high interest rates and lower investment and growth. Control of the fiscal deficit will, therefore, remain an important instrument for moderating inflation and stimulating investment and growth.