

TRENDS IN CENTRAL AND STATE FINANCES

B3.1 Government revenues and expenditures in India have grown rapidly since Independence. The combined revenue receipts of the Centre and the States which formed 6-7 per cent of Gross Domestic Product (GDP) in the early fifties have now reached the level of 20 per cent; there has been a somewhat faster growth of revenue expenditures. We are here concerned with more recent trends. We note that between 1974-75 and 1986-87, total revenue receipts of the Centre and the States have grown in real terms at 8.4 per cent per annum as against the average growth rate of 4.6 per cent per annum of real GDP. Real government expenditures within the revenue account grew at 10.3 per cent per annum. In other words, during this period, in real terms, total government revenues increased 2.5 times and total revenue expenditures 3.2 times.

B3.2 In nominal terms, revenue receipts grew at an annual rate of 14.5 per cent between 1974-75 and 1986-87, while the growth rate of revenue expenditure was higher by almost 2.5 percentage points at 17 per cent. This outpacing of revenue growth by expenditure growth has led to an era of revenue deficits beginning from 1982-83. However, it appears that recent trends rather than the long term trends have caused the imbalance.

B3.3 As a proportion of GDP, both revenue receipts and revenue expenditure registered substantial increases during the period 1974-75 to 1986-87. [Ref. Table B.3.1]. However, while the revenue receipts registered an increase of 4.8 percentage points from 15.1 per cent in 1974-75 to 19.9 per cent in 1986-87, the increase in revenue expenditure was by over 9 percentage points from 13.5 per cent to 22.6 per cent. The excess of expenditure growth over the growth of revenue is particularly noticeable in the 1980's. Revenue expenditure as a percentage of GDP continued to accelerate, but the growth of receipts slowed down. The former increased from 17.5 per cent in 1980-81 to 22.6 per cent in 1986-87 whereas, increase in the latter was from 17.6 per cent to only 19.9 per cent during the period. As a consequence, the combined revenue deficit which emerged in 1982-83 for the first time at 0.21 per cent of GDP increased to 2.6 per cent of GDP in 1986-87 and the projected revenue deficit in 1988-89 is placed at 3.9 per cent of GDP according to Revised Estimates.

B3.4 If the Central Government's finances alone are considered, it is seen that the gross revenue receipts increased from 10.5 per cent to 14.1 per cent of GDP during the period 1974-75 to 1986-87, the rate of growth being 14.4 per cent. Its net revenues (i.e., gross revenues minus tax devolution to the States) increased from 8.9 per cent to 11.2 per cent of GDP. Thus, the ratio of the devolution to GDP increased from 1.6 per cent of GDP in 1974-75 to 2.9 per cent of GDP in 1986-87. As against this, the revenue expenditure of the Central Government (including grants) increased from 7.8 per cent of GDP to 13.9 per cent during the period. Of this, grants to the States increased from 1.4 per cent of GDP to 2.4 per cent of GDP and other revenue expenditures of the Central Government increased from 6.4 per cent to 11.5 per cent of GDP. Thus Centre's own expenditure increased by 5.1 percentage points while grants increased by one percentage point.

B3.5 The own revenues of the States increased from 5.1 per cent of GDP in 1974-75 to only 7 per cent in 1986-87, but their total revenue receipts including devolution of taxes and grants from the Centre increased from 8.2 per cent to 12.3 per cent (total revenues

increased by 4.1 percentage points, while own revenues increased by only 1.9 percentage points). Revenue expenditures of the States increased from 7.7 per cent of GDP to 12.3 per cent, i.e., by 4.6 percentage points during the period. This may be compared with the increase of 5.1 percentage points in the own expenditures of the Centre. The following conclusions may be drawn about fiscal trends since 1974-75:

- (a) There has been a substantial growth in the revenue receipts of the Central Government.
- (b) The growth in revenue expenditures of the Centre has been much faster mainly because of the rise in its own expenditure and partly also because of the rise in the proportion of grants.
- (c) The growth of own revenues of the States is marginally higher than that of the Central revenues. However, the period since 1980-81 shows that the growth of own revenues of the States has not been as fast as that of Central revenues. Nevertheless, when supplemented by Central transfers, States' revenue receipts grew fairly fast.
- (d) States' revenue expenditure increased faster than revenues, although not as fast as Centre's own expenditure.

B3.6 Since non-Plan revenue expenditure accounts for around 20 per cent of GDP, the entire Plan revenue expenditure (at the aggregate level) has to be met out of borrowing. The non-Plan revenue expenditure of the Centre and the States increased almost steadily from 13.3 per cent of GDP in 1974-75 to 19.5 per cent in 1986-87. At the Central level, until 1985-86, the greater part of the rise in the non-Plan revenue expenditure was accounted for by increases in interest payments and subsidies. However, since 1986-87, there has also been a substantial increase in defence expenditure which has caused the ratio of non-Plan revenue expenditure to GDP to grow further. At the level of the States, the non-Plan revenue expenditure ratio grew from 7.3 per cent in 1974-75 to 10.1 per cent in 1986-87; more than half of the increase in the ratio was accounted for by increases in development expenditure. The growth in non-Plan development expenditure within the revenue account at the States' level and a good part of the increase in interest payments at the Central level may be attributed to the successive development Plans (which leave behind increased commitments), borrowing for meeting revenue expenditure and also capital expenditure not generating adequate returns.

B3.7 The combined revenue deficit of the Central and State Governments is estimated at Rs. 13,354 crore in 1988-89 which may form about 3.9 per cent of GDP. Of this, the share of the Centre is Rs. 11,030 crore or 3.2 per cent of GDP. Although the total net revenue deficit of the States in that year is only Rs. 2,324 crore, the combined revenue deficit of the deficit States is around Rs. 2,990 crore. Indications are that revenue expenditures would continue to increase faster than revenue receipts and the revenue deficits would rise both absolutely and in relation to GDP. Drastic changes in fiscal policies are required if this trend is to be reversed.

B3.8 Another cause for serious concern is the rapid increase in public debt, especially in recent years. The combined public

debt of the Centre and the States increased from only Rs. 29,933 crore at the end of 1974-75 to Rs. 1,92,797 crore at the end of 1986-87 amounting to 65.7 per cent of GDP. It is estimated to have reached Rs. 2,63,758 crore by March 31, 1989. Until the revenue deficit emerged, public borrowing (including borrowing from the Reserve Bank of India) was resorted to for financing public investment in physical assets or for granting loans to enterprises in the public and the private sectors. With a large public sector in core enterprises and the State playing an active interventionist role in promoting growth, it is inevitable that there is a large public borrowing programme. But such a borrowing programme and the consequential growth of public debt need not have resulted in a corresponding growth of interest burden on the budget itself if the investment in public enterprises as well as in financial assets had earned adequate returns. The total capital employed in the Central public enterprises (covered by The Public Enterprises Survey) amounted to about Rs. 52,000 crore at the end of 1986-87. Of these, 100 units were making losses amounting to Rs. 1,708 crore; 109 units were making after-tax profit of Rs. 3,478 crore of which Rs. 2,142 crore came from the petroleum sector. Hence, the profit after-tax of enterprises in other than the petroleum sector amounted only to Rs. 1,336 crore. All in all, the rate of return on the capital of Rs. 51,931 crore amounted to 6 per cent before tax and 3.4 per cent after tax. Of course, if the petroleum sector is excluded, the rate of return would be negative. But the government has to continue to service the debt incurred for a large part of this huge investment. At the level of the States, the most important public enterprises are the State Electricity Boards and the State Road Transport Corporations. The total capital employed (net fixed assets) in State Electricity Boards amounted to Rs. 13,534 crore in 1985-86 and together they incurred a commercial loss of Rs. 1,520 crore. The State Road Transport Corporations made an aggregate loss of Rs. 226 crore on a block capital of Rs. 1,882 crore. One of the major causes of the rise in the net interest burden on the general budget is the poor returns on the major investments of Central and the State Governments. Another cause is the creation of public debt for financing revenue expenditure which by its very nature cannot yield any direct return.

B3.9 The total public debt of the Centre and the States now constitutes about 77 per cent of GDP and the gross interest burden amounts to 4.7 per cent of GDP and the net interest burden 3.1 per cent. The total fiscal deficit (the total borrowing requirements) of the Central Government has become large amounting to nearly 9.4 per cent of GDP. This in itself is not

conducive to the maintenance of monetary stability. Besides, the consequent rise in interest burden tends to enhance the revenue deficit further.

B3.10 The low level of income and the fairly moderate rate of economic growth that we have been able to achieve together constrain the extent of resources that can be raised by the governments. But the resources which the governments need for providing essential public services and for performing other functions expected of them are large and rising. The problem of scarcity of resources, however, cannot be solved through increasing revenue deficits, which is tantamount to living beyond one's means. The fiscal scenario in the country has worsened to an alarming extent and corrective steps are required now to reverse the trend and to create conditions for the restoration of health to the financial system. Therefore, in our considered view, one of the major objectives of financial policy in the medium term should be the elimination of the revenue deficit.

B3.11 Table B.3.2 indicates the trends in the share of the States in the total combined tax revenues of the Centre and the States. It is seen that over the years the share of total taxes accruing to the States has increased with some fluctuations. Since 1974-75 the rise has been fairly steady; the share of the States has increased from 44.8 per cent in 1974-75 to 50.6 per cent in 1986-87. In a similar manner, Table B.3.3 indicates the changing share of the States in total revenue accruals. (In this table besides devolution of taxes, Plan and non-Plan grants from the Centre are also included in the States' share). We note that the share of revenues accruing to the States has increased from 54.3 per cent in 1974-75 to 61.6 per cent in 1986-87. In other words, as of now, as much as 62 per cent of the total revenues raised by the Centre and the States are placed at the disposal of the States although they themselves raise only 35.2 per cent of total revenues.

B3.12 The dependence of the States on devolution and grants has gradually increased. While their own revenues have declined from 61.9 per cent of their total revenues in 1974-75 to 57.2 per cent in 1986-87, their dependence on current transfers from the Centre has correspondingly increased from 38.1 per cent to 42.8 per cent (Table B.3.4). In this connection, it is worth noting that the proportion of shared taxes in States' revenues is lower now than the high point reached in 1979-80 as a result of the application of the Seventh Finance Commission's recommendations. This decline, however, has been made up by an increase in the share of grants.

TABLE B.3.1

Revenue Receipts And Revenue Expenditures Of Central And State Governments As A Percentage Of GDP
(Per cent)

Year	Revenue Receipts Of Centre :		Revenue Expenditure Of Centre :		Revenue Deficit Of Centre	Revenue Receipts Of States :		Revenue Expenditure Of States	Revenue Deficit Of States	Combined Revenue		
	Gross	Net	Including Transfers To States	Excluding Transfers To States		Gross	Own			Receipts	Expenditure	Deficit
1974-75	10.52	8.85	7.80	6.36	1.04	8.20	5.07	7.65	0.55	15.09	13.49	1.59
1975-76	12.13	10.10	8.98	7.35	1.13	9.49	5.83	8.28	1.21	17.38	15.04	2.34
1976-77	12.14	10.15	9.80	7.93	0.35	10.19	6.35	8.90	1.29	17.97	16.33	1.64
1977-78	11.86	9.98	9.54	7.55	0.45	9.79	5.92	8.72	1.06	17.11	15.60	1.51
1978-79	12.44	10.56	10.28	7.82	0.28	10.57	6.23	9.47	1.09	18.02	16.65	1.37
1979-80	12.65	9.67	10.28	8.36	-0.61	11.42	6.52	10.07	1.35	18.55	17.80	0.75
1980-81	11.98	9.19	9.76	7.73	-0.57	11.07	6.25	10.41	0.66	17.55	17.46	0.09
1981-82	12.18	9.50	9.68	7.90	-0.18	10.98	6.53	10.16	0.82	18.12	17.48	0.64
1982-83	12.47	9.86	10.56	8.55	-0.71	11.40	6.77	10.90	0.50	18.63	18.84	-0.21
1983-84	12.08	9.54	10.70	8.62	-1.16	11.08	6.58	10.98	0.11	17.88	18.94	-1.05
1984-85	12.72	10.22	11.73	9.54	-1.52	11.37	6.64	11.76	-0.39	18.63	20.53	-1.91
1985-86	13.54	10.68	12.80	10.31	-2.12	12.15	6.89	11.95	0.21	19.43	21.34	-1.91
1986-87	14.12	11.23	13.88	11.48	-2.65	12.26	7.01	12.26	0.01	19.92	22.56	-2.64

Note : 1. States include Union Territories. 2. New series of GDP estimates used.
Source : Indian Economic Statistics - Public Finance, Ministry of Finance, Government of India.

TABLE B.3.2

The Share Of States In The Total Tax Revenues Of The Centre And States

(Rs. Crores)

Year	Taxes Levied By The States	Devo- lution Of Taxes	Taxes Accruing To States	Total Taxes (Centre And States)	Taxes Accruing To States As Per Cent Of Total Taxes	(1)	(2)	(3)	(4)	(5)	(6)
(1)	(2)	(3)	(4)	(5)	(6)						
1961-62	48944	17892	66836	154318	43.31	1973-74	220837	117476	338313	726038	46.60
1962-63	58003	22404	80407	186507	43.11	1974-75	290131	122850	412981	922306	44.78
1963-64	69070	25824	94894	232446	40.82	1975-76	357294	159912	517206	1118173	46.25
1964-65	77811	25874	103595	259880	39.86	1976-77	406079	167983	574062	1233196	46.55
1965-66	86092	27600	113692	292159	38.91	1977-78	437780	180563	618443	1323718	46.72
1966-67	95468	37273	132741	326119	40.70	1978-79	500269	195272	695541	1552756	44.79
1967-68	110284	41159	151443	345524	43.83	1979-80	570943	340779	911772	1768308	51.56
1968-69	121141	48398	169539	370119	45.81	1980-81	666417	378903	1045320	1984375	52.68
1969-70	137694	62535	200229	420001	47.67	1981-82	829491	425820	1255311	2414241	52.00
1970-71	154562	75562	230124	475241	47.42	1982-83	954590	463262	1417852	2724157	52.05
1971-72	107275	94210	264485	557518	47.44	1983-84	1080342	500718	1581060	3152545	50.15
1972-73	193086	106140	299226	644055	46.46	1984-85	1234283	585343	1819626	3581342	50.81
						1985-86	1459652	725974	2785626	4326671	50.52
						1986-87	1670075	835974	2506049	4953922	50.58
						1987-88 (RE)	1896126	946603	2842729	5694962	49.92
						1988-89 (BE)	2154834	1047815	3202646	6414681	49.93

Source : Indian Economic Statistics - Public Finance, Ministry of Finance, Government of India.

TABLE B.3.3

Revenue Accruals Of The Union Government And The State Governments

(Rs. Crores)

Year	Revenue Receipts Of Centre And States	Revenue Accruals Of States	Revenue Accruals Of Centre	Per Cent Revenue Accruals To State	Per Cent Revenue Accruals To Centre
1974-75	11048	6004	5044	54.34	45.66
1975-76	13687	7475	6212	54.61	45.39
1976-77	15258	8652	6606	56.70	43.30
1977-78	16435	9401	7034	57.20	42.80
1978-79	18775	11008	7767	58.63	41.37
1979-80	21211	13060	8151	61.57	38.43
1980-81	23835	15036	8799	63.08	36.92
1981-82	28881	17504	11377	60.61	39.39
1982-83	33086	20243	12843	61.18	38.82
1983-84	36959	22908	14051	61.98	38.02
1984-85	42933	26220	16713	61.07	38.93
1985-86	51011	31906	19105	62.55	37.45
1986-87	58434	35981	22453	61.58	38.42
1987-88 (RE)	67349	41383	25966	61.45	38.55
1988-89 (BE)	74781	45549	29232	60.91	39.09

Note : States include Union Territories.

Source : Indian Economic Statistics - Public Finance, Ministry of Finance, Government of India.

TABLE B.3.4

Composition Of State Revenues

(Per cent)

Year	States' Own Tax Revenue	Devolution Of Taxes Revenue	States' Non-Tax	Grants-in-Aid	Total Revenue	States' Own Revenue
1974-75	48.32	20.47	13.57	17.64	100.00	61.89
1975-76	47.80	21.39	13.62	17.19	100.00	61.42
1976-77	46.94	19.42	15.33	18.32	100.00	62.26
1977-78	46.57	19.21	13.92	20.29	99.99	60.49
1978-79	45.45	17.74	13.48	23.33	100.00	58.93
1979-80	43.71	26.09	13.35	16.85	100.00	57.05
1980-81	44.32	25.20	12.15	18.33	100.00	56.47
1981-82	47.39	24.32	12.06	16.22	99.99	59.45
1982-83	47.16	22.89	12.25	17.70	100.00	59.41
1983-84	47.16	21.86	12.25	18.74	100.00	59.41
1984-85	47.07	22.32	11.33	19.27	99.99	58.40
1985-86	45.75	22.75	10.95	20.54	99.99	56.70
1986-87	46.42	23.23	10.78	19.57	100.00	57.20
1987-88 (RE)	45.82	22.87	10.58	20.72	99.99	56.40
1988-89 (BE)	47.31	23.00	10.50	19.19	100.00	57.80

Source : Indian Economic Statistics - Public Finance, Ministry of Finance, Government of India.