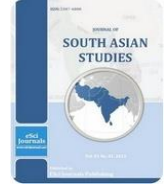




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CHANGING ROLE OF THE STATE: AN ANALYSIS OF ECONOMIC INTERVENTION OF THE GOVERNMENT IN INDIA AFTER LIBERALIZATION

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ABSTRACT

Economic liberalisation policies are mostly aimed to reduce the role of government in economic activities. It is argued that as a country moves on its growth path it should slowly reduce the role of government in economic activities and allow the more efficient private sector to take up the growth momentum. This study investigates into the changing role of government in India by looking into the nature, trends and pattern of revenue and expenditures of Central and State governments after the economic liberalization policies of 1991. The study shows that there is no much paradigm shift in the government's expenditure pattern after the 1991 economic reforms. Though we expected an increased trend in developmental expenditure of the governments because of its facilitator role, the study indicates declining trend in the share of developmental expenditure while the share of non-developmental expenditure showed a slightly increasing trend during the liberalization regime. Unlike the case of government expenditure, there were considerable differences in the pattern of government receipts, especially in tax receipts. While the share of indirect taxes in the total revenue receipts showed a steady fall, there was a corresponding increase in the share of direct tax revenue. The increase in direct taxes and income taxes was propelled by the significant growth in corporation taxes and income taxes mainly due to the privatisation measures adopted during the economic liberalization period. We conclude that the economic liberalization measures have not much changed the role of government in terms of its expenditures but helped in restructuring the pattern of government receipts.

Keywords: India, Economic intervention, Liberalization, Investment, Fiscal policies.

INTRODUCTION

In the current global scenario, a large number of countries around the globe are increasingly reforming and liberalizing their economies by re-examining the role of government in the overall development of the nations. There has always been debate about the role of government in economic activities. During the last three decades both developed and developing nations are in the pursuit to reduce the role of government and reforming the public sector activities. It is always argued that the government has a larger role in developing countries as compared to developed countries. This is based on the perception that the government will always protect the common interest (national interest) compared to individual or private interest. This is more imperative especially in the economic development

process where growth with equity is more important. A section of the economists and policy makers consider that as a country moves on its growth path it should slowly reduce the role of government in economic activities and allow the more efficient private sector to take up the growth momentum, and the role of government should just be a moderator or facilitator. Batley and Larbi (2004) observed that the efficacy of such 'interventionalist' role of government depends on the levels of public management capacity, resource allocation, political inclusiveness, legal effectiveness, and political and economic stability of the State.

The main objective of this paper is to analyse the broad shifts over the last twenty years in the role of government from a developing country context by taking the case of the Republic of India. Since the year 1991, India has taken radical reforms in her economic affairs, public services, and on the social, political and managerial aspects. The analysis is important because

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economic reforms mean reducing the role of government in business activities and creating a favourable environment for private sector to do a more efficient business by utilizing the resources for infrastructure and social development. Therefore, economic liberalization should come along with adequate improvements in infrastructure which should form a major part of capital expenditure. As Ahluwalia (1995) pointed out, a stable and improved fiscal position of the government is important not only to bring increased investment in infrastructure, but also for creating a favourable macroeconomic environment in which the reforms can operate. However, it should be noted that increased private investments has to be complemented with a higher level of public investment in critical infrastructure areas such as power, railways, roads and ports.

The paper is organized into six sections. Section 2 presents a concise review of theoretical arguments regarding the role of government in economic activities of a nation. Section 3 provides a short analysis about the role of government in India from a historical perspective. Section 4 analyses in brief the framework of Indian federal system. Section 5 carries out an in-depth analysis of the trend and pattern of government expenditure and receipts in India during the economic reform period to understand the role of government in influencing the aggregate demand and thus, the overall economic activities. Section 6 concludes the study by bringing out the major observations and findings.

THEORETICAL BACKGROUND

The role of government in the economic activities of a nation (mainly envisaged in fiscal policies) is mostly viewed in two different schools of thought. One section of economists following the concept put forth by the economist John Maynard Keynes emphasis that the fiscal policies of the government are crucial factors in influencing the aggregate demand (though not much the aggregate supply). They argue that for developing economies increased public sector investment is required to keep the aggregate demand at high levels in order to stimulate economic growth and employment (Murty and Soumya, 2007). According to these economists (often known as *fiscalists*), an increase in public expenditure, especially due to infrastructure spending, will encourage growth in the private sector investment. This is generally referred to as the positive "crowding in" impact of increased government spending.

The other school of thought following the classical and neo-classical theory, on the other hand, postulate that high government spending leading to fiscal deficits may displace private investment. According to this argument, public expenditure-driven fiscal deficits "crowd out" private investment through an increase in the interest rate since the fiscal deficits is mostly financed through borrowings. This is more dismal when government borrowings are mostly used for non-developmental expenditures. Moreover, these economists (often known as *monetarists*) argue that public expenditure increases aggregate consumption in the economy which in turn leads to a reduction in aggregate savings resulting in higher interest rates. Increased interest rates in turn discourage private investment and overall economic activity in a closed economy. An implicit assumption in the above argument is that the economy is already at near full capacity level (Acharya 2001; Rangarajan 2009). Rangarajan and Srivastava (2005: 5) observed that high levels of fiscal deficit relative to gross domestic product (hereafter GDP) tend to adversely affect savings and investments in the economy directly or through its effects on interest rates and inflation, and consequently the economic growth. An empirical study by the Reserve Bank of India (RBI, 2001) found that public investment in manufacturing appears to adversely affect private investment in India. However, government expenditure on infrastructure crowds in private investment.

Fiscal stabilization is an essential precondition for the success of economic reforms. It is argued that economic liberalization warranted for large scale privatization of production sectors by divesting the public sector undertakings and moves these public investments to production facilitating sectors like infrastructure and basic utilities. Similarly, the sources of government receipts are expected to move from more borrowings to more tax revenues. According to the automatic stabilization fiscal policy principle, when the economy grows at a faster rate the government revenue position will improve through increased tax revenue, and the government expenditures will come down due to reduced transfer payments, thus reducing the fiscal deficits or improving the fiscal balance of the government. Therefore, the changing role of the government can be analyzed by observing the trends and patterns of government expenditures and the sources of government revenues. Shah (2004) observed that the expenditure assignments in many developing

and transitional economies have undergone significant structural changes during the past two decades. He noted that this is mainly due to the changes in the role of public sector in these economies. He has pointed out the changing role of governments by observing the sharp decline in the proportion of sub-national expenditures as percentage of GDP in the selected developing and transitional economies.

Though there are number of studies investigating on the impact of increasing fiscal deficits on the financial sustainability and growth of an economy in a liberalized economic framework, there are hardly any studies looking into the changing role of government and thus, the changing pattern of resource allocation. This study attempts to analyze the economic role of the Centre and State governments in the Republic of India for the last two decades (1990–2009), which span the post-economic reforms period. This will be analyzed by observing the trends and patterns of expenditures and revenues of Centre and State governments since 1990. We expect that with economic reforms the government expenditures should be moving from production sectors to facilitating sectors like infrastructure. Similarly, governments' tax revenues should go up compared to non-tax revenues. The analysis is based on an annual time series corresponding to the fiscal year (1 April to 31 March). The data is drawn mostly from various issues of Indian Public Finance Statistics published by the Department of Economic Affairs, Ministry of Finance, and Government of India. The trends are mostly analysed by observing the movements of various variables as percentage of GDP. However, the movements in the pattern of various components of government expenditures and receipts were analysed by observing changes in the share of each components in the total expenditure or receipts.

ROLE OF GOVERNMENT IN INDIA – A HISTORICAL PERSPECTIVE

In a democratic country like India, the economic role of government is supposed to change according to the economic conditions of the nation and the political, social and economic ideologies of the governing political parties. The history of India's post-Independence era shows that during the first three decades after Independence in 1947, the state held clear authority in the socio-economic affairs of the nation. In the 1950s and 1960s, India propagated the idea of the state bureaucracy by adopting a democratic socialistic pattern

of society. The focus of economic development was mostly designed through the Five Year Plans started in 1950. The main idea of state-led development was to achieve economic development with social justice.

As Todaro (1994) pointed out the adaptation of state-led development was not only imitative but also was because of the local circumstances. At the time of Independence in 1947, the market institutions and indigenous entrepreneurs were weak in India. Therefore the state has taken the initiative to invest in almost all the areas of business or to takeover the foreign-owned companies set up during the colonial era. India has mainly adopted an "inward looking" policy in its industrial development on the basis of import substitution.

However, since 1980s there was a changed view about the role of government throughout the world. As Hyden (1983) indicated there was lot of criticism to the 'statist' model in almost all the countries where it was followed. The critics mainly questioned the capacity of the state and public administration of these countries in acting as agents of development. They argued that bureaucrats are mostly against any change and always favour status co. Even though, sometimes they look like rational bureaucracies, in practice often served particular interests (Hyden, 1983). The same thinking has also influenced a section of Indian intellectuals and public administrators, though not as strong as experienced by many other countries. Moreover, the experiences of the newly industrialized East Asian countries showed that the developing nations can achieve faster and sustained growth and development by reducing the role of state in economic activities and by integrating more with the international economy. These countries have also shown that there is a positive role for the government to achieve faster development by acting as a facilitator rather than a regulator or controller.

India has adopted a series of economic reform measures in the 1980s and 1990s. Though the economic reform measures started during the mid-1980s, the full scale liberalization took place only in 1991 with the New Economic Policy of 1991. The main objective of the policy was to completely reform the economy through liberalization, privatization and globalization measures by reducing the role of government in economic activities and rather being a facilitator of faster production and economic growth. Initially, these reform policies mostly focused on the process of industrial de-

licensing and trade liberalization measures, and then slowly extended to financial sector reforms and tax reforms. A quick look over the last twenty years after the liberalization clearly shows that these reforms have helped the economy to achieve a faster growth. The real GDP has shown remarkable growth from a 'Hindu rate of growth'¹ of 3.5% during 1950-51 to 1990-91 (the pre-liberalization period) to a compound annual growth rate (CAGR) of 6.5% during 1991-92 to 2009-10 (the post-liberalization period).

INDIAN FISCAL FEDERALISM

India is the largest democratic country in the world with a federal government set up spread across twenty eight States and seven Union Territories. At the time of Independence in 1947, India as a country was highly fractured with many princely states having their own jurisdiction of governance. The economy was highly stagnated under the colonial rule. Soon after Independence, the Indian policy makers created a centralized, federal system of constitution to ensure a democratic system of government that was expected to facilitate a favourable environment for faster economic growth and development. The Constitution of India, which has been adopted on 26 January 1950, divided the powers of the federal government into three lists: The Union or Central list, State list, and Concurrent list. The Central list includes functional responsibilities of the Centre in the context of public expenditure management, mostly related to national economy like management of credit and monetary systems, mineral resources, large scale industries, infrastructural areas like railways, posts and telegraph, communication and also strategic areas of defence, and external affairs. Matters like maintenance of law and order, public health and sanitation, development of agriculture, fisheries, forests, small and medium industries, infrastructures like roads, irrigation, etc. are placed on the States List. Matters relating to population control, education, minor ports, electricity, etc. have been placed on the Concurrent List (McCarten, 2003).

With regard to government receipts, the Constitution of India divided most taxing powers between the Centre and the States without any overlap. Most of the major taxes are assigned to the Centre. This is mainly because the functions required for maintaining macroeconomic stability, international relationships and activities having huge investments have been assigned exclusively to the Centre. Centre can levy taxes on production

(excise duty) but the tax on sale of goods is mostly levied by the States. Similarly, taxes on agricultural incomes and wealth are in States' domain whereas the tax on non-agricultural incomes comes under the Centre. The States also get revenues from excises on alcoholic products, stamps and registration, and taxes on motor vehicles and road transportation. The Constitution also provides provisions for sharing Central tax revenues with the States since most of the tax revenues are accrued to the Centre (Rao, 1998).

Fiscal Scenario in Pre-liberalization Era: Democratic governance set up is always tenable towards more populist policies. Such policies always impose a greater pressure on the public expenditure decisions of the government. McCarten (2003) noted that during the 1980s many Indian States started overstaffing in response to populist demands, and adopted wage parity with the Centre that has substantially pulled up their expenditures. As a result, during the second half of 1980s the combined fiscal deficit of Centre and States widened, causing serious macroeconomic imbalances. Moreover, the increased expenditures on wages and salaries, and subsidies, had reduced the expenditures on socially productive capital, especially the expenditures on basic health and primary education. The financial sector liberalization in the beginning of 1990s substantially increased interest rates, and interest payments absorbed a major portion of state resources.

Fiscal Decentralization in recent years: The period 1980s and 1990s are known for liberalization and globalization policies among countries across the globe. This was more prominent in South East Asia. Policy makers in so called East Asian "Miracle" countries such as Korea, Taiwan, Malaysia, Hong Kong, and Singapore, reformed their industrial policies and provided specific effective financial and infrastructural supports to the private sectors to invest and produce in sectors of national and international importance, combined with publicly supported access to education and health. Realizing the importance of less control on productive sectors, Government of India also started economic reform policies in 1991. During the 1990s, various political and economic factors led to greater decentralization of powers. In the economic front, the factors that contributed to this decentralization were the liberalization and globalization policies adopted since 1991. On the political front, the end of single party rule and the emergence of coalition of parties in power at the

Centre and in many States and the increasing importance of regional political parties caused this greater decentralization. Moreover, the adaptation of the 73rd and 74th Constitutional amendments in 1992 to empower the rural and urban local governments – known as *Panjayati Raj* institutions and urban local bodies -, accelerated the power decentralization. Above all, each State government is required to appoint a State Finance Commission to recommend tax devolution and grants to the local governments.

TRENDS AND PATTERNS OF COMBINED GOVERNMENT EXPENDITURE AND RECEIPTS SINCE 1991

Budgetary transactions (government receipts and expenditures) in India are usually classified as capital items and revenue items. Capital items are durable non-recurring types of transactions while revenue items are

related to current or consumption items. Moreover, government expenditures are sometimes classified under development expenditures and non-development expenditures. All expenditures that facilitate further production are termed as development expenditures. Expenditures that do not add to the production are termed as non-development expenditures.

In a Federal system of governance the role of public finances are best analyzed through the construct of “Consolidated” finances of Centre and State governments. In India, after due process of adjustment for inter-governmental transfers, the aggregation of State and Central government finances is usually taken as the Consolidated General Government Finances (Economic Survey, 2008).

A summary of the major fiscal trends of Centre and State governments in India are shown in Table 1.

Table 1. Main Fiscal Trends of Centre and States Combined (Percentage of GDP). (Fiscal year ending March 31)

	1990-91	1995-96	2000-01	2005-06	2006-07	2007-08	2008-09 (RE)
TOTAL REVENUE	17.21	17.28	16.51	18.54	20.10	21.10	21.30
A. TAX REVENUE	15.40	14.70	14.52	15.86	17.20	18.01	18.64
Direct Taxes	2.15	3.00	3.41	4.52	5.40	6.15	6.52
Indirect Taxes	13.25	11.70	11.11	11.33	11.80	11.87	12.12
B. NON-TAX REVENUE	2.16	2.76	2.35	2.68	2.88	2.78	2.37
TOTAL EXPENDITURE	27.24	24.59	26.26	25.19	25.36	26.94	26.25
A. NON-DEVELOPMENTAL EXPENDITURE	12.15	12.85	14.22	13.26	12.73	12.58	12.61
Interest payments	4.39	4.95	5.84	5.57	5.44	5.38	5.20
Defence services	2.71	2.25	2.36	2.17	2.00	1.87	1.89
Social security & welfare	0.43	0.46	0.40	0.32	0.30	0.36	0.36
B. DEVELOPMENTAL EXPENDITURE	12.99	10.62	11.23	11.28	12.12	13.84	13.20
Social & Community Services	5.44	4.92	5.42	5.11	5.32	5.82	6.17
Power, irrigation & flood control	1.77	1.76	1.61	1.72	1.87	1.94	1.88
Transport & Communications	0.80	0.72	1.17	1.31	1.46	1.45	1.39
Centre's Deficit (% GDP)	7.84	5.05	5.65	3.95	3.33	2.56	5.86
States' Deficit (% GDP)	3.3	2.64	4.18	2.43	1.81	1.53	2.63
Adjusted Combined Deficit (% GDP)	9.41	6.52	9.51	6.46	4.8	3.93	8.33

Source: Computed using data from Indian Public Finance Statistics (various years).

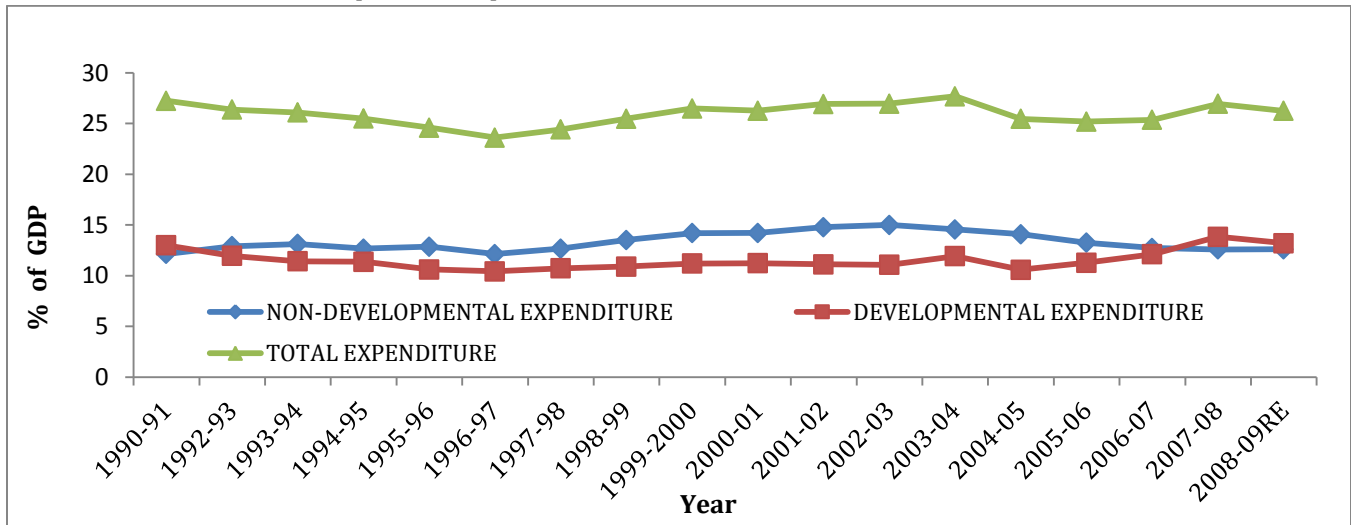
TRENDS AND PATTERNS IN THE COMBINED EXPENDITURES OF CENTRE AND STATES GOVERNMENTS

Trends in the Combined Expenditures of Centre and States Governments to GDP Ratios:The trends in the combined expenditure of Centre and States as percentage of GDP during 1990-91 to 2008-09 are shown in Graph 1. The combined government

expenditures of the Centre and States stood at 27.4% of GDP in 1990-91. There was a clear fall in this indicator during the early nineties, especially because of the fall in developmental expenditures (which has fallen from 14.8 per cent in 1990-91 to 11.5 per cent of GDP in 1996-97). Since then there was a steady increase in the expenditure-GDP ratio till 2003-04 reaching a peak of 27.98 per cent. This was mainly due to the increase in

non-development expenditures, mostly contributed by the increased interest payment burden of the government (see Graph 2). However, from 2004-05 onwards the share of developmental expenditures to

GDP started increasing and reached a peak of 15 per cent in 2007-08. This has of course, slightly pulled the combined government expenditures to GDP ratio to 28.2%.

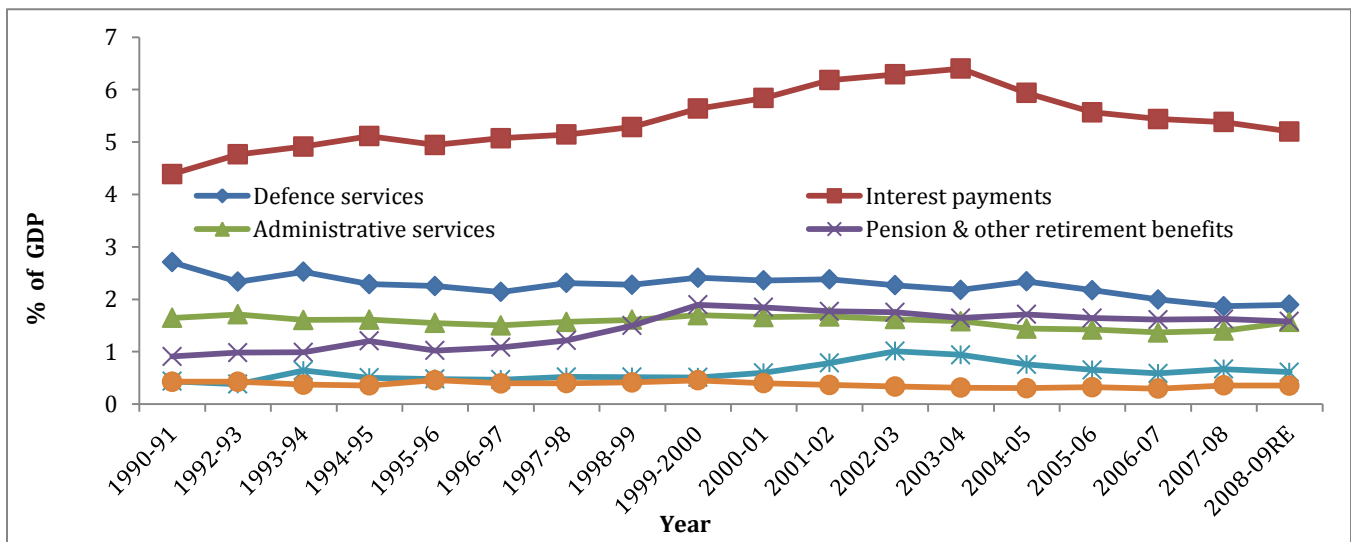


Graph 1. Combined Government Expenditures (as % of GDP) since 1991
Source: Compiled using data from Indian Public Finance Statistics (various years).

The trend in combined total expenditure is clearly influenced by the non-development expenditure throughout the analysis period, where the interest payments burden contributes the major share. Though the capital expenditure of government has actually come down after the economic liberalization, the debt burden of the government was haunting it mainly in the form of interest payments (see Graphs 1 and 2). In 2002-03 an amount equivalent to almost 6.3% of GDP

was spent for interest payments. This was almost 23.33% of the combined total expenditure of Centre and States.

In 1990-91, the year just before major economic reforms, the development expenditure of the government as percentage of GDP was above the non-developmental expenditure. Since then, there was a steady decline in the share of developmental expenditure of the government.



Graph 2. Components of Non-development Expenditures of the Government (as % of GDP)
Source: Compiled using data from Indian Public Finance Statistics (various years).

However, since 2004-05, there was an upward trend in the development expenditure, which was mostly warranted due to an upbeat growth of Indian economy at an average annual rate of 8.9 per cent.

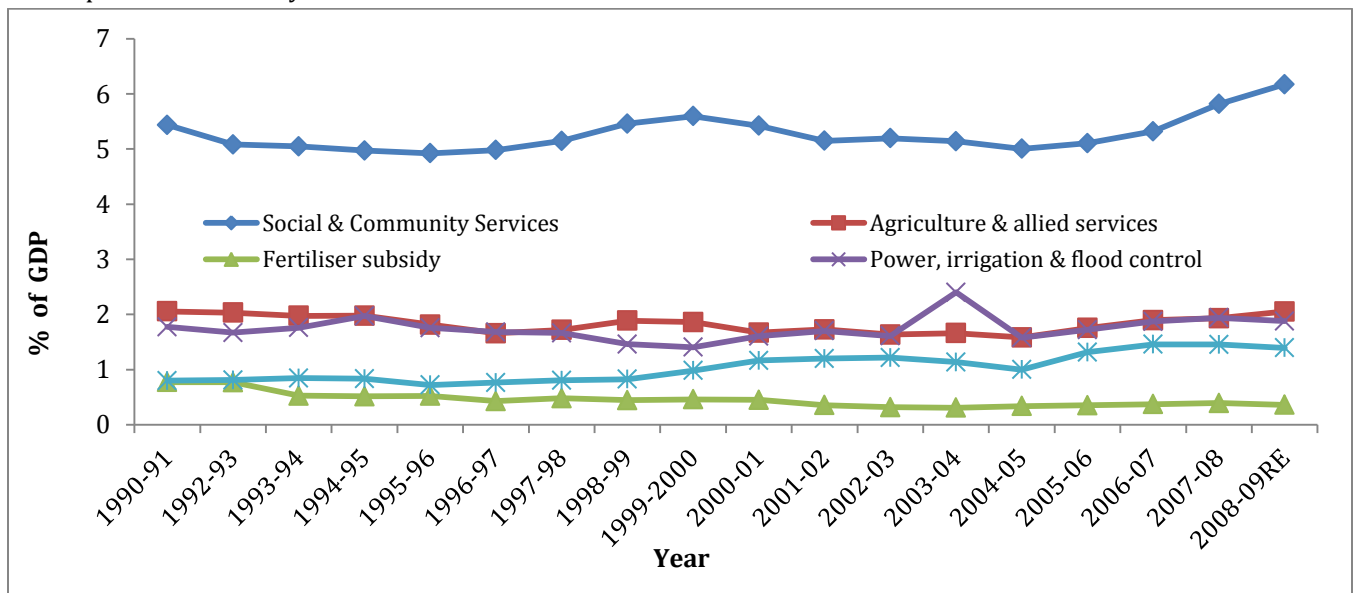
Consequently, in 2007-08 again the development expenditure of the government overshoot the non-development expenditure. This can be attributed to the increased spending in social and community services (National Rural Employment Guarantee Act (NREGA), etc.), agriculture and allied activities (farm loan waiver), and transportation and communication (National Highway Development Program, etc.) (see Graph 3). This was the period when the government embarked a sleuth of social security measures, especially to achieve inclusive growth by focusing more in the rural areas that were mostly excluded from the fruits of economic reforms of 1990s.

Analysis based on the Components of Expenditures:

A component-wise analysis of the trend in combined

expenditures of Centre and State governments shows that the percentage share of expenditure on defence remained almost consistent at around 2.3% of GDP throughout the reform period though it was falling, especially after 2004-05 (see Graph 4). The combined expenditure on agriculture and allied activities as ratio to GDP has also remained almost consistent at around 2%. Though this expenditure component has showed a slightly declining trend till 2004-05, there was an increasing trend then onwards.

The combined expenditure on social sector to GDP ratio has showed a declining trend in the initial years of economic reforms and started picking up since 1995-96 onwards, reaching to a new high of 4.5% in 1999-2000 and then started falling again to reach 3.9% in 2004-05. Since then the social sector expenditure was consistently moving up reaching to the level of around 4.5% of GDP in 2007-08 and 2008-09.



Graph 3. Components of Development Expenditures of the Government (as % of GDP)

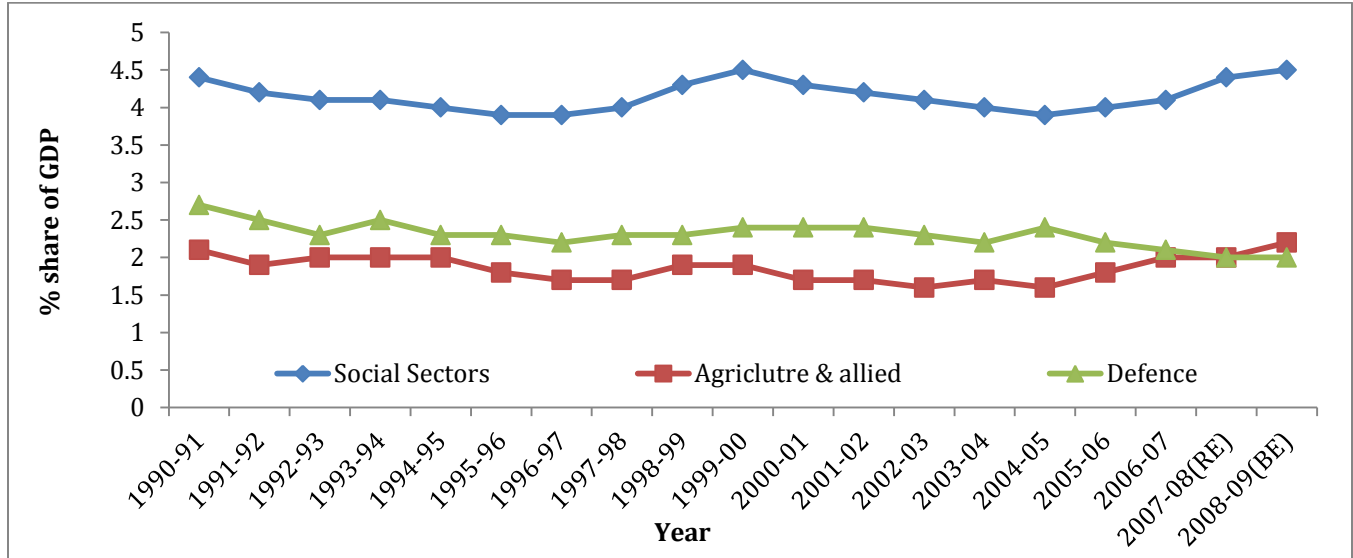
Source: Compiled using data from Indian Public Finance Statistics (various years).

The whole analysis shows that there is no paradigm shift in the combined expenditure pattern of Centre and State governments after the economic liberalization of 1991. Though we expected an increased trend in developmental expenditure of the governments because of its facilitator role, the analysis indicates that the share of developmental expenditure was showing a declining trend while the share of non-developmental expenditure was slightly increasing during the liberalization regime. **Changing Pattern of Combined Government**

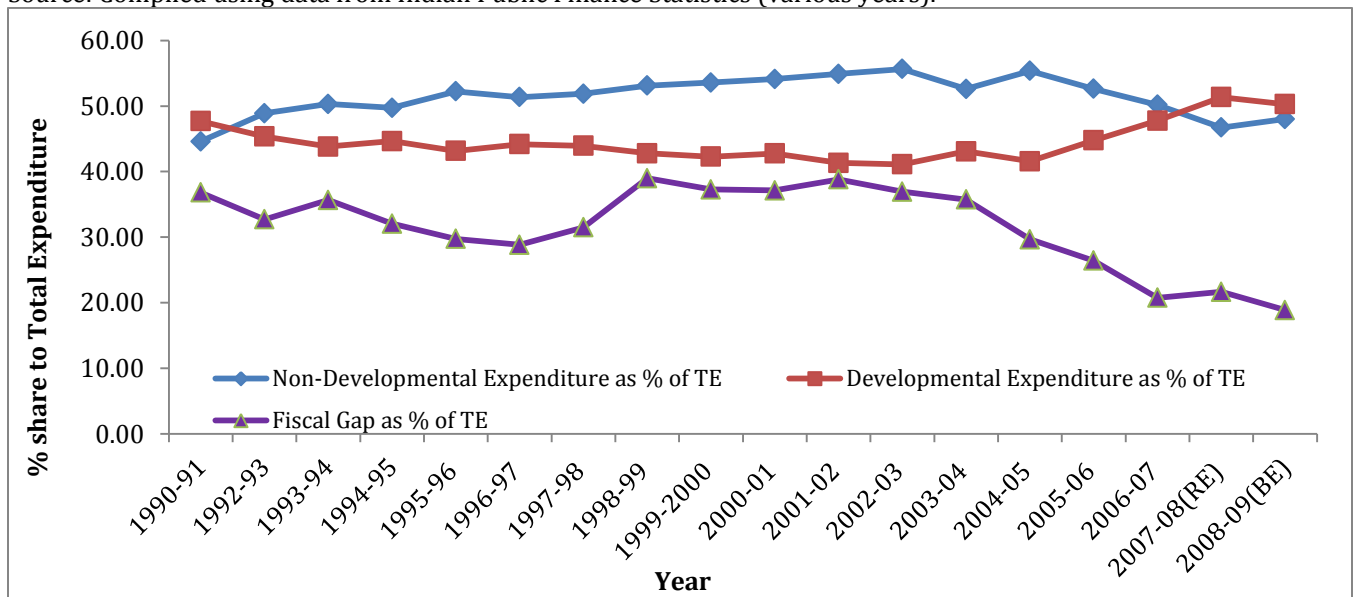
Expenditures during Economic Reforms: The changes in the expenditure pattern of Centre and State governments (consolidated), since the full scale economic liberalization in 1991, are shown in Graph 5. The non-developmental expenditures of the government has gone up substantially as percentage of total expenditure from 44.6% in 1990-91 to 50.90% in 1993-94 and reached a peak of 55.65 per cent in 2002-03. As a result, the percentage share of developmental expenditures has come down from 47.7% in 1990-91 to

43.8% in 1993-94 and touched the lowest of 41.1% in 2002-03. However, the graph also shows that since 2004-05 there was a steady decline in the non-developmental expenditures of the government, which in turn increased the share of developmental expenditures from 41.6% in 2004-04 to 50.3% in 2008-

09. This of course shows a healthy trend for the economy. Graph 5 also indicates that the fiscal deficit (combined revenue expenditure gap) as percentage of total expenditure has come down during the initial years of liberalization. It has come down from 36.8% of total expenditure in 1990-91 to 28.8% in 1996-97.



Graph 4. Trends in Sector-wise Combined Government Expenditures (as % of GDP) since 1991
Source: Compiled using data from Indian Public Finance Statistics (various years).



Graph 5. Trends and Patterns of Combined Government Expenditures since 1991
Source: Compiled using data from Indian Public Finance Statistics (various years).

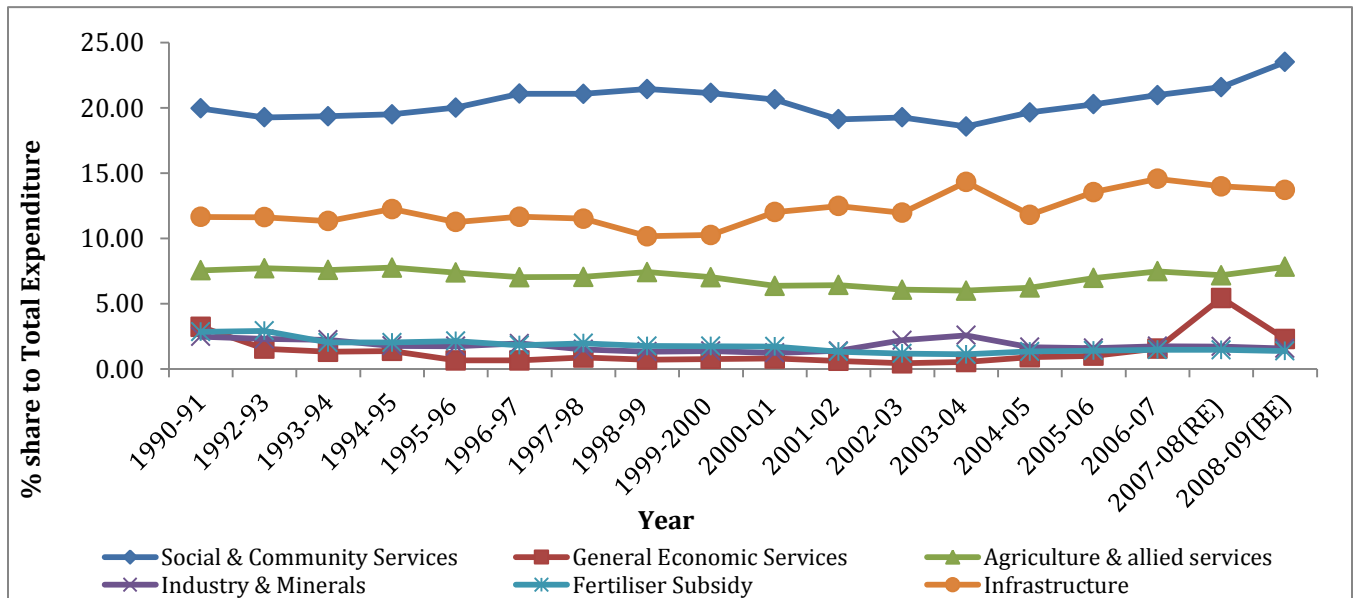
Nevertheless, in 1997-98 it has gone up sharply and reached a peak of 39 per cent in 1998-99 mainly due to increase in the non-developmental expenditures. One of the reasons for this sudden surge in fiscal deficit is the exceptionally turbulent and unfavourable international economic environment caused by the East Asian

currency crisis in 1997-98. Another major reason is the sharp escalation in the government's salary bill and pension payments due to the implementation of the Fifth Central Pay Commission recommendations (Economic Survey, 1999)ⁱⁱ. However, there was a declining trend in the fiscal gap indicator since 2001-02 as the economy

started picking up the growth graph momentum. The share of fiscal deficit to total expenditure has fallen to 18.9% 2008-09. Moreover, the enactment of Fiscal Responsibility and Budget Management Act (FRBMAⁱⁱⁱ) in 2003 stipulated that public expenditure must be reoriented for the creation of productive assets. Another interesting observation from the graph is that most of our analysis period the share of non-developmental expenditure and share of fiscal deficit shows the same trend making us to conclude that most part of the non-developmental expenditure was financed through

borrowing.

The changing patterns in the development and non-development expenditures of the Centre and State governments (combined) are given in Graphs 6 and 7, respectively. Graph 6 indicates that there are no substantial changes in the pattern of the combined developmental expenditures of Centre and State governments. During the initial years of economic liberalization, the shares of almost all the major components of the developmental expenditures remained more or less the same at least till 1996-97.



Graph 6. Trends in Development Expenditure Patterns of Centre and State Governments since 1991.

Source: Compiled using data from Indian Public Finance Statistics (various years).

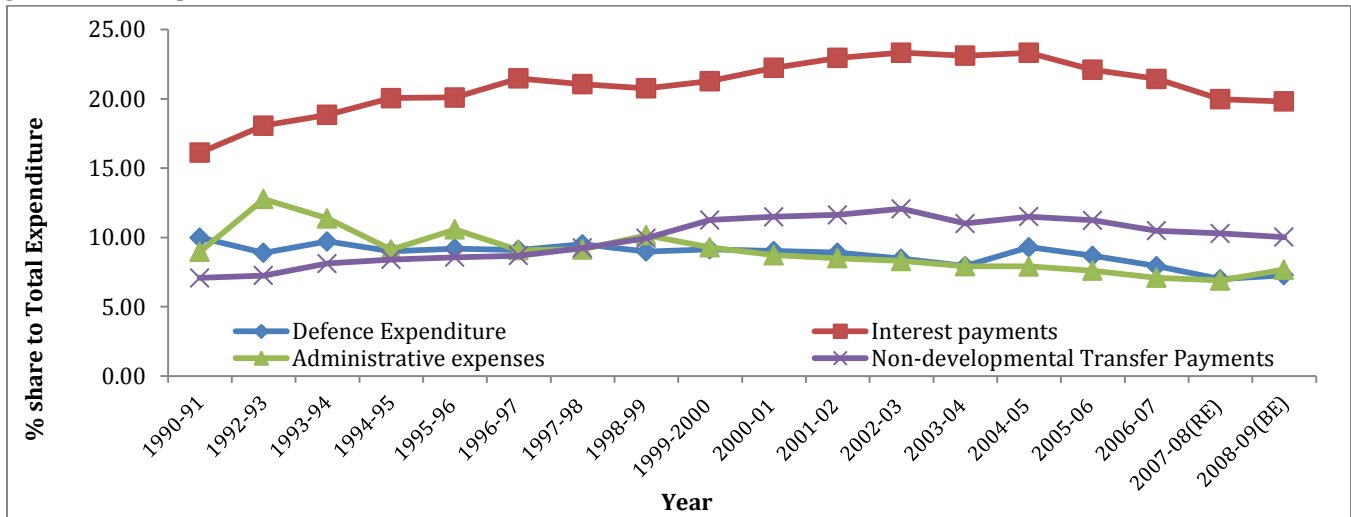
A close observation of the graph shows that most of the years the changes in the share of social and community services expenditures is at the cost of expenditures on infrastructure sector. During the period 1990-91 to 1994-95, the share of expenditure on social and community services showed a slightly declining trend, while the respective share of infrastructure showed a slight upward movement. Similarly, during the period 1994-95 to 1999-2000, while the share of expenditure on social and community services moved up, the share of infrastructure showed a declining trend. The period from 2003-04 to 2007-08 showed upward movement in the shares of almost all the developmental expenditure components of the government. This is mainly because this was the period where the Indian economy was growing at more than 8 per cent per annum. Moreover, the major fiscal indicators of the State Governments have witnessed significant improvement during this

period. This is mainly because of the increased receipts through taxes. In many cases, the improvement is also associated with the enactment of Fiscal Responsibility Legislation by the State Governments. During this period there has been some increase in social sector spending at State level, while the Central Government has also stepped up its outlays on social sectors and rural development programmes substantially through Centrally Sponsored Schemes. Bharat Nirman, a time-bound plan for rural infrastructure by the Government of India in partnership with State Governments and Panchayati Raj Institutions, remained the cornerstone of the Government's policy during this period (Economic Survey, 2008).

The trends in the pattern of non-developmental expenditures of the Centre and State governments, as given in Graph 7 shows that while the shares of administrative expenses and defence expenditure as

percentage of total expenditure has been slightly falling, the shares of interest payments and non-developmental transfer payments are showing consistent upward movements, at least till the year 2003-04. This is of course not in tandem with the automatic stabilization principle that expects the non-developmental government expenditure to come down due to reduced

transfer payments when the economy grows at a faster pace. This support the argument that the automatic stabilization principle may not hold good for developing countries like India where the government has to focus more on the economically weaker sections to ensure growth with equity.



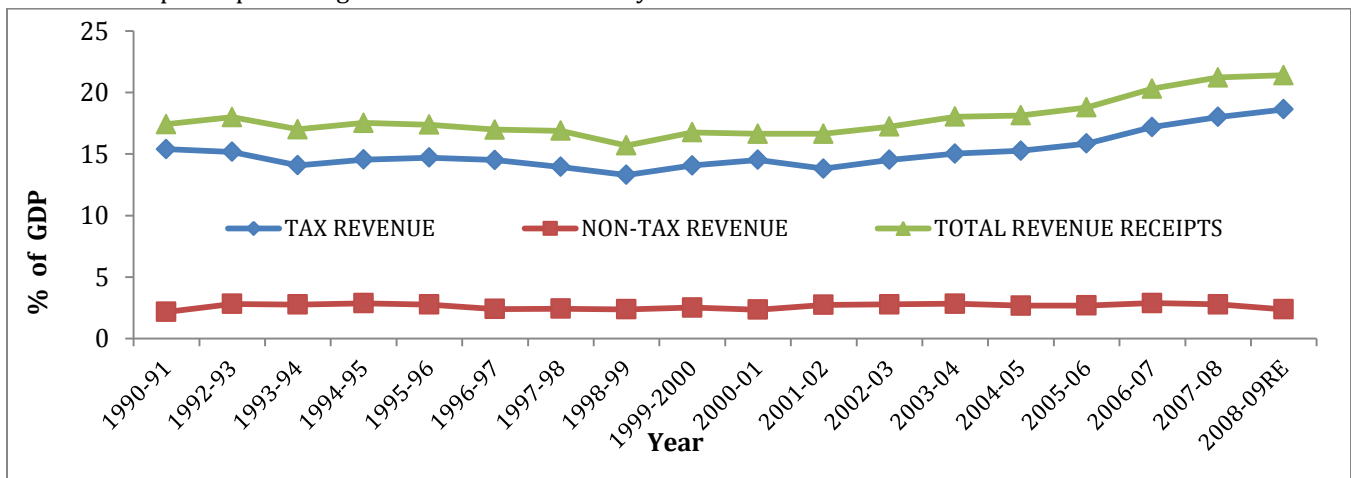
Graph 7. Trends in Non-Development Expenditure Patterns of Centre and State Governments since 1991

Source: Compiled using data from Indian Public Finance Statistics (various years).

TRENDS AND PATTERNS IN THE COMBINED RECEIPTS OF CENTRE AND STATES GOVERNMENTS

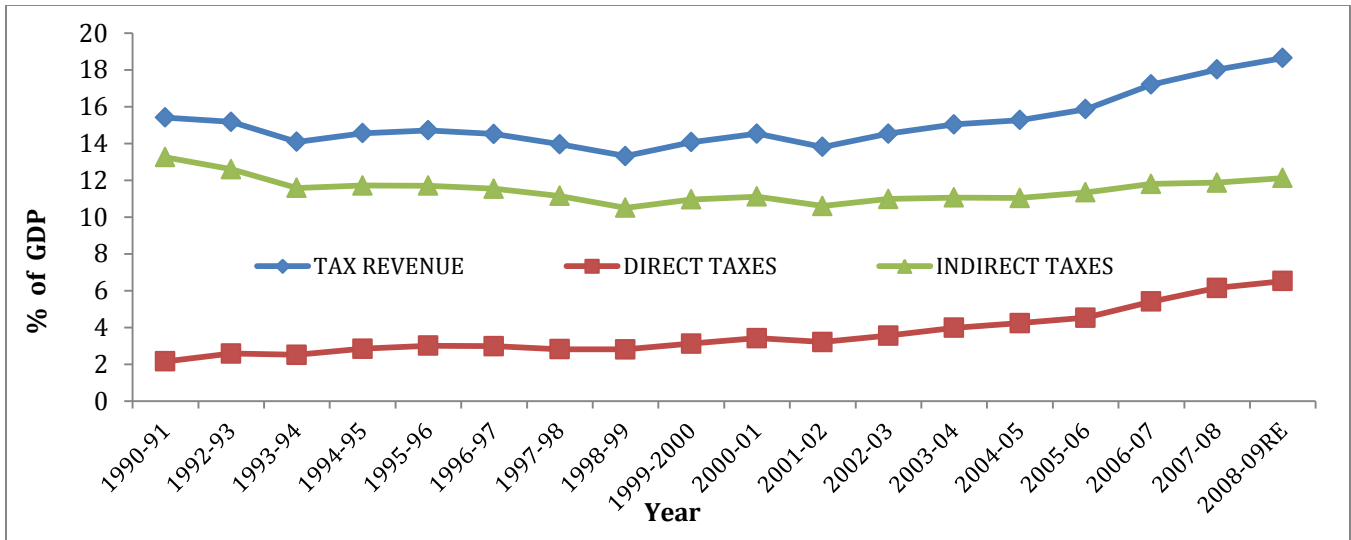
Trends in the Combined Expenditures of Centre and States Governments to GDP Ratios: Graph 8 shows the trends in combined revenue receipts of the Centre and States for the period from 1990-91 to 2008-09. The total revenue receipts as percentage of GDP showed a steady

fall since the economic reforms of 1992 till the year 1998-99. In the initial years of economic liberalization, a fall in the revenue receipts are expected since a number of dispensations has to be offered to attract the private investors and to amplify their optimism regarding the reform policies.



Graph 8. Combined Revenue Receipts of the Government (as % of GDP)

Source: Compiled using data from Indian Public Finance Statistics (various years).



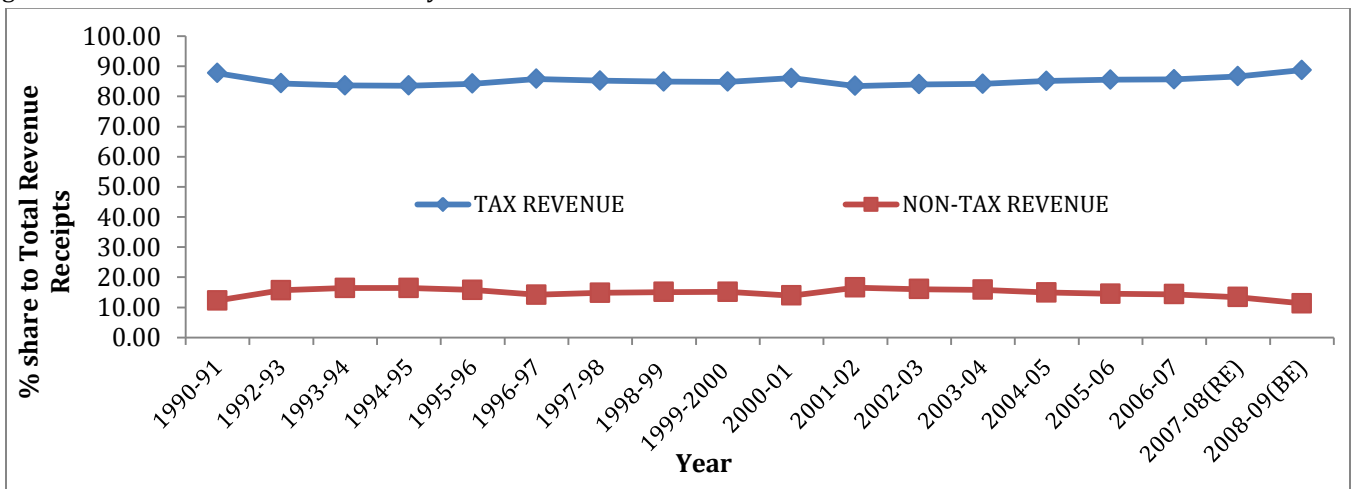
Graph 9. Components of Tax Revenue Receipts of the Government (as % of GDP)
 Source: Compiled using data from Indian Public Finance Statistics (various years).

During this period several tax concessions and other measures were offered to attract both domestic and foreign private investors. This has helped in confidence building measures and a steady growth in investments. As a result, there was buoyancy in revenue receipts since 1998-99, mostly because of the augmentation in tax revenue.^{iv} Robust economic growth and improved performance of the manufacturing and services sectors helped to keep tax revenues buoyant.

The major source of tax revenue in India is from the indirect source. However, the trends in tax revenue receipts show a steady decline in the share of indirect taxes while the share of direct taxes increasing consistently (see Graph 9). Since 2001-02, the increased growth in tax revenues is mainly because of the

advancements in the direct taxes.

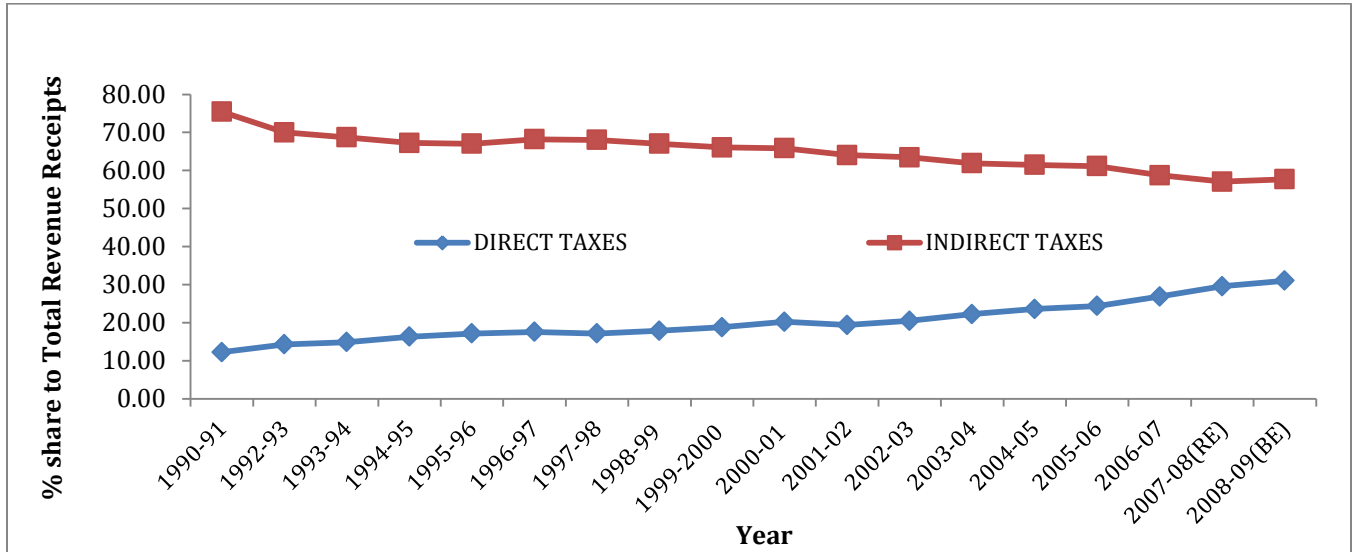
Changing Pattern of Combined Government Receipts during Economic Reforms: The trends in the combined revenue receipts of Centre and State governments during the economic liberalization are shown in Graph 10. The graph clearly indicates that there is no systematic change in the revenue sources of the governments. Though, immediately after the introduction of New Economic Policy in 1991 the tax revenue share to total revenue receipts fell from 87.7% in 1990-91 to 84.3% in 1992-93, it has not shown any drastic changes till 2007-08. Consequently, the share of non-tax revenue has initially increased from 12.3% in 1990-91 to 15.7% in 1992-93.



Graph 10. Pattern of Combined Revenue Receipts of Centre and State Governments since 1991
 Source: Computed using data from Indian Public Finance Statistics (various years).

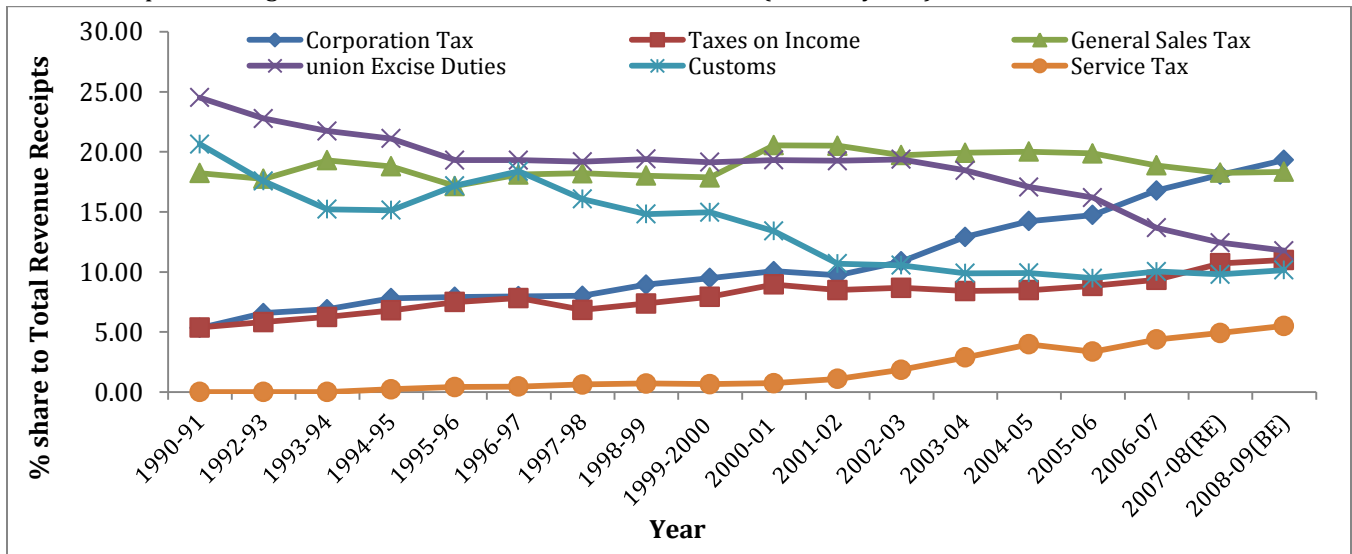
Changing pattern of tax Revenue Receipts: There were substantial changes in the tax revenue sources as depicted in Graph 11. The role of indirect taxes as a major source of revenue receipts has come down drastically from 76 per cent in 1990-91 to 56.6% in 2008-09. This is mainly because of the drastic fall in the union excise duties and customs duties as shown in Graph 12. At the time of economic liberalization in 1991

the major sources of tax revenue were the union excise duties and customs duties. However, the economic liberalization measures and the tax reforms have completely changed the pattern of tax revenue receipts in India. The share of union excise duties as a major revenue source has fallen from 24.7% in 1990-91 to 11.6% in 2008-09 and the share of customs duties has fallen from 20.8% in 1990-91 to 10% in 2008-09.



Graph 11. Pattern of Combined Tax Revenue Receipts of Centre and State Governments since 1991.

Source: Computed using data from Indian Public Finance Statistics (various years).



Graph 12. Changing Pattern of Major Components of Tax Receipts of Centre and State Governments since 1991

Source: Computed using data from Indian Public Finance Statistics (various years).

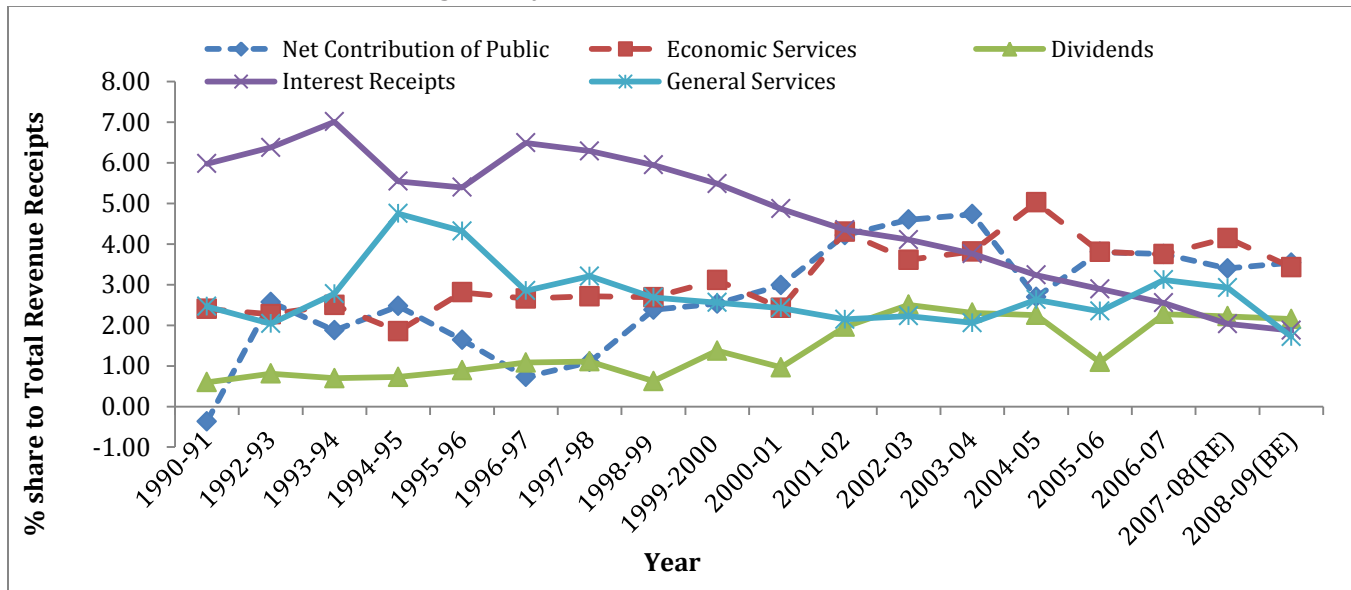
Consequently, the share of direct taxes has increased from 12.4% in 1990-91 to almost 30.5% in 2008-09. This is mainly because of the increased revenue from the corporation taxes for which share in total revenue has increased from 5.4% in 1990-91 to almost 19% in 2008-

09. Especially, the growth in the share of corporation tax revenue was substantial during 2001-02 to 2008-09 (from 9.7% in 2001-02 to 19% in 2008-09). This can be attributed to the economic boom during this period during which the real GDP has recorded an average

growth rate of 7.8% (Government of India, Economic Survey, various years). The emergence of corporation tax as a major source of tax revenue receipts clearly shows the increased role of private participation in the economic growth of the country after the economic liberalization. Similarly, there was a consistent growth in the share of income taxes in the total revenue receipts of the government even after periodic widening of the income tax exemption band. The share of taxes on income in total revenue receipts has increased from 5.4% in 1990-91 to 10.8% in 2008-09. This is because of the increase in the per capita income due to the reform measures adopted in India during this period. The real per capital income of the people has increased from Rs.11, 535 in 1990-91 to Rs.21, 345 in 2007-08 (in 1999-2000 prices), which has helped the buoyancy in income tax collection. Service tax was introduced in 1994-95 to redress the differential treatment of goods and services in the tax framework and to widen the tax net. It has been a buoyant source of revenue in recent years. The number of services liable for taxation was raised from 3 in 1994-95 to 6 in 1996-97, and then gradually to 100 in

2007-08 (Government of India, Economic Survey, various years). The share of service taxes to total revenue receipts has increased from a mere 1% in 2001-02 to almost 5.4% in 2008-09.

Changing pattern of non-tax Revenue Receipts: The trends in the major components of combined non-tax revenue receipts of the Centre and State governments are shown in Graph 13. One of the major sources of non-tax revenue for the government was interest receipts which had a drastic fall during the liberalization period. In 1990-91 it was around 6 per cent of total revenue receipts which went up to 7 per cent in 1993-94 but fallen continuously since then with an exception in 1996-97. It has reached a level of just around 2 percent by 2007-08. Other major components of non-tax revenue receipts like receipts from general economic services, dividends, and net contributions of public showed upward trends, though volatile, during the period of economic reforms. These upward trends can be attributed to the economic growth recorded in Indian economy during this period.



Graph 13. Trends in the Major Components of Non-Tax Revenue Receipts of Centre and State Governments. Source: Computed using data from Indian Public Finance Statistics (various years).

CONCLUSION

The main objective of the economic liberalization policies adopted in India in the early 1990s was with the intention to reduce the role of government in productive sectors and give more freedom to the relatively efficient private sector. As a result, many sectors earlier reserved for public sector have been opened for private sector

participation and the government has started withdrawing from many of these sectors through disinvestment. This was with the view to concentrate more on the infrastructural and social development of the nation. Therefore, it is expected that the role of government in production sectors, especially various sectors in manufacturing and services, would come

down and there would be steady increase in the role of state in economic-development-facilitating sectors like infrastructure, education, and health, among others.

The study shows that though the share of total government expenditure as percentage of GDP has showed a declining trend during the initial years of economic liberalization. While there was a fall in the combined capital expenditure of the Centre and States, the combined revenue expenditure showed a steady increasing trend in the initial periods of economic liberalization. This was as expected because economic liberalization is meant to reduce the role of government in economic activities and allow the more efficient private sector to take up the growth momentum. In a liberalized scenario the role of government is to facilitate the growth momentum by providing adequate infrastructural and social support.

The total government receipts as percentage of GDP has shown an average decline during 1990s when the full scale liberalization process was initiated in India. However, during 2000s there was a steady increase in the government receipts as a percentage of GDP, mainly because of the buoyancy in revenue collections. With respect to the compositions, the study found that while there was no substantial change in the pattern of government expenditures after the economic liberalization of 1991, there were considerable differences in the pattern of government receipts, especially tax receipts. From the receipts side, tax revenue is the major contributor of government receipts in India, which contributes around 85-90 per cent of total revenue receipts. Though in a broad perspective, the revenue receipts did not show any substantial changes in its pattern, there were substantial movements in the pattern of various sub-components of both tax and non-tax revenue receipts, especially the movements in the pattern of tax revenue components are noticeable.

The study shows that there is no much paradigm shift in the government's expenditure pattern after the 1991 economic reforms. Though we expected an increased trend in developmental expenditure of the governments because of its facilitator role, the study indicates that the share of developmental expenditure was showing a declining trend while the share of non-developmental expenditure was slightly increasing during the liberalization regime. However, there were considerable differences in the pattern of government receipts,

especially in tax receipts. While the share of indirect taxes in the total revenue receipts showed a steady fall, there was a corresponding increase in the share of direct tax revenue. The increase in direct taxes and income taxes was propelled by the significant growth in corporation taxes and income taxes mainly due to the privatisation measures adopted during the economic liberalization period. Therefore, we conclude that the economic liberalization measures have not much changed the role of government in terms of its expenditures but helped restructuring the pattern of government receipts.

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ⁱ The “Hindu rate of growth” is an expression coined by economist Raj Krishna used to hide the disastrous socialist policies followed by successive Indian National Congress governments. India's low annual growth rate of economy before 1991 was stagnant around 3.5%, and had been so since the 1950s.

ⁱⁱ The salary bill and pension outgo of the Central government escalated sharply by 33.6% and 35% respectively in 1997-98.

ⁱⁱⁱ The enactment of the Fiscal Responsibility and Budget Management Act (FRBMA), 2003 provided the required mandate and lent credibility to the fiscal reforms process in India. FRBMA highlights the significance of keeping the revenue expenditure under control and envisages elimination of the revenue deficit by the end of 2008-09.

^{iv} The data shows that the major share of revenue receipts is from taxes. Therefore, the trend in total revenue receipts is in tandem with the tax revenues.