AN ANALYSIS OF INDIAN FISCAL SYSTEM WITH REFERENCE TO FISCAL REFORMS

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India inherited an economically stagnant economy at the time of independence in 1947. The framers of the Indian Constitution tried to build a strong united India to build a sound fiscal system of government. So India adopted federal structure with the union of central and state governments to actualize and uphold the values of national unity, cultural diversity, regional autonomy and rapid socio-economic transformation. Under such a fiscal system, the fiscal performance of both the centre and state governments remained comfortable till 1980. But there was a significant deterioration in the fiscal situation in 1980s, especially by the second half, due to high and persistent fiscal deficits. This large fiscal deficit had some spill-over effects on the external sector which was reflected in the widening current account deficit in the early 1990s. This underlined the need for a comprehensive fiscal reform programme to raise revenue and compress expenditure. In this study an effort has been made to analyse the fiscal performance of centre, states and general government of India with reference to fiscal reforms by comparing pre-reform period and post-reform period each covering one and half decade. The period chosen for the study is of thirty years i.e., from 1975-76 to 2005-06. While comparing India's fiscal position with selected federal nations, it has been found that countries like Canada, Argentina, Mexico and Germany are also highly indebted as expenditure has remained greater than revenue as per cent of GDP. But countries where the size of vertical fiscal imbalance is very small and have started the program of fiscal tightening with the help of expenditure control are recovering at a very faster pace (like Canada). However, the fiscal condition of India and Argentina is worse. Several fiscal reforms were made by the central government to raise revenue
which mainly targeted taxation front in 1990s and 2000s, while to curtail expenditure by introducing Expenditure Reforms Commission very late in 2000s and to reduce the debt burden in mid-1990s by reducing the difference between the interest rate on market borrowings and other internal liabilities (small savings, provident funds, etc.). States took some steps to augment revenue mainly tax revenue at their own but no major tax reform was undertaken during 1990s. Since 2003, a major tax reform i.e., the implementation of Value Added Tax (VAT) by replacing sales tax was introduced. In the process of fiscal reforms, the expenditure front was neglected during 1990s and it was only during 2000s specifically since 2003 that the state governments have initiated various measures to compress expenditure by enactment of Fiscal Responsibility and Budget Management Act (FRBMA). The issue of reforms in borrowing process has attracted the attention of policy makers during 2000s and one reform on this front was the formulation of Debt Swap Scheme. The study is concluded with the judgement that fiscal performance of Indian economy has no doubt started showing signs of improvement on account of decline in the growth of capital receipts and decline in the growth of revenue expenditure during post-reform period of centre, states and consolidated general government of India. But the performance has been lesser than satisfactory on some fronts like comparatively lower growth of revenue receipts in the case of centre, states and consolidated general government of India during post-reform period. Besides, central government has been making a huge share of revenue expenditure on non-developmental purposes. Thus, reforms of the central government should target improvement in the quality of expenditure. As the major share of revenue receipts
comes from tax sources of central as well as of state governments so both layers of government should pay special attention to augment revenue receipts not only from tax sources but also from non-tax sources in order to tackle fiscal crisis. Capital receipts are growing at a much rapid rate in the case of state governments as compared to the central government showing thereby the huge and increasing burden of debt liabilities on the states. Thus states should undertake rigorous reforms on the borrowing front immediately and should reduce their reliance on borrowings in order to decrease the burden of growing public debt. Centre and state governments have undertaken various measures to reduce both fiscal deficit and revenue deficit. However, the enactment of FRBM Act, 2003 made a watershed in fiscal reforms process. As a result, the fiscal position of both the centre and state governments has shown a sign of improvement. But the fiscal situation of the states (consolidated picture) has shown a better performance in terms of reduction in fiscal deficit and revenue deficit as compared to the central government in the post-FRBMA period. Thus central government should also target to eliminate fiscal deficit as well as revenue deficit.