CHAPTER - 1

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Public debt is the debt which state owes to its subjects or to the nationals of other countries. Public debt arises due to borrowing by the government. The government may borrow from banks, business organizations, business houses and individuals. The borrowings of the government may be within the country or form outside the country or both. The public debt is generally in the form of bonds or treasury bills if the loan has been acquired for a short period. These bonds carry the promise of the government to pay interest to their holders at the specified rate of interest at regular intervals or in lumpsum at the end of the stipulated period, in addition to the principal amount. According to Taylor, "The debt is in the form of promises by the Treasury to pay to the holders of these promises a principal sum and in most instances interest on that principal." ¹ Government obligations can be of various types. Government incurs some obligations in the form of short-term debt whose maturity is normally of less than one year at the time of issue and consists of treasury bill, treasury deposit receipts and borrowings from the banking sector. These obligations are short-term obligations. Some obligations of the government are called as floating debt which do not have any specific maturity but some part of it may be repayable according to pre-determined terms and conditions. These include provident funds, small savings, reserve funds and deposits and so on. In India, the Central Government issues certain special securities to meet its obligations towards

(1)
international financial institutions like the IBRD and the IMF. These are known
as special floating debt. Then there is permanent or funded debt whose
maturity is of more than one year at the time of issue. Some parts of these
debts are non-terminable which means that the government only pays the
interest and not the principal amount. The above mentioned obligations may
be to some extent to the foreigners—individuals, institutions, firms and
governments and are called external loans. It would then be clear that public
debt is a debt or loan taken by the government from its own people as
well as from foreign countries.

Government loans differ from one another in many ways. The
differences in the various types of loans arise because of a number of
factors like the purpose of the loan, the period of the loan, rate of interest
offered, the terms and conditions of the loan etc. The public debts have
been classified as follows: (i) Internal and External Debts, (ii) Productive
and Unproductive Debts, (iii) Redeemable and Irredeemable Debts, (iv)
Funded and Unfunded Debts, (v) Voluntary and Compulsory debts.

1. **Internal and External Debts**: Public loans floated within the country
are called internal debt. Public borrowings from other country are referred
as external debt. External debt represents a claim of foreigners against
the real income (GNP) of the country. The payment of interest on external
debt reduces the net income of the debtor country by transferring a
part of its income abroad, the payment of interest on internal debt has
no such effect. The country's national income is the same whether the
interest on internal debt is left with the tax-payers or is taken from
them as taxes and paid out as interest on internal loan. Hence the
payment of such interest does not affect the productive capacity of country as a whole, but there may be indirect effects on production.

2. **Productive and Unproductive Debts**: If public debt is used for creating income yielding tangible assets so that it is made self-liquidating, then it is productive and if it is used for purposes which do not yield any income then it is unproductive debt. For example, public loans may be raised to construct railways or factories owned by the government. Income generated from such capital assets that is profits of the enterprises or revenue from railways, is used to pay the interest or repay the principal. Such loans are productive public debt as they add to the productive capacity of the economy through capital formation. However many times public loans are raised to pay for wars, to recover from the war-torn economy to feed the people during famines or to fill up budgetary deficits on revenue account or defence expenditure and so on. Such debts are permanent burden on the posterity or future generations. These loans are classified as unproductive public debt.

3. **Redeemable and Irredeemable Debts**: Redeemable debts are those for which the government is committed to repay at an appointed date, whereas loans for which there is no such commitment from the government are irredeemable loans. When a loan is redeemable the government has to make some arrangement for its repayment, which the government generally does through taxation. In the case of irredeemable loans the government pays the interest and there is no commitment for the repayment of the principal amount. These debts are also known as terminable debts. Redeemable loans can be
short-term say for a period of 3 to 9 months like treasury bills, long-term say for a period of 10 years or more and medium-term debts ranging between a period of 5 to 10 years. The rate of interest is the lowest in the case of short-term debts, highest in the case of long-term debts and it is moderate in the case of medium term debts.

4. Funded and Unfunded Debts: Funded debts are those that are redeemable after a year or are not redeemable at all. Unfunded debts are those which are redeemable within a year. Treasury bonds are unfunded debts, for they are for three or six months, never for a longer period than a year. The unfunded debts are incurred for filling temporary gaps in the budgets. Such borrowings are always in anticipation of public revenue. On the other hand, long period or funded debts are never incurred for such purposes. They cannot be paid off within a year and generally they should be paid off within the period of their productive use.

5. Voluntary and Compulsory Debts: When government borrows from people by using coercive methods, loans so raised are referred as compulsory public debts. In India under the Compulsory Deposit Scheme, tax payers have to compulsorly deposit a prescribed amount. This is a case of compulsory debt. Usually, public borrowings are voluntary in nature. When the government floats loans by issuing securities the members of the public and institutions like commercial banks may subscribe to them. Generally because of its high credibility, government loans are over subscribed and that is why the rate of interest on government securities is low as compared to loans funded by a private company.
Classification of Total Liabilities of the central Government.

The total liabilities of the Central Government has been officially classified as (a) Public Debt (b) Small Savings Scheme (c) Provident Funds, etc., (d) Reserve Funds and Deposits. Although except public debt "Other liabilities" are also the obligations of the Central Government and should not be separated from the public debt of Central Government. But this classification is justified on the ground that while public debt obligations are to be met out of the Consolidated Fund of India, other liabilities are to be met out of the public Account Fund of India.

Public debt of Central Government comprises : (1) Internal debt, and (2) External debt.

Internal debt : It comprises of loans raised within the country. Internal debt has been classified further as given below :

(I) Market Loans :

These are known by various names like term loans, funded loans, dated loans and permanent loans. These are generally term loans, and dated loans and form a major portion of the internal debt. The Government issues market loans every year by the sale of securities or otherwise. This has become an important source of financing public expenditure. The volume of market loans has grown from Rs. 70520 crore in 1990–91 to Rs. 348593 crore in 1999–2000 (B.E.).

(II) Market Loans in Course of Repayment :

The loans raised by the Government in the past are repaid by the issue of new securities and are called as market loans in course of
repayment. Though, they are very similar to the market loans, but it points out the proportion of currency which has been re-invested. Such loans were estimated at Rs. 54 crores in 1973-74 and they increased to Rs. 46 crores in 1990-91 and Rs. 134 crores in 1999-2000. (B.E.)

(III) Treasury Bills:

(91 Days treasury bills) Treasury bills are the most important source of short term funds for the Government to fill the gap between revenue and expenditure. They provide an attractive form of investment to the banks to meet the increasing demand for funds for investment in Five Year Plans, the Government has taken recourse to heavy borrowing through the issue of these bills. The Reserve Bank of India holds the major portion of the treasury bills while State Governments, Commercial Banks and other parties stand comparatively lower in order. These bills can be converted into cash without the holder suffering much loss. These are of two kinds:

a. Ad-hoc treasury bills issued by the Central Government to the Reserve Bank of India.

b. Bills sold to the public: The amount of debt as a result of treasury bills has increased from Rs. 19452 crores in 1984-85 to Rs. 56519 crores in 1996-97. Such loans are estimated at Rs. 1600.76 crores (R.E.) for 1998-99 and Rs. 1600.76 crores (B.E.) for 1999-2000.

364 Days Treasury Bills:

These bills were introduced in 1992-93 to enable the development of market for government securities. These are not rediscountable with the Reserve Bank of India and are periodically offered for sale on auction basis by the Reserve Bank of India at Mumbai. These bills are of short term and
are offered to financial institutions and other parties. The amount of loan as a result of these bills was estimated at Rs. 8776.74 crore in 1992-93 and Rs. 16242.65 Crores (R.E.) in 1998-99 and Rs. 16242.65 crores (B.E.) for 1999-2000.

(iv) Compensation and other Bonds: Such loans are long term in nature. For instance, Capital Investment Bonds were put on tap from 28th June 1982. These Bonds carry interest at the rate of 7 per cent and have a maturity period of 10 years. National Rural Development Bonds provide investment facility to persons desirous of availing exemption from Capital Gains Tax on transfer sale of capital assets. These 7 year Bonds were put on tap from 9th July 1979 and carried an interest at the rate of 7.5 per cent per annum. Besides, The National Rural Development Bonds (Second issue) with a smaller period of three years put on tap from 7th July 1983. These bonds also carry interest at the rate of 7.5 per cent per annum. The Government of India has nationalized six more commercial banks in 1980. Therefore, the Central Government has to pay specified amounts to these banks. For this purpose, it has announced the issue of two bonds (i) 6 per cent Bonds, 1990 to be issued at 100.00 per cent and redeemable at par on 15th April 1990. (ii) 7 per cent Bonds, 2010, to be issued at 100.00 per cent and redeemable at par on 15th April 2010. The total debt as a result of such Bonds at the end of 1990–91 was Rs. 788.32 crore which increased to Rs. 6647.48 crores (R.E.) for 1998–99 and Rs. 9135.98 crores (B.E.) for 1999–2000.

Special Bearer Bonds:

These bonds were issued on 2nd February 1981 whose maturity
period was 10 years from the date of sale and the holders of these bonds were entitled to receive Rs. 12000/- for every bond of the value of Rs. 10000/- on maturity. Such bonds have been issued several times since 1950-51. The total amount of public debt as per Budget estimates was Rs. 950.97 crores in 1990-91, Which however, has not increase in 1991-92. It was reduced to Rs. 42.87 crores in 1992-93 and Rs. 2.70 crores in 1994-95.

v) Special Floating and other Loans :

Special floating loans represent India's contribution towards share capital to international financial institutions. Non-negotiable, non-interest bearing securities issued to the International financial institutions such as International Monetary Fund, International Bank for Reconstruction and Development, Internation Development Association, International Fund for Agricultural Development, African Development Bank and Asian Development Bank in lieu of their share capital. The government has to pay the amount of these securities at the call of these institutions, in his own currency and in this sense it is a kind of short term loan. Special floating and other loans were of the order of Rs. 705 crores in 1970-71, they increased to Rs. 6566.21 crores in 1990-91. These are estimated at Rs. 19980.26 crores (R.E.) for 1998-99 and Rs. 20525.83 crores (B.E.) for 1999-2000.

vi) Special Securities Issued to the R.B.I. :

The Central Government also takes loan as a temporary measure from Reserve Bank of India by issuing special securities, which are non-negotiable and non-interest bearing. The Government has to repay the amount of this debt at the call of the Reserve Bank of India. Since there
is no interest admissible on these securities they are sold at a discount. These bills are a source of medium-term loans and are funded into special securities. It implies that these bills are converted into special securities whose payment is made in instalments. The amount of debt as a result of these bills stood at Rs. 72047 crore in 1992-93 which increased to an estimated amount of Rs. 122865 crore (R.E.) in 1997-98.

Other Outstanding Liabilities:

There are certain outstanding liabilities of which the Government is liable to make repayments. Hence, these outstanding liabilities are taken as debt upon the Government. These outstanding liabilities can be grouped under the following heads:

1. Small Saving Schemes
2. Other Provident Fund
   a) State Provident Funds
   b) Public Provident Funds
   c) Other Accounts
3. Reserve Funds and Deposits

1. Small Savings Scheme: Small savings as a source of borrowing of the Government has a special significance, particularly for growth-seeking and inflation sensitive economy. It is the safest form of government borrowing as it takes the genuine savings of the people and provides the government much needed, capital without aggravating, the inflationary situation in the economy. The greater the contribution of the small savings to the Government's borrowing the better it is for the economy to maintain monetary stability. But, the contribution of small savings is
rather limited even in developed countries. In under developed countries it is not an unusual situation because the people are poor and they are unable to save. However, in India the Government has always made efforts to promote small savings. The instruments through which the government collects small savings in India are the Post Office Savings, Bank Deposits, Cumulative Time Deposits, National Saving Certificates. Small savings amounted to Rs. 2209 crores in 1970-71. Since then there has been a tremendous increase in their amount. In 1990-91 these were of the order of Rs. 50100.18 crore. It is estimated at Rs. 172207.32 (R.E.) crores for the year 1998-99. It is estimated at Rs. 25000.00 crores (B.E.) for the year 1999-2000.

2. Provident Funds etc. : The central government has certain outstandings as a result of the Provident Fund Contributions. The transactions under this head relate to

a) State Provident Funds
b) Public Provident Funds
c) Other Accounts

The total outstandings which the government is liable to repay in 1973-74 on account of other provident funds was of the order of Rs. 1323 crores, these funds increased to Rs. 57007 crores in 1990-91. It is estimated at Rs. 167078.00 crores (R.E.) for the year 1997-98. Here other Accounts are special deposits of Non-Government Provident Funds.

3. Reserve Funds and Deposits : They consist of deposits under the Income Tax Annuity Deposits Schemes and deposits under the Special Deposits Schemes, depreciation and other interest bearing reserve funds
of departments like Railways, Post and Telegraphs. Besides, it also consists of deposits of Local Funds and civil deposits and unclaimed balance of old loans which have ceased to bear interest from the date of discharge. The total amount in respect of Reserve, Funds and Deposits was of the order of Rs. 1757.00 crores in 1970-71, which has increased to Rs. 21922.17 crores in 1990-91, these are estimated at Rs. 32818.43 crores (R.E.) for 1998-99 and Rs. 45902.15 crores (B.E.) for the year 1999-2000.

The main reason for the phenomenal rise in other liabilities is that the government in order to fulfil its financial needs has tried to explore all possible means for raising additional resources. Consequently the government also exploited this source of funds to the maximum. The government adopted various means like tax incentives to divert the savings of the economy to the government treasury in the form of various schemes described above.

Financing Economic Development: The Role of Public Debt

The problem of stimulating the growth of the Indian economy has been engaging the attention of our people since the dawn of political independence and the coming into existence of a national democratic government. Economic Planning, launched within the framework of democracy, has the aim of promoting rapid and balanced economic development which is a very complicated process. It is difficult to consider any single factor as the prime mover in the process of economic development. Development conscious people, reasonably abundant natural resources, spirited enterprise,
technically trained labour force and a dedicated civil service are the essential requirements for achieving rapid economic development. But capital formation or mobilization of financial resources is fundamental to the whole problem of economic development. It is true that mere supply of capital is not a sufficient condition for economic development, but increased capital is obviously a necessary concomitant of it. To ensure adequate supply of capital without which economic progress cannot be achieved, appropriate methods of mobilizing the financial resources have to be adopted.

As Ursula K. Hicks observes, "Choosing the appropriate methods of finance cannot make a bad plan good, but it can make it better using the wrong methods can wreck even the best of plans." Therefore, selection of appropriate methods of financing development is very important for the success of development plans. Various methods to be adopted for mobilizing financial resources and their implications for the economy are among the leading issues in the Economics of Development. "Financial aspects are as important as the other aspects of economic development and their study should receive proper attention."

In this study we are concerned with the debt-financing of economic development and its implications for the Indian economy. Before going to this problem, it would be appropriate to study briefly the magnitude of developmental effort needed to launch the economy into the self sustained growth, the economic handicaps and institutional defects and deficiencies inhibiting the mobilization of resources for a large scale investment and the role of state in promoting rapid development of the economy.
Theory of "Big Push"

To lift the Indian economy from the morass of poverty, a massive investment effort is needed. The theory of "Big Push" developed by Paul N. Rosenstein-Rodan suggests that the initial investment must be fairly big to launch a country into self-sustaining growth. According to him, "There is a minimum level of resources that must be devoted to a development programme if it is to have any chance of success. Launching a country into self-sustaining growth is a little like getting an airplane off the ground. There is a critical ground speed which must be passed before the craft can become airborne. Proceeding "bit by bit" will not add up in its effects to the sum total of the single bits. A minimum quantum of investment is a necessary, though not sufficient, condition of success." Investment in infrastructure or social overhead capital must be undertaken by the state and this investment should be fairly high because of the indivisibility of social overhead capital. Rosenstein Rodan mentions four indivisibilities of social overhead capital:

(1) It is indivisible in time. It must be preceded by other directly productive investments

(2) Its equipment has high minimum durability. Lesser durability is either technically impossible or much less efficient. For this and other reasons it is very lumpy.

(3) It has long gestation periods.

(4) An irreducible minimum social overhead capital industry mix is a condition for getting off the dead end."

(5) Indivisibility of demand or complementarity of demand is another factor which necessitates a high level of investment. Because of the interdependence of the investment decisions, one investment must be
accompanied by complementary investment. Any single investment will be considered to be too risky if there is no assurance that there will be complementary investment. The newly produced products can find a market only if there is investment in other lines. Moreover, there is need for producing a "bundle" of wage goods on which additionally employed people can spend their income. What is needed for all this is a fairly big amount of investment.

Critical Minimum Effort Thesis:

The critical minimum effort thesis of Harvey Leibestein also emphasizes the fact that the amount of initial investment must be sufficiently big to achieve economic progress. According to him, "......... in order to achieve sustained secular growth, in the general case, it is necessary that the initial stimulant or stimulants to development be of a certain critical minimum size."6 A stimulant to growth is defined as any event that changes the value of a variable away from its equilibrium value so that the consequence of this event is an initial increase in per capital income.7 In terms of the magnitude of the stimulant that it takes to achieve sustained development, Leibenstein defines the critical minimum effort as the amount of externally created investment. The rate of growth of the economy depends upon the magnitude of stimulant provided in the form of investment. In a backward economy, long run economic development does not occur because the magnitude of stimulant is too small. Owing to the vicious circle of poverty, the required amount of capital formation is not possible. According to Leibenstein, "......... the only reason the vicious circles appear vicious is because it is so very difficult to find and Marshal stimulants to development
that are of sufficient magnitude. A critical minimum effort is necessary to break the vicious circle. In the absence of a critical minimum effort, the increase in income and the increase in accumulation of capital are small because the stimulant to growth is small. In the economy, both the per capita income-raising and the per capita income-depressing forces operate side by side. Investment in the economy must be so large as to offset the effects of income depressing forces so that income per head may rise significantly and facilitate large scale capital formation to stimulate further growth. As leibenstein puts it, "................. if the income-raising factors are stimulated beyond the maximum of the income-depressing factors, the critical minimum has been reached and the economy would in this case, be on the road to development." Further according to him there is need for a minimum effort in order:

(1) to overcome internal diseconomies of scale due to indivisibilities in the factors of production
(2) to overcome external diseconomies due to external interdependencies and to achieve what has some times been called ‘balanced’ growth,
(3) to overcome income depressing obstacles that may be generated by the stimulants to growth, and
(4) to generate sufficient momentum in the system so that the factors that stimulate growth continue to play their part.

According to the “Big Push” argument and the critical minimum effort thesis, sufficiently large investment is necessary in the early stages of development to launch the economy into self sustaining growth. But in any underdeveloped economy, generally there are many difficulties in putting through
the “Big Push” and India has been no exception. On the one hand, lack of complementary factors of production and inability to check inflationary forces inherent in huge development efforts and the balance of payments problems seriously limit the aggregate investment that the economy could absorb and on the other hand, there are several impediments in the way of mobilizing domestic savings as well as attracting foreign capital. In the first place, in spite of the massive developmental efforts under The Five Year Plans, widespread poverty still continues to dominate the Indian economic scene. N.N.P. at factor cost has indeed recorded a rise from Rs. 8525 crores in 1950-51 to Rs. 546023 crores in 1992-93 and Rs. 1140895 crores in 1996-97* and per capita NNP has risen from Rs. 239 in 1950-51 to Rs. 6262 in 1992-93 and Rs. 12099 in 1996-97* (at current prices)+ But, this by no means is an impressive record and compared to the needs of the growing population and to the level of per capita N.N.P. in advanced countries, India's per capita N.N.P. is incredibly low. Economic progress requires that a part of the increased output be devoted for capital formation. But, owing to the operation of the Demonstration Effect, the consumption expenditure goes on rising, leaving a narrow scope for saving. The marginal propensity to consume being high, the margin available for saving is low or nil for most of the people. Secondly, the existence of non-monetised sector makes mobilization of financial resources difficult. Thirdly, some of the non-bank financial intermediaries which offer higher interest rates attract and divert funds to speculative trade and unproductive private expenditure and come in

* Quick Estimates.
+ Source: Data obtained from National Accounts Statistics (New Series) 1950-51. The advance estimates have been prepared on the basis of methodology adopted in 1994.
the way of mobilization of financial resources for development. Inspite of all these it is a well known fact that though the Indian economy is still under-developed, Indian capital and money markets are fairly well developed. However, further strengthening of the institutions of money and capital markets will go a long way in facilitating mobilization of savings for development.

Low saving and Investment:

Owing to the economic handicaps and institutional defects and deficiencies mentioned above, the level of saving in India is very low compared to the needs of investment in the context of planned development of the economy. Public sector savings as percentage of GDP improved from 1.8 per cent in 1950-51 to 3.4 per cent in 1980-81 and thereafter declined to 1.9 per cent in 1995-96. As against it, the share of the private sector improved from 8.6 per cent of GDP in 1950-51 to 17.7 per cent in 1980-81 and further to 23.3 per cent in 1995-96. The gap between domestic saving and the total investment is covered by foreign assistance. But for the inflow of external capital on both public and private accounts, even the present rate of investment would not have been possible.

Role of State in Capital Formation: The need for a "Big Push" and a critical minimum effort on the one hand and the need for mobilizing financial resources for this purpose on the other, call for an increased participation of state in promoting development and stimulating the rate of capital formation.

The history of economic development shows that in the early stages of development, the state plays a crucial role in stimulating the rate of growth of the economy. To quote W.A. Lewis, "No country has made economic
progress without positive stimulus from intelligent governments, least of all
England, the foundations of whose greatness as an industrial power were
laid by a series of intelligent rulers, from Edward III onwards, or the United
States, whose governments, State and Federal, have always played a large
part in shaping economic activity. The need for increasing participation of
the state in economic activities is all the more great in India in the context
of initiating planned development of the economy. The state's role is very
important for stimulating the rate of growth of the economy for several
reasons. Several projects like health and education are not attractive to
private enterprise, but promise large social gains.

Investment in such projects or investment in human capital is as
important as investment in physical capital in the process of growth and
since the private enterprise is not coming forward to invest in human capital,
the government has to take this responsibility. Even some of the physical
investments such as investments in transport, power and river projects can
hardly be undertaken by the private sector. Building up of infra-structure which
forms the basis of cumulative growth of the economy has to be financed by
the state. Similarly the projects which yield slow or remote returns and the
projects too large to be handled by the private investors have to be financed
by the state.

The Constitution of India, through its directive principles of state
policy, has made it obligatory on the part of the State to assume a great
amount of responsibility in economic activities. The directive principles of
state policy require that the state must take suitable measures for establishing
an economic and social structure which would accommodate progressively
those fundamental urges which express themselves in the demands for the right to work, the right to adequate income, the right to education and to a measure of insurance against old age, sickness and other disabilities. State's participation on a large scale in social and economic activities is inevitable in order to fulfil these obligations. Under the scheme of planned economic development, the state has to take up several activities relevant to economic growth, viz., maintaining public services, influencing attitudes, shaping economic institutions, ensuring full employment, influencing the use of resources and level of investment and keeping these objectives in view, the public sector has been assigned a crucial role in Indian economy. Thus, in the process of development, the state is called upon to shoulder many responsibilities.

But, lack of competent machinery to draw up developmental plans and to implement them, is a serious deficiency in an underdeveloped country. As W.A. Lewis observes, "...... planning requires a strong, competent and incorrupt administration. It must be strong enough to be able to enforce its measures, such as to collect taxes from the peasantry, or to enforce a rationing system without black markets, measures which so ancient a Government as that of France has not found itself fully able to enforce." The absence of a strong, competent and incorrupt administration is a hindrance to development.

With the assuming of wide responsibilities by the state, public expenditure, both developmental and non-developmental, has been rising. Public expenditure of the Government of India, both on revenue account and capital account, has increased from Rs. 530 crores in 1950-51 to Rs. 232068 crores in 1997-98. The mounting pressure on the state exchequers for financing
development and defence calls for a massive effort on the part of the state to mobilize financial resources.

Nurkse's Thesis

One way of mobilizing savings in an underdeveloped country, according to R. Nurkse, is to shift the surplus labour of the agricultural sector to manufacturing industry or construction projects. The people who are now employed in non-agricultural activities can be maintained, if the Government can collect from the agricultural sector, what these people would have consumed, if they had remained where they were before. That means, the consumption level of the agricultural sector should not rise after shifting the surplus labour to other activities. If this is effectively implemented, disguised unemployment can be a potential source of saving and capital formation. But, in practice it is not so simple as this, it is highly impracticable to restrict the consumption level of the agricultural sector. Imposition of a very high rate of agricultural tax is not possible for several reasons. Nurkse's idea of stimulating the rate of capital formation by shifting the surplus labour from agriculture to other activities is not practicable because of the difficulties in restricting the consumption level in the agricultural sector. Though a surplus exists in the agricultural sector after shifting a part of the labour force to other sectors, mobilising this surplus for development is fraught with many practical difficulties. Moreover, it is doubtful if such surplus exists in any great degree. As Gottfried Haberler observes, "The cases where after removal of a part of the labour force output remains unchanged (or even rises) without capital having been increased, technology improved, social habits changed, etc., or where such changes can be expected to be the automatic
and immediate consequence of a prior reduction in labour input, must be comparatively rare and inconsequential compared with the increase in output due to the gradual introduction of all those changes and improvements.  

Fiscal Policy and Capital Formation

Fiscal policy in a developing economy is concerned with the Government's taxing, borrowing and spending policies to achieve rapid economic development with reasonable monetary stability. It has to serve both the objectives of capital accumulation and maintenance of stability. Since these countries have a low per capita income, low level of employment, slow rate of capital formation, unequal distribution of wealth, they have to depend largely on the imports of technical and scientific know-how, capital equipment and consumer goods. Consequently, they are also faced with the problem of balance of payments. Some of these countries have adopted the path of planned development. They are using deficit budgets for financing their plans. These countries are engrossed with the problem of fighting inflation. Besides these countries are also faced with the problem of social development. Fiscal policy can help such countries in accelerating the pace of economic development by affecting the allocation of resources between different sectors and industries and regions in accordance with the objectives of the economic plan; by changing the distribution of income on a more equitable basis; by increasing the rate of capital formation and by controlling inflation. The special features of the underdeveloped economies required that capital accumulation should be given top priority though maintenance of stability is equally important. Since voluntary saving is very low, the state must play a positive role in stimulating capital formation. As Higgins observes,
"The sheer poverty of underdeveloped countries makes the raising of the propensity to save, as well as of inducement to invest, a necessary part of fiscal policy." In a developed economy, the level of income being high, greater saving is automatically generated and in such an economy fiscal policy has nothing to do for stimulating capital formation except providing tax incentives to savers. But in a low income country like India, a vigorous fiscal policy must be adopted to maximize domestic savings.

The availability of capital funds can be increased considerably not only through incentives to savers but also through compulsory savings in the form of import restriction, taxation, borrowing and deficit financing. Severe import restriction is necessary to curtail consumption and to divert funds to developmental investment. Promotion of 'collective thrift' through taxation is perhaps the most important source of capital formation. Government borrowing whether compulsory or voluntary, is another important source of capital formation. Deficit financing which is in a way a forced saving, has also a place in resource mobilization for development, though its scope is very limited. Inflow of foreign capital whether on public account or on private account, is yet another important source of capital formation. All these sources are complementary in nature from the point of view of maximizing savings and providing the necessary capital funds in the process of economic development. What deserves a careful study is the relative importance of each source in financing economic development and the implications of relying heavily on one source or the other.

**Taxation and mobilization of Resources:**

In an developing country which has a moderate rate of voluntary
saving compulsory saving through high rate of taxation is perhaps the best means of mobilizing resources for development. Moreover since economic development must be achieved with minimum inflation, taxation which is the most important source of non-inflationary finance should be given high priority in mobilizing the resources. The traditional view of public finance is that the tax proceeds should be used for the normal and recurring expenditure of the State and that the loan proceeds should be used for building of assets which yield direct returns to the economy. A.C. Pigou, in his classic work on public finance observes, "There is a general agreement that ordinary running expenses should be met out of current taxes .... Government expenditure devoted to producing capital equipment, the fruits of which will subsequently be sold to purchasers for fees, must be raised by loans. If this is done, violent and sudden changes in tax rates are avoided: The people who benefit from the service which the new capital equipment renders pay for it in proportion to their use and provided, of course, that the fees charged are sufficient to wipe out the principal of the loan during the life time of the capital equipment, no additional taxation has ever to be raised on account of it. Upon this matter, as upon that of the proper methods of finance for normal recurrent expenditure, there is no room for controversy." The U.N. Report on the Domestic Financing of Economic Development also observes, "As to the relative share of taxation and Government borrowing in the fiscal structure, few general principles can be stated. Taxation should cover at least current expenditure on normal Government services. Borrowing is particularly appropriate to finance government expenditure which results in the creation of capital assets or which is otherwise directly productive." But in a developing economy, taxation should go beyond
financing normal expenditure and supply a considerable amount of funds for
investment in development projects. The traditional view does not fit into the
conditions of a developing economy. It is, however, difficult to determine the
relative share of taxation and borrowing in financing economic development.
But it is possible to indicate that taxation has a certain limit beyond which
it is bound to have undesirable consequences.

In view of the above analysis, it can be said that for the purpose
of promoting a country's economic development, taxation may be used to
achieve the following objectives:

(i) to curtail consumption and thus transfer resources from consumption to
   investment;
(ii) to increase the incentives to save and invest;
(iii) to transfer the resources from the hands of the public to the hands of
     the government in order to make public investment possible.
(iv) to modify the pattern of investment into socially desirable manner;
(v) to reduce economic inequalities; and to make equitable distribution of
    income and wealth in the society;
(vi) to mobilize economic surplus; and to increase national output and
    income.¹⁷

Taxation has an important role to play in providing saving incentives
and dis-incentives to luxury consumption. Business saving may also be
encouraged through system of business income taxation which encourages
the retention and re-investment of earnings. Under-developed countries suffer
from a high degree of inequality in distribution of income.
Table 1.1

Budgets of the Central Government since 1950-51

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue Account</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receipts</td>
<td>406</td>
<td>12830</td>
<td>57650</td>
<td>203670</td>
</tr>
<tr>
<td>Expenditure</td>
<td>347</td>
<td>14540</td>
<td>76210</td>
<td>281100</td>
</tr>
<tr>
<td>Surplus (+)/Deficit (-)</td>
<td>+59</td>
<td>-1710</td>
<td>-18560</td>
<td>-77430</td>
</tr>
<tr>
<td><strong>Capital Account</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receipts</td>
<td>120</td>
<td>8770</td>
<td>39000</td>
<td>134820</td>
</tr>
<tr>
<td>Disbursements</td>
<td>182</td>
<td>9630</td>
<td>31780</td>
<td>57390</td>
</tr>
<tr>
<td>Deficit/Surplus</td>
<td>-62</td>
<td>-860</td>
<td>+7220</td>
<td>+77430</td>
</tr>
<tr>
<td>Over-all budgetary deficit</td>
<td>-3</td>
<td>-2570</td>
<td>-11340</td>
<td>Nil</td>
</tr>
</tbody>
</table>


Table 1.1 shows the Central Government budgets since 1950-51 for selected years to show the growth of receipts and disbursements of the Government during the last 50 years. It is clear from the table that both receipts and expenditures on the revenue account have been rising fast, revenue receipts had increased from Rs. 406 crore in 1950-51 to Rs. 12830 crores in 1980-81 and then to Rs. 203670 crores in 2000-2001 (B.E.). This
huge increase in revenue receipts reflects the imposition of new taxes, broadening the tax coverage, better tax administration and rise in prices and incomes due to general inflationary pressure and consequent increase in tax revenues. It is clear from the table that revenue expenditure had increased much faster than revenue receipts. This enormous increase in public expenditure of Central Government was due to financing economic development, expansion of government machinery, increase in defence expenditure and continuous rise in the salaries and dearness allowances of Government servants because of the rise in prices and the consequent rise in the cost of living. Till the middle of the 1970’s, revenue receipts exceeded revenue expenditure resulting in revenue surplus to finance economic development. Since then, however, the current expenditure has been rising much faster than current revenue resulting in huge deficits in the revenue account. In 1980-81 the revenue deficit was Rs. 1710 crores and in 2000-2001, it is expected to touch Rs. 77430 crores. Deficit in the revenue account implies that the Government is living beyond its means and that it is forced to borrow even to meet its current expenditure. The estimates of receipts on revenue account have been grouped under two broad heading viz. tax revenue and non-tax revenue. Tax revenue has been sub-divided into; taxes on income, taxes on property and capital transactions, and taxes on commodities and services. Non-tax revenue has been sub-divided into; fiscal and other services, interest receipts and dividends and profits.

Table 1.2 reveals that the total revenue of the Central Government has been rising quite fast, the total revenue of the Central Government was Rs. 406 crores in 1950-51 and Rs. 57650 crores in 1990-91. In the budget
Table 1.2

Revenue of Central Government in the Revenue Account
(Rs. Crores)

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts</td>
<td>357</td>
<td>9390</td>
<td>42980</td>
<td>146210</td>
</tr>
<tr>
<td>Tax Revenue (Net of States Share)</td>
<td>(88)</td>
<td>(73)</td>
<td>(75)</td>
<td>(72)</td>
</tr>
<tr>
<td>Non-Tax Revenue</td>
<td>49</td>
<td>3440</td>
<td>14670</td>
<td>57460</td>
</tr>
<tr>
<td></td>
<td>(12)</td>
<td>(27)</td>
<td>(25)</td>
<td>(28)</td>
</tr>
<tr>
<td>Total Revenue Receipts</td>
<td>406</td>
<td>12830</td>
<td>57650</td>
<td>203670</td>
</tr>
<tr>
<td></td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
</tr>
</tbody>
</table>

Source: "Budget at a Glance" (GOI), 2000-01 and other previous issues.

Of 2000-2001 it would be around Rs. 203670 crores, between 1991 and 2001, the total tax revenue had increased by 1587 per cent. Relatively, tax revenue was 88 per cent of total revenue in 1950-51 but it declined to 73 per cent in 1980-81, it is around 72 per cent of the total revenue in 2000-2001. Proportionally, the yield from non-tax revenue gradually rose from 12 per cent to 28 per cent of the total revenue receipts during 1950-51 to 2000-2001.

The revenue collected by the Central Government from all the taxes on income and expenditure is shown in Table 1.3. It is clear from the table, the volume of revenue collected from personal income tax has been steadily
Table 1.3

Central Government Revenue from Taxes on Income and Expenditure
(Rs. Crores)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Personal Income Tax</td>
<td>140</td>
<td>1510</td>
<td>5370</td>
<td>31590</td>
</tr>
<tr>
<td>Less State Share</td>
<td>50</td>
<td>1000</td>
<td>4120</td>
<td>19770</td>
</tr>
<tr>
<td>Net receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>From income tax</td>
<td>90</td>
<td>510</td>
<td>1250</td>
<td>11820</td>
</tr>
<tr>
<td>2. Corporation tax</td>
<td>40</td>
<td>1310</td>
<td>5340</td>
<td>40040</td>
</tr>
<tr>
<td>3. Interest Tax</td>
<td>-</td>
<td>90</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>4. Expenditure Tax</td>
<td>-</td>
<td>-</td>
<td>80</td>
<td>330</td>
</tr>
<tr>
<td><strong>Net Revenue from Income Taxes</strong></td>
<td>130</td>
<td>1910</td>
<td>6670</td>
<td>52190</td>
</tr>
</tbody>
</table>

Source: “Budget at a Glance” (GOI), 2001-01 and other previous issues.

increasing, this has been so, even though the rates of income tax have been reduced and a large number of people have been let out of the income tax net. Regarding corporation tax, it yielded revenue of Rs. 40 crores in 1950-51, and is expected to yield Rs. 40040 crores in 2000-2001 (B.E.) reflecting the growing industrialization in the country. The Interest Tax Act 1974 provided for the levy and a special tax on the gross amount of interest accruing to the commercial banks on loans and advances made by them. The yield from this tax was Rs. 90 crores in 1980-81. The Government
withdrew the interest tax in 1985 but later reintroduced it. The tax is levied on the gross interest income of credit institutions like banks, public financial institutions, financial companies etc.

During the 1999-2000 receipts from this source was estimated at Rs. 1000 crores. But the interest tax of 2 per cent has been abolished in 2000-2001 budget. As from November 1987, the Government imposed an expenditure tax under the Expenditure Tax Act 1987. The 2000-2001 budget anticipates a revenue of Rs. 330 crores from this source. The Central Government has imposed certain taxes on wealth and capital transactions. Wealth tax and Gift tax are the important taxes of this group. But the net income from these sources has always been insignificant viz., Rs. 4 crores in 1950-51, Rs. 240 crores in 1990-91 and Rs. 170 crores, in 2000-2001 (B.E.). The Government felt the need for additional revenue for purpose of economic development and it found in excise duties a very good source of revenue. These duties are levied by the centre on commodities which are produced within the country but commodities on which State Governments impose excise duties (as for instance, on liquor and drugs) are exempted from Central Excise Duties. Gross Revenue from Central excise duties has risen from about Rs. 70 crores in 1950-51 to Rs. 24510 crores in 1990-91; the budget estimates for 2000-2001 anticipate gross excise tax collection at Rs. 71250 crores. Under the terms of the Tenth Finance Commision, 47.5 per cent of the proceeds of excise duties are transferred to the States, this would come to Rs. 34300 crores in 2000-2001. The net receipt from excise duties would amount to Rs. 36950 crores so far as the Central Government is concerned. Besides excise duties, the Government of
India is now imposing service tax on telephones, insurance and brokerage. The budget for 2000-2001 anticipates income of Rs. 2200 crores from service taxes. Table 1.4 reflects clearly that there has been considerable increase in revenue from customs duties because of heavy imports of iron and steel, chemicals, drugs and medicines, fertilizers, petroleum products, etc. In 1980-81, the Central Government, collected over Rs. 3410 crores by way of customs duties. The Government hopes to collect Rs. 53570 crores from customs duties during 2000-2001 (B.E.). From Table 1.4 it is clear that customs duties were more important than excise duties in 1950-51 but in course of time they lost their pride of place to excise duties. Even then, customs duties are still quite significant in India’s tax structure and their tremendous growth clearly reflects the expansion of India’s imports.

Table 1.4

Revenue from Commodity Taxes

(Rs. Crores)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Union Excise Duties Less States' Share</td>
<td>70</td>
<td>6500</td>
<td>24510</td>
<td>71250</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>2780</td>
<td>10410</td>
<td>34300</td>
</tr>
<tr>
<td>Net Receipt From Excise Duties</td>
<td>70</td>
<td>3720</td>
<td>14100</td>
<td>36950</td>
</tr>
<tr>
<td>2. Customs Duties</td>
<td>160</td>
<td>3410</td>
<td>20640</td>
<td>53570</td>
</tr>
<tr>
<td>3. Service Tax</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2200</td>
</tr>
<tr>
<td>4. Other Commodity taxes Total Income From Commodity Taxes</td>
<td>-</td>
<td>310</td>
<td>1330</td>
<td>1130</td>
</tr>
<tr>
<td></td>
<td>230</td>
<td>7440</td>
<td>36070</td>
<td>93850</td>
</tr>
</tbody>
</table>

Source: "Budget at a Glance" (GOI), 2000-2001 and other previous issues.
Table 1.5

Analysis of non-tax revenue

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts</td>
<td>180</td>
<td>9540</td>
</tr>
<tr>
<td>1. Fiscal and other Services*</td>
<td>590</td>
<td>36720</td>
</tr>
<tr>
<td>2. Interest Receipts</td>
<td>120</td>
<td>11200</td>
</tr>
<tr>
<td>3. Dividends and Profits</td>
<td>890</td>
<td>57460</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>890</strong></td>
<td><strong>57460</strong></td>
</tr>
</tbody>
</table>

* These include: general, economic & social services, currency, coinage and mint and also external grants, non-tax revenue of union territories, etc.

Source: "Budget at a Glance" (GOI), 2000-2001 and other previous issues.

Besides taxes on income, property and commodities, the Central Government gets revenue from other sources also, which are collectively called non-tax revenue. These non-tax revenues include receipts from fiscal services, interest receipts, dividends and profits of government enterprises, general services, etc. In 1950-51, non-tax revenue amounted to Rs. 49 crores but in 1970-71 it went up to Rs. 890 crores. The budget for 2000-2001 places it at Rs. 57460 crores. The growth of non-tax revenue in recent years can be seen from Table 1.5 Fiscal services relate to revenue received by the Central Government from currency, coinage, mint, and other fiscal services relating to India Security Press, Nasik, Hyderabad, etc.
Services include social community services, economic services and grants-in-aid and contributions. Interest receipts which constitute the most important source of non-tax revenue comprise of interest on loans to states and union territories, interest payable by Railways and Postal services, and other interest receipts (such as loans to public enterprises etc.). Profits and dividends relate to profits of RBI, nationalized banks, LIC, public enterprises etc.

Table 1.6

Comparative Position of Direct and Indirect Taxes

(Rs. Crores)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Taxes</td>
<td>130 (36)</td>
<td>6910 (16)</td>
<td>52360 (36)</td>
</tr>
<tr>
<td>Indirect Taxes</td>
<td>230 (64)</td>
<td>36070 (84)</td>
<td>93850(64)</td>
</tr>
<tr>
<td>Total Tax Revenue</td>
<td>360 (100)</td>
<td>42980 (100)</td>
<td>146210 (100)</td>
</tr>
</tbody>
</table>

Source: As in Table 1.1

Revenue of the Central Government in India, has shown a rising tendency. With the growth of national income and per capita income, the sources of revenue available to the Government are increasing. Another trend which is significant is the relative increase in the revenue of the Central Government in the combined revenues of the Governments. In 1953-54, the share of the central Governments in the total revenue of all Governments was 48 per cent by 1999-2000, this had increased to 64 per cent. This is because the Central Government taxes are highly productive and elastic. The composition of public revenues has been undergoing significant changes,
Indirect taxes (commodity taxes) contribute 70 per cent of the revenue (it was as high as 84 per cent till recently) and direct taxes contribute about 30 per cent in 1998-99. This clearly shows that the burden of taxation is being borne largely by the lower and middle income groups. This is despite the declared objective of the Government of that the riched would be taxed more heavily and that the poor would be let off lightly. At one time, personal income tax was the most important single tax for the Central Government closely followed by the custom duties. Union excise duties were a poor third. But, at present, the most important source of revenue for the Central Government is the excise duties. However, nearly half the excise revenue goes to the states. Accordingly, the important sources of revenue to the Central Government in order of importance, are: custom duties followed by Central excise duties and corporation tax.

Although, taxation is the most desirable method of financing development plans, there are several limitations in exploiting it to the full extent. This method may lead to an increase in involuntary saving, voluntary saving may be decreased, as people may reduce their voluntary saving for maintaining their former levels of living. Hence, though resources are made available to the public sector, as private savings decrease, the total sum available for economic development would not be increased by the full amount of the tax. Not only that heavy taxation may have negative effects on incentives to work, in connection, "If taxes on wage earners diminish their incentive to work harder, if taxes on profits of higher income group reduce their incentives to save and make investments in new enterprises and if taxes on the output of income of farmers diminish the incentive to improve
agricultural techniques, then the forced saving through these taxes will not be an unmixed gain.\textsuperscript{18}

Taxation of income is considered by most of the developing economies as an important means of increasing the revenue of the Government. Income tax has an important place in the Indian tax structure also not only because of its revenue potential but also because of its contribution to equity and distributive justice. But in pushing the taxation of income too far, the Government will have to face the risk of adversely affecting the initiative and enterprise and even discouraging foreign private investment. Custom duties is another important source of revenue to the Government. Though there has been a substantial rise in the contribution of this source to the tax revenue, further increase in its contribution is difficult. As export duties reduced the competitive position of Indian goods in international markets, the Government has removed export duties. About import duties, The L.K. Jha committee, known as the Enquiry Committee on Indirect Taxation, had strongly recommended for the rationalization of import duties. According to the committee, since these fall mainly on raw material, intermediate products and machinery, they bring about a general increase in the cost and price which tends to make Indian industries less competitive in international markets.

The committee emphasized that the long-term objective of reform of import duties should be to lower the rates of taxation to a level which would be necessary to give adequate protection to domestic industries and discourage imports. The committee also observed that as soon as the import duties are rationalized, they could be harmonized with the operation of the
excise tax system because then the countervailing duty on imported products would be given the same treatment as excise duties on these products. It may be mentioned, however, that the yield of customs duties is not always certain. It depends very much on international situations and domestic economic changes. In times of war and depression the revenue from customs duties diminishes. It may also fluctuate from year to year because of a number of factors like the fluctuations in the availability of foreign exchange, changes in the export and import policies, changes in the overseas demand for the country's primary exports, availability of supply, changes in the shipping policy and changes in the world prices of main items of export and import.

Commodity taxation is the backbone of the Indian revenue system. Union excise, state and sales tax have been supplying the major part of the revenue and also their share in the total revenue has been rising continuously. Gross revenue from central excise duties has risen from about Rs. 70 crores in 1950-51 to Rs. 24510 crores in 1990-91; The budget estimates for 2000-2001 anticipate gross excise tax collection at Rs. 71250 crores. Like the Central Government, the State Governments too have found commodity taxes (states excise duties, general sales tax, motor vehicles tax, electricity duties, share in the union excise duties) as the best source of revenue. Taxation of commodities which has a wide coverage including lower income groups, is in accordance with the anti-inflationary policy which requires that more should be collected from lower income groups which have a high propensity to consume. But even in the case of this tax, there is certain limit beyond which it cannot be increased. As Richard Goode observes, "Where a large fraction of the population is desperately poor, heavy taxes on necessities
and on so called luxuries of mass consumption will impose a cruel burden and may also impair health and productive efficiency.\textsuperscript{21}

A developing country like India with limited alternative sources of revenue, is compelled to depend upon company taxation to raise revenue. For example the corporation tax yielded revenue of Rs. 40 crores in 1950-51, and is expected to yield Rs. 40040 crores in 2000-2001 (B.E.) although reflecting the growing industrialization. But company taxation also has its own limitations in providing revenue. High rate of company taxation distorts the growth of private corporate sector and also discourages foreign private investment. In the budget of 1997-98 following changes were made in the corporate tax structure; deduction in the tax rate from 30 to 20 per cent on royalty and technical service fees payable to foreign companies, modification of the minimum alternate tax (MAT) on companies, abolition of tax on dividends in the hands of the shareholders and imposition of a tax on undistributed profits at the rate of 10 per cent. This was done to persuade the companies to plough back their profits into fresh investments. In the past a number of concessions and allowances were granted to business and industry to promote corporate and business investment. However, these were used by the private sector companies to escape from the corporate tax net.

One source of revenue which remains to be fully exploited is the land tax. Rural sector has not contributed much to the state revenue partly because of the existance of a large non-monetized sector which escapes all taxes and partly because of the small coverage of agricultural income-tax and the Governments inability to increase the rate of land revenue due to (36)
political considerations. Besides, in India, effective land taxation is difficult, where food is home consumed and land survey are inadequate in providing proper valuations. It is increasingly felt that by evolving a new pattern of land tax, the contribution of the rural sector to the revenue could be increase. But, because of political opposition to any increase in the taxation of rural sector, the Government is unable to take any step in the direction of increasing the contribution of the rural sector to the revenue.

From the point of view of resource mobilization for development, the contribution of expenditure tax, wealth tax and gift tax has been very insignificant. It is the improvement in depth and coverage of old taxes that has substantially contributed to the increase in the tax revenue.

Between 1950-51 and 1990-91, the tax revenue of the Central Government increased by nearly one hundred twenty times from Rs. 357 crores to Rs. 42980.00 crores. In the 2000-2001 budget it would be around Rs 146210 crores. The revenue receipts have also been increasing as a proportion of gross National produce. In 1950-51 this proportion of Gross National product. In 1950-51 this proportion was 4.33 per cent which rose to 10.1 per cent in 1990-91. But, inspite of substantial recourse to additional taxation, it declined to 9.1 per cent in 1997-98 and further declined to 8.2 per cent in 1998-99. But it anticipated 9.2 per cent in 2000-2001 budget.22

This proportion is less than what it is in most of the other countries. But the problems arising from heavy taxation viz., loss of incentive to save and invest and distortion of the productive capacity and the inflationary effect of heavy taxation make it abundantly clear that while maximum efforts should
be made to mobilize resources through taxation, it should not be carried too far and that the tax effort should be supplemented by other sources such as surpluses of public enterprises, deficit financing and borrowing.

Surpluses of public Undertakings :

The performance of public enterprises in India has not been commendable. There has been considerable criticism of their poor performance and in some cases even of their utter failure. Public undertakings in India have not been able to evolve a system of reward and punishment since they are bound by government regulations and they work under the pressure of trade unions. Besides, the government authorities take lot of time in formulating the project and in implementing it. The situation of the project is determined by a number of noneconomical factors. Several instances of inappropriate technology, predetermined marketing arrangement etc. have come to notice. Public undertakings are over staffed and suffer from over-investment, not only that these undertakings also suffer from the burden of inefficiency and expensive management. Executive positions are held by people not on merit but by political pressures. They are not fit for the job and do not possess the qualifications for it. These top positions are held by bureaucrats who are frequently transferred from one undertaking to another. Consequently, they do not have the grasp of the problems of any undertaking.

Railways play a central role in the economic and social development of the country. In order to improve, modernize and expand railway infrastructure the resources required are huge which cannot be entirely
### Table 1.7

**FINANCIAL PERFORMANCE OF INDIAN RAILWAYS**

(Rs. Crores)

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>1</td>
<td>2624</td>
<td>12096</td>
<td>20101</td>
<td>22418</td>
<td>24319</td>
<td>28589</td>
<td>29619</td>
<td>32939</td>
<td>36529</td>
</tr>
<tr>
<td>i)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ii)</td>
<td>827</td>
<td>3147</td>
<td>5464</td>
<td>6125</td>
<td>6633</td>
<td>7573</td>
<td>8550</td>
<td>9581</td>
<td>10148</td>
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<tr>
<td>iii)</td>
<td>116</td>
<td>336</td>
<td>491</td>
<td>557</td>
<td>563</td>
<td>586</td>
<td>649</td>
<td>825</td>
<td>856</td>
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<td>iv)</td>
<td>1618</td>
<td>8408</td>
<td>13670</td>
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<td>23608</td>
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<td>v)</td>
<td>82</td>
<td>242</td>
<td>452</td>
<td>522</td>
<td>488</td>
<td>541</td>
<td>665</td>
<td>658</td>
<td>1417</td>
</tr>
<tr>
<td>vi)</td>
<td>-19</td>
<td>-325</td>
<td>24</td>
<td>-76</td>
<td>-33</td>
<td>23</td>
<td>-205</td>
<td>-186</td>
<td>500</td>
</tr>
<tr>
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<td>2537</td>
<td>11154</td>
<td>16590</td>
<td>18525</td>
<td>21001</td>
<td>25876</td>
<td>27834</td>
<td>30844</td>
<td>35552</td>
</tr>
<tr>
<td>i)</td>
<td>2233</td>
<td>8234</td>
<td>12700</td>
<td>14375</td>
<td>16186</td>
<td>20665</td>
<td>23254</td>
<td>25645</td>
<td>28115</td>
</tr>
<tr>
<td>ii)</td>
<td>220</td>
<td>1850</td>
<td>1885</td>
<td>2060</td>
<td>2200</td>
<td>1904</td>
<td>1155</td>
<td>1670</td>
<td>2441</td>
</tr>
<tr>
<td>iii)</td>
<td>84</td>
<td>970</td>
<td>2005</td>
<td>2090</td>
<td>2615</td>
<td>3367</td>
<td>3425</td>
<td>3529</td>
<td>4996</td>
</tr>
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<td>7437</td>
<td>8526</td>
<td>9516</td>
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<td>10698</td>
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<td>27712</td>
<td>30912</td>
<td>33846</td>
<td>36846</td>
<td>39772</td>
<td>43198</td>
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<td>14.9</td>
<td>11.7</td>
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<td>4.5</td>
<td>1.1</td>
<td>2.1</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Source: Ministry of Railways (39)
generated from the normal operations of the Indian railway. The disproportionate surge in staff costs and pension liability on account of the implementation of the Fifth Central Pay Commission's recommendations and increase in other operating expenses in recent years have eroded the capacity of Railways to generate sufficient resources. To mitigate the resource constraint and maintain reasonable levels of plan outlays, the Railways have resorted to market borrowings. These borrowings have been utilized for acquiring rolling stock on lease. Lease charges, which form part of the revenue expenditure, have risen sharply from Rs. 25 crore in 1987-88 to Rs. 3014 crore in 2000-01, adversely affecting the internal resource generation of the Indian Railways.  

Financial performance of Indian Railways is given in table 1.7.

The revenue receipts of the Department of Telecom Services are estimated at Rs. 19814 crore (including registration fee) in 2000-2001 (B.E.) indicating an increase of 8.5 per cent compared with Rs. 18257 crore in 1999-2000. The net receipts are budgeted to increase by 40.8 per cent from Rs. 7494 crore in 1999-2000 to Rs. 10548 crore in 2000-2001 (B.E.) (Table 1.8). The percentage of net operating expenses (excluding provision for redemption of bonds) to operating revenue earned (excluding registration fee) is budgeted at 47.0 per cent in 2000-2001, compared to 42.9 per cent in 1999-2000. The increase in the operating ratio is due to inclusion of grant to C-DOT under the working expenses of the Department which was earlier met out of the revenue reserve fund directly. The service functions of the department of Telecom services (DTS) and the Department of Telecom Operations (DTO) have been transferred to Bharat Sanchar Nigam Limited, a public sector enterprise formed under the administrative control of the
Table 1.8

FINANCIAL PERFORMANCE OF THE DEPARTMENT OF TELECOMMUNICATIONS

(Rs. Crores)

<table>
<thead>
<tr>
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</tr>
</tbody>
</table>

1 Gross receipts
2 Net Working Expenses*
3 Net receipts (1-2)
4 Devidend to General Revenue
5 Surplus / Deficit (3-4)


** Includes provision for C-DOT of Rs. 168 crores.

Source: Department of Telecommunications, Ministry of Communications.
Table 1.9

FINANCIAL PERFORMANCE OF THE DEPARTMENT OF POSTS

(Rs. Crores)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Net Working Expenses</td>
<td>346</td>
<td>1033</td>
<td>1522</td>
<td>1810</td>
<td>1918</td>
<td>2560</td>
<td>3314</td>
<td>3616</td>
<td>3982</td>
</tr>
<tr>
<td>4. Dividend to General Revenue</td>
<td>4</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Department of Posts, Ministry of Communications.
Regarding the Department of posts, the gross receipts during the year 1999-2000 were Rs. 2020 crore, gross working expenses were Rs. 4778 crore and net working expenses were Rs. 3616 crore, there was therefore a deficit of Rs. 1596 crore. During the year 2000-2001 as per the budget estimates the gross receipts are placed at Rs. 2000 crore and the gross working expenses Rs. 5242 crore, with net expenses being Rs. 3982 crore. The deficit is estimated to be Rs. 1982 crore for 2000–2001 (Table 1.9).

The performance of public enterprises is judged mostly on the basis of their profit earning capacity, but as a matter of fact public enterprises in India are governed by a variety of considerations and therefore profit earning does not seem to be a positive criterion to measure their inefficiency. This is more particularly true in the case of public utilities like railways, post and telegraphs, supply of water, electricity etc. in these cases it is not possible for the government to increase, the prices with the rise in costs. A number of enterprises are such where the gestation period is quite long and the investment is not giving immediate return, for example, heavy and basic industries. Some of such enterprises are under construction or in a stage of expansion. So, it is only in the case of running concerns that the profitability, as an index of good or bad performance, can be applied. Moreover, it would not be appropriate to apply this criterion in a purely commercial sense.

In 1999–2000, 108 PSUs signed memoranda of undertaking (MOUs). Department of Public Enterprises has evaluated the annual MOU
# Table 1.10

**Profitability of Central Public Sector Undertakings**

(Rs. In billion)

<table>
<thead>
<tr>
<th>S.NO.</th>
<th>91-92</th>
<th>92-93</th>
<th>93-94</th>
<th>94-95</th>
<th>95-96</th>
<th>96-97</th>
<th>97-98</th>
<th>98-99</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Number of units</td>
<td>237</td>
<td>239</td>
<td>240</td>
<td>241</td>
<td>239</td>
<td>238</td>
<td>236</td>
<td>235</td>
</tr>
<tr>
<td>2 Paid-up capital</td>
<td>457</td>
<td>519.4</td>
<td>559.7</td>
<td>582.9</td>
<td>595.9</td>
<td>624.3</td>
<td>721.2</td>
<td>770.7</td>
</tr>
<tr>
<td>3 Net Worth</td>
<td>603.3</td>
<td>705.3</td>
<td>795.3</td>
<td>899.5</td>
<td>991.8</td>
<td>1138.9</td>
<td>1350.6</td>
<td>1480.2</td>
</tr>
<tr>
<td>4 Capital employed</td>
<td>1179.9</td>
<td>1401.1</td>
<td>1598.4</td>
<td>1824.5</td>
<td>1739.8</td>
<td>2311.8</td>
<td>2536.6</td>
<td>2737</td>
</tr>
<tr>
<td>5 Gross profit</td>
<td>136.7</td>
<td>159.6</td>
<td>185.6</td>
<td>225.3</td>
<td>275.9</td>
<td>309.1</td>
<td>372.1</td>
<td>397.7</td>
</tr>
<tr>
<td>6 Pre-tax profits</td>
<td>40</td>
<td>50.8</td>
<td>66.6</td>
<td>97.7</td>
<td>136.2</td>
<td>153.8</td>
<td>193.5</td>
<td>197.3</td>
</tr>
<tr>
<td>7 Profit after Tax (PAT)</td>
<td>23.6</td>
<td>32.7</td>
<td>45.5</td>
<td>71.9</td>
<td>95.7</td>
<td>101.9</td>
<td>137.2</td>
<td>132.3</td>
</tr>
<tr>
<td>8 Gross Margin to Capital employed (%)</td>
<td>18.8</td>
<td>18</td>
<td>17.3</td>
<td>20.6</td>
<td>23.1</td>
<td>19.2</td>
<td>20.9</td>
<td>20.7</td>
</tr>
<tr>
<td>9 Gross Profit to Capital employed (%)</td>
<td>11.6</td>
<td>11.4</td>
<td>11.6</td>
<td>13.9</td>
<td>15.9</td>
<td>13.4</td>
<td>14.7</td>
<td>14.5</td>
</tr>
<tr>
<td>10 Pre Tax Profit to Capital employed (%)</td>
<td>3.4</td>
<td>3.6</td>
<td>4.2</td>
<td>6</td>
<td>7.8</td>
<td>6.7</td>
<td>7.6</td>
<td>7.2</td>
</tr>
<tr>
<td>11 PAT to Net Worth (%)</td>
<td>3.9</td>
<td>4.6</td>
<td>5.7</td>
<td>8</td>
<td>9.6</td>
<td>8.8</td>
<td>10.2</td>
<td>8.9</td>
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Table 1.11

Disinvestment in Public Sector Undertakings

<table>
<thead>
<tr>
<th>Year</th>
<th>Target (Rs. Crores)</th>
<th>Achievement (Rs. Crore)</th>
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</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>2500</td>
<td>3038</td>
</tr>
<tr>
<td>1992-93</td>
<td>2500</td>
<td>1913</td>
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<tr>
<td>1993-94</td>
<td>3500</td>
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<tr>
<td>1994-95</td>
<td>4000</td>
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<td>1995-96</td>
<td>7000</td>
<td>362</td>
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<td>1996-97</td>
<td>5000</td>
<td>380</td>
</tr>
<tr>
<td>1997-98</td>
<td>4800</td>
<td>902</td>
</tr>
<tr>
<td>1998-99</td>
<td>5000</td>
<td>5371</td>
</tr>
<tr>
<td>1999-2000</td>
<td>10000</td>
<td>1829</td>
</tr>
</tbody>
</table>

performance of these PSUs on the basis of provisional data. Out of one hundred eight, 48 were rated excellent, 28 very good, 9 good, 17 fair and 4 poor. In 1999–2000, the aggregate gross margin of MOU signing PSUs was 14 per cent more than that of 1998-99 and 13 per cent more than the target for them (Table 1.10).

**Public Enterprise Policy**:

The main elements of Government policy towards Public Sector Undertaking (PSUs) are: (i) bring down government equity in all non-strategic PSUs to 26 per cent or lower, if necessary (ii) restructure and revive potentially viable PSUs (iii) close down PSUs which cannot be revived and (iv) fully protect the interest of workers. In order to give thrust to the process of disinvestment in PSUs, a new Department of Disinvestments has been set up. The Union Budget (2000–2001) proposed to raise Rs. 10,000 crore through disinvestments in public sector enterprises during the year 2000–2001. Details of disinvestment target and achievement are given in (Table 1.11).²⁴

**Deficit Financing**:

Deficit financing in India has been adopted mainly to obtain necessary resources for the execution of Five Year Plans. Because the levels of outlay laid down in plans have been of an order which could not be met only through taxation or a revenue surplus, and therefore the gap in resources had to be made with the help of external assistance and deficit financing. Until 1970s Government tried to achieve the plan targets through resources obtained from taxation and external borrowings but since the middle of the
1970s the Indian Government could not muster adequate resources to meet the plan targets and therefore had to resort to deficit financing. It has been observed that during the last decade fiscal deficit of the Government of India has grown at a faster pace. The overall budgetary deficit of the Central and the State Governments has been raising alarmingly in recent years. During the early seventies deficit finance ranged between Rs. 554 crores and Rs. 876 crores. It declined to Rs. 281 crores in 1975-76 and further Rs. 81 crores in 1976-77. But it again rose to Rs. 1162 crores in 1977-78. There was a steep rise in the budgetary deficit during 1979-80. The overall budgetary deficit during 1979-80 was of the order of Rs. 4937 crores in 1985-86 and Rs. 8261 crores in 1986-87.

The term "deficit financing" as used by the Indian Government for a long time referred to "over all budget deficits" or financing through budgetary deficits. Accordingly, it excluded government borrowing from the market, or raising other funds from the public. These receipts come under capital receipts and they formed part of the total receipts and are thus excluded from the calculation of budgetary deficit. This traditional concept of deficit financing was restrictive and it could just indicate the extent of monetary deficit. B.R. Shenoy was the first economist to point out as far back as 1954-55, the dangerous implications of regarding market borrowings and other capital receipts as part of total receipts and taking only over all budget deficit as deficit financing. B.R. Shenoy's warning was brushed aside by other economists and the Indian Government, It was finally left to the Sukhmoy Chakravarty Committee on the working of the Monetary system in India to
point out the inherent weakness of the definition of the budgetary deficit and the necessity to change the concept. The real deficit of the fiscal operations, the committee emphasized, should include not only budgetary deficit but also market borrowings and other liabilities.

The Government of India accepted this recommendation of Sukhmoy Chakravarty Committee and started the calculation of a third concept of deficit, known as fiscal deficit. In recent years the Finance Ministry has introduced one more concept of deficit known as “primary deficit”. Primary deficit means, fiscal deficit minus interest payments.

Table 1.12 brings out the deficit trends in the country in recent years. This table brings out clearly, the fiscal deficit as a proportion of GDP is budgeted at 5.1 per cent in 2000-2001 a level lower than the 5.5 per cent in 1999-2000. The revenue deficit, a measure which shows the excess of current expenditure over the current receipts, is budgeted at 3.6 per cent of GDP in 2000-01 compared with 3.5 per cent in 1999-2000. The primary deficit i.e., the fiscal deficit net of interest payments, which reflects the current fiscal stance of the Government, is budgeted at 0.5 per cent of GDP in 2000-01 as against 0.8 per cent in the previous year. The fiscal deficit is the outcome of growth in aggregate expenditure and revenue trends. Revenue receipts (tax and non tax), net to centre, are budgeted to grow by 12.3 per cent from Rs. 181434 crore in 1999-2000 to Rs. 203673 crore in 2000-01 (B.E.). The tax receipts components (net of state’s share) is estimated to increase by about 14 per cent during 2000-01. It is noteworthy that the growth in aggregate expenditure was projected to decelerate from 17.0 per cent in 1999-2000 to 12.8 per cent in 2000-2001. This compression in the
Table 1.12
Trends in Parameters of Deficit of Central Government

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Deficit</th>
<th>Primary Deficit</th>
<th>Fiscal Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(As Percent of GDP)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1990-91</td>
<td>3.3</td>
<td>2.8</td>
<td>6.6</td>
</tr>
<tr>
<td>1991-92</td>
<td>2.5</td>
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<td>0.2</td>
<td>4.1</td>
</tr>
<tr>
<td>1997-98</td>
<td>3.1</td>
<td>0.5</td>
<td>4.8</td>
</tr>
<tr>
<td>1998-99</td>
<td>3.9</td>
<td>0.7</td>
<td>5.1</td>
</tr>
<tr>
<td>1999-2000*</td>
<td>3.5</td>
<td>0.8</td>
<td>5.6</td>
</tr>
<tr>
<td>2000-2001 (B.E.)</td>
<td>3.6</td>
<td>0.5</td>
<td>5.1</td>
</tr>
</tbody>
</table>

* Provisional and unaudited as reported by Controller General of Accounts, Department of Expenditure, Ministry of Finance.

Note: 1. Ratios to GDP at current market prices (New Series, Base: 1993-94).

2 The ratios to GDP at current market prices for 2000-2001 are based on CSO's Advance Estimates.

3 The fiscal deficit excludes the transfer of states share in the small savings collections.
growth of aggregate expenditure is sought to be attained by moderating growth in revenue expenditure from 15.3 per cent in 1999-2000 to an estimated to 12.2 per cent in 2000-01. However, over the same period, capital expenditure which increased by 26.9 per cent in 1999-2000 is budgeted to grow by only 16.2 per cent in 2000-01. (Annexure-1) Total capital receipts (excluding State's share in the small savings collections) are budgeted to grow by 13.7 per cent to Rs. 134814 crore in 2000-2001 from Rs. 118560 crore in 1999-2000. Gross borrowings and other liabilities at Rs. 1112.75 crore in 2000-2001 still account for an overwhelming 82.5 per cent of total capital receipts as against 90.0 per cent (Rs. 106724 crore) in 1999-2000. The non-debt capital receipts (recovery of loans plus PSUs disinvestment receipts) are placed at Rs. 23539 crore in 2000-2001 and show around two fold jump from Rs. 11836 crore in 1999-2000 (Annexure-1) Net market borrowings at Rs. 76383 crore in 2000-2001 are budgeted to finance about 69 per cent of the fiscal deficit compared with about 66 per cent in 1999-2000.

The experience of the policy of deficit financing during the period of planned development in India gives rise to a number of important lessons. In the first place, deficit financing can act as an important instrument for promoting the growth of a developing economy. Secondly, some amount of deficit financing is necessary as also unavoidable in such an economy, but it can act as an instrument of growth only when it is kept within reasonably safe limits. In India, the safe limits have been continuously and consistently exceeded leading to a continuously upward rise in prices since the beginning of the second plan. This was tended to erode the real content of the plan.
investments and upset the entire arithmetic of the plans. It has been observed that during the nineties fiscal deficit of the Indian Government has grown at a faster pace. Consequently the debt servicing charges are also mounting. This is the single largest-component of the non-plan revenue expenditure and is in the nature of contractual obligation arising out of past borrowings interest payments are estimated to absorb 69.3 per cent of total tax receipts during 2000-01, therefore the Government is not in a position to meet even urgent social needs. In India, though deficit financing has not led to a run-way inflation so far, there is great evidence of its having operated as a significant factor in raising the price level. An abnormal rise of prices is bound to retard the rate of growth of the economy because it will adversely affect the formation of savings and investment and the allocation of productive resources.

In an inflationary situation there is a tendency for productive resources to flow into inflation-hedges which have a low productivity potential. Prof. Kurihara's hypothesis that the sigma effect will exceed the multiplier effect of deficit financing and there will be no danger of secular inflation has not proved very correct in the Indian economy so far. The Indian experience has further showed that the monetary impact of deficit financing on the economy magnifies itself in terms of the working of the money multiplier as a result of which the total supply of money has increased more than the amount of deficit financing since the Third Five Year Plan. This phenomenon, therefore, further emphasizes the fact that the policy of deficit financing in the context of economic planning should be resorted to with due regard to its total effects on the supply of money, and the behavior of aggregate output.
So, these are the evil effects of deficit financing. Deficit financing, no doubt can be a helpful device for promoting economic development in the initial stages but, it is necessary that extra caution is exercised and proper controls and checks are maintained. In our country the situation has reached such a pass that a solution does not seem to be in sight in the near future.

Public Borrowing and Mobilisation of Resources

If the State is not able to raise adequate resources through taxation, for developmental planning it can raise loans from the public in the open market. Such loans would be obtained from the people out of their savings and therefore would not be inflationary in nature. Since these have to be ultimately repaid, it would always be suggestable if these are invested in long-term capital projects so that they may yield enough return. People also like to invest in government securities because they are safer than other types of investment, even small and middle savers can invest in government bonds which may not be possible in other alternative investments, government securities are highly liquid and can be converted into cash any time; and investor have a feeling that the funds will be utilized for the development of the country. Debt-financing of development has by itself every justification. Borrowing for investment in developmental projects leads to building up of assets which yield returns to the economy. As the U.N. report on the Domestic Financing of Economic Development observes, "Types of development suitable to be financed by borrowing are instances where publicly owned assets are created, where profitable returns are expected from specific projects, where the development is not of long-term character and will result
In increases in productivity in the immediate future, where the development is such that charges, fees or specific taxes can be imposed upon the beneficiaries so that the original debt incurred for construction can be serviced from fees.  

Internal Public debt contributes to development in other respects also. The role of public debt in a developing economy goes beyond financing developmental expenditure. In connection, “Indeed a vitally important role of public debt in an underdeveloped territory is to secure funds, not for the Government itself, but in order to establish a regular and acceptable channel by which private investors may obtain access to funds which would otherwise have been lost to investment within that territory.” In India the majority of the population is primarily engaged in producing for subsistence so the difficulties inherent in taxation as a source of development finance. As regards the investible surpluses of public enterprises, the public undertakings suffer from the burden of inefficiency and expensive management, in near future they could not be expected to contribute much to the financing of the Government’s share in economic development. It has been observed that deficit financing as the method of mobilizing resources has been in disfavour for the simple reason that it is counterproductive. Inflationary rise in prices kills a plan and puts an effective break upon the development effort. But the fact remains that capital is of crucial importance in accelerating the rate of economic growth. Non-inflationary borrowing has a proper place among means of financing economic development. Given the inadequacy of aggregate exchequer income-the tax and non-tax together for financing the rapidly expanding fiscal expenditure. Public debt has to play a positive role in making
Public debt constitutes an effective mechanism of mobilizing resources into desired channels of public investment. The historical experience of countries like U.K. and U.S.A. bears ample testimony to the fact that the growth of equity capital was facilitated to a considerable extent by the confidence that the investment in Government bonds gave to the investors. The introduction of treasury bills which have a high degree of liquidity helps the establishment of an ever growing short-term money market. "In India the issue of Treasury bills by tender was adopted soon after the setting up of the Reserve Bank and the later provided rediscount facilities from 1937 onwards."28

A substantially greater progress in the creation of a government securities market has been made in India since independence. Public debt plays a decisive role in the development of a capital market through the establishment of a securities market which is one of the "two institutions which help to bring about this type of liquidity for an investor's funds: the limited liability company and the securities market".29 The role of public borrowings in the establishment of a securities market cannot be overemphasized for "in the early stages of a rudimentary stock exchange the public debt and government operations in it, will play a fundamental role in the development of the market ....... the expansion of the economy presupposes an adequate flow of capital to the productive enterprises of the country. In the first instance this is likely to be done to a large degree through the medium of the public debt.30 "At present, India's debt market is one of the largest in Asia next to Japan and Korea."31
An expanding public debt in a developing country is a necessary tool of monetary policy which aims at promoting the accelerated economic development of the country with stability and social justice. It is obvious that a Central Bank cannot carry on traditional open market operations in an economy where there exists no security markets in which to conduct the operations. Existence of a large public debt constitutes an effective medium through which monetary policy operates to achieve target of economic development with price stability. Variations in the size and composition of Government indebtedness either to the banking sector or to the general public change the liquidity of the economy and affect the structure of interest rates. The impact of public borrowing on the asset structure of the economy as a whole—including assets directly created with the help of borrowed funds is also of significance. Thus not only the size of the public debt but also the method of raising and utilizing the borrowed funds are vitally important in a developing economy. “There is no neat way to distinguish monetary policy from debt management, the province of the Federal Reserve from that of the Treasury. Both agencies are engaged in debt management in the broadest sense and both have power to influence the whole spectrum of debt.” In India, where institutional investors absorb a large part of Government securities, maintenance of sufficient liquidity in the economy is a necessary condition for successful borrowing programmes. While restraining speculative and inessential investment a development oriented monetary policy allows adequate scope for the expansion of productive investments and creates a good environment for the flow of resources into Government bonds.

OBJECTIVES OF THE STUDY
The main objectives of the present study may be stated as follows:

A. To find out the trends and variability in the different heads of internal public debt of Central Government.

B. To analyse the structural change in the internal public debt of Central Government, during the period from 1970-71 to 1999-2000.

C. To find out the impact of domestic borrowing on the economic development.

D. To study the burden of internal public debt of Central Govt.

E. To present some valuable suggestions regarding the present study.

STUDY PERIOD

The Study covers a period of 30 years i.e. from 1970-71 to 1999-2000.

LIMITATION OF THE STUDY

Since the study covers a period of 30 years, i.e. from 1970-71 to 1999-2000, but due to non-availability of data for treasury bills, compensation and other bonds, special floating and other loans and special securities issued to R.B.I. for the year 1999-2000, study of the above four heads are taken up to the year 1998-99.

RESEARCH METHODOLOGY

A. Collection of data: The present study is based on secondary data collection. The time series data is collected mainly from various issues of R.B.I. Bulletins, Reports on Currency and Finance, Economic Survey and the budgets of Central Government.

B. Analysis of data: Various statistical tools have been used to fulfil the
objectives set-forth in this inquiry; These are described as:

(i) Growth of public debt at constant prices: The growth of public debt in money terms does not give the real picture, as there are, 'permanent influences' that effect such growth. These influences are 'population' and 'price changes'. Thus in the present study, the growth of public debt is measured both at current and constant prices.

(ii) Coefficient of Variation: Magnitude of variability in the public debt and its different heads has been measured with the help of coefficient of variation.
The formula is: $c.v. = \frac{\sigma}{\bar{x}} \times 100$
Where,
- $c.v.$ = Coefficient of variation (in%)
- $\sigma$ = Standard deviation
- $\bar{x}$ = Arithmetic average

(iii) Compound growth rate: Exponential growth rates of public debt and its different heads have been computed to study the trend pattern. For evaluating annual compound growth rate the following semi-log trend equation has been used:
$Y = Ab^t$
Taking log on both sides, the equation is specified as follows:
$\log Y = \log A + t \log B$
Where,
- $Y$ = Public debt (in crore Rs.)
- $A$ = Intercept (constant)
- $B = 1 + r$, ($r = C.G.R.$ in %)
\[ t = \text{Time} \]

The compound growth rate is obtained by
\[ r = (B-I) \times 100 \]

(iv) To analyse the significance of growth of public debt, null hypothesis is formed.

**Null Hypothesis** : The growth in public debt in the period under review is statistically not significant.

To test the significance of growth of public debt, student's 't' test is used.

'tc' is calculated by using the following formula:
\[ tc = b / S.E. \]

where, \( tc \) = calculated value of 't'
\( b \) = 'b' Coefficient
\( S.E. \) = Standard Error of 'b' coefficient

(v) **Multiple Regression Analysis** :

A quantitative estimate has been made to analyse the effect of internal public debt and tax revenues on economic development. For this purpose a multiple regression model has fitted to show the behaviour of NNP at factor cost as a function of internal public debt and tax revenues (net).

The formula used is: \[ Y = a + b_1 x_1 + b_2 x_2 \]

Where,
\[ Y = \text{NNP at factor cost (Dependent Variable)} \]
\[ a = \text{Constant} \]
\[ b_1 & b_2 = \text{Regression Co-efficient} \]
$x_1 = \text{Internal public debt (Independent Variable)}$

$x_2 = \text{Tax revenue (net) of Central Government (Independent Variable)}$

To find out the statistical significance of the impact of independent variables on dependent variables standard error of the estimates has been calculated.

The formula is:

$$S_{1.23} = \sqrt{1 - r_{12}^2 - r_{13}^2 - r_{23}^2 + 2r_{12}r_{13}r_{23}} \over 1 - r_{23}^2}$$

Where,

$S_{1.23} = \text{Standard error of the estimates (of dependent variable)}$

$r^2 = \text{Square of correlation coefficient}$

$r_{12} = \text{Correlation coefficient between NNP at FC and internal public debt.}$

$r_{13} = \text{Correlation coefficient between NNP at FC and tax revenue (Net).}$

$r_{23} = \text{Correlation coefficient between internal public debt and tax revenue.}$

**Plan of the Study**

The present study has been divided into five chapters.

The first chapter is an introductory chapter. This chapter discusses the meaning, importance, main objectives and the research methodology of the study. This chapter also deals with the importance of public debt in financing economic development.
Second chapter presents a brief survey of relevant literature.

Magnitude of variability and trends in different heads of internal public debt of Central Government have been analysed in third chapter. In this chapter an attempt has also been made to find the impact of internal public debt on economic development.

In the fourth chapter, an attempt has been made to find out the burden of internal public debt.

Fifth chapter which is the last chapter gives summary, conclusions and the main suggestions of the present study.
REFERENCES

8. Ibid, p. 98.
10. Ibid, p. 106.
20. Ibid
24. Ibid.


