CHAPTER - 2
REVIEW OF LITERATURE

The literature pertinent to this study has been discussed under different heads:

2.1 Studies on fiscal system
2.2 Studies on fiscal performance
2.3 Studies on fiscal reforms:
   2.3.1 Studies on tax reforms
   2.3.2 Studies on reforms in public expenditure
   2.3.3 Studies on reforms in public borrowing process.

2.1 Studies on Fiscal System

The studies on fiscal system mainly target the issues related to expenditure powers, revenue assignment, inter-governmental transfers and problems of the system.

Rao and Singh (1998) in their study ‘The Assignment of Taxes and Expenditure in India’ find that the Constitution exhibits a clear centripetal bias in the distribution of fiscal powers. In addition to the functions assigned, the centre can also influence the expenditure decisions of the states. They conclude that the assignment of tax powers follows the principle of ‘separation’ in contrast to that of ‘concurrence’ followed in federations like the USA and Canada.

Rao (2000) in his paper ‘Fiscal Decentralization in Indian Federalism’ analyses fiscal decentralization in three-tier federal framework in India. He brings out anomalies in assignments between both centre and states; and states and local bodies. He retrieves that structural deficits in the country are due to the fiscal mismanagement at both central and state levels. He notices that in spite of
constitutional recognition to the third tier, the local governments seem to play a very limited role both in raising revenues and in spending. It is also seen that initiative for decentralization at the third level has come from the centre and not from the states.

Rao and Singh (2001) in the paper ‘Federalism in India: Political Economy and Reform’ have tried to assess the state of India’s federal structures and the reforms of the last decade. They are of the view that the transfer system has not done much (or not enough) to manage inter-state disparities. They suggest that the system of centre-state transfers be simplified, and the Finance Commission be given a greater role in governing these explicit transfers.

Rao (2004) in his paper ‘Changing Contours in Federal Fiscal Arrangements in India’ attempts to bring out the major shortcomings impinging on the efficiency and equity in the federal fiscal system in India and addresses the issues of reforms in fiscal arrangements in the context of liberal and open economy environment. He observes that from the revenue sources assigned to the state governments, they could finance only 48 per cent of their current expenditures and 43 per cent of their total expenditures. He observes that the proportion of formula based transfers given by the Finance Commission and the Planning Commission has declined and that of discretionary transfers has increased in recent years.

Singh and Srinivasan (2006, 2008), while comparing India’s federal system with China’s federal system, notice that China’s overall fiscal situation and that of its sub-national governments is stronger than India’s both in terms of quality of expenditure and overall fiscal health. They also offer some reform proposals. These are – to create a Fiscal Review Council (FRC) for joint review of state and central fiscal policies and plans, the centre assume sole responsibility for what
are now called centrally sponsored schemes, and to reconstitute the Planning commission into a Fund for Public Investment.

2.2 Studies on Fiscal Performance

In India, until the mid-1980s, discussion on fiscal imbalance focused primarily on the so-called overall budgetary deficit, or deficit financing. The deficit thus measured was taken to represent the creation of fresh credit or reserve money. The study of relationship between deficit financing and price level has remained a debatable issue in the pre-reform period. Rao (1977) mentions that deficit financing is like a double-edged knife, which can be used both for good and for bad purposes. The policy of deficit financing is indeed a boon to the nation if it is intended for securing adequate money supply that will enable the use of other resources in productive and developmental activities. However, it turns to be a bane to the country and its consequences are disastrous, if inflationary forces are allowed to flourish in the economy.

Sen (1976) analyses the effectiveness of deficit financing in developing countries during 1969-70 to 1975-76, with reference to India. He finds that financing the process of development through deficit financing gives rise to an increase in price level. Rao (1977) in his article ‘Deficit Financing: The Dangers of Overstepping a Safe Limit’ examines the reasons for the ineffectiveness of deficit financing during 1960-61 to 1974-75. He finds that deficit financing increases the volume of money supply in the economy without increasing the level of output. Srivastava (1980) in her article ‘Impact of Deficit Financing on Price Level’ observes that deficit financing has aggravated the price level. Thus most of the studies conducted in India up to 1980 conclude that deficit financing causes inflation.

However some studies find that there is no relationship between
deficit financing and price level. The international experience examined by Mody (1992) during 1983-90 shows that it is the budget deficit and not the fiscal deficit, which is relevant for price stability. He concludes that money financed budget deficit is an important instrument for price stability.

In 1991, a need to find out a proper methodology for estimating and monitoring budget deficit was realized and the term fiscal deficit was perhaps first used in 1991 (by the then Finance Minister, Dr. Manmohan Singh). Raja J. Chelliah (1993) is of the view that in bringing about fiscal adjustment or in other words, restoring fiscal balance, three types of deficit needs to be considered – the fiscal deficit, the revenue deficit and the monetized deficit. Many public finance experts like Chelliah (1993), Lahiri (2000), Gupta (2001), Dholakia and Karan (2005) have tried to define different concepts of deficit in order to measure fiscal imbalance.

After 1990s, the issue shifted from the study of the relationship between deficit financing and inflation to the study of relationship between fiscal deficit and interest rates. Studies comprising Cebula (1990), Corriea et.al. (1995), Patnaik (2001) show positive association between interest rate and fiscal deficit. Khatkhate and Villanueva (2001) also assert that the rise in fiscal deficit does push up the interest rate. Goyal (2004), using monthly data for the period 1980-81 to 2002-03, argues that there is a two-way causality between fiscal deficit and interest rates. According to Das (2007), high level of fiscal deficit causes higher level of interest rate.

On the other hand, the studies by Ostrosky (1979), Dalamagas (1987), Kulkarni and Erickson (1996) find no evidence of positive linkage between interest rate and fiscal deficit.
Chakraborty (2002) in his article ‘Fiscal Deficit and Rate of Interest: An Econometric Analysis of the Deregulated Financial Regime’ finds that fiscal deficit does not put upward pressure on the interest rate rather the causality run from real rate of interest to deficit.

Rakshit (2005) points out that fiscal deficit affect macro stabilization and growth. He points out that high fiscal deficit implies faster accumulation of public debt, larger interest payments and higher revenue deficit or government dissaving.

Different researchers like Gupta (2001), Singh and Srinivasan (2004), Rao (2005) have analysed the fiscal situation of the central government of India after reform. They are of the view that the factor which has strained the fiscal position of the central government has been the sharp escalation in its salary bills (pays and allowances) and pension payments. Salary bills and pension payments now absorb more than one fifth of the total revenue receipts of the central government.

Gupta (2001) mentions that rising interest rates on public borrowings in the eighties were the structural factor contributing to fiscal imbalance. This has led to unsustainable growth of public expenditure. Growth accelerated to 5.8 per cent during the 1980s, but the cost of this debt-led growth was growing macro-economic imbalances (fiscal and current account deficits) which worsened at the beginning of the 1990s as a result of external shocks and led to the macro-economic crisis of 1991.

The reason of higher cost of market borrowings has also been mentioned by Goyal (2004) after post-reform deteriorating fiscal situation of central government.

However the fiscal imbalance in the states has also worsened over recent years. This situation has been examined by different researchers like Jani (2001), Ramji et.al. (2001), Rao (2002) and Khan
and Hasan (2006). According to Jani (2001), state government finances in Indian economy since the 1980s have been found under heavy stress as most of the state governments are facing a worsening budgetary situation which has substantially affected their development expenditure. This has happened largely due to declining share of tax and non-tax revenue in their budgets.

Ramji et.al. (2001) are of the view that the most important contribution to fiscal imbalance in the states have been on the expenditure side. This could be seen from the steep increase in total expenditure of state governments over the last decade.

Bansal (2001) in his paper makes an attempt to study the budgetary trends and amount of revenue deficit of different states of India from the period 1990-91 to 1997-98. He finds that the amount of budget deficit as well as revenue deficit has increased over the period. He mentions, “The problem of fiscal deficit is not confined to the central government alone, the states are facing it more acutely. The fiscal deficit first appeared at the central level in 1979 but the states followed suit only in 1984.”

The study by Murty (2001) shows that fiscal deficit of Madhya Pradesh has gone up by 36.7 per cent in 1996-97, 22 per cent in 1997-98 and 65.3 per cent in 1998-99. Parkash et.al. (2001) show that revenue deficit as proportion of fiscal deficit in Punjab had risen considerably from 9.9 per cent in 1985-90 to 71.05 per cent in 1999-2000. This ratio was quite higher in Punjab as compared to all other states.

Rao (2002) notices that the major reason for increasing fiscal imbalance at the state level has to be found in declining share of transfers in states’ revenues and more importantly, the impact of pay revision triggered by central pay revision.
Khan and Hasan (2006) are of the view that state finances have been facing a serious problem of growing fiscal imbalance in terms of widening gap between revenue expenditure and revenue receipts. This, on the one hand, is attributed to the growth of current expenditures, particularly in wages and salaries, interest payments, transfers and subsidies, and on the other hand, to the inability of the state governments to impose proper user charges and get economic returns on their investments.

The issue of vertical fiscal imbalance in the Indian federal set up is also of great significance. The study by Bernardi and Fraschini (2005) mentions that the assignment of tax powers is based on the principle of separation. Most broad based taxes are assigned to the centre, whereas in practice states have a narrower tax base and the consequence is a vertical fiscal imbalance.

2.3 Studies on Fiscal Reforms

Many less developed countries like Bangladesh, Malawi, The Gambia, and the United Republic of Tanzania faced severe macro-economic difficulties during the 1980s, which included the growth of unsustainable fiscal deficits, as a consequence of which both tax and expenditure reforms were undertaken, a process which remains ongoing. The study by Basu and Greenway (1997) analyses fiscal reforms in these countries. The study concluded that fiscal performance improved in the post-1990 period as a result of these reforms in Bangladesh, Malawi, The Gambia, and the United Republic of Tanzania.

Only a few studies have broadly examined the extent to which the fiscal reforms initiated in the 90s have contributed to improve the finances of the centre and that of the state governments of India.
Public Expenditure Management’ covers wide range of issues on fiscal reforms in India for the period 1950-51 to 1999-2000. The study finds that notwithstanding the initial fiscal adjustment measures for correcting the fiscal imbalances immediately after the crisis and the subsequent fiscal reforms, a high level of deficits in the government budgets particularly during the second half of 1990s, continue to constrain growth impulses for the economy. The level of fiscal deficit combined both for the central government and state governments is more or less at the same level at the end of 1990s as it was at the beginning.

Sarma and Gupta (2002) in their paper ‘A Decade of Fiscal Reforms in India’ have attempted to evaluate the impact of fiscal reforms, on the public finances of the centre and state governments during 1981-82 to 1999-2000. They observe that the fiscal reforms initiated since June 1991 by central government have had the expected effect on its fiscal balance. They notice that the fiscal reforms introduced by the central government have positive impact on its revenue balances. On the other hand, states’ primary revenue balances continued to deteriorate in the 90’s largely because of lack of any effective reform efforts.

Kapila (2003) in the paper ‘Fiscal Reforms in India: Policy Measures and Developments’ is of the view that deterioration of finances of the centre and state governments during the latter part of the reform period was much sharper for the states than that for the central government. According to her, the factors responsible for the deterioration of fiscal condition of the state governments are: rising interest payments, inadequate recovery of costs or lower user charges, rising expenditure on wages and salaries and sluggishness in the central transfers to states.
Relatively only a few studies have examined the fiscal process reforms initiated at the state level. Rao (2002) analyses the problem of state finances in India for the period 1980-81 to 2000-01 with a view to identify the policy and institutional reforms to achieve fiscal rectitude in his paper ‘State Level Fiscal Reforms in India’. The analysis shows that fiscal deterioration has occurred despite the attempts to contain expenditures by the states. He finds that there has been a sharp deterioration in state finances particularly after 1997-98 as evidenced by sharp increase in revenue deficit, fiscal and primary deficits, increases in their indebtedness and contingent liabilities, and decline in capital and maintenance expenditures.

Bhargava (2006) in his paper on ‘Why State Level Fiscal Reforms are Necessary?’ analyses the fiscal position of state governments from 1991-92 to 2000-01. He observes that state governments are discharging more functions and their expenditure has increased several times, leading to increasing stress for the states.

George (2006) in his paper on ‘Major Issues in State Level Reforms’ analyses the reasons for the fiscal crisis in the states. Factors like stagnant tax and non-tax revenues and the hidden subsidies were responsible for such situation during the period 1990-91 to 1999-2000. He discerns that attempts to bring out fiscal reforms have not been very successful, as the fiscal deficits have continued to increase.

Khan and Hasan (2006) in their paper ‘Fiscal Reforms at State Level: Problems and Prospects’ analysed the fiscal reforms initiated at the state level for the period 1990-91 to 2001-02. They find that the financial position of the state governments continues to show sharp deterioration since 1998-99. The strain on state finances is largely the outcome of significant growth in committed expenditures. The revenue expenditure mismatches and the consequential rise in the borrowings
by the states added further stress to the state finances and fiscal sustainability. They are of the view that effective reforms in tax, expenditure and borrowing policies at the state level are extremely important.

2.3.1 Studies on Tax Reforms

The studies done prior to 1991 on tax system in India emphasized mainly on direct taxes (Chopra, 1976), progressivity of taxes (Sen, 1978), comparison of effective taxes with nominal taxes (Stern, 1983), features of Indian tax system and its lacuna (Bhargava, 1984), the issue of measuring tax buoyancy and elasticity (Subrahmanyam et.al., 1986 and Shome, 1988).

Chopra (1976) in his article ‘Direct Taxes: Welcome reliefs’ discussed the reliefs in direct taxes by taking into consideration the recommendations of different committees for the period 1950-51 to 1976-77. He found that the share of direct taxes in total tax revenue came down to 27 per cent in 1975-76 from 43.3 per cent in 1950-51. The main reasons for this were the reduction in confiscatory rates of taxes and raising the exemption limit in the case of income tax.

Sen (1978) found that for income tax during the period 1970-78, the increase in burden was found to be progressively declining. Stern (1983) compared the effective taxes with nominal taxes and found that effective taxes were more spread across commodities than nominal taxes.

On the basis of the analysis of data of Indian federation from 1950-51 to 1980-81, Bhargava (1984) concluded that the richer states did not necessarily had higher per capita tax incidence and the existence of disparity even among those states whose per capita income was same.

Subrahmanyam et.al. (1986) discussed the importance of
measuring tax buoyancies and elasticities as accurate tax revenue forecasts provided the basic ingredient for budgetary gap estimation and grants-in-aid allocation.

Shome (1988) in his article ‘On the Elasticity of Developing Country Tax System’ found that the tax system needed the design that would automatically yield higher tax revenue with growth in gross domestic product.

Bird (1993) after analysing tax reforms in many countries observed, “…..fiscal crisis has been proven to be the mother of tax reform”. Beginning with the early 1990s, Indian tax system entered a way of reforms. In 1991, in reaction to a severe macro-economic crisis involving high fiscal deficits, India carried out a series of economic reforms, along with a tax reform.

Since 1991, the emphasis has been on studying the impact of tax reforms on tax revenue of the centre and state governments (Rao, 2000; Aggarwal, 2001).


Chelliah (1999) lays more emphasis on tax reforms. He suggested that the structural reform and the reduction in rates would help in better enforcement, thereby reducing the scale of evasion of indirect taxes.

While assessing the performance of tax reforms implemented by the central government since 1991, Muhleisen (1998) shows that the decline in overall revenue relative to GDP is due to substantial tax cuts. He suggested that the reform priorities should be on base-broadening measures, while longer-term steps needed to include
shifting to Value Added Tax (VAT), improving taxation of agriculture and strengthening tax administration.

Rao (2000) in his paper ‘Tax Reform in India: Achievements and Challenges’ analyses the reform initiatives undertaken since 1991. He is of the view that systemic reforms in the tax system in India in the 1990s are the product of crisis. He finds that there has been a steady increase (17 per cent) in the tax-GDP ratio from 1970s to mid 1980s but it declined thereafter to 13.9 per cent in 1993-94. He stated that the economic crisis of 1991 resulted in a significant decline in revenues.

As revenue of the centre and state governments is heavily weighed in favour of taxes, taxes account for 80 per cent of the revenue raised by the centre and states. Aggarwal (2001) in his study focuses on the implications of Indian tax reforms on tax performance of the centre and state governments from 1980-81 to 2001-02. He finds that tax performance, at the state level, remained unchanged during the 1990s and improved only since 1999-2000 following certain pro-revenue reforms. However, reform of direct taxes, at the central level, is found to be revenue productive only in the long run.

The paper by Acharya (2005) sketches the contours of India’s tax reform from the mid-1970 to 2000. He perceives that enormous progress has been made in the last 30 years, judged by the standards of economic efficiency, equity, built-in revenue elasticity and transparency.

Rao (2005) has examined the Indian tax system from 1980-81 to 2003-04. As the tax reforms at the state level have not coincided with those at the centre, he observes that there is no systematic attempt by individual state governments to streamline the reform process even after 1991. Infact the pace of tax reforms in the states accelerated in the latter half of the 1990s, to meet the targets set by the medium term
fiscal reforms facility. He finds that despite systemic reforms, the revenue productivity of the tax system has not shown appreciable increase. But revenue productivity of personal income tax has improved after comprehensive tax reforms initiated in 1991.

While interpreting the tax reforms in India during 1989 to 2002, Bernardi and Fraschini (2005) notice that the development of general government tax structure does not show striking changes since the late 1980s to the turn of the century, but shows just some ups and downs and some increasing/decreasing trends as to certain tax items.

Poirson (2006) assesses the effects of India’s tax system on growth through the level and productivity of private investment during 1974-75 to 2004-05. She discovers that the overall tax burden, as measured by the Average Effective Tax Rates (AETR), is low in India as compared to advanced economies and higher-income emerging markets in the region. She views that the proposed introduction of GST with few exceptions should enhance indirect tax productivity and improve economic efficiency by harmonizing tax rates across states.

While interpreting the state taxes in India for the period 1980-81 to 2000-01, Gaur (2006) observes that due to mounting expenditure, the fiscal position of state governments has been under stress since the mid-eighties. He is of the view that there is an urgent need for tax reforms at the state level.

2.3.2 Studies on Reforms in Public Expenditure

Rising public expenditure is considered as the one of the crucial factors for accelerating economic growth, on the one hand and unbalancing fiscal condition of a nation on the other. In spite of it, the issue of reforms in public expenditure has received very little attention of the researchers as very few studies could be found related to this aspect.
The issue of causality between public expenditure and economic growth has been discussed at large in India in the pre-reform as well as post-reform period. The economists who discussed the association between public expenditure and economic growth, Wagner and Keynes are among the most noted with their apparently contrasting view points on the cause relation. Adolf Wagner, who is famous for his Wagner’s Law, was probably the first scholar to recognize a positive correlation between economic growth and economic activities. He states that as GDP grows, the public sector/public expenditure tends to grow. On the other hand, Keynesian framework postulates that public expenditure causes GDP to grow (Liu et.al, 2003).

Vakil (1979) observed that since independence, expenditure in government had grown to astronomical figures. He suggested for appointment of a high powered expenditure commission, without delay, so that wasteful expenditure is brought under control.

The issue of public expenditure reform as a key element of the strategy for alleviating resource constraints has been addressed by public experts nearly a one decade later than the issue of tax reforms. Pasha (2000) in his paper ‘Public Expenditure Reform’ explains the factors which attribute to the failure of public expenditure reforms. He has also highlighted the problems of public sector. He observes that the reform of public expenditure will have to take into account the many major challenges confronting developing country governments today like rise of the private sector, globalization, rapid technological change, severe fiscal constraint.

Joseph (1996), giving the reasons of why government spending in India is out of control, points out that after independence, when expenditure on planning shot up suddenly no action was taken to revise the rules and change the emphasis from routine matters to expenditure
involving big amounts. Often government officials did not have the necessary experience to deal with expenditure on a large scale. However, he notices that even after 1991, all the committees appointed by the finance minister has done nothing to examine and reduce public spending. Revenue receives all the attention, expenditure has been the finance minister’s blind spot.

Even during first decade of twenty first century the issue of growing public expenditure in India and its composition [Reddy (2000), Ramji et.al. (2001), Sinha and Pant (2004)] has remained the main target.

Reddy (2000) argues, “Over the years the composition of central government expenditure has become highly rigid and prone to large, pre-committed increases.”

Ramji et.al. (2001) observed that the total expenditure of the centre increased, but declined as a proportion of GDP in the nineties. The rising tide of expenditure could not be adequately met by the revenue receipts and capital receipts put together. It resulted in an increase in centre’s borrowing at high costs and consequent steep rise in interest payments reflected in the mounting non-plan expenditure affecting public investment and capital investment.

According to Sinha and Pant (2004), the fiscal trend of 1970s suggests that this was a period of moderate growth in public expenditure in line with revenue flows. The break came during eighties, when the total expenditure of the central government increased from 16.23 per cent of GDP in 1980-85 to 19.26 per cent of GDP in 1985-90. The expenditure behavior of the state governments during the last twenty years nearly shows the similar pattern as was witnessed in the case of central government finances.

The issue of control of public expenditure in Indian states
(Maharashtra, Andhra Pradesh, Tamil Nadu, Karnataka and Kerala) has been discussed by Ramji et.al. (2001). He concludes that the states have begun in the late nineties, to realize the importance of expenditure control and took important policy initiatives towards fiscal reforms.

JBIC research paper no. 11 (2001) mentions, “To carry the process of reducing the growth in non-developmental expenditure, the government has set up Expenditure Reforms Commission (in February, 2000).” The study finds that the state governments measures to contain expenditure inter alia includes restrictions on fresh recruitment/creation of new posts, review of manpower requirements and cut in establishment expenses and reduction in non-merit subsidies through better targeting. On the other hand, NCT Delhi has set up an expenditure review committee to review non-plan expenditure (JBIC Research Paper No. 11, 2001).

Sarma and Gupta (2002) and Kapila (2003) have explored changes in growth rate and composition of public expenditure by taking into consideration the process of fiscal reforms. According to them, the annual average total expenditure (current + capital expenditure inclusive of loans and advances) of the central government stood at 17.9 per cent of GDP in the 80s. It declined to 15.7 per cent of GDP in the 90s. The average revenue expenditure raised from 11.7 per cent of GDP in the 80s to 12.3 per cent of GDP in the 90s while capital expenditure slumped to 3.5 per cent of GDP in 90s as compared to 6.2 per cent of GDP in the 80s – a fall of 44 per cent. Since the beginning of the 1990s up to 2001-02, while the revenue expenditure to GDP ratio increased from 22.8 per cent to 25.2 per cent, the capital expenditure to GDP ratio declined from 6.0 per cent to 4.4 per cent.

Ram kumar (2008) tries to discuss trends in expenditure between
1950-51 and 2005-06, with special emphasis on the period of economic reforms in India in the 1990s and 2000s. He finds that the public expenditure of the central government has declined sharply in the 1990s and 2000s, as compared to the 1980s. On the other hand, the total expenditure by the states as a share of GDP has risen in the 1990s and early 2000s, but this rise is primarily to finance non-developmental expenditure like interest payments.

2.3.3 Studies on Reforms in Public Borrowing Process

The issue of external as well as internal debt, burden of public debt, utilization of debt, ownership of government securities and debt servicing were most often discussed by different authors in India such as Levin (1970), Naidu and Rao (1975), Das Gupta (1988), Bhattacharya and Guha (1990), Sarma and Mehta (1990) in the pre-reform period.

Debt-income ratio which is an important indicator of the financial burden of the debt was lower in India than the ratio in most of the developed countries in 1970. Levin (1970) observed that public debt as a percentage of GDP was 78.8 in the United Kingdom, 68.7 in Ireland, 52.0 in Ceylon, 49.5 in New Zealand, 48.2 in Belgium, 47.5 in Canada, 43.6 in Rhodesia, 41.2 in United States, 40.0 in Australia, 38.0 in South Africa and 33.9 in Luxemburg whereas in India it was 32 in 1970.

Researchers like Naidu and Rao (1975), Bhattacharya and Guha (1990), analysed internal debt position of India. Naidu and Rao (1975) examined the management of internal public debt of the Government of India during 1950-51 to 1973-74. They measured the burden of public debt in terms of financial and real burden. The mounting debt burden of the Government of India, by way of debt servicing indicates the financial burden (increased from Rs. 371 crore in 1965-66 to Rs. 1,022
crore in 1974-75). The relative growth of public debt and national income determine the real burden (between 1950-1970 rose by 357.7 per cent and 327 per cent, respectively).

They concluded that although the ratio of internal debt to national income was small, the rate of growth of public debt was higher than the rate of growth of national income, so it imposed a heavy real burden.

While analysing the growth and composition of internal public debt of Government of India during 1970-71 to 1987-88, Bhattacharya and Guha (1990) concluded that debt-GDP ratio rises if real growth rate of GDP is smaller than real interest rate on debt.

The issue of external debt was investigated by Das Gupta (1988), Sarma and Mehta (1990). While examining the problem of external debt of India, Das Gupta (1988) found that first time in 1981-82 India had to tap the international money market to meet the deficit in the balance of current account. Experts apprehended that it was a clear signal of the impending external debt trap.

Sarma and Mehta (1990) analysed that why the accumulation of external debt had taken place at a faster pace during 1980 to 1987 even if the openness of the economy was neither wide nor had it increased over time. They examined that between 1984 and 1987, India fell among the first ten countries (selected developing countries) recording high growth in external debt. The rate of growth (compound) was as high as 15 per cent.

Only a few researchers such as Rao and Reddy (1980) and Patel (1984) have analysed the debt position of states in the pre-reform period.

Rao and Reddy (1980) examined the extent of indebtedness of the states to the centre and the financial burden that was imposed on
them during 1951-80. They classified states’ debt into central loans and non-central debt. They discovered that the amount of central loans to state governments had increased during these 30 years and this growing indebtedness of the states to the centre led to emergence of many problems.

Patel (1984) looked at the various aspects of the problem of rising debts of the states and the deficits in their non-plan capital budgets from 1951-52 to 1980-81. As the borrowing operations of the centre and states were carried out by a centralized system, he revealed that two-third of the total borrowing was absorbed by the centre. As a result, state budgets were in a very precarious condition in spite of massive revenue and capital transfer of resources.

In the Indian context, a number of studies have empirically tested sustainability of public debt. Amongst the studies conducted during 1980s, Seshan (1987) found that the internal debt of the government that had evolved by the mid-1980s was unsustainable.

Many other studies in the 1990s, and thereafter, have also shown the unsustainability of public debt. Buiter and Patel (1992) using annual data for 18 years (1970-71 to 1987-88), with four alternative interest rates, demonstrate that discontinued public debt in India is non-stationary.

On the other hand, the study by Khundrakpam (1998) finds that Indian public debt is sustainable in terms of Domar’s stability condition. Similarly, Moorty et.al. (2000) state that if the growth of a state economy is higher than the nominal effective interest rate on the debt, the state is fiscally sustainable.

It was only in mid 2000s that studies by Pradhan (2004), Goel (2004), Rangarajan and Srivastava (2005), Rajaraman et.al. (2005) have interpreted reforms regarding public borrowings.
While studying India’s external debt position during 1971-2003, Pradhan (2004) explains that the most notable outcome of external debt management during 1990s has been the control over short term debt whose share declines significantly from over 10 per cent in 1990-91 to 4.4 per cent in 2002-03. He finds improvement in India’s debtor position since 1991 as India ranked eighth in 2002 from the top fifteen debtor countries in the world coming after Brazil, China, Russian Federation, Mexico, Argentina, Indonesia and Turkey.

While examining the growth of public debt in India in pre-reform and post-reform period, Goel (2004) finds out that although the annual rate of growth of debt declined from 19 percent during 1980-81 to 1989-90 to 11.3 percent during 1990-91 to 1999-2000, but it is still high.

Rangarajan and Srivastava (2005) examine the long term profile of fiscal deficit and debt relative to GDP in India during 1950-51 to 2002-03. They are of the view that debt would become unsustainable, if fiscal deficits follow a course that leads to a self-perpetuating rise in the debt-GDP ratio, which affects negatively on the growth rate and positively on the interest rate, such that the existing levels of primary government expenditures cannot be sustained, given the configuration of growth and interest rates.

Continuous government borrowing to cover the fiscal imbalance resulted in ever rising public debt, the servicing of which must eventually come out of public revenues in subsequent years. Many state governments are dangerously close to such a situation and it is this which motivated Rajaraman et.al. (2005) to analyse debt sustainability from 1992 to 2002. They find that during 1997-2002, the average debt-GSDP across major states was 6.6 percentage points higher than in the previous five year period. The debt position
deteriorated further in 2002-03 as a ratio to GSDP. They suggest that states are in need of institutional reforms such as participating in the Consolidated Sinking Fund (CSF) and in the Guarantee Redemption Fund (GRF), enactment of ceilings on guaranteed debt and enactment of fiscal responsibility legislation. There should also be comprehensive cap on borrowing by each state.

Pradhan (2004), Rangarajan and Srivastava (2005), Rajaraman et.al. (2005) have observed the significant initiatives taken by states. The states of Andhra Pradesh, Arunachal Pradesh, Goa, Maharashtra, Mizoram, Nagaland and West Bengal have taken initiatives for setting up of consolidated sinking funds to help retire debt repayments. The states of Gujarat and Karnataka have prescribed limits on guarantees, while Rajasthan has proposed the setting up of a GRF.

Misra and Misra (2006) in their article on ‘Burden of Debt and its Mitigation – A Study of a Backward State of India’ notice that Orissa is incurring mounting revenue deficits which have resulted in the huge borrowings. The debt was 42 per cent of GSDP in 1990-91 and increased to 51 per cent by 2000-01. They have highlighted factors leading to the higher debt burden, particularly subsidies and higher interest payments.

On the basis of the review of literature it may be concluded that some studies find out that reforms carried out during 1991 have some favourable effect on the Indian economy. After reforms, in general, India did not suffer any drop in total GDP, high inflation or sizeable increase in unemployment. Rather, it has been experiencing high rates of growth, improved quality of life, reduction of inequity in income distribution, no balance of payment problem after 1991-92. A tremendous increase in foreign investment, a very large flow of remittances with realistic exchange rate, remarkable growth in exports,
increase in investment in agriculture and sharp reduction in the share of Non-performing Assets in the portfolio has been noticed.

On the fiscal head, the corrective initiative produced some promising results in the first two years only namely 1991-92 and 1992-93. Only a few studies show that fiscal situation has improved as there is a decline in fiscal deficit, decline in debt-GDP ratio, and decline in total expenditure of the central government. Expenditure growth was reined in and the deficits were down, but only for a while. Deficit reduction since 1990-91 has relied on expenditure compression, with economic services bearing the brunt.

Many studies have shown that the fiscal situation has not improved as there has been unsustainable deficit which crowds out private investment. Similarly, it has been found that the problem of imbalance in resources and expenditure is more serious in case of the states as the states' fiscal deficit is rising. The rise in revenue expenditure is only at the cost of capital expenditure.

From the review of available literature, it also clearly emerges that a large number of studies are available which discuss the issue of fiscal reforms particularly taking into consideration only one or the other fiscal instrument i.e., either tax reforms or reforms in public expenditure. The issue of reforms in public borrowing process has remained totally neglected. Similarly, the fiscal position of either central government or state governments has been explored. There are only a few studies which explore the issue of Indian fiscal system with reference to fiscal reforms. The significance of this study is that it analyses the issue of fiscal performance of the central government, state governments and the consolidated general government of India by taking into consideration tax reforms, expenditure reforms and reforms on borrowing front. Thus the study is much more comprehensive as compared to the earlier studies.