CHAPTER III

GOVERNMENT FINANCES IN INDIA - AN OVERVIEW

The distinction between public and private goods and the concept of the public sector lead us to look into the subject matter of public finance. Quite obviously, public finance is related to the financing of state activities, and can be narrowly defined as a subject which discusses financial operations of the fiscal and public treasury. Earlier writers on the subject tend to define public finance in such a narrow manner, though it is no longer the case now.

Public finance deals with the income and expenditure of public authorities. Public authorities include all sorts of governments, central, state and local that are studied in the science of public finance.

Prof. Dalton\(^1\) defined public finance as, "Concerning with the income and expenditure of public authorities and with the adjustment of one to another."

Bastable\(^2\) defined, "Public finance, dealing with expenditure and income of public authorities and their mutual relation as also with the financial administration and control".

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In early days of capitalism it was widely believed that private sector was always more efficient than the public one. The role of the government was not to interfere with the working of the market forces but to limit its own activities to the barest minimum necessary.

Firstly, it was to protect the society against internal disruption and ensure that effective law and order situation prevailed. For this the state was to maintain itself and was to create the needed administrative, judicial and police set-ups.

Secondly, the society was to be protected against any foreign aggression that might take place. The state was to maintain armed forces to meet this objective.

Thirdly, where private sector found itself unable to create and run social overheads or infrastructural facilities for reasons of their commercial non-viability but they were otherwise essential for efficient working of the economy, the state was to step forth and assume the responsibility of creation and maintenance of such social overheads.

COMPONENTS OF PUBLIC FINANCE

Public finance includes four major divisions.

1. Public Revenue
2. Public Expenditure
3. Public Debt
4. Budget
Public revenue includes income from taxes, prices of goods and services supplied by public enterprises, revenue from the administrative activities such as fees, fines, etc. and gifts and grants.

In other words, all the incomes of the government which it may have during a given period of time.

Public expenditure refers to the expenses which a government incurs for,

i) its own maintenance
ii) the society and the economy, and
iii) helping other countries.

In practice, however, with expanding state activities, it is becoming increasingly difficult to separate the portion of public expenditure meant for the maintainance of the government itself from the total.

In other words, public expenditure is the expenditure incurred by public authorities, central, state and local governments.

Public debt is the debt which the state owes to its subject, or to the nationals of other countries. Public debt arises due to the borrowings of the governments. Government may borrow within the political boundaries of its own territory or beyond the political boundaries or both.
On the other hand, the government may borrow from banks, business organisation, business houses and individuals.

Prof. Philip E. Taylor has defined public debt as "Government debt arises out of borrowing by the treasury from banks, business organisations and individuals. The debt is in the form of promises by the treasury to pay the holders of these promises a principal sum and in most instances interest on that principal. Borrowing is resorted to in order to provide funds for financing a current deficit.

The term budget, in modern times, denotes that document which contains estimates of revenue and expenditure of a country, usually for the fixed period of one year.

In other words, government budget is a financial plan covering outlays and receipts of the government.

**HISTORY OF INDIAN PUBLIC FINANCE**

Indian federal structure is the result of gradual evolution from a centralised authority. Indian empire under the British rule was divided into two parts - the provinces, which were directly administered by the government of India and the princely states, which had internal financial autonomy. Until 1871, the provincial governments had no independent source of revenue and they received fixed grants from the central
government to meet their public expenditure. The first step by which the provinces were given some heads of revenue was taken in 1871 when income from certain heads like registration, police, jails, medicine, education, road and civil works were handed over to the provinces. Due to obvious inadequacy of these resources, the system of lump sum grants continued.

It was only in 1904 that a system of divided heads of revenue was adopted on a quasi-permanent basis and was made permanent in 1912. In this scheme, some taxes like land revenue, irrigation, excise duties and stamp duties were shared between the centre and the provinces.

THE MESTON AWARD

Financial relations committee (under Lord Meston) was constituted to recommend a scheme of provincial contributions to the central government. This committee suggested a scheme which was based upon what is called the initial contributions and standard contributions. The Meston award maintained that the provinces would acquire larger revenues on account of the abolition of the scheme of the divided heads and on account of the abolition of the scheme of the divided heads and on account of their share in the income tax (which it was recommending additionally). They were, therefore, expected to be able to make contributions to the central government out of their surplus revenue receipts, starting from some lower initial contributions in 1921-22 and
rising upto the standard contributions in seven years. The standard contribution, of course, was to be determined separately for each province on the basis of its financial conditions.

**NEIMEYER AWARD**

To give practical shape to the above mentioned provisions of the federal financial adjustments, Sir Otto Neimeyer was asked to make a report and recommend on matters connected with sections 138(1), 138(2), 149(2) and 142 of the government of India Act 1935. Sir Neimeyer recommended that 62% (according to the act they could be 50% or more) of the net proceeds of jute export duty should be assigned to the provinces of Bengal, Bihar, Assam and Orissa.

Keeping in view the necessity to ensure financial stability of the central government and the needs of the provinces, Sir Neimeyer recommended that 50% of the net proceeds of income tax should go to the provinces. Regarding the determination of individual shares of provinces in their combined total, he concluded that substantial justice should be done by fixing the scale of distribution partly on residence and partly on population.

On these considerations, he recommended that the percentage share in the divisible pool of different provinces be as under: Madras 15; Bombay 20; Bengal 20; United provinces 15; Punjab 8; Bihar
10; Central provinces 5; Assam 2; North West Frontier province 1; Orissa 2 and Sind 2.

DESHMUKH AWARD

Indian constitution came into force in 1950 and it provided for a finance commission for recommending the principles governing the sharing of divisible taxes and grants-in-aid. But in the mean time a transitory provision was made. Accordingly, C.D. Deshmukh was appointed to examine the question of revenue sharing and to make recommendations. He stuck to the basic principles as laid down by Neimeyer Award. However, because of partition, 14.5% of the share of income tax proceeds meant for the provinces had been reallocated. That is to say, the share going to Sind, North-West Frontier Province, and parts of Punjab and Bengal was now available for re-division between other states. An adhoc arrangement had been made in the meanwhile. Deshmuck Award made only some marginal changes in the light of population of the states.

FISCAL FEDERATION UNDER CONSTITUTION

The constitution of India came into force in 1950. It allows more or less the pattern laid down in the government of India Act of 1935. It divides the functions and financial powers of the government into central and state. It also provides for sharing of taxes in various forms and a system of grants-in-aid. The approach, in general has been to give
priority to efficiency at both administrative and financial levels. The centre has been assigned those resources which have national or inter-state base.

The seventh schedule of the constitution of India (Article 246 to 292) divides functions and financial resources between the centre and states as

List I. Union List

TAX REVENUE

The Union list consists of 97 entries and contains the following sources of tax revenue for the central government.

1. Taxes on income other than agricultural income (entry 82).
2. Duties on customs including export duties (entry 83).
3. Duties of excise on tobacco and other goods manufactured or produced in India except (a) alcoholic liquors for human consumption, and (b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substanice included in this sub-paragraph (entry 84).
4. Corporation tax (entry 85)
5. Taxes on the capital value of the assets exclusive of agricultural land of individuals and companies, taxes on the capital of companies (entry 86)
6. Estate duty in respect of property other than agricultural land (entry 87).

7. Duties in respect of succession to property other than agricultural land (entry 88).

8. Terminal taxes on goods or passengers carried by railways, sea or air, taxes on railway fares and freights (entry 89).

9. Taxes other than stamp duties on transactions in stock exchanges and future markets (entry 90).

10. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts (entry 91).

11. Taxes on sale or purchase of newspapers and on advertisements published therein (entry 92).

12. Taxes on sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-state trade or commerce (entry 92-A).

13. Taxes on inter-state consignments goods for trade or commerce (entry 92-B).

14. Fees in respect of any of the matters in the list but not including fees taken in any court (entry 96).

15. Fees taken in supreme court (entry 77).
NON-TAX REVENUE

The non-tax resources for the union government include the following.

1. **Borrowings, both internal and external**
   
   Under Article 292 of the constitution, the government of India can borrow on the security of the consolidated fund of India, subject to any limit which parliament may lay down.

2. **Income from Various government undertakings and monopolies**
   
   These include income from currency and mint, Reserve Bank of India, railways, posts and telegraphs and other commercial and non-commercial undertakings, including income from lotteries organised by the central government.

3. **Incidental receipts**
   
   Income accruing to the government of India on account of the exercise of its sovereign rights and performance of functions connected with or arising out of these rights. This category includes, for example, income from government property, income or property accruing from lapse or escheat, war indemnities, income from cultivation, manufacture and sale for export of opium, and so on.
List II. State List

List II of the seventh schedule covers the functions and the financial resources of the states with 66 entries.

TAX REVENUE

List II contains the following sources of tax revenue for the state governments.

1. Land revenue (entry 45)
2. Taxes on agricultural income (entry 46)
3. Duties in respective of succession to agricultural land (entry 47).
4. Estate duty in respect of agricultural land (entry 48)
5. Taxes on lands and buildings (entry 49)
6. Taxes on mineral rights subject to any limitations imposed by parliament by law relating to mineral development (entry 50)
7. Duties of excise on the following goods manufactured or produced in the state and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India: (a) alcoholic liquors for human consumption, and (b) opium, Indian hemp and other narcotic drugs and narcotics, but not including medicinal and toilet preparations containing alcohol or any substance included in this sub-paragraph (entry 51).
8. Taxes on the entry of goods into a local area for consumption, use or sale therein (entry 52)
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8. Taxes on the entry of goods into a local area for consumption, use or sale therein (entry 52)
9. Taxes of the consumption and sale of electricity (entry 53).
10. Taxes on the sale or purchase of goods other than newspapers excluding inter-state sale (entry 54).
11. Taxes on advertisements other than advertisements published in the newspapers (entry 55).
12. Taxes on goods and passengers carried by road or on inland waterways (entry 56).
13. Taxes on vehicles for use on roads (entry 57).
14. Taxes on animals and boats (entry 58).
15. Tolls (entry 59).
16. Taxes on professions, trades, callings and employment (entry 60).
17. Capitation taxes (entry 61).
18. Taxes on luxuries, including taxes on entertainments, amusements betting and gambling (entry 62).
19. Rates of stamp duty in respect of documents other than those subject to stamp duty by the government of India (entry 63).
20. Fees in respect of any of the matters in the state list, but excluding court fees (entry 66).
21. Fess taken in all courts except supreme court (entry 3).
22. Share in some specified union taxes.
NON-TAX REVENUE

The non-tax revenues of the states include the following.

1. The state governments are authorised to borrow under Article 293, upon the security of their respective consolidated funds, but only within the country, including loans from the government of India. A state legislature may impose an upper limit upon the total borrowings by that state. Further more, if any state is under debt to the government of India or if any debt guaranteed by the government of India is still not fully paid, then in that case the state government can borrow further only with the permission of the central government and subject to any conditions which the central government may impose.

2. Income from government undertakings owned fully or partly by the state government.

3. Income from public property owned by the state government.

4. Royally from mines, forests, treasure-trove etc.,

5. Grants-in-aid from the central government.

6. Other grants from the central government.

MECHANISM OF RESOURCE TRANSFER

In view of the recognized inadequacy of the revenue resources of the states, the constitution provides for a mechanism of transfer of resources from the centre to the states, in the form of tax sharing, grants-in-aid and loans.
It may be added that in our constitution no specific provision has been made for the use of transfers from the centre to states for removing or reducing regional disparities. However, this problem is a serious one and cannot be ignored. At the same time, it is interlinked with a poor financial discipline on the part of the states. Successive Finance Commissions in their recommendations have given only a limited attention to this problem.

**GOVERNMENT OF INDIA FINANCES**

All tax and non-tax receipts, recoveries of outstanding loans granted by it and fresh borrowings which belong to government of India go to the consolidated fund. All payments from this fund (except those 'charged' on it) can be made only after authorisation from parliament. Similarly, the contingency fund is an imprest placed at the disposal of the President to meet urgent and unforeseen expenditure pending authorisation from parliament. In the same way, there are several transactions which enter into government accounts in respect of which the government acts more as a banker (such as transactions relating to provident funds, small saving collections, and other deposits etc.) All receipts and payments of this type belong to the public account. Since these funds do not belong to the government, therefore, parliamentary authorisation for payments from public account fund is not required.
Indirect taxes dominate tax revenue in India, and this proportion is extremely large in the case of state taxes. Under prevailing circumstances, it is very difficult to increase the proportion of direct taxes in the total. However, an effort should be made to modify this proportion in favour of direct taxes because indirect taxes have some serious drawbacks. They are regressive in nature and rise the cost price level in the economy. In their present form, many of them have a cost-cascading effect as well.

Predominance of indirect taxes in Indian tax system indicates of its inequity. The authorities claim that the rates of direct taxes quite progressive. Similarly in indirect taxation, most basic necessities are exempt from taxation and luxuries are taxed at high rates.

The financial frontiers of Indian federation is clearly demarcated though our constitution, still there are issues concerning both centre and state. These issues are large in numbers and both the centre and states are striving their best to sort out those from time to time. These attempts of government at different levels refine and re-structure the fiscal federalism to ensure equity and justice.