CHAPTER I

INTRODUCTION

SECTION I

ANDHRA PRADASH STATE - ITS FORMATION:

Andhra Pradesh is one of the twenty two states in the Indian Union. It was constituted on 1st November, 1956, with twenty districts inhabited by Telugu speaking people. This was a consequence of the States' Reorganisation Act 1956, when nine Telangana districts of the erstwhile Hyderabad State were merged with the former Andhra State. Andhra State itself was part of the Composite Madras Province till it was constituted into a separate State on 1st October 1953. The State of Andhra Pradesh has an area extending over 2,75,068 Sq.kms. and a population of about 535.93 lakhs, according to 1981 Census. With 8.4 per cent of geographical area of the country and 7.8 per cent of the country's total population, Andhra Pradesh ranks as the fifth largest State in the Indian Union both from the point of geographical area and population.

Though Andhra Pradesh is one of the 22 States in the Indian Union, it is comparable to some of the
independent and sovereign states in the world in respect of population. Andhra Pradesh with 462.92 lakhs of population in 1974 was bigger by four times than Iraq (107.65 lakhs) and Venezuela (116.32 lakhs), roughly three and half times than Australia (133.39 lakhs), two and half times than Afghanistan (187.96), two times than Columbia (239.52 lakhs) and one and half times than Iran (321.39 lakhs). Even, in respect of geographical area, Andhra Pradesh with 2,75,068 Eq.km. is roughly twice the size of Bangladesh (1,43,998 Eq.km). It is also bigger than the United Kingdom of Great Britain and North Ireland (2,44,046 Eq.km) and Federal Republic of Germany (2,48,577 Eq.km).

With respect to both population and area, Andhra Pradesh has an edge over countries like Austria (75.45 lakhs population; 83,849 Eq.km area), Belgium (97.72 lakhs; 30,513 Eq.km), Czechoslovakia (146.86 lakhs; 1,27,869 Eq.km), Denmark (50.45 lakhs; 43,069 Eq.km), Netherlands (135.41 lakhs; 40,844 Eq.km), Scotland (52.26 lakhs; 78,772 Eq.km), Yugoslavia (211.53 lakhs; 2,55,804 Eq. km) and the like.

Telugu and Urdu are the official languages of the State and Telugu was spoken by 45 million people in
It may be of interest to note that Telugu takes the fourteenth place among the languages spoken all over the world in respect of numbers.6

The state is situated between the latitudes 12° 14' to 19° 54' N and the longitudes 76° 50' E to 84° 50' E. It is located on the eastern side of the peninsula and forms the south-eastern part of India.7

Andhra Pradesh is bounded on the North by Orissa and Madhya Pradesh, and by Maharashtra on the north-west, Karnataka (Mysore) on the western frontier and Tamil Nadu (Madras) on the South. The eastern borders are guarded by the Bay of Bengal, which provides it with a maritime exposure of nearly 600 miles. The smooth coastline takes bends at the mouths of the rivers of Krishna and Godavari. There are ten ports in all, sheltered on this coastline: one major port at Visakhapatnam, two intermediate ports at Kakinada and Machilipatnam and seven small ports. Thus Andhra Pradesh is accessible both by land and sea.

The state consists of the following three regions.
1. Coastal Andhra
2. Rayalaseema and
3. Telangana

The three regions differ from one another in their socio-economic conditions. The Coastal area has a large fertile delta but ends up in the north in a backward and a predominantly tribal strip. Rayalaseema is a chronically drought affected area with a limited potential for agricultural development. The Telangana region, rich in natural resources has been lagging behind in economic development due to historical factors. For example, the per capita income of Coastal Andhra, Rayalaseema, and Telangana regions, according to NCAER estimates were Rs. 257, Rs. 225 and Rs. 201 respectively during 1955-56. The per capita income for the entire state was Rs. 232. Thus there are wide regional disparities in the natural endowment of the State. These socio-economic conditions have their own impact on the financial position and thereby on the economic development of the State.
SECTION 2

1. NEED FOR THE STUDY OF TAX STRUCTURE:

The importance of the study of tax structure follows logically and essentially from the growing importance of the role of Government in accelerating the rate of economic development particularly in developing countries/States. These countries generally regard development as a process to be planned and guided by the State. Taxation is considered as the most important source of development finance. The steady increase in the demand for governmental services and economic plans for the rapid growth of a country's economy have considerably changed the role and scope of taxation. Taxation is treated as an important fiscal instrument in increasing the state revenue and in achieving the economic and social objectives of the community. It is viewed primarily as a means of transfer of resources from private hands to the exchequer to be utilised for financing developmental expenditure.

As the Royal Commission on Taxation (Carter Commission) of Canada has stated "if the government had to choose one method to the exclusion of all other methods by
which it can command over resources, taxation would be preferable because it can be more equitable, can be less disruptive to the economy and can give the government more effective control over the total demand for goods and services.\(^9\) Goods also stated that "the way to economic development is not along the easy path of low taxation and minimum government activity.\(^{10}\) In other words, taxation is a powerful tool which can and should be used primarily to influence the volume of economic activity. Thus the emphasis on taxation is mainly because of the basic characteristics of the developing countries such as low income levels, absence of voluntary savings and the consequent low investment.

The strategy of development policy in these countries is to concentrate on additional investment primarily in the public sector. Since economic development generates a demand for more public services, higher levels of taxation become necessary. However, the level of taxation in these countries is found to be quite low. The tax GNP ratios in these countries are typically low ranging from 8 to 18 per cent.\(^{11}\) These countries/states should work steadily towards a flexible tax system, in
which the total tax yield will increase more than proportionately to the rise in national income/state income.

The functions of the tax system in a developing country should be (1) curtailing consumption (2) re-allocating resources from less to more productive investments (3) providing a flow of funds to Government and (4) providing incentives to alter economic behaviour so as to facilitate growth. In other words, the tax structure should maximise the output at a given level of government expenditure.

While it is important to know, what over-all level of tax revenue is required to secure a given rate of growth, the feasibility of achieving that level of taxation also is an important consideration. The tax policy must be considered along with other aspects of developmental policy. The policy should be directed to mobilising resources for development and allocating them according to priorities.

The efficiency of tax system in promoting a country's development depends on the tax structure it adopts. The tax structure of any country at a given time and place depends on a set of available 'tax-bases',


level of development reached and also on the social, political factors, including the cultural style of the taxing governments.

In the early stages of economic development of a country/state, the 'tax-handles' are scarce and the tax-GNP ratios are very low. But as the economy advances to higher stages of development, the availability of tax bases increases and the extent of reliance on direct taxation increases. So depending on the stage of economic development, the tax structure varies from country to country. The feasibility of a particular tax structure depends on factors such as the countries' particular legal systems, the balance of political and social power within the country, the administrative ability to enforce the tax comprehensively and justly, the effects of different taxes on incentives, and the objective of a proper balance between short-term revenue-raising measures for financing urgent development projects and long-run resources which will give steady encouragement to economic development over the longer pull. To be more precise the tax systems of different countries are not uniform and they differ widely from one another with the structure
of the economy in which they are applied and with the climate of the public attitude towards taxation.

However, it may be stated that the optimum level of taxation for a given country at a particular time will be one that is within the limit of that country's taxable capacity. It may be noted, in this context, that the increase in the rates are not always accompanied by an increase in the revenues and the reverse may, in fact, be the case. Therefore, the level of taxation should not be strained beyond the taxable capacity. However this potential should grow as economic development proceeds. In the context of this vital linkage between tax structure and economic development, the study of tax structure of Andhra Pradesh during the first quarter century of its existence after reorganisation in 1956 is undertaken.

2. Survey of the Earlier Studies:

Besides being one of the five big states in the country, Andhra Pradesh is incidentally one of the States to be reorganised largely on a linguistic basis. However, since the formation of the State on 1-11-1956, no detailed study of the tax structure of Andhra Pradesh seems to
have been undertaken to examine the long term trends of the level and composition of taxation. Studies undertaken by the Finance Department of the Government of Andhra Pradesh and by individuals and institutions are mostly either micro-level studies of individual taxes or studies for shorter period less than twenty five years.

Questions like the following remain to be examined in greater detail. How did the tax structure of Andhra Pradesh evolve from 1956 to 1981 in relation to the tax structure of other states in India? What changes have taken place in the tax system as a whole? What is its composition? What are the individual elements in the tax structure and what are their rates of growth and what are the economic variables that affect them? To what extent the level of economic development determined the tax structure? What are the political, economic and social factors that influenced the tax structure? How does the rate-structure of taxes compare itself with the rate-structure of other states in India? In short, how well, the tax structure of Andhra Pradesh has been designed and executed? How far it has been influencing the rate of economic growth and in turn has been influenced by it? These are the vital questions that remain to be examined.
3. **OBJECTIVES OF THE STUDY:**

1. to review the tax structure of Andhra Pradesh for the last twenty five years.

2. to examine the relationship between the economic development of the state and the growth of the tax structure in the context of the studies made by Hinrichs\(^15\), Musgrave\(^16\) and others.

3. to find out the overall levels of taxation and the changes that came about along with changes in the state domestic product (SDP) i.e., the overall responsiveness of the tax system to state domestic product.

4. to make an analytical and critical survey of the composition of taxation in Andhra Pradesh in relation to other individual states in India and the All-States Model\(^17\) and bring out the significant shifts in the tax composition.

5. to study the individual elements of the tax structure of the state with reference to their revenue significance and their capacity to influence development.
6. examining the objectives of fiscal policy of the state and how far these objectives have been achieved.

4. **SCOPE AND METHODOLOGY OF THE STUDY:**

This is a study of the tax structure of Andhra Pradesh state for a quarter century starting from 1-11-1956 to 31-3-1982. The financial year 1957-58 (1-4-1957 to 31-3-1958) however was chosen as the basis for purposes of the study since 1957-58 was the first 'full' financial year for the state after its reorganisation in 1956.

Annual Budget Documents of Andhra Pradesh Government naturally constitute the primary source of data for this study. Among the important, the following documents may be mentioned.

1. Explanatory Memorandum on the Budget by Finance Secretary.
3. Budget speech of the Finance Minister.
4. Review of Economic conditions and state plan.
5. Memorandum submitted to the different Finance Commissions by the Government of Andhra Pradesh.
6. Reports of the Finance Commissions.


However, wherever possible persons connected in different capacities with the payment and collection of taxes have been contacted and their views have been elicited. For inter-state comparisons, most of the data for this study are obtained from the annual reviews of the Finances of the State Governments published in the Bulletins of Reserve Bank of India.

Comparisons are made on the basis of the following indices:

1. Ratios of tax revenue to State Domestic Product in Andhra Pradesh and ratios of tax revenue of All-States to net national product.

2. Percentage of states' own tax revenue (SOTR) to total tax revenue and also to total revenue in Andhra Pradesh and the corresponding figures for All-States in India.
3. Ratios of revenue from different taxes to state domestic product in Andhra Pradesh and in other states.

4. Share of direct and indirect taxes in total tax revenue and their proportions to total income in Andhra Pradesh and to the corresponding figures in respect of all states in India.

5. Percentage share of Andhra Pradesh in All-State's total in respect of own tax revenue, total tax revenue, non-tax revenue and total revenue.

6. Co-efficients of buoyancy and elasticity of Total Revenue and its sub groups and of individual taxes.

7. Annual growth rates of different taxes and also of state income for different periods.

Annual growth rates are calculated by employing linear regression equations and compound interest formula. To arrive at the coefficients of buoyancy and elasticity, log-linear growth models are employed. For measuring elasticity of taxes, that part of the growth of tax receipts accounted for by discretionary changes was
eliminated from the series of tax receipts. In this study, estimates of net additional tax-yields, due to changes in tax base and rates have been taken as discretionary changes. The separation of discretionary effects is done in two steps as detailed in the relevant chapter.

5. LIMITATIONS OF THE STUDY:

This is a study undertaken by an individual research scholar, without any substantial financial assistance from any institution or agency. As such, several aspects of the tax structure which could have been studied in detail, could not be undertaken for reasons of time and other resources. For instance detailed and independent studies on the incidence of different taxes, tax potential and tax effort of the State Government could not be undertaken. As a consequence, the findings of Governmental committees and commissions and of research institutes are adapted wherever possible. Similarly, as taxation and expenditure are the two sides of the same coin, a study of how the tax money (money that is taxed) is spent would have been a useful complement. However, this study also could not be undertaken for the reasons stated above.
NOTES TO CHAPTER I:


2. Ibid. Basic Statistics of Indian Economy, Reserve Bank of India.


4. Ibid.

5. Ibid.

6. Ibid.


8. Ibid., p. 8.


17. India is a Union of states. At present (i.e., after several reorganisations) there are 22 states in the Indian Union of which Andhra Pradesh is one. Besides, there are nine centrally administered areas. Of the
22 states, 16 are big and 6 are small. The aggregate revenue collected by all these states is generally referred to as 'All-States' revenue in India. Similarly, the total sales tax revenue collected by all the twenty two states of the Indian union is referred to the 'Sales Tax of All States'. The mix and types of taxes collected by all the 22/16 state governments in India is referred to as the tax structure of all-states put together or 'All-States Model'. Though there is variability in the tax structure of different states in the country, yet some generality exists among all the states. So the tax structure that emerges on the basis of the aggregated data of states, which has been described in this study as All States Model will be a representative model of the tax structure of the states.

18. Tax Receipts for 1980-81 and 1981-82, were revised and budget estimates respectively (particularly for purposes of calculations of growth rates etc.) However, accounts for these two years are not available and they have also been incorporated wherever possible.