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# *A VAT in India: Problems and Options*

Robin Burgess[#] and Nicholas Stern[*]



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# *A VAT in India: Problems and Options*

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The Indian tax system has yielded substantial revenue increases in the last two decades but these have been outstripped by expenditure growth. A weak budgetary position, the desire for trade and domestic liberalisation, the complexity and anomalies in the existing system and the weakness of direct taxation together point to the need for a major reform in indirect taxation. An obvious candidate is a VAT. While the benefits of a VAT in terms of economic efficiency are well known, its introduction in a federal context, such as India, poses problems. We review some conceptual issues and international experience with VAT. Careful consideration of questions relating to the choice of bases and rates, revenue sharing and tax administration will be required. A number of possible versions of a VAT in a federal context are identified. Each has its advantages and disadvantages and further research will investigate particular issues that arise.

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## SUMMARY

**Section 1:** The growth in total tax revenue in India over the last four decades (from 7% to 16% of GDP) has not, by international standards, been poor. This growth, however, has been achieved through the *ad hoc* imposition, and adjustment of rates, of a range of excises and sales taxes and with heavy reliance on import duties. At the same time revenue growth has been heavily outstripped by growth in expenditure (from less than 10% to close to 30% of GDP), as indicated by rising budget deficits. India has also seen, in recent years, a shift in economic policy towards liberalisation with the introduction of measures which give a freer reign to markets and international trade. These developments have two important implications. First, it is necessary to rid the indirect tax structure of existing problems of complexity and cascading which obstruct efficiency and trade. Second, substantial extra revenue is required both to combat rising budget deficits and to fill the revenue gap left by falling trade taxes. While direct taxes must play a role in economic reform, the small share of these taxes in total tax revenue and the magnitude of the challenge point to the need for major changes in the indirect tax system.

This paper presents options for reform of the indirect tax structure in terms of different versions of a VAT designed for a federal context. It must be emphasised that these constitute only an agenda and the objectives of the paper are limited to a review of theory and experience in a way which points to this

agenda. The further specification and appraisal of the options will be the subject of further work.

**Section 2.1:** In this section we outline the principles of Value-Added Taxation. The VAT has numerous variations and we provide a brief description together with a discussion of the advantages, problems and choices inherent in the different possibilities for VAT design. It is found that the option using a consumption base (with investment goods being deductible) and the destination principle together with the tax crediting method in administration has, justifiably, been the most popular.

**Section 2.2:** Here we analyze VAT options in a federal context. In a federal structure such as India, questions relating to choice of bases and rates for the centre and the states, revenue sharing and tax administration require careful consideration. Three main versions of VAT are outlined based on different responsibilities and bases for the centre and states and different revenue sharing arrangements.

**Section 2.3:** This section examines the experience of four federal economies, namely Brazil, Mexico, Germany and Canada, with VAT introduction. In each case we examine - the type of VAT introduced, the structure it replaced, the effects on overall revenue, rate setting, responsibilities for collection, revenue-sharing arrangements, and particular problems. The experience of these federations and the difficulties encountered provide useful lessons, both positive and negative, and point to the need for careful design in meeting the particular requirements of India.

**Section 3:** Here we review centre-state relations in India. In various subsections we look at the historical origins of the current tax system, the form of expenditure and tax assignments, as stipulated in the Indian Constitution, the form of revenue sharing and the constraints imposed by these factors on tax reform.

**Section 4:** This section sets out an agenda for India. It is our view that the problems of the existing system make it untenable as the basis of indirect taxation in the medium term. While charting an agenda for reform we emphasise that we do not expect direct and indirect taxes to achieve great things on the distribution front. The major contributions towards redistribution, and they can be vital, are likely to come on the expenditure side. Whilst we underline the need to lower the share of import duties in tax revenue, revenue considerations will mean that this lowering should proceed only as domestic sources of revenue rise to fill the gap. There should be a major role for specific excises (non-rebatable when used as inputs) on items like alcohol, tobacco and petroleum products, which generate strong externalities. Having explored the various options for a VAT we draw attention to four possibilities in particular. These are:

(i) The Jha Committee (1978) proposal of a central VAT up to the manufacturing stage plus retail sales tax in the states.

**(ii)** The Chelliah Committee (1991) interim report proposal of a central VAT supplemented by a state retail sales tax.

**(iii)** The Chelliah Committee (1992) final report proposal of a VAT applying up to the wholesale stage but with the states levying VAT at the wholesale stage, and retaining the revenue.

**(iv)** The Poddar (1990) proposal for a VAT with a unified base but separate federal and state taxation on the single base.

The Jha and Chelliah proposals attempt to move step-by-step from the *status quo* whereas the Poddar proposal is an example of more radical reform. Each of these has its advantages and disadvantages and further research will investigate particular issues including some of the constraints associated with centre-state relations as indicated in Section 3. The set of possibilities may also be broadened as further options are developed in the course of the research.

## §1 Introduction

There can be no doubt that the fiscal challenge facing India is severe. In the last four decades government expenditure (centre plus states) has grown from less than 10% of GDP to close to 30% (see Table 1 and Figure 1). In the same period tax revenue as a percentage of GDP has grown from 7% to around 16%, whilst non-tax revenue has grown from just under 2% (see Table 1). As a result, the overall fiscal deficit has risen from around 1% in 1950-51 to around 10% of GDP in 1988-89 (see Figure 1).[3] The data from which Figures 1 and 2, and subsequent Figures in this introductory section are constructed, are drawn from Government of India (various issues), Indian Economic Statistics (Public Finance) and set out in Table 1.

From most perspectives a deficit of this magnitude must be regarded as unsustainable (see Buiter and Patel, 1992). This has been recognised by the Indian government and, in the two most recent budgets, measures have been put in place which may begin the process of bringing the deficit down. To a substantial extent this deficit arose as a result of growth in public expenditure. From the narrow perspective of revenue performance, growth of tax revenue, from around 7% (as a fraction of GDP) to 16% or so in a 40-year period should not be regarded as poor by international standards. There are, however, two important

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[3] The overall fiscal deficit is calculated as combined centre and state total outlays (revenue and capital) less total revenue (tax and non-tax).

features of this growth which give rise to serious concern. First, revenue growth has been slower than expenditure growth(see Figure 1).[4] The second is that the growth in tax revenue has occurred by straining an out-of-date system to the limits through *ad hoc* imposition of a range of overlapping excise and sales taxes on a narrow base, by increasing rates of indirect taxes and, in particular, by increasing the share of import taxes in the total. The structure of the indirect taxes taken together is of a highly distortionary and cascading kind. Further, indirect taxes have become more and more predominant in revenue whilst the role of direct taxes has declined. The revenue potential of direct income taxes appears limited[5] (see Figures 2 and 3). Both from the point of view of adequacy of total revenue and of the defects of the current tax structure, it seems clear that the time has come for a major fiscal reform in India. Also, given the current tax structure and dynamics over the past two decades shown in Figures 2 and 3, it would appear likely that at least in revenue terms a major focus of the reforms must be on indirect taxation.

If we examine at Figures 2 and 3 and the numbers displayed in Table 1 it is clear that past developments in tax structure in India run against both international trends and consideration

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4 The rapid growth of the total expenditure series in Figure 1 relative to the revenue series is worrying and suggests that expenditure reform must accompany tax reform.

5 Their limited importance in revenue, relative to that in a developed country, also limits their role in redistribution. Even in developed countries direct taxes play a limited redistribution role, relative to that played by expenditures. For the UK, for example, see Economic Trends (various issues).

of economic efficiency. The share of customs duties in total tax revenue over the last two decades has been increasing, whilst the share of income tax and central excise taxes has been generally declining. Sales taxes have been roughly constant as a fraction of total tax revenue in the last decade or so (see Figure 3). The fall in the share of direct taxes, though understandable in terms of administrative difficulties, is not in keeping with historical trends elsewhere. In industrial countries personal income tax and social security contributions generate close to 60% of total revenue (see Burgess and Stern, 1992). Within indirect taxes the stagnancy (sales) or falling share (excises) of domestic indirect taxes and the rising dependence on foreign trade taxes runs counter to international trends, where one sees foreign trade taxes being replaced by domestic indirect taxation (see Burgess and Stern, 1992). Increasing reliance on customs duties is both distortionary and is in conflict with India's desire to become better integrated into the global trading system. The rising role of customs is further illustrated in Figure 4, which compares imports as a fraction of GDP with customs revenue as a fraction of GDP. It may be seen that the increase in customs revenue as fraction of GDP is partly explained by an increase in the share of imports in GDP since 1970. Given this tax structure, the challenge, is not simply to raise more revenue (and of course control expenditure) but to raise it in a way which is consistent with the desire to raise economic efficiency and expand international trade.

The reforms we shall be discussing in this paper will be largely of indirect taxation which contributes the bulk of tax revenue in India. It will also be of importance to expand direct taxes, but they are not our main concern here, and further they have been thoroughly discussed in the recent reports of the Chelliah Committee (1991 and 1992). The major indirect taxes in India are the union excises which are levied on goods at the production stage and have to be paid before they can leave the factory (this system is known as clearance). The centre, or union, is also responsible for customs revenues and for the taxation of incomes (personal or corporate) other than incomes arising from agriculture. The states, on the other hand, are responsible for sales taxation, which is their main revenue generator, and the taxation of alcohol (via excises). In both cases there are a number of further sources of tax revenue, but the ones described cover the bulk (see Tables 4, 6 and 7 for breakdowns). The main lines of the division of responsibilities are drawn in the Indian Constitution. Further details of state and central tax revenues are provided in §3.

In looking at the reform of indirect taxes we focus our attention in this paper on the value-added tax. The expansion of this form of taxation through the developed and developing world in the last 25 years has been remarkable (see Tait, 1988). Value-added tax was first introduced in the Ivory Coast in 1960 with Senegal (1961), Morocco (1962) and Colombia (1965) following shortly. It was introduced in Brazil in 1967 and was then rapidly adopted in the European Economic Community. It has now been introduced in more than 20 developing countries (see Tait, 1988, 1991, and Gillis, Shoup and Sicat, 1990). It has a number of advantages from the point of view of economic principles, in particular it avoids the taxation of intermediate goods, but it has also shown itself to be administratively feasible with some robustness to evasion. There are few examples, however, of a VAT in a federal context. Prominent amongst these are Brazil, Mexico, Germany and (very recently) Canada. In §2 of this paper we begin by describing and setting out some of the theoretical background to VAT. We go on to analyse the problems of and options for a VAT in a federal context, and this analysis is complemented by an examination of the experience with VAT introduction in the four federations named above. In §3 we look more closely at how the constitutional position and centre-state relations have affected and constrained tax design in India. Finally, in §4, we discuss how VAT principles, international experience and the Indian fiscal background combine to suggest some possible options for a VAT in India.

It must be emphasised at the outset that these options constitute only a preliminary agenda. The objectives of the paper are limited to a review of theory and experience in a way which points to this agenda. The further specification and appraisal of the options will be the subject of further work.

# §2. Principles and Experience of VAT

## §2.1 Principles

As we saw in the preceding section, India faces very strong pressures on its public finances. The budgetary position worsened during the 1980s and it is clear that amongst other things, extra tax revenue will need to be raised. At the same time India has embarked on a programme of economic reform, designed to give a freer play to market forces and to remove, what are now seen as, impediments to efficiency and growth, arising from some government controls and taxes. A logical objective of this liberalisation programme is a general reduction in trade taxes. Decades of protection, it is argued, should now make way for greater competition between domestic and foreign producers.[6] Given the desire both to raise more revenue and to reduce import tariffs, India must look closely at domestic sources of taxation.

Over the past four decades India has not been very successful at collecting direct taxes, due largely to problems of information and evasion and the narrowness of the tax base. As can be seen from Figure 3 the share of direct taxes in total tax revenue collected by the centre has been falling. Whilst it is to be hoped that the poor performance on this front will be

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[6] Aside from the efficiency gains in the private sector associated with removing quotas or reducing tariffs, trade liberalisation may also play a central role in restructuring inefficient parts of the state enterprise sector in India.

improved, there is no doubt that in the process of raising extra revenue a major role must be played by those taxes which currently form the bulk of Indian domestic tax revenue, that is indirect taxes. The main heads for domestic indirect taxes are the central excise taxes, the state sales taxes, and the state excise tax on alcohol. Our primary purpose in this paper is to examine the possibility for a major reform in Indian domestic indirect taxation that would be oriented towards meeting the goals just described - raising additional revenue, promoting liberalisation and reducing trade distortions - whilst taking account of India's special constitutional federal structure.

In assessing the options amongst indirect taxes we may apply a number of criteria. These include: neutrality/efficiency in production and trade; flexibility with respect to other government objectives, including those concerning the distribution of welfare; buoyancy; administrative feasibility; and political and legal acceptability. Amongst general indirect taxes (as opposed to taxes on particular goods such as tobacco, alcohol and petroleum products) the two most prominent options are value-added taxation and retail sales taxation. The most common forms of a VAT (those with a consumption base) are equivalent, in theory, to a retail sales tax. They have both practical advantages and disadvantages relative to retail sales taxation. The advantages of the VAT include being more robust against evasion, in the sense that if revenue is lost at one stage it can be recouped further down the chain of production and sales, whereas all revenue is lost if the sales tax is evaded at the retail stage. VAT registered producers/wholesalers will have an incentive to include their purchases in their VAT returns, and thus bring their suppliers into the net, as they require receipts in order to be rebated on inputs. The audit trail is thereby extended. With the retail sales tax, however, there is no incentive to record tax payments (aside from penalties) and as retailers are typically geographically diffused and difficult to monitor, evasion is often widespread. The natural response to these difficulties is to tax at more easily monitored stages of the production chain, such as through manufacturers or wholesalers taxes, and this indeed is the manner in which most sales taxes are levied in India (see Purohit, 1988). This can, however, lead to inefficiencies and anomalies (see below). An associated disadvantage of the VAT, in that it involves taxation throughout the chain, is that it imposes a substantial administrative burden on both the authorities and individuals. However, with this disadvantage comes a corresponding advantage that earnings may be brought more fully into administrative records, providing possible benefits not only to taxpayers themselves in terms of more careful and systematic accounts, but also to the state in information which is potentially useful for income tax purposes.

Both the VAT and the retail sales tax have the advantage that they do not distort production decisions and fall only on final consumption. Any other form of sales or turnover taxation carries with it the problem that production inefficiencies arise if intermediate goods are taxed (see Tait, 1988, 1991). Multiple point sales taxation involves cascading and inefficiency in that prices to the producers do not reflect marginal costs since they include a tax element. Single point production taxes often share these problems and in addition are incapable of taxing value added beyond the production stage. Taxes along different stages of the chain from production to sales accumulate and the tax-content at final sale or of exports is thus difficult to assess. If taxes at earlier stages in production are credited then we move essentially to a VAT. It should be noted that neither the retail sales tax nor the value-added tax requires uniformity of rates and in practice both forms of taxation are differentiated, although typically retail sales taxes are differentiated more highly than value-added taxes (see Shoup, 1990).[7]

Since our main focus in this paper is the value-added tax we shall not look at the problems and virtues of retail sales taxation in great detail. It should, nevertheless, be remembered that it is the main competitor to the value-added tax as an efficient and administratively feasible form of taxation. It has been, and still is, operated quite successfully in a number of countries. Any country considering tax reform should not rule it out without careful consideration and in principle both systems could be run in tandem. In some developing countries, however, where much of the retail sector is informal, the retail

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[7] This is often the case because different sales tax rates may be attached to different product types, whereas in the case of the VAT, tax bases are wider, with a general rate being applied to the bulk of goods and services, a low rate for basic necessities, a high rate for luxuries and zero rating for exports.

sales tax does generate administrative difficulties which, taken together with the problem of loss of all revenue from the product if the tax is evaded or not implemented at final sale, can militate in favour of a VAT as opposed to the retail sales tax. Historically, however, it should be noted that VATs have generally replaced a range of manufacturer, wholesale, resale or turnover taxes (see Tait, 1988, Table 1.2). In India these and a wide range of production excises are the most common forms of domestic indirect taxes.

We now proceed to provide a brief description of the operation of a system of value-added taxation, pointing out as we do some of its advantages and problems, and the choices inherent in VAT design. As its name implies, the VAT is a tax on the value-added by a business or firm. The value-added may be seen as the value of sales less the value of purchased inputs, or as payments to factors within the firm.[8] In a closed and static economy the sum of all the values-added at each stage will equal final retail sales, which are in turn equal to total factor payments, so that the tax may be seen either as a tax on retail sales or as a tax on factor payments. This situation, however, is not quite so straightforward when an economy is open and growing. In an open economy some retail sales will arise from imports and not from domestic value-added. Similarly, exports embody domestic value-added but do not enter retail sales. In practice most value-added tax systems do not levy tax on exports,

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[8] Care is necessary in the notion of value-added here, particularly the extent to which value added is attributed to capital. Different forms of VAT treat it in different ways.

allowing taxes paid at previous stages to be rebated, but they levy the value-added tax on imports. This practice preserves the base of taxation as retail sales. In an economy which is not static the treatment of capital goods and depreciation will influence the basis of taxation as we shall describe in our discussion of the various options for a VAT which follow.

Shoup (1990) identifies eight choices which need to be considered in specifying a VAT. "The chief decisions concern:

1. The three broad types of VAT: consumption, income and gross product. The personal exemption VAT, a variant of the consumption type, has never been used and is not covered here (see United States, Treasury Department Report, 1984, pp.35-38).

2. The regime for international trade: the origin principle (exports taxable, imports exempt) versus the destination principle (exports exempt, imports taxable).

3. The three methods by which the taxpaying firm may compute its tax liability: subtraction, tax credit or "invoice", or addition.

4. The products, firms or sectors to be free of VAT.

5. Techniques of freeing from VAT: outright exemption (the firm need not file a VAT return) and "zero-rating" (the

firm must file a return, but pays a zero gross tax and gets a refund for VAT payments made at a prior stage).

6. The sectors and firms that, although taxable, are thought to require special rules or regimes.

7. A single-rate VAT versus a VAT with two or more rates (in addition to the zero rate, if any).

8. A tax-inclusive VAT rate versus a tax-exclusive VAT rate. The former is levied on the total amount of money transferred, including the tax itself. The latter is levied on the price before tax."

We comment only briefly on these choices (for further development see Gillis, Shoup and Sicat, 1990). The first choice in the list above concerns the appropriate base for the VAT. By far the most popular choice is that of consumption. The purchase of capital goods is deducted from the tax base, just like the purchase of any other input. There is therefore no need to distinguish in the tax system between capital and "deductible" current inputs. Investment goods are therefore taken out of the base of the indirect tax system which becomes final consumption. The base for the income VAT is consumption plus investment less depreciation (this base will be equal to factor payments). This can be implemented either by looking at factor payments directly or distinguishing between current and capital inputs in allowing deductibility of purchases (with the latter not being deductible) and making some allowance for depreciation. Argentina, Peru and Turkey have adopted this form. It is much less common than the consumption bases (see Tait, 1988).

The second choice involves the origin versus the destination principle. Countries have almost universally favoured the destination principle, Brazil being an exception (see §2.3.1). Under certain circumstances they are equivalent, but the equivalence must arise through adjustments of the exchange rates, with the exchange rate being lower (so that the imports are more expensive) under the origin principle rather than the destination. The indirect way in which this equivalence operates detracts from its political acceptability, where it looks as though imports are going tax-free. The choice is an important one when we come to think of the taxation of states in a federal context (as exchange rates between states in a federal country will be fixed) and we shall come back to it in the next subsection.

The subtraction method (see the third choice) involves simply the subtraction of total purchases from total sales for a firm to arrive at the tax base. The tax credit or invoice method involves adding up the total tax invoices issued by a firm, and taking from that sum the total of the tax charged on the invoices paid by the firm, to give the tax liability. The addition method adds factor payments to arrive at the base, and is generally used only with the income VAT since, as we have seen, the basis for a consumption VAT is not total factor payments.

The choice between the subtraction and tax credit method turns on administrative ability and problems of evasion. Under both methods there are some built-in checks, because a taxpayer has an incentive to overstate the value of purchases (and understate the value of sales) whereas the supplier of the goods which are purchased as inputs will have an incentive to understate their value. Even though the incentive structures are the same in both cases the tax credit system does allow more explicit cross-checking. Perhaps the main advantage of the tax credit system over the subtraction method is that it does not lose revenue if a link in the chain is broken. Under the tax credit system, if the chain is broken by evasion or exemption then any purchaser of inputs further down the chain will have less tax credit to show, so that the value-added will be brought into the tax net later in the process. The subtraction method does not allow such simple recoupment.

The fourth choice, which concerns the issue of who should be 'free' of VAT, would be influenced by administrative problems and distributional judgements. Most countries would have an exemption limit ruling out very small traders. Some sectors, such as agriculture and financial services, may pose particular difficulties. These exemptions may reduce administrative burdens but they generally carry some inefficiencies with them from "uneven" treatment. For VATs based on the destination principle, exports are typically zero-rated in order to maintain economic neutrality in trade taxation.

The fifth choice revolves around how freedom from the VAT should be achieved for selected agents or sectors. Being exempt frees the agent from the bother of VAT returns and records, but means that it is not possible to reclaim tax paid on inputs. In the latter sense being zero-rated is more advantageous.

The sixth choice involves special rules for some sectors. Of particular relevance are hard-to-tax sectors where records tend to be incomplete. Agriculture and services are of importance here. Presumptive methods can be helpful in these cases where, given basic characteristics of an enterprise, a value-added is estimated using simple indicators such as size (for example, of restaurant) or estimated turnover. This 'presumed value-added' can then be overturned only if detailed accounts are made available.

As we have already mentioned, there is nothing in the VAT system, either in theory or in practice, to suggest that it must be at a single rate, and indeed most countries do have more than one rate, often on distributive grounds (see Tait, 1988, chapter 2). A multiplicity of rates can cause administrative problems both for tax payers and tax authorities. It opens avenues for evasion where goods sold in a particular establishment may be classified at a lower rate for the purposes of making tax returns. It should be noted that even if there is a single rate of VAT the system of exemptions and zero rating of some sectors or agents will imply that the tax embodied in the final price for the good will not be at a uniform rate. Notice that differentiation of rates, if it is to occur, is of particular relevance at the final stage of sale to a consumer. Differentiation at an earlier stage is rendered irrelevant by the crediting system unless the purchaser is exempt.

The final choice of a tax-inclusive versus tax-exclusive VAT is, from one perspective, a matter of expression, in the sense that it simply reflects the way in which tax rates are described. Most countries have chosen the tax-exclusive rate - a rate of 10% on a pre-tax bill of 100 means that the post-tax bill is 110. This does have the advantage of clarity in that the actual tax paid appears explicitly on invoices in a more transparent way. This can be valuable in the federal context.

It would appear that there are a large number of choices available in selecting a VAT. The consumption-based, destination, tax-credit method has been by far the most popular, as has the tax-exclusive form of expression. On choices 4-7, the countries have varied considerably depending on their circumstances and priorities.

## §2.2 VAT Options in a Federal Context

The issues described above arise with a VAT in a national context. A federal structure raises further significant problems, the form and resolution of which will be profoundly influenced by decisions on the questions we have been discussing. The additional problems concern how rates and bases are set, how revenue is shared and how tax administration is organised. Where there are separate central and state powers to choose bases and rates for related taxes, we must ask how those decisions are to be coordinated. Where tax rates are chosen separately by states, questions of the treatment of goods crossing internal borders may be of importance. There also needs to be an analysis of what institutional bodies carry out the collection of taxes and of how revenue is to be shared between different levels of government. The answers to these questions aid our understanding of the political arrangements and influences, administrative complexities, anomalies and incentive structures associated with any given system. Our primary concern in this paper is with taxation but the allocation of expenditure powers is a feature which will exert strong influences on tax pressures and politics. It is something to which we return only briefly (see §3) but is likely to be the subject of further work. Generally one should avoid analysing the revenue and expenditure sides of the budgets entirely separately since they are clearly closely related, both in theory and practice. Indeed, fiscal correction involves both expenditure and tax reform as has been heavily emphasised in the two most recent Indian budgets.

Examples of possible general arrangements for centre-state relationships include the following. There may be a tax system which is largely national in its decision-making, but where there is formula sharing of aggregate tax revenue. Formulae may be based on population, income per capita, "special needs", and the like. If taxes are administered at the local level this kind of arrangement means that there is no special incentive for localities or regions to concentrate their effort on one tax or the other since they get a similar share in each. Also there is no incentive for a given state to out-perform other states, as regards tax collection, if shares in the total are determined independently of collection. A second example might involve formula sharing of individual taxes. This type of system has the incentive problems that a state, or the centre, may not want to devote as much energy and resources to collecting taxes in which it has a lower share. This problem is avoided if there are allocations of taxes of a very different kind between different levels of government, for example income taxes to the centre and sales taxes to the state. The state may then retain 100% of the taxes allocated to it and would have an incentive to pursue them energetically. This has been the case for example with alcohol taxation in some states (for example, Karnataka) where collection has been pursued fairly effectively (Musgrave and Stern, 1988). On the other hand, for different reasons some taxes allocated to the states, such as the agricultural income tax in India, have not been vigorously pursued. In the United States we have income taxes imposed at the federal level and sales taxes at the state level, although some states and cities raise income taxes too.

A third variety of relationship between centre and states might have a given tax (on sales or income) being levied separately but on exactly the same base. For example, one could have a local or state income tax levied on exactly the same base as the federal one. This would mean, of course, that there would not be freedom for the states to choose the base of taxes which would have to be perfectly coordinated with the centre. The attraction of this system is that administration is simplified and inefficiencies kept to a minimum.[9] A fourth system has overlapping bases with the centre and states attempting to levy taxes on the same types of activity but under different rules. Whilst, in principle, it gives greater flexibility in decision-making, such a system can lead to real confusion, inequities and inefficiencies. Political and administrative problems with separate and semi-autonomous state and federal VATs (see §2.3) have apparently been serious in Brazil. In India the allocation of excise taxes to the centre and sales taxes to the states results in haphazard effects including cascading, since there is no rebating of central excises against state sales taxes and because both types of tax are being levied on a similar base. The central excise system does involve some rebating of excises on inputs against excises on outputs through the MODVAT system, introduced in 1986 (see Naryana et. al. 1990 and the Report of the Committee on MODVAT appointed by the Ministry of Finance in

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9 The system may operate by allowing the state to add a surcharge on the federal rate of taxation, the revenue from which they would retain. This would provide states with a degree of autonomy over revenue raising and would act as an incentive to collect the tax as a whole, as the states' take will be proportional to total revenue collected.

1990). It is nonetheless clear that in India the degree of inefficiency within each of the major domestic indirect taxes is fairly high and that these are compounded by poor coordination between the authorities responsible for administering these taxes, in particular between the central and state tax authorities.

With this background we now look more closely at the possibilities for VAT in a federal context. Poddar (1990) sets out the following options. "The various options for the imposition of a general sales tax at the state level fall into the following broad categories:

A national tax with revenue-sharing arrangements.

Origin-based taxes

  VAT with uniform rates

  VAT with variable rates

Destination-based taxes

  Retail sales tax

  VAT with uniform rates

  VAT with variable rates

A joint federal-state VAT."

As regards operating and collecting a national tax with revenue-sharing arrangements, the problems, in principle, are no bigger or smaller than with an ordinary VAT and a unitary authority. Problems arise, however, with the sacrifice of fiscal independence by the states. If the revenue-sharing agreement is fixed then state revenue, at least from this particular tax, is determined entirely by central authorities. States may have different revenue needs at different points of time, which are not adequately reflected in the formula. They also may have different preferences as regards the taxation of particular goods or different attitudes to income distribution, or distribution across various different groups in the population. Because the composition of household budgets varies widely across India, taxes on a particular commodity will have different implications for households in different states. For example, heating and warm clothing may be regarded as a necessity in northern states but not in the south. Some states may decide they would want a larger role in the economy than the others and so on. Thus, the objections to this form of a state-federal value-added tax are not to do with efficiency or administrative feasibility, on which counts such a system works quite well, but to do with political acceptability. VATs in general replace a host of sales and excises taxes, some of which are under state control, thus these types of problems may seriously limit adoption of a VAT of this type (see §2.3 on Mexico and Canada).

The second group of taxes are origin-based. In other words the tax is levied at the point where production takes place. At one point in time it was thought that origin-based taxes were necessary where there were no formal internal borders between states (Neumark Committee, 1963, had advocated an origin-based system on the grounds that it was intended to operate in the European community where border controls would be eventually removed). As we shall see, the argument is not valid. Further, origin-based taxes generate their own problems as regards distortions and cross-border movements. If an origin-based tax were at the same rate in every state then it would in principle have the same economic effects as the more familiar destination-based taxation. For the reasons just described, however, it is likely that rates will vary across states as there is competition both to raise revenue and to attract investment. In this case origin-based taxation will generate incentives to produce where taxes are lowest and thus artificially distort the location of economic activity.

The problems with differential rates under the origin principle go beyond that just discussed. For example, under a credit-system VAT a good shifted from a high-tax state to a low-tax state will show a large tax credit which, if it is allowed by the low-tax state against local taxation, would seriously undermine its revenue base. It is clear that under such a system arrangements for the allocations of credits may prove difficult. Similar problems arise with the allocation of credits for international trade flows. Whether or not the VAT rates under the origin system are uniform across states there will be difficulties associated with the valuation of shipments. For example, an integrated firm might have a production plant in state A and distribution and retail activity in state B. The prices which are used to do the accounting in the transfer between one part of the firm and another will have a major effect on the tax revenues in the two different states. Further problems arise with goods such as electricity and transport for which the origin of supply poses conceptual problems. It would seem that the problems of origin-based taxation are, in principle, severe. Attempts to reduce these inefficiencies will lead to complex rules on both inter-state and international trade with an accompanying proliferation of administration and border controls. Indeed, many of them have arisen in practice, in the case of the imposition of federal and state VATs based on the origin principle, as in Brazil (see §2.3).

As Poddar (1990) points out, destination-based state taxes do meet the objectives of autonomy and economic neutrality. There are important problems, however, concerning procedures for inter-state flows and the arrangements for the allocation of crediting responsibilities. There is also the problem of cross-border purchasing, but where states are large this problem may not be serious. Mail ordering activities could be dealt with by requiring mail-order firms to levy rates associated with the address of the purchaser.

Transactions across states could be zero-rated, just as are transactions in international trade, so that a producer who exports from one state to another gets back all the tax paid prior to export. It is not necessary, however, to have border controls in order to collect tax on imports into a state, if there is an inter-state tax clearance mechanism as described below. For a cross-border sale the exporter could charge the full tax and the buyer receive full credit, but this credit would be reported by the buyer as an import from another state (VAT receipts would have to be separated by state of origin which would impose work on tax payers) The inter-state tax clearance system would work as follows. The VAT account of the exporting state would be debited, and that of the importing state credited so that the rebate would in fact come from the exporting and not the importing state. Such a system would work for sales from one firm to another but sales to final consumers would effectively be taxed at the rate associated with the point of sale, even if the consumer comes from and is returning to another state. It appears difficult to deal with these problems of cross-border purchases, but it is a matter for research just how important these are likely to be.

We note three further issues to which we shall return. First, it is possible to do the inter-state accounts in approximate form using aggregate flows across state borders rather than recording each transaction. The less differentiated are tax rates across goods the more accurate such aggregate methods are likely to be. Second, one could in principle do without an inter-state tax-clearance mechanism. An exporter from state A to state B would claim tax back on inputs and zero-rate outputs. The importer would have no tax paid on the input to show as credit so it would effectively be taxed when output is sold, at a rate relevant to state B. Revenue is lost if such sales are to final consumers or entities exempt from VAT. Evasion is possible if goods denoted as for export to another state and zero-rated are diverted to final, local consumers (if diverted to other local producers then the goods should in principle be taxed when their output is taxed). Third, the introduction of a destination-based principle where the VAT replaces origin-based taxes can cause problems as states which are net exporters may object to loss of revenue.

The final option described by Poddar has a number of attractions. It provides much of the simplicity of the system of revenue-sharing, from a tax operated at the national level, whilst at the same time allowing the states some fiscal autonomy. Essentially the tax base would be identical across states and there would be a basic federal rate common to all states, although it could vary across commodities and activities. The states would then be free to levy additional rates on the same base. There would be no need for a wholly separate system and each transaction would simply have two rates of VAT on it rather than just one. A tax clearing agency could have credit and debit accounts associated with each state government, which would be fairly straightforward to operate, at least in principle. The drawback is some loss of flexibility for states in the selection of bases. They would, however, be free to zero-rate activities if they did not wish to tax them. In §4 we discuss how some of these schemes might fare in an Indian context.

## §2.3 VAT Experience in Selected Federations

In this section we examine the experience of four large federal economies with the introduction of VAT. The countries selected, Brazil, Mexico, Germany and Canada have tried different methods of reforming their systems of indirect taxation, have encountered very different problems and have achieved their reforms with varying degrees of success. Their experience provides a useful backdrop to the problems facing India.

For each of the four economies surveyed we are interested in asking a set of questions which will provide empirical content for the discussion of VAT options in a federal context contained in §2.2. For an overview of the experience surveyed here see Table 2, where the columns correspond to key questions identified in §2.2. An examination of the system of sales taxation which the VAT system replaced provides insights into the motivation for VAT introduction. As we shall see this often has to do with efficiency and simplicity as well as revenue in the sense that pre-VAT domestic sales taxes often exhibit cascading, complexity, awkward segmentation of bases and multiple rates. Pressure to raise additional revenue from domestic indirect taxes may be strong, in particular when other taxes do not perform well for administrative reasons (e.g. direct taxes) or are perceived as distortionary (e.g. foreign trade taxes). It is therefore interesting to look at both the overall tax picture in a country and the net revenue effect of VAT introduction. As regards centre-state relations, we saw in §2.1 and §2.2 that the issues of base and rate setting, responsibility for collection, and revenue sharing arrangements are critical in determining the success or otherwise of VAT introduction. We examine these issues in detail and attempt to highlight the types of problems that have arisen with different VAT specifications in these federal contexts. Finally we look at how countries have attempted to adjust their VAT system to correct for anomalies and shortcomings.

### §2.3.1 Brazil[10]

The history of taxation in Brazil is short. Until the mid-1930s it would appear that there was little significant taxation in Brazil (Longo, 1990). The 1934 constitution established a basis for taxation with the federal government having control over income taxes, import tariffs and excises while the state governments were able to levy taxes on inter-state trade. These state level trade taxes were gradually replaced by a turnover sales tax which by 1965 accounted for 80% of total state tax revenue. Wholesale sales taxes were also gaining in importance at the federal level and were levied on a range of industrial products, often at multiple rates. 1967 was the year of VAT introduction with the federal VAT (*Imposto sobre Produtos Industrializados* - IPI) replacing the wholesale sales tax, and the state VAT (*Imposto sobre Circulacao de Mercadorias* - ICM) replacing the state turnover tax.

Between 1967 and 1980 tax revenue collections by the centre rose from 45.8 percent of total revenue to 58.7 per cent. State collections correspondingly fell from 49.4 per cent to 36.2 per cent (Shah, 1991). This was partly because the central

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10 See Table 2 for a summary of the operation of VAT in selected federations.

government's control over income and foreign trade taxes, augmented by its ability to impose VAT on industrial products and excises on a number of consumption items, eroded the state tax base. The states lost the autonomy to create new taxes and a rigid system of uniform VAT rates and exemptions was imposed by the centre. This meant that any given state had little capability to respond independently to revenue shortfalls and the centre was able to exercise greater control over state expenditure policy.

Changes in the overall structure of taxation have been somewhat perverse when compared to international experience. Between 1970 and 1988 total tax revenue as a percentage of GDP declined from 26.0 percent to 19.9 percent. Most of this fall is accounted for by the decline in indirect tax revenues, which dropped from 16.8 percent in 1970 to 10.2 percent in 1988. Within this total, over the same period, the federal VAT (IPI) share fell from 4.4 percent of GDP to 1.8 percent of GDP, whereas the state VAT (ICM) share fell from 6.9 percent of GDP to 4.6 percent of GDP. Direct taxes, comprised mainly of corporation tax, maintained their share over the period, rising from 9.2 percent of GDP to 9.7 percent of GDP with a peak of 11.8 percent of GDP in 1984 (see World Bank, 1990b). There has been a trend towards the displacement of tax revenue by non-tax revenue within total revenue, with privatisation proceeds playing an important role in recent years. This tax evolution in the face of rising deficits and debt provided grounds for serious concern. The lack of success of VAT in reversing these trends requires further scrutiny.

Part of the problem derives from the fact that Brazil represents one of the few attempts to levy VAT separately at the central government and state government levels. The tax base of the federal VAT (IPI) is industrial production - agriculture, minerals and services are excluded. Within the industrial sector, particular industries (e.g. steel) have been treated favourably and are exempted from VAT. Specific imports (e.g. high technology and capital goods) are also exempted or subjected to tax reductions. VAT rates range from 0 percent for exports and production within the Manaus Free Trade Zone, to 300 percent on tobacco and alcohol. Concessions and exemptions have significantly dented the revenue potential of the VAT and the growing complexity of the system has challenged administrative capacity (see Shah, 1991, Longo, 1990).

The tax base of the state VAT (ICM) includes, in theory, all goods at all stages of production. In practice a range of industrial products, imports, agricultural inputs and food products are exempted. Services are excluded from the tax base largely for administrative reasons. There is a standard rate of 17 percent for transactions within the state. In 1989 additional rates of 12 percent for basic necessities and 25 percent for luxuries were introduced.[11] As regards inter-state trade, a complex system applies where revenue allocation is contingent on the difference between importer and exporter state VAT rates

[11] Note that because these tax rates are imposed on prices inclusive of tax , effective rates of taxation are higher than statutory rates. For example, the 17 percent standard rate corresponds to a 20.84 percent effective rate (Estache, Fernandez and Roy, 1990).

(see World Bank, 1990b). State VAT is administered by the Council of States having finance ministers from all states (including the Federal District) as its members. Any changes in tax rates or base must be presented by the individual states to the Council for approval. Due to the complexity of the state VAT system, a great deal of the Council's time is spent sorting out inter-state tax credit issues and conflicts. Another implication is that there has been little autonomy for individual states to set bases and rates in line with their perceived expenditure needs.[12]

Tax assignment and collection are clearly delineated between the different levels of governments in Brazil (see Shah, 1991). The federal government has exclusive responsibility for the taxes on income, payroll, wealth, foreign trade, banking, finance and insurance, rural properties, hydroelectricity and mineral products. The main source of revenue for state governments is the state VAT (ICM).[13] The taxation of inheritance and gifts and motor vehicles registration also contributes substantial amounts to state tax revenue. As the bases of the federal and state VAT overlap, responsibility for the taxation of industrial products is shared between the federal and state governments. The state and federal VATs are administered separately and, it seems, in

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[12] Shah (1991) notes that changes in tax rates have been resisted quite strongly by the Council as these can change the pattern of revenue allocation across states. Exemptions of commodities or services from the tax base are however more easily agreed as their net effect is only to reduce revenue in the state in question.

[13] A variety of taxes on services, urban properties, fuel retail sales are also levied by the municipal government.

a fairly uncoordinated fashion, leading to double taxation of a range of industrial products.

Tax collection responsibility is shared between federal, state and municipal governments.[14] Sharing of revenues is always downward, the net effect being a decrease in federal disposable revenue, an increase in state disposable revenue and an increase in municipal disposable revenue.[15] To some extent the lower tiers of government are compensated for their narrow tax assignment by downward revenue sharing. The state participation fund is made up of 21.5 percent each of federal income tax and VAT (IPI) and is distributed by the Council of States.[16] The Council first sets aside 85% of the fund for distribution to states in the poor north, north-east and centre-west regions, with the remaining 15% going to states in the more prosperous south and southeast regions. Distribution between states is then carried out on the basis of a formula that takes into account population (a proxy for fiscal need) and the inverse of per capita income (fiscal capacity indicator - see Shah, 1991, Box 1).[17]

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[14] For example, in 1986, the breakdown of tax revenue collection was: federal-53.5%, states-42.2%, municipalities-4.3% (see Shah, 1991, Table 5).

[15] Thus the corresponding disposable revenue shares for 1986 are: federal-39.5%, states-40.7%, municipalities-19.9% (Shah, 1991, Table 6), see preceding footnote for collection shares.

[16] Significant proportions of the federal payroll tax, hydroelectricity tax, and mineral products tax are also shared downwards (see Shah, 1991, Table 4).

[17] This sharing formula embodies not only a concern with regional equity but also the realization that the introduction of a VAT in Brazil led to higher state tax collections in the

We conclude this sub-section with a brief discussion of problems with the federal-state VAT in Brazil which may together contribute to an explanation of why, in revenue and in other terms, VAT performance in Brazil has been poor. The first problem has to do with difficulties of administration. A new and complex system introduced where administration is weak and without additional safeguards, checks or enforcement can lead to revenue falls. In Brazil bases are segmented, multiple rates and exemptions apply, large sectors of the economy are missed out and there is little coordination between the different levels of administration of the VAT. The second reason concerns the way in which the two-tier VAT system is operated. The federal and state VAT bases overlap in Brazil and the fact that the two systems are under separate jurisdiction complicates tax administration. The third problem has to do with tax assignment and revenue sharing. States feel that their tax base is too narrow and too inflexible to meet adequately their expenditure needs. Their share in federal revenues is not perceived as sufficient to make up for the curtailment of their tax powers and the sharing formula itself is widely perceived as being unfair, making them less co-operative in the collection of taxes in which they have a lower share. Decentralisation of taxes has also weakened the ability of the central government to carry out

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industrial states which are located mainly in the south and southeastern regions. The origin principle reinforces this inequality as it implies that the richer producing states retain most of the VAT irrespective of where the final products are sold.

macroeconomic stabilisation through fiscal instruments.[18] The fourth problem has to with the origin-based principle of the state VAT. Under this system net exporting states (which tend to more developed) obtain a larger share of revenue while importing states obtain a smaller share. Attempts to address this imbalance through the taxation of inter-state trade have proved to be distortionary and administratively costly (see Poddar, 1990).

### §2.3.2 Mexico[19]

Until 1950 the tax structure in the Mexican federation was fairly undeveloped. The main emphasis was on a range of specific taxes levied on three easy to tax bases: natural resources, industrial production and international trade. A national turnover tax introduced at the end of the 1940s replaced a large number of production and sales taxes and represented the first stage of indirect tax reform. The deficiencies of the federal turnover tax as regards cascading, calculation of the tax content of exports, vertical integration and the favouring of large firms, and the taxation of investment, led policymakers to consider a VAT. The VAT was attractive because it had the potential to streamline and simplify the existing domestic indirect tax system, which comprised many sales and excise taxes

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[18] Boutsin and Shah (1991) identify three inter-related factors contributing to a lessening of macroeconomic control: (i) devolution of fiscal policy instruments, (ii) the undermining of federal fiscal instruments by behaviour at lower levels and, (iii) the fiscal squeeze on central government as a result of tax transfers to lower government levels not being accompanied by the transfer of expenditure responsibilities.

[19] Please refer to Table 2 for an overview.

with multiple rates and bases, often under the jurisdiction of different tax authorities. These considerations along with rising inflation and budget deficits, and thus extreme revenue pressures, led to the adoption of a VAT in 1980. The VAT replaced 30 federal excise taxes and 400 municipal and state taxes, thereby simplifying tax administration and improving compliance with indirect taxation (Gil Diaz, 1987 , Aspe, 1992). VAT introduction was a central feature of the 1978-1981 tax reforms and the share of VAT in total revenue has consistently trended upwards (see, World Bank, 1989). The latest episode of tax reform which took place between 1989 and 1991 focused on base broadening, strengthening administration and enforcement, as well as on the simplification and reduction of VAT rates (Aspe, 1992).

The Mexican VAT is levied on activities connected with the sale of goods, the provision of independent services, the granting of the temporary use of property and the importing of goods and services. Coverage is thus extensive though exemptions and zero-rating of products has increased since VAT introduction, when only exports were zero rated. Agricultural products and machinery, medicines and exports are all zero-rated. Housing construction and rentals, passenger transport, education, most medical services and public administration are exempt. As a result, though large fractions of value-added in mining (90%), manufacturing (80%) and commerce (70%) fall within the taxable base, the taxable proportion of value-added in construction (30%) and agriculture (10%) is low (World Bank, 1989). There are also administrative problems connected with the inclusion of the self-employed and small businesses in the VAT net (World Bank, 1989).

When first introduced, VAT was levied at a single rate of 10%. In 1983 this general rate was increased to 15% as part of a response to rising fiscal deficits. An additional rate of 20% on luxury goods was subsequently introduced to improve the progressivity of the system. A 6% rate on food was also included at a later date. In 1991 the general rate was lowered from 15% back to 10%. At the introduction of VAT, taxable production activities in border areas had been subject only to a rate of 6% as an incentive for investment. In 1991 this rate was replaced by a single 10% rate implying that the bulk of transactions are now taxed on the same basis in all parts of the country (Aspe, 1992).

In Mexico, the federal government has control over the VAT though administration and collection is carried out by both the states and federal districts (e.g. Mexico City) in exchange for a share of the proceeds. For this type of system to work it is necessary that two conditions are met: (i) that there are sufficient incentives for state and local governments to collect the tax, (ii) that state and local taxes which tax the same base as VAT, but which give states either exclusive or more favourable revenue claims, are not allowed or are at least contained. The federal constitution and the Value Added Tax Act both embody strong limitations on the types of taxes that states and municipalities may impose.[20] The centralization of indirect tax revenues has its antecedents in reforms in 1973 when the federal government raised the nationwide turnover tax rate from 1.8% to 4% and gave the states the offer of 1/2 of the local revenues from this tax *if* they eliminated their state turnover taxes.[21] Take-up was universal (see Gil Diaz, 1987). The present system of VAT is designed to be rigid in order to simplify administration, promote national tax harmonization and to prevent the introduction of distortions. VAT rates and bases are uniform across different states, VAT is imposed on the basis of the destination principle, and inter-state and intra-state transactions are treated on the same basis. There are problems with zero rating and exemptions, and the taxation of particular sectors (e.g. agriculture, self-employed, small businesses), however from the perspective of administration and efficiency the system is attractive and has performed well. The tax is essentially a unified national tax with revenue sharing. The main difficulties have related to the workings of collection incentives and revenue sharing.

A General Revenue Sharing Fund (GRF) was set up as an incentive for VAT adoption.[22] This fund was to constitute 17.5%

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[20] This type of tax structure where the destination of the great bulk of revenue is the federal government reflects a highly centralized system of expenditures.

[21] At the time these state turnover taxes were being levied at a rate of about 1.2% on average.

[22] The share of federal revenues going to the states was calculated for three years preceding VAT introduction. The share was approximately 12% and this was increased to 13% to make the system more attractive to states. Gil Diaz( 1987), also notes

of total federal revenues and would act to match, at the local level, the revenue raised from previous taxes. It is comprised of 30% of VAT plus a complementary fund which equals 13% of the total federal revenue pool less "jurisdictional VAT rebates" (World Bank 1989). Distribution of the GRF to the 31 states and the Federal District is done in accordance with a formula which takes into account the state's share in the preceding year and its effort in collecting federal taxes. The main problem with the system relates to the fact that because states have given up their ability to levy state taxes in exchange for revenue sharing there is less of an incentive for collection. This disincentive has been increased by the lag between collection performance and rewards. Recent reforms which allow a state to retain 30% of the VAT assigned to it have increased collection effort and partly overcome this problem. States also feel that the rigid revenue sharing system is not responsive enough to their expenditure needs. Richer states feel penalized both by the sharing formula which favours redistribution and by the lag between collection performance and rewards which is largely the result of low administrative capabilities in other regions. Poorer states feel that revenue sharing does not go far enough in redressing inequalities. The system does, however, have strong advantages as regards having a coherent base and rate structure and a coordinated administration which together reduce the scope for inefficiencies and evasion. Also, partly because fiscal policy is largely under the control of the powerful central government,

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that this fixed sharing arrangement had a lure as the take of states had been falling because income elasticities of taxes assigned to states were lower than those assigned to the centre.

macroeconomic stabilisation through fiscal correction has proved to be fairly successful and is identified as being one of the main factors underlying Mexico's recent economic turnaround (see Aspe, 1992).

### §2.3.3 Germany[23]

VAT was introduced in Germany in 1968 and replaced a cumulative all-stage turnover tax which had been in effect for nearly fifty years. The VAT in Germany is based on the destination principle and is levied on all taxable transactions carried out within the boundaries of Germany at all stages of consumption and production (see Ernst and Young , 1991). Using this definition imports into Germany are included in the tax base and are taxed on the same basis as domestic goods. The main advantage of VAT over the turnover tax that it replaced is that cascading is eliminated. VAT was revenue-neutral in its design and the share of total revenue has been remarkably constant averaging between 12 and 13% throughout the 1980s (see IMF, 1980-1991).

At the time of introduction the general VAT rate was 10%. This was subsequently revised upwards to 14% in 1980 to conform with EC directives. Financial and insurance activities, real estate transactions, and services of physicians and dentists are exempt. A system of exemption with credit for VAT paid on inputs (i.e. zero-rating) applies to the export of goods and to a number

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23 See Table 2 for an overview.

of transactions relating to cross-border transportation. A reduced rate of 7% applies to certain foodstuffs, raw materials, books, dental technician services and cultural activities. The base of VAT in Germany is thus very wide and the number of exemptions limited so that the tax reaches a large fraction of the value added in the country.

At the base of the success and stability of the German VAT system is a strong administration and a centre/state consensus on revenue sharing. The VAT system is controlled and legislated by the federal government so that common rates apply on a common base. This arrangement simplifies administration and minimises inefficiencies. The states however are responsible for the day-to-day running of the system and collection of VAT revenue. The federal/state split of total VAT revenue has varied only slightly over the years, between 70/30 and 68/32, and there is some redistribution for weaker states. As rates are common and VAT is based on the destination principle there are no problems connected with inter-state trade.

VAT in the German federation is characterised by inflexibility both as regards base and rate setting and revenue sharing. For such a system to work, federal and state legislatures must agree on a common base, revenue sharing formula, tax structure and administration, and rates. This agreement is greatly facilitated where the federal government has ultimate power over such proceedings. In a federal system where the states try to maintain greater discretion over exemptions, rates and revenues in order to better meet their expenditure and other policy objectives, such a system is less likely to work. The system has attractions for the federal government in that it can maintain careful control over its fiscal position and macroeconomic policy.

### §2.3.4 Canada[24]

VAT was introduced in Canada on 1 January 1991. There is thus relatively little experience with VAT to draw upon. The events and factors which led up to the introduction of VAT are nonetheless of interest. Before 1984, Canada had an unsatisfactory manufacturers' tax which was widely perceived as exhibiting strong elements of cascading. For example in 1984 a survey showed that the average effective tax rate for domestic goods was 33% higher than the tax on imports (Tait, 1988). Amendments to this tax transformed it into a hybrid wholesalers' tax whereby several broad categories of goods were taxed at the wholesale level, the most important of these being cosmetics, automobiles, televisions, audio goods and household chemicals. The incompleteness and distortionary effects of this form of taxation led the government to consider VAT. The main hindrance to VAT introduction was the reluctance of state governments to give up substantial independent retail sales tax revenue as this was the only type of indirect taxation allowed to them in the constitution. It was also realised that due to the decentralised

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[24] See Table 2 for an overview.

nature of the Canadian government there would be substantial problems in reaching a consensus on VAT rates and bases.

In a proposal on sales tax reform published in 1987 one suggestion was that a national VAT be introduced with a single federal rate (eg. 10%) on a uniform base for all provinces but leaving each of the provinces with the option of charging an additional rate (eg. 3-5%). However, all that has been achieved so far is that a federal VAT (called GST - Goods and services tax) was introduced in 1991. This can be applied to all supplies of goods and services, unless they are zero-rated or exempt, and effectively moves the tax to a final consumption basis. Two federal VAT rates apply, a standard rate of 7% and a zero-rate for exports, transportation services, financial services, certain medical categories and agriculture and fishing supplies. Health, educational and legal aid services, and some financial services are exempt as are public-sector bodies, real property and transportation tolls (Ernst and Young, 1991).

A provincial VAT which would replace provincial retail sales taxes and harmonize with the federal VAT has also been proposed. However so far only Quebec has adopted a provincial type VAT as of 1 January 1992. Under the previous sales tax system the federal and provincial bases were very different with the former levied at the production or wholesale stage while the latter was constitutionally limited to the final retail stage. As the federal VAT and the provincial retail sales tax now both focus on consumption, the overlapping of bases is likely to be problematic, generating a need for harmonization. However only three provinces have announced their intention to harmonize their retail sales tax with the federal VAT and even in Quebec the provincial VAT base deviates from the federal VAT base so that harmonization is far from complete (Mintz and Wilson, 1991).

There can be few arguments in favour of an unharmonized dual federal/state VAT system with separate administrations. This system has emerged largely from political considerations particularly the reluctance of the provinces to give up their revenue generating autonomy. The process of converting provincial retail sales taxes into regional VATs is itself far from complete. Harmonization across federal and state sales tax bases is also at a very early stage. Thus though it is likely that there will be efficiency gains from the replacement of federal wholesale taxes with a federal VAT, coordination across the whole sales tax system has so far been poor. It must , however, be emphasised that any judgement on the Canadian experience is as yet premature.

## §3 Indian Centre-State Relations

India is a federal economy consisting of twenty five states. According to terms set out in the Indian Constitution, responsibility for different expenditure and revenue categories is shared between the federal and state governments. The constitutional position and centre-state relations are thus critical to the understanding of fiscal policy in India and to any attempts at reform. In §3.1 we sketch out the historical origins of centre-state relations in India. The current allocation of expenditure responsibilities is considered in §3.2. In §3.3 we discuss tax assignment between the federal and state governments and some of the implications of this pattern for tax reform. In §3.4 we examine revenue sharing. As in most federations (see Table 2), revenue sharing in India is downward, however there is considerable disagreement between the centre and states as to whether transfers to states are sufficient to meet their perceived expenditure needs. Having described the general functioning of centre-state fiscal relation in India we turn in §3.5 to a discussion of particular problems as regards the possible introduction of a VAT.

## §3.1 Historical Origins

Under British rule, the Government of India Act of 1919 had transferred a large measure of responsibility to provincial governments. This was followed by the Government of India Act of 1935 which established a revenue and expenditure sharing arrangement between the Indian states and British India. Under this Act the functions of defence, foreign relations, railways, currency, coinage and public debt remained the preserve of the federal authorities. The functions of education, medical and public health, police, and law and order became the responsibility of the provincial governments, whilst responsibility for labour relations was shared between provincial and federal authorities (see Varma and Sinha, 1989). Provinces obtained autonomy over legislation for the functions under their control, thus the Act specified considerable political devolution.

The Act of 1935 for the first time assigned separate sources of revenue to the different levels of government, foreshadowing the constitution of 1947. At the same time a system of federal-provincial sharing of key central tax revenues namely of income taxes, export duties and excise duties was introduced. Central grants in aid were also available to states experiencing difficulty in balancing their budgets. The allocation of revenue sources to the provinces did increase financial independence and thus lent credibility to the notion of provincial autonomy. Despite the provisions of the Act the provincial authorities, however, felt that the taxes allocated to them (in combination with their share in central taxes and central grants) were inadequate to meet their expenditure demands and as a result most provinces ran deficits between 1935 and 1947 (Varma and Sinha, 1989).

Following independence in 1947, legislators formulating the Indian Constitution followed the precedent of the Act of 1935 and retained the bulk of its tax assignments and revenue sharing measures.[25] The divisions of expenditure and revenue responsibilities stipulated in the Indian Constitution of 1947

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[25] The Act of 1935 itself embodied many features of the financial systems of the UK.

remain more or less intact and still determine fiscal relations today. It is against this set of constraints that potential tax reform measures must be viewed.

## §3.2 Expenditure Assignment

The Indian Constitution of 1947, following the Act of 1935, separated government functions according to Centre, State and Concurrent lists. The federal government was given responsibility for defence, national industries and mines, foreign affairs, banking and currency, inter-state commerce, national highways, railways, airways, telecommunications and waterways while the state governments were made responsible for health, education, agriculture, irrigation, roads, and law and order. Joint responsibility was specified for labour relations, education and criminal law. Federal expenditures are thus focussed on security, communications and industry whilst state expenditures tended to reflect more local concerns for which information might be better and administration more effective at the state government level.

In Table 3 we set out a more precise picture of the pattern of current expenditures in 1987-88. A measure of the extent of decentralisation and devolution in India can be seen from the fact that total state expenditures now exceed total central expenditures. As can be seen from Table 3, the four major headings for central (current) expenditures are, in order of importance: interest payments, defence services, social and community services and major food subsidies. Defence and interest payments alone constitute almost 60% of current expenditures. Defence expenditures have traditionally been viewed as a priority expenditure by successive Indian governments (see Gupta, 1988), however interest payments on (internal and external) public debt have increased rapidly during the 1980s and now represent the principal expenditure item. Buiter and Patel (1992) report that total public sector debt increased from 37.3% of GNP in 1970/71 to 59.8% of GNP in 1987/88.[26] Accelerating debt payments partly explain why expenditures have been outstripping revenues and the steep slope over the last two decades of the overall deficit line (see Figure 1). Major subsidies, which comprised 11.3% of total expenditures in 1987-88 are now also on the agenda for expenditure reform.

The four main headings of expenditure for the state government are: social and community services; general services; agriculture and allied services; power; and irrigation and flood control (Table 3). Demand for these categories of expenditure varies from year to year due partly to the concentration of economic activity in rural agriculture.

It is clear from Table 3 that the states in India play a pivotal role in the provision of basic economic and social services. Strong demand for these services is reflected in a rising share of total state disbursements as a percentage of GDP

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[26] This total may be broken down into 38.5% of GNP, domestic debt and 21.3% of GNP, foreign debt (see Buiter and Patel, 1992, Table 1).

(see Figure 7). State expenditures play a central role in social sectors such as health and education, perceived by many as crucial to human and economic development. The inadequacy of state revenues has led to increasing dependence on central revenues (see Figures 6 and 7). However the intricate system of revenue sharing and grants is not sufficient to bridge the disbursement-own revenue gap and has led to an increased dependence on debt financing from the centre, thus worsening the budgetary position (for further discussion, see §3.4).

## §3.3 Tax Assignment

Income tax, customs, excises, and taxes on capital gains are all the responsibility of central government,[27] while sales taxes, excise duties on alcohol, tax of agricultural income, tax on professions and trades, taxes on land and buildings, entry tax for good entering the state, taxes on musical rights, taxes on vehicles, stamp duty and taxes on entertainment are the preserve of the state governments. There are several problems associated with this form of tax assignment. First, both state and central revenue systems are complex and reflect *ad hoc* extensions of

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[27] Tax assignment may have more to do with the preferences of central government at the time of the 1947 constitution than with the dictates of any administrative or economic logic. The original recommendation of the Peal Committee in 1930 was to assign income taxes to the states. The fact that this advice was ignored probably reflects a wish of central government to retain income taxation which at that time was a major source of revenue. The assignment of sales taxes to the states in the 1947 Constitution and the growing share of this tax type may have reversed the preference ordering over these two tax types. However the state tax base has remained sufficiently narrow to guarantee state dependence on the centre.

taxes and rate increases over time to meet expenditure needs. This is reflected in the multiplicity of taxes levied at multiple rates on segmented and uncoordinated bases. Haphazard evolution of tax structure has also led to the widespread taxation of inputs, both by excises and sales taxes, thus adding to cascading and other inefficiencies. This complex structure is problematic in terms of both evasion and administration. Second, though it is not clear from the constitutional lists, there is significant overlap between the tax bases of the federal and state governments. This is because the tax base for the states' main revenue generator, the sales tax, is largely consumption goods and many of these are taxed either directly by the centre or indirectly through taxes on inputs and capital goods via excises and import duties. Indeed it can be argued that whereas excises cover only a limited range of products in most countries (i.e. tobacco, alcohol, fuel), constitutional exclusion of sales taxation from the federal tax base led to the proliferation of excises to a much wider base. Double taxation, cascading and various inconsistencies result. A third problem relating to the overall assignment of taxes is that the taxes assigned to the states tend to be less elastic than those assigned to the centre, so that their revenue share as a percentage of GDP does not grow as rapidly. Some support for this common complaint of the states is given in Figure 5 where the slope of state tax revenue line is flatter than the central tax revenue line. This, however, has much to do with the fact that the states do not benefit from customs revenue whose share grew rapidly over the same time period (see Figure 4), for reasons which may have more to do with incentives associated with sharing arrangements than with underlying differentials in elasticity.

A detailed picture of the breakdown of central and state tax revenues is presented in Tables 6 and 7 respectively. The main revenue generator for central government is customs duties, which in 1989/90 accounted for almost 50% of central tax revenue (Table 6), and the trend of the share of this tax type is upwards in the last two decades (see Figures 2 and 3). This is worrying from an efficiency point of view due to the distortionary effects of trade taxation. Recognition of this problem by the government and recent reforms to counter this trend imply that alternative domestic sources of tax revenue will need to be found as existing indirect taxes are severely stretched. The second major revenue source of the central government is central excises which are overly complex and have exhibited a falling share in total revenue over the last two decades. Compared to developing countries as a whole the share of excises in central revenues is very high and may be attributable to dependence on this instrument by central government as a means of taxing industrial production (see Burgess and Stern, 1992). Income taxes constitute a relatively small share of total central tax revenue (15.9%).

As can be seen from Table 7, state governments obtain the bulk of their tax revenue from the indirect taxes assigned to them (95%) whilst the main direct taxes assigned to them (agricultural income tax, land revenue) contribute little, only

4.5% of state total tax revenue. Within indirect taxes, sales taxes and state excise duties are the main revenue generators contributing 57.9% and 14.9% of total state tax revenue respectively. In Figure 5 we see that state tax revenue has grown less quickly than total (centre and state) tax revenue. If we examine Figure 7 it is notable that aggregate state disbursements have outstripped the revenue potential of both state tax and non-tax sources. This has led to a deficit, which rises from 7% of GDP to 10% of GDP in the 1970 to 1990 period[28]. This rough analysis suggests that state revenue sources, as currently organized and operated, are inadequate relative to state expenditure needs, as currently perceived. This state of affairs explains the rising dependence of state finances on central transfers and the general fragility of state finances. Whilst this situation does underline the desirability of reform it must be recognised that there is substantial evasion of sales tax, which might be more vigorously pursued, that little has been done in the way of taxation of agricultural income, and that there would seem to be considerable further potential for taxing urban real estate. Also, the aggregate figures presented in the tables and figures conceal a great deal of variability across states which is the subject of future research.

[28] The state's own deficit here is described as aggregate state disbursement - own revenue (tax and non-tax). See Reserve Bank of India (various issues).

## §3.4 Revenue Sharing

Various central transfers have been designed to bridge the shortfall between state expenditures and the revenue generated from the tax and non-tax sources assigned to states. These transfers take three main forms: revenue sharing, grants and loans.

Revenue sharing is in accordance with the recommendations of the successive Finance Commissions which report every five years. The Indian Constitution stipulates that revenue from (central) taxes on non-agricultural income of non-corporate entities be shared between the centre and states; it also stipulates that revenue from union excises may be shared with the states if Parliament approves this (see Chelliah, 1991). In essence, revenue sharing constitutes a partial transfer of personal income tax and union excise proceeds to the states under the discretion of the Finance Commissions. The Finance Commission also approves grants-in-aid to states in need of assistance. Distribution of central tax revenues to the states takes into account the backwardness of the state and their resource gap in meeting their revenue expenditures. Based on the recommendations of the Eighth Finance Commission for the period 1985 to 1990, 45% of the proceeds from the union excise duties and 85% of the proceeds from personal income taxes were transferred to the states. The Ninth Finance Commission recommended retention of these percentages for the period 1990-95.

It is notable that shared central taxes (personal income tax and union excises) have shown declining fractions of total tax revenue whilst the fully retained central taxes (corporation tax and customs duties) have shown rising fractions, suggesting that sharing may carry with it a disincentive effect on central tax collection.

States also receive central assistance with their plan expenditures in the form of grants and loans disbursed under the direction of the Planning Commission. These take two forms. First, there are block grants and loans which are used for general purposes and, second, there are matching grants and loans for specific centrally-sponsored schemes. Grants fall under the non-tax income heading.

If we examine Figure 6 it is notable that the share of the different sources of state revenue have remained relatively constant over the last two decades. Revenue sharing and grants act to compress deficits in the states (see Figure 7). However, even after their inclusion a sizeable gap exists between aggregate disbursements and aggregate revenue (Figure 7) and this must be filled by loans granted mainly by the centre.

## §3.5 Constraints on Taxation and Tax Reform

Before turning to an examination of options for a VAT in India let us briefly outline the main difficulties associated with centre-state relations on taxation and tax reform. These may be arranged under seven headings.

**(i) Overlapping bases.** The pattern of tax assignment in India has led to significant overlap between the tax bases of the state sales tax and union excises. This leads to cascading and other inefficiencies. Central excises now cover a much larger range of products than at independence and include many products which in other countries appear to be more efficiently taxed using sales taxation.

**(ii) Taxation of inputs.** *Ad hoc* evolution of the tax structure in India has led to widespread taxation of inputs under the sales tax as states attempt to extend their revenue net. Central excises have rebating of tax paid on inputs under the MODVAT system but state taxes are not rebateable against excises, and neither state taxes nor central excises are generally rebateable against sales taxes.

**(iii) Complexity.** The system of domestic indirect taxation in India is typified by a maze of different rates and bases which lacks a coherent structure. This complexity is partly the result of the parallel but uncoordinated proliferation of central and state indirect taxes in response to growing revenue demands and influenced strongly by the centre-state constraints to different heads and the sharing arrangements.

**(iv) Administration.** Complexity has led to significant difficulties in administration and possibilities for evasion. Also a large proportion of economic activity (value-added) remains outside the tax net.

**(v) Inter-state trade.** The prerogative of each state to set both its own rates and bases for sales taxation has led to problems in inter-state trade and competition between states for revenue and investment. This competition is subject to the restrictions on taxation of inter-state trade (and some items within the state which are important to inter-state trade) laid out in the Central Sales Tax Act of 1956. Nevertheless it has often resulted in states undercutting each other with an overall fall in their total revenues. A further problem is the 'exporting' of sales tax.

**(vi) Foreign trade taxes.** Revenue constraints and rising deficits have led to a growing dependence of the central government on import duties. Such taxes distort decisions in favour of domestic sources and production, and are not in keeping with the liberalisation efforts of the present government. As the current set of domestic indirect taxes is severely strained and the potential for direct taxation is limited, it is unclear how the revenue gap created by trade liberalisation can be filled without a major reform of domestic indirect taxation.

**(vii) Macroeconomic control.** Rising indebtedness and deficits at both the central and state levels are partly indicative of the inadequacy and fragility of the Indian tax system and represent a major threat to macroeconomic stability. In a system where both major revenue raising and expenditure powers lie with the states, the ability of the government to stabilise the economy using fiscal or monetary instruments is greatly constrained (see Chelliah, 1991).

## §4 An Agenda for India

The agenda to be discussed here builds on the above discussion of India's fiscal position, of the VAT in a federal context, and of India's particular constitutional position and difficulties. It also draws on the recent, and most valuable, report of the Chelliah Committee (1991) and (1992). The Chelliah Committee's work was oriented towards central taxes. It concentrated on direct taxation in the interim (December 1991) report, although the final report (August 1992) contained some specific recommendations on indirect taxation. The report marks a milestone in the analysis of taxes in India. In this it follows a distinguished tradition, going back to the Taxation Enquiry Commission of 1953/54 and including the Jha Committee report of 1978, of careful and thoughtful reports on Indian taxation. The general recommendations of the Chelliah Committee for income taxation included a broadening of bases and reductions of rates. On the indirect side, it recommended a reduction in the level and spread of rates for import tariffs, a move towards a value-added tax system to replace central excises with excises becoming a separate category focussed on goods associated with externalities or luxuries, and the extension of the base of central indirect taxes to include services. It further recommended that the states take steps to avoid 'cascading' in the system of state sales taxation. In addition there was some discussion of the problems of inter-state trade, in particular with the proposed introduction of the consignment tax to curb tax exporting and evasion by the method of consignment transfers.

Before proceeding to set out an agenda for India and provide some preliminary assessment of the possibilities, it is useful to review, very briefly, the reasons for taxation and the criteria with respect to which tax systems and their reform might be judged. The basic reasons for taxation are first to raise revenue, second to correct market failures, particularly externalities, and third to redistribute income (as we are concerned with medium-run issues we put short-term stabilisation to one side). Generally, taxes will generate their own associated inefficiencies and an economic analysis of tax design should demonstrate and help keep down the tax-induced distortions.

In considering efficiency issues in a federal context, a prominent aspect must be locational efficiency. In other words, the tax system should avoid giving unwarranted incentives for activity to be located in one place rather than another. It should also avoid any special incentives for restructuring industries (for example, through vertical integration), or for sending goods by particular routes or in particular ways. It should be emphasised that from the economic point of view the efficiency of indirect taxation does not, as a criterion, point to the uniformity of percentages rates of taxation across goods. There are good arguments for uniformity, including particularly administration and political economy (see Stern, 1990), but efficiency is not, in general, one of them. In practice, however, the information on which we might base differentiation across goods on grounds of efficiency (the structure of demand functions) is unlikely to be available with the kind of reliability one might wish. The more powerful economic arguments for differentiation are based on income distribution and equity. Indeed, these are the arguments which are most commonly used in practice to justify differential rates.

So far the criteria discussed have been largely economic but the designers of tax systems must take account of other, and often powerful, considerations. These include consistency with the constitution; political acceptability; administrative feasibility; stability; and buoyancy. Political acceptability has a number of dimensions. There will be constituencies within the population which have to be balanced. In a federal structure there will be political acceptability to states and centre separately. More generally, and this has become very serious in India, there is the acceptability by the taxpayers themselves. The tax system in India has, in many ways, become intrusive and a means by which government, either officially or through the behaviour of its agents, can disrupt and make difficult the life of its citizens. Dissatisfaction with the way in which the tax system is operating has led to great concern in India. It was a major and understandable preoccupation of the Chelliah Committee that the tax system should become less intrusive, less discretionary and more simple if relationships between taxpayers and tax collectors were to be restored to something more acceptable. Where there is a substantial propensity to evade, where accounting may not be of a high standard and where administrative resources are limited, it is important to keep a tax structure in a form where administration is as straightforward as possible.

We turn now to a consideration of some of the options for a VAT in India's federal structure. A list of possible options in a general federal context was set out in §2.2 and we return to some of those here. We start with the presumption that the problems of the existing system are too severe for it to form the basis of indirect taxation in India in the medium term. The criticisms and problems have been amply described in the Jha Committee Report of 1978 and the Chelliah Committee of 1991. To reiterate, these include: excessive dependence on very high rates of import duty; specific rates of taxes which are revised too infrequently for revenue purposes, although too frequently for administration; the clearance system for excises whereby goods cannot leave the factory until valuations have been agreed (leading to problematic and frequent disputes); the sales taxes, with their problems of cascading; the impediments to the movements of goods associated with the origin-based nature of the Central Sales Tax and with octroi. We shall also exclude from consideration any medium-run system based on the origin principle. This implies a divergence from the current state of affairs in India whereby both union excises and central sales taxes are essentially origin based. As the example of Brazil has shown, the problems of the taxes which are origin-based are severe in practice and this experience is, in part, echoed by that of India.

We shall also see the reform of domestic indirect taxation as set in the context of increasing efforts to collect more revenue from direct taxes. This must not, however, be confused with a move towards greater progression. Too often in India we hear the slogan that direct taxation is progressive and indirect taxation is not. How progressive the two sorts of taxes are is a matter of analysis not of assertion, and can vary according to tax design and administration. But we should not expect, in India's circumstances, either direct or indirect taxation to achieve great things on the distribution front. Experience, analysis and common sense teach us that the major contribution towards redistribution in developing countries is likely to come on the expenditure side through, for example, social services, food or cash for work programmes and other support for the worse off. In fact the same is true for developed countries where we find that the major redistribution, where it occurs, comes not from the tax system, but through the system of transfers, support for the unemployed, the old, and so on (see, for example, various issues of the UK's Economic Trends).

We shall also assume that the domestic tax reform will be set in the context of a reform of trade that is likely to be not only in the direction of reducing distortions, but also of reducing revenue, at least as a fraction of GDP. This will place greater strain on the domestic tax system so that it is important to look for a structure that will raise substantial revenue. We shall also assume that there will be a major role for specific excises. Of the greatest importance here will be alcohol, tobacco and petroleum products. All of these are goods with strong externalities so that their taxation without rebate at further points in the production chain (where relevant) is entirely justified. There may also be ignorance as to their effects so that on these grounds too (the merit, or rather demerit, good argument) they are suitable targets for taxation. But taxation for externalities is not confined to those three groups. Non-rebatable taxes for externalities should also apply to other polluting products, with coal being an example of considerable quantitative importance. The list of possibilities for this heading may well be rather longer, and should be carefully scrutinised. If there were a tax on carboniferous inputs into electricity, there would be no further need for electricity duty on externality grounds. It may, however, have some justification on distributive grounds since the poor are likely to be very small domestic users of electricity.

The considerations described in §2.2 lead us to focus attention on just four amongst the possibilities for federal-state taxation that have been advanced. These are set out as follows. We give each one of them a name according to authors or committees who have emphasised their particular virtues or drawn attention to their possibilities. We begin with the propositions which originated in India.

The first is the Jha Committee proposal, as suggested in the Jha Committee Report of 1978. This was for a central value-added tax up to the manufacturing stage plus retail sales tax in the states.

The second is the proposal in the Chelliah Committee Interim Report of 1991, which suggests, at least as a long-term strategy, a central value-added tax supplemented by a state retail sales tax.

The third is contained in the Chelliah Committee Final Report of 1992; this is for a VAT up to the wholesale stage but with states levying, and retaining the revenue from, the tax at the wholesale stage. The states may supplement their revenue with other taxes, including on selected value-added in manufacturing.

Finally, we have the Poddar (1990) proposal for a VAT with a unified base, but with separate federal and state taxation on the single base.

Each of these proposals has its strengths and weaknesses but each of them has sufficiently strong advantages, at least relative to the current system, that they are worthy of detailed analysis. We cannot in this paper provide that detailed analysis, indeed it will require substantial research. That further analysis should consider different rate structures and bases for the different options and look at their revenue, distributional, efficiency and administrative implications. Various versions of each of them will also have to be tested for their constitutional position and eventually, if the discussion were to proceed that far, for political acceptability with the states and the centre. Such an examination would require detailed analysis of how revenues might be shared between the centre and states, which taxes are to be replaced and the transitional arrangements. There is, however, considerable flexibility within each of the systems so that there may be versions which one can find which would satisfy most parties. In looking for such a balance, one might also include minor constitutional adjustments, such as that suggested by the Chelliah Committee, with the transfer of tobacco from the centre to the states.

There is one important advantage shared by the four proposals (although not to an equal extent). This is that the prime responsibility for a VAT, since it would primarily replace the 'union' excise, would lie with the centre, which also administrates the income tax. There are great advantages in proximity between VAT and income tax authorities in checking information and it is likely that a VAT would improve personal income tax collection.

We may also wish to examine the merits of different options that may arise in research or discussions. For example, Mahesh Purohit of the National Institute of Public Finance and Policy has suggested to us in discussions (September 1992) the possibility of separate state and central VATs. The state VATs could operate independently of each other, as do current sales taxes. The Central Sales Tax for cross-border trade could be retained, but its proceeds distributed on a destination rather than the original principle (the latter operates at present). The redistribution could be based on aggregate rather than individual cross-border flows. This provides an interesting step on the way to a more integrated structure which, being less radical, may command greater acceptance as a first move. Different allocation mechanisms (mixed origin and destination) for the CST could be considered. Some distortions are likely to remain.

The Jha Committee proposal would work essentially with two separate authorities (or groups of authorities). One levying the value-added tax to the manufacturing stage (it has been called MANVAT), would be a central authority and the other levying the retail sales tax. In this formulation each selling agent would have to deal with only one authority. If it were classified as manufacturing or trading prior to retail, then it would come under the central system and if it were retail it would come under the state system. Retailers would not be concerned with claiming back any taxes on their inputs. This system has relatively attractive efficiency properties in the sense that intermediate goods are not taxed. There is one element of cascading from the manufacturer to the retailer, but that should not disturb efficiency - it simply means that the retail tax is levied on the price of a good which already includes the VAT, so that the tax element in the price of a good comes from both sources and, in this sense, the retail tax rate understates the rate at which state taxation is levied. But this is a problem, essentially, of appearance rather than of substance. This system would seem to have its attractions. There are, however, the usual problems of administering taxes at the retail stage and the states might be worried about their ability to administer such taxes. They could, however, be brought forward to the wholesale stage with little violence done to the concept.

The second possible system is the Chelliah-Interim one, with a VAT for central taxation, together with a retail sales tax. This has the advantage relative to the preceding one as far as the centre is concerned, of bringing more of value added into the central tax net. It is also quite consistent with efficiency. Under this system, however, retailers, or wholesalers if the system is operated at that point, would have to deal with two tax authorities. There may be scope for playing one off against the other and for disputes about what constituted the different bases. Thus one might get into the problems of overlapping bases which have been encountered in Brazil.

The Chelliah-Final proposal attempts to separate state and central taxation but under a single form of taxation. This is done by splitting the chain at the wholesale stage and giving prior value-added to the centre as tax base and wholesale and retail to the states. The report is very brief on this proposal (the Chelliah Committee's terms of reference were focussed mainly on central taxes). Revenue calculations would be necessary to see just how much revenue would go to the states. There is an acknowledgement that it may be insufficient for the states in that there is a reference to further state taxes on certain manufacturing value-added. There might also be scope for game-playing between states and centre in valuations at the wholesale stage and artificial incentives as to where to locate wholesalers. It may be that if there is to be a single VAT the Poddar approach has advantages in terms of simplicity and incentives.

Finally, we have the Poddar system where there is a VAT with one base only, on which both centre and state levy taxes. As we saw, this means that there need only be essentially one administrative mechanism, but it does require the complexity of the tax clearing system on allocation of revenues across states. How far such a tax clearing mechanism could be made to work in India would be a subject for research.

In appraising the different taxes the agreement of the states will be paramount. Any relevant constitutional amendment would require the consent of an absolute majority of states and a two-thirds majority in Parliament. In practice a bare majority of states would be insufficient if a few major states were vehemently opposed to a reform since co-operation in taxation will be required. Hence there may be some attraction in the approaches of the Chelliah-Final report and the suggestion of Purohit in that they build more 'gently' on the current position. Against this has to be set the decision, negotiation and administrative costs of tax reform. It cannot and should not be done frequently and as such one does not want to lose the opportunity to major change by making a minor one. The balance between these less radical and more radical approaches is a matter for careful analysis and judgement.

In conclusion, we would argue that the pressures on the Indian domestic indirect tax system, both for revenue and in terms of complexities and inefficiencies, are such as to warrant serious consideration of a major overhaul. Such a case has been convincingly argued by the Chelliah Committee reports which proposed interesting and useful first steps in the direction of major reform. It is important, however, to develop early in the reform process a picture of where the structure should settle. We have argued that there are a number of serious contenders for a domestic VAT based system which take into account various aspects of India's federal structure. In further papers we shall be looking more closely at the advantages and disadvantages of the various proposals on the agenda we have described, as well as, possibly, considering some others.

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## TABLE 1: REVENUES AND EXPENDITURES OF THE CENTRE, STATES AND UNION TERRITORIES

| Year | 50-51 | 55-56 | 60-61 | 61-62 | 62-63 | 63-64 | 64-65 | 65-66 | 66-67 | 67-68 | 68-69 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | |
| A. Total Expenditure (i + ii) | 899.76 | 1437.19 | 2673.40 | 2883.91 | 3518.15 | 4243.77 | 4839 | 5464.45 | 6185.48 | 6261.23 | 6428.36 |
| i) Revenue Expenditure | 730.67 | 1029.81 | 1697.66 | 1923.14 | 2306.4 | 2707.8 | 3011.94 | 3418 | 3857.14 | 4261.43 | 4712.95 |
| ii) Capital Expenditure | 169.09 | 407.38 | 975.74 | 960.77 | 1211.75 | 1535.97 | 1827.06 | 2046.45 | 2328.34 | 1999.8 | 1715.41 |
| B. Total Revenue (i + ii + iii) | 786.48 | 1026.65 | 1772.71 | 2002.47 | 2442.78 | 2978.92 | 3342.66 | 3703.68 | 4033.06 | 4364.28 | 4813.9 |
| i) Tax Revenue (I+II) | 626.67 | 767.56 | 1350.41 | 1542.98 | 1865.07 | 2324.55 | 2598.8 | 2921.59 | 3261.19 | 3455.51 | 3758.73 |
| I. Direct | 230.56 | 259.07 | 402.07 | 449.19 | 560.06 | 692.63 | 742.32 | 734.14 | 766.83 | 780.12 | 839.6 |
| Corporation Tax | 39.33 | 36.52 | 109.7 | 156.46 | 221.5 | 274.59 | 314.05 | 304.84 | 328.9 | 310.51 | 299.77 |
| Personal Income Tax | 133.89 | 132.02 | 168.73 | 165.39 | 185.96 | 258.6 | 266.55 | 271.8 | 308.69 | 325.89 | 378.47 |
| Land Revenue | 51.57 | 78.89 | 97.78 | 100.08 | 124.42 | 130.5 | 128.48 | 120.18 | 95.1 | 107.85 | 125.72 |
| Agricultural Income Tax | 3.59 | 7.68 | 9.71 | 9.44 | 9.6 | 9.42 | 10.79 | 9.91 | 10.34 | 12.09 | 9.94 |
| Others \1 | 2.18 | 3.96 | 16.15 | 17.82 | 18.58 | 19.52 | 22.45 | 27.41 | 23.8 | 23.78 | 25.7 |
| II. Indirect | 395.66 | 508.49 | 948.34 | 1093.99 | 1305.01 | 1631.92 | 1856.48 | 2187.45 | 2494.36 | 2675.39 | 2919.13 |
| Customs | 157.16 | 166.7 | 170.03 | 212.25 | 245.96 | 334.75 | 397.5 | 538.97 | 585.37 | 513.35 | 446.5 |
| Union Excise | 67.54 | 145.25 | 416.35 | 489.31 | 598.83 | 729.58 | 801.51 | 897.92 | 1033.78 | 1148.25 | 1320.67 |
| State Excise | 47.79 | 45.09 | 53.08 | 58.59 | 62.82 | 73.53 | 86.06 | 98.5 | 111.66 | 134.5 | 163.59 |
| Sales Tax | 58.2 | 81.59 | 163.92 | 187.42 | 216.91 | 277.8 | 330.02 | 381.54 | 460.44 | 530.29 | 598.31 |
| Others \2 | 64.97 | 69.86 | 144.96 | 146.42 | 180.49 | 216.26 | 241.39 | 270.52 | 303.11 | 349 | 390.06 |
| ii) Non Tax Revenue \3 | 155.37 | 240.86 | 374.37 | 404.74 | 459.63 | 543.79 | 590.52 | 687.59 | 748.59 | 893.08 | 1042.12 |
| iii) Others \4 | 4.44 | 18.23 | 47.93 | 54.75 | 118.08 | 110.58 | 153.34 | 94.5 | 23.28 | 15.69 | 13.05 |
| Overall Deficit (A - B) | 113.28 | 410.54 | 900.69 | 881.44 | 1075.37 | 1264.85 | 1496.34 | 1760.77 | 2152.42 | 1896.95 | 1614.46 |
| SHARE IN TOTAL TAX REVENUE | | | | | | | | | | | |
| Tax Revenue (I+II) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| I. Direct | 0.37 | 0.34 | 0.30 | 0.29 | 0.30 | 0.30 | 0.29 | 0.25 | 0.24 | 0.23 | 0.22 |
| Corporation Tax | 0.06 | 0.05 | 0.08 | 0.10 | 0.12 | 0.12 | 0.12 | 0.10 | 0.10 | 0.09 | 0.08 |
| Personal Income Tax | 0.21 | 0.17 | 0.12 | 0.11 | 0.10 | 0.11 | 0.10 | 0.09 | 0.09 | 0.09 | 0.10 |
| Land Revenue | 0.08 | 0.10 | 0.07 | 0.06 | 0.07 | 0.06 | 0.05 | 0.04 | 0.03 | 0.03 | 0.03 |
| Agricultural Income Tax | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Others | 0.00 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| II. Indirect | 0.63 | 0.66 | 0.70 | 0.71 | 0.70 | 0.70 | 0.71 | 0.75 | 0.76 | 0.77 | 0.78 |
| Customs | 0.25 | 0.22 | 0.13 | 0.14 | 0.13 | 0.14 | 0.15 | 0.18 | 0.18 | 0.15 | 0.12 |
| Union Excise | 0.11 | 0.19 | 0.31 | 0.32 | 0.32 | 0.31 | 0.31 | 0.31 | 0.32 | 0.33 | 0.35 |
| State Excise | 0.08 | 0.06 | 0.04 | 0.04 | 0.03 | 0.03 | 0.03 | 0.03 | 0.03 | 0.04 | 0.04 |
| Sales Tax | 0.09 | 0.11 | 0.12 | 0.12 | 0.12 | 0.12 | 0.13 | 0.13 | 0.14 | 0.15 | 0.16 |
| Others | 0.10 | 0.09 | 0.11 | 0.09 | 0.10 | 0.09 | 0.09 | 0.09 | 0.09 | 0.10 | 0.10 |
| AS A % OF GDP | | | | | | | | | | | |
| GDP at current market prices | 9366 | 10258 | 16201 | 17177 | 18476 | 21237 | 24765 | 26145 | 29571 | 34611 | 36674 |
| A. Total Expenditure (i + ii) | 9.61 | 14.01 | 16.50 | 16.79 | 19.04 | 19.98 | 19.54 | 20.90 | 20.92 | 18.09 | 17.53 |
| i) Revenue Expenditure | 7.80 | 10.04 | 10.48 | 11.20 | 12.48 | 12.75 | 12.16 | 13.07 | 13.04 | 12.31 | 12.85 |
| ii) Capital Expenditure | 1.81 | 3.97 | 6.02 | 5.59 | 6.56 | 7.23 | 7.38 | 7.83 | 7.87 | 5.78 | 4.68 |
| B. Total Revenue (i + ii + iii) | 8.40 | 10.01 | 10.94 | 11.66 | 13.22 | 14.03 | 13.50 | 14.17 | 13.64 | 12.61 | 13.13 |
| i) Tax Revenue (I+II) | 6.69 | 7.48 | 8.34 | 8.98 | 10.09 | 10.95 | 10.49 | 11.17 | 11.03 | 9.98 | 10.25 |
| I. Direct | 2.46 | 2.53 | 2.48 | 2.62 | 3.03 | 3.26 | 3.00 | 2.81 | 2.59 | 2.25 | 2.29 |
| Corporation Tax | 0.42 | 0.36 | 0.68 | 0.91 | 1.20 | 1.29 | 1.27 | 1.17 | 1.11 | 0.90 | 0.82 |
| Personal Income Tax | 1.43 | 1.29 | 1.04 | 0.96 | 1.01 | 1.22 | 1.08 | 1.04 | 1.04 | 0.94 | 1.03 |
| Land Revenue | 0.55 | 0.77 | 0.60 | 0.58 | 0.67 | 0.61 | 0.52 | 0.46 | 0.32 | 0.31 | 0.34 |
| Agricultural Income Tax | 0.04 | 0.07 | 0.06 | 0.05 | 0.05 | 0.04 | 0.04 | 0.04 | 0.03 | 0.03 | 0.03 |
| Others | 0.02 | 0.04 | 0.10 | 0.10 | 0.10 | 0.09 | 0.09 | 0.10 | 0.08 | 0.07 | 0.07 |
| II. Indirect | 4.22 | 4.96 | 5.85 | 6.37 | 7.06 | 7.68 | 7.50 | 8.37 | 8.44 | 7.73 | 7.96 |
| Customs | 1.68 | 1.63 | 1.05 | 1.24 | 1.33 | 1.58 | 1.61 | 2.06 | 1.98 | 1.48 | 1.22 |
| Union Excise | 0.72 | 1.42 | 2.57 | 2.85 | 3.24 | 3.44 | 3.24 | 3.43 | 3.50 | 3.32 | 3.60 |
| State Excise | 0.51 | 0.44 | 0.33 | 0.34 | 0.34 | 0.35 | 0.35 | 0.38 | 0.38 | 0.39 | 0.45 |
| Sales Tax | 0.62 | 0.80 | 1.01 | 1.09 | 1.17 | 1.31 | 1.33 | 1.46 | 1.56 | 1.53 | 1.63 |
| Others | 0.69 | 0.68 | 0.89 | 0.85 | 0.98 | 1.02 | 0.97 | 1.03 | 1.03 | 1.01 | 1.06 |
| ii) Non Tax Revenue | 1.66 | 2.35 | 2.31 | 2.36 | 2.49 | 2.56 | 2.38 | 2.63 | 2.53 | 2.58 | 2.84 |
| iii) Others | 0.05 | 0.18 | 0.30 | 0.32 | 0.64 | 0.52 | 0.62 | 0.36 | 0.08 | 0.05 | 0.04 |
| Overall Deficit (A - B) | 1.21 | 4.00 | 5.56 | 5.13 | 5.82 | 5.96 | 6.04 | 6.73 | 7.28 | 5.48 | 4.40 |

| Year | 69-70 | 70-71 | 71-72 | 72-73 | 73-74 | 74-75 | 75-76 | 76-77 | 77-78 | 78-79 | 79-80 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | |
| A. Total Expenditure (i + ii) | 6867.42 | 7844.92 | 9363.38 | 10435.29 | 11473.29 | 14033.54 | 17289.74 | 19760.11 | 21120.9 | 24748.93 | 28614.7 |
| i) Revenue Expenditure | 5271.73 | 5717.14 | 6991.43 | 7848.44 | 8669.84 | 9881.74 | 11846.95 | 13863.43 | 14986.34 | 17347.72 | 20356.49 |
| ii) Capital Expenditure | 1595.69 | 2127.78 | 2371.95 | 2586.85 | 2803.45 | 4151.8 | 5442.79 | 5896.68 | 6134.56 | 7401.21 | 8258.21 |
| B. Total Revenue (i + ii + iii) | 5330.98 | 5862.83 | 6900.56 | 7796.58 | 8789.01 | 11047.94 | 13686.72 | 15258.49 | 16435.28 | 18775.4 | 21210.67 |
| i) Tax Revenue (I+II) | 4200.01 | 4752.41 | 5575.18 | 6435.77 | 7388.58 | 9223.06 | 11181.73 | 12331.74 | 13237.18 | 15527.76 | 17683.08 |
| I. Direct | 963.04 | 1009.07 | 1170.95 | 1346.09 | 1552.13 | 1833.87 | 2492.55 | 2584.54 | 2680.2 | 2850.71 | 3095.85 |
| Corporation Tax | 353.4 | 370.52 | 472.07 | 557.86 | 582.6 | 709.48 | 861.7 | 984.23 | 1220.77 | 1251.47 | 1391.9 |
| Personal Income Tax | 448.45 | 473.17 | 536.74 | 625.47 | 741.37 | 874.41 | 1214.36 | 1194.38 | 1002.02 | 1177.39 | 1340.31 |
| Land Revenue | 116.09 | 120.82 | 102.21 | 94.6 | 159.53 | 162.36 | 234.1 | 187.49 | 178.54 | 201.37 | 164.86 |
| Agricultural Income Tax | 14.09 | 10.53 | 12.9 | 12.26 | 11.82 | 13.89 | 28.48 | 34.55 | 61.96 | 80.38 | 58.36 |
| Others \1 | 31.01 | 34.03 | 47.03 | 55.9 | 56.81 | 73.73 | 153.91 | 183.89 | 216.91 | 140.1 | 140.42 |
| II. Indirect | 3236.97 | 3743.34 | 4404.23 | 5089.68 | 5836.45 | 7389.19 | 8689.18 | 9747.2 | 10556.98 | 12676.99 | 14587.23 |
| Customs | 423.31 | 524.02 | 695.67 | 856.64 | 996.43 | 1332.9 | 1419.4 | 1553.7 | 1824.1 | 2423.51 | 2924.16 |
| Union Excise | 1524.31 | 1758.55 | 2061.1 | 2324.25 | 2602.13 | 3230.51 | 3844.78 | 4221.45 | 4447.51 | 5367.17 | 6011.09 |
| State Excise | 178.24 | 196.13 | 236.93 | 282.66 | 358.41 | 393.1 | 441.72 | 510.75 | 577.44 | 592.1 | 705.49 |
| Sales Tax | 683.95 | 786.4 | 860.43 | 989.31 | 1179.04 | 1582.49 | 1982.47 | 2323.17 | 2476.37 | 2852.32 | 3302.26 |
| Others \2 | 427.16 | 478.24 | 550.1 | 636.82 | 700.44 | 850.19 | 1000.81 | 1138.13 | 1231.56 | 1441.89 | 1644.23 |
| ii) Non Tax Revenue \3 | 1122.85 | 1105.67 | 1310.24 | 1354.44 | 1396.27 | 1780.55 | 2348.32 | 2759.58 | 3033.3 | 3157.26 | 3471.23 |
| iii) Others \4 | 8.12 | 4.75 | 15.14 | 6.37 | 4.16 | 44.33 | 156.67 | 167.17 | 164.8 | 90.38 | 56.36 |
| Overall Deficit (A - B) | 1536.44 | 1982.09 | 2462.82 | 2638.71 | 2684.28 | 2985.6 | 3603.02 | 4501.62 | 4685.62 | 5973.53 | 7404.03 |
| SHARE IN TOTAL TAX REVENUE | | | | | | | | | | | |
| Tax Revenue (I+II) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| I. Direct | 0.23 | 0.21 | 0.21 | 0.21 | 0.21 | 0.20 | 0.22 | 0.21 | 0.20 | 0.18 | 0.18 |
| Corporation Tax | 0.08 | 0.08 | 0.08 | 0.09 | 0.08 | 0.08 | 0.08 | 0.08 | 0.09 | 0.08 | 0.08 |
| Personal Income Tax | 0.11 | 0.10 | 0.10 | 0.10 | 0.10 | 0.09 | 0.11 | 0.10 | 0.08 | 0.08 | 0.08 |
| Land Revenue | 0.03 | 0.03 | 0.02 | 0.01 | 0.02 | 0.02 | 0.02 | 0.02 | 0.01 | 0.01 | 0.01 |
| Agricultural Income Tax | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.01 | 0.00 |
| Others | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.02 | 0.01 | 0.01 |
| II. Indirect | 0.77 | 0.79 | 0.79 | 0.79 | 0.79 | 0.80 | 0.78 | 0.79 | 0.80 | 0.82 | 0.82 |
| Customs | 0.10 | 0.11 | 0.12 | 0.13 | 0.13 | 0.14 | 0.13 | 0.13 | 0.14 | 0.16 | 0.17 |
| Union Excise | 0.36 | 0.37 | 0.37 | 0.36 | 0.35 | 0.35 | 0.34 | 0.34 | 0.34 | 0.35 | 0.34 |
| State Excise | 0.04 | 0.04 | 0.04 | 0.04 | 0.05 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 |
| Sales Tax | 0.16 | 0.17 | 0.15 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.19 | 0.18 | 0.19 |
| Others | 0.10 | 0.10 | 0.10 | 0.10 | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 |
| AS A % OF GDP | | | | | | | | | | | |
| GDP at current market prices | 40387 | 43163 | 46257 | 51005 | 62007 | 73235 | 78761 | 84894 | 96067 | 104190 | 114356 |
| A. Total Expenditure (i + ii) | 17.00 | 18.18 | 20.24 | 20.46 | 18.50 | 19.16 | 21.95 | 23.28 | 21.99 | 23.75 | 25.02 |
| i) Revenue Expenditure | 13.05 | 13.25 | 15.11 | 15.39 | 13.98 | 13.49 | 15.04 | 16.33 | 15.60 | 16.65 | 17.80 |
| ii) Capital Expenditure | 3.95 | 4.93 | 5.13 | 5.07 | 4.52 | 5.67 | 6.91 | 6.95 | 6.39 | 7.10 | 7.22 |
| B. Total Revenue (i + ii + iii) | 13.20 | 13.58 | 14.92 | 15.29 | 14.17 | 15.09 | 17.38 | 17.97 | 17.11 | 18.02 | 18.55 |
| i) Tax Revenue (I+II) | 10.40 | 11.01 | 12.05 | 12.62 | 11.92 | 12.59 | 14.20 | 14.53 | 13.78 | 14.90 | 15.46 |
| I. Direct | 2.38 | 2.34 | 2.53 | 2.64 | 2.50 | 2.50 | 3.16 | 3.04 | 2.79 | 2.74 | 2.71 |
| Corporation Tax | 0.88 | 0.86 | 1.02 | 1.09 | 0.94 | 0.97 | 1.09 | 1.16 | 1.27 | 1.20 | 1.22 |
| Personal Income Tax | 1.11 | 1.10 | 1.16 | 1.23 | 1.20 | 1.19 | 1.54 | 1.41 | 1.04 | 1.13 | 1.17 |
| Land Revenue | 0.29 | 0.28 | 0.22 | 0.19 | 0.26 | 0.22 | 0.30 | 0.22 | 0.19 | 0.19 | 0.14 |
| Agricultural Income Tax | 0.03 | 0.02 | 0.03 | 0.02 | 0.02 | 0.02 | 0.04 | 0.04 | 0.06 | 0.08 | 0.05 |
| Others | 0.08 | 0.08 | 0.10 | 0.11 | 0.09 | 0.10 | 0.20 | 0.22 | 0.23 | 0.13 | 0.12 |
| II. Indirect | 8.01 | 8.67 | 9.52 | 9.98 | 9.41 | 10.09 | 11.03 | 11.48 | 10.99 | 12.17 | 12.76 |
| Customs | 1.05 | 1.21 | 1.50 | 1.68 | 1.61 | 1.82 | 1.80 | 1.83 | 1.90 | 2.33 | 2.56 |
| Union Excise | 3.77 | 4.07 | 4.46 | 4.56 | 4.20 | 4.41 | 4.88 | 4.97 | 4.63 | 5.15 | 5.26 |
| State Excise | 0.44 | 0.45 | 0.51 | 0.55 | 0.58 | 0.54 | 0.56 | 0.60 | 0.60 | 0.57 | 0.62 |
| Sales Tax | 1.69 | 1.82 | 1.86 | 1.94 | 1.90 | 2.16 | 2.52 | 2.74 | 2.58 | 2.74 | 2.89 |
| Others | 1.06 | 1.11 | 1.19 | 1.25 | 1.13 | 1.16 | 1.27 | 1.34 | 1.28 | 1.38 | 1.44 |
| ii) Non Tax Revenue | 2.78 | 2.56 | 2.83 | 2.66 | 2.25 | 2.43 | 2.98 | 3.25 | 3.16 | 3.03 | 3.04 |
| iii) Others | 0.02 | 0.01 | 0.03 | 0.01 | 0.01 | 0.06 | 0.20 | 0.20 | 0.17 | 0.09 | 0.05 |
| Overall Deficit (A - B) | 3.80 | 4.59 | 5.32 | 5.17 | 4.33 | 4.08 | 4.57 | 5.30 | 4.88 | 5.73 | 6.47 |

| Year | 80-81 | 81-82 | 82-83 | 83-84 | 84-85 | 85-86 | 86-87 | 87-88 | 88-89 |
|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | |
| A. Total Expenditure (i + ii) | 34845.04 | 39641.5 | 46098.4 | 53855.69 | 65303.88 | 75458.68 | 90292.04 | 101495.9 | 111441 |
| i) Revenue Expenditure | 23711.28 | 27863.62 | 33451.27 | 39138.68 | 47329.09 | 56030.97 | 66188.96 | 77474.35 | 85695.67 |
| ii) Capital Expenditure | 11133.76 | 11777.88 | 12647.13 | 14717.01 | 17974.79 | 19427.71 | 24103.08 | 24021.51 | 25745.36 |
| B. Total Revenue (i + ii + iii) | 23834.9 | 28880.61 | 33085.7 | 36958.77 | 42933.21 | 51010.72 | 58434.4 | 67349.19 | 74781.19 |
| i) Tax Revenue (I+II) | 19843.75 | 24142.41 | 27241.57 | 31525.45 | 35813.42 | 43266.71 | 49539.22 | 56949.62 | 64146.81 |
| I. Direct | 3268.28 | 4133.19 | 4491.96 | 4907.57 | 5329.49 | 6252.03 | 6889.32 | 7852.87 | 8804.25 |
| Corporation Tax | 1310.79 | 1969.97 | 2184.51 | 2492.73 | 2555.9 | 2865.07 | 3159.96 | 3650 | 4099 |
| Personal Income Tax | 1506.39 | 1475.5 | 1569.72 | 1699.14 | 1927.76 | 2509.61 | 2878.97 | 3350 | 3659.94 |
| Land Revenue | 156.85 | 228.11 | 226.21 | 255.31 | 318.72 | 353.32 | 374.46 | 414.92 | 520.69 |
| Agricultural Income Tax | 46.4 | 38.25 | 30.22 | 44.02 | 91.33 | 126.92 | 103.76 | 70.9 | 99.45 |
| Others \1 | 247.85 | 421.36 | 481.3 | 416.37 | 435.78 | 397.11 | 372.17 | 367.05 | 425.17 |
| II. Indirect | 16575.47 | 20009.22 | 22749.61 | 26617.88 | 30483.93 | 37014.68 | 42649.9 | 49096.84 | 55342.56 |
| Customs | 3409.28 | 4300.36 | 5119.41 | 5583.44 | 7040.52 | 9525.78 | 11475.03 | 13500 | 15626.31 |
| Union Excise | 6500.02 | 7420.74 | 8058.5 | 10221.75 | 11150.84 | 12955.72 | 14470.18 | 16580.12 | 18172 |
| State Excise | 838.33 | 1128.54 | 1355.66 | 1582.81 | 1857.36 | 2071.14 | 2426.66 | 2623.16 | 2851.62 |
| Sales Tax | 4017.86 | 5063.08 | 5666.82 | 6507.09 | 7326.02 | 8742.18 | 9975.34 | 11502.02 | 13018.93 |
| Others \2 | 1809.98 | 2096.5 | 2549.22 | 2722.79 | 3109.19 | 3719.86 | 4302.69 | 4891.54 | 5673.7 |
| ii) Non Tax Revenue \3 | 3781.42 | 4432.46 | 5580.35 | 5396.32 | 6840.08 | 8027.77 | 9330.73 | 10510.68 | 11490.45 |
| iii) Others \4 | 209.73 | 305.74 | 263.78 | 37 | 279.71 | -283.76 | -435.55 | -111.11 | -856.07 |
| Overall Deficit (A - B) | 11010.14 | 10760.89 | 13012.7 | 16896.92 | 22370.67 | 24447.96 | 31857.64 | 34146.67 | 36659.84 |
| SHARE IN TOTAL TAX REVENUE | | | | | | | | | |
| Tax Revenue (I+II) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| I. Direct | 0.16 | 0.17 | 0.16 | 0.16 | 0.15 | 0.14 | 0.14 | 0.14 | 0.14 |
| Corporation Tax | 0.07 | 0.08 | 0.08 | 0.08 | 0.07 | 0.07 | 0.06 | 0.06 | 0.06 |
| Personal Income Tax | 0.08 | 0.06 | 0.06 | 0.05 | 0.05 | 0.06 | 0.06 | 0.06 | 0.06 |
| Land Revenue | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| Agricultural Income Tax | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Others | 0.01 | 0.02 | 0.02 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| II. Indirect | 0.84 | 0.83 | 0.84 | 0.84 | 0.85 | 0.86 | 0.86 | 0.86 | 0.86 |
| Customs | 0.17 | 0.18 | 0.19 | 0.18 | 0.20 | 0.22 | 0.23 | 0.24 | 0.24 |
| Union Excise | 0.33 | 0.31 | 0.30 | 0.32 | 0.31 | 0.30 | 0.29 | 0.29 | 0.28 |
| State Excise | 0.04 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.04 |
| Sales Tax | 0.20 | 0.21 | 0.21 | 0.21 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| Others | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 | 0.09 |
| AS A % OF GDP | | | | | | | | | |
| GDP at current market prices | 136013 | 159760 | 178132 | 207589 | 231387 | 261920 | 291974 | 332616 | 394992 |
| A. Total Expenditure (i + ii) | 25.62 | 24.81 | 25.88 | 25.94 | 28.22 | 28.81 | 30.92 | 30.51 | 28.21 |
| i) Revenue Expenditure | 17.43 | 17.44 | 18.78 | 18.85 | 20.45 | 21.39 | 22.67 | 23.29 | 21.70 |
| ii) Capital Expenditure | 8.19 | 7.37 | 7.10 | 7.09 | 7.77 | 7.42 | 8.26 | 7.22 | 6.52 |
| B. Total Revenue (i + ii + iii) | 17.52 | 18.08 | 18.57 | 17.80 | 18.55 | 19.48 | 20.01 | 20.25 | 18.93 |
| i) Tax Revenue (I+II) | 14.59 | 15.11 | 15.29 | 15.19 | 15.48 | 16.52 | 16.97 | 17.12 | 16.24 |
| I. Direct | 2.40 | 2.59 | 2.52 | 2.36 | 2.30 | 2.39 | 2.36 | 2.36 | 2.23 |
| Corporation Tax | 0.96 | 1.23 | 1.23 | 1.20 | 1.10 | 1.09 | 1.08 | 1.10 | 1.04 |
| Personal Income Tax | 1.11 | 0.92 | 0.88 | 0.82 | 0.83 | 0.96 | 0.99 | 1.01 | 0.93 |
| Land Revenue | 0.12 | 0.14 | 0.13 | 0.12 | 0.14 | 0.13 | 0.13 | 0.12 | 0.13 |
| Agricultural Income Tax | 0.03 | 0.02 | 0.02 | 0.02 | 0.04 | 0.05 | 0.04 | 0.02 | 0.03 |
| Others | 0.18 | 0.26 | 0.27 | 0.20 | 0.19 | 0.15 | 0.13 | 0.11 | 0.11 |
| II. Indirect | 12.19 | 12.52 | 12.77 | 12.82 | 13.17 | 14.13 | 14.61 | 14.76 | 14.01 |
| Customs | 2.51 | 2.69 | 2.87 | 2.69 | 3.04 | 3.64 | 3.93 | 4.06 | 3.96 |
| Union Excise | 4.78 | 4.64 | 4.52 | 4.92 | 4.82 | 4.95 | 4.96 | 4.98 | 4.60 |
| State Excise | 0.62 | 0.71 | 0.76 | 0.76 | 0.80 | 0.79 | 0.83 | 0.79 | 0.72 |
| Sales Tax | 2.95 | 3.17 | 3.18 | 3.13 | 3.17 | 3.34 | 3.42 | 3.46 | 3.30 |
| Others | 1.33 | 1.31 | 1.43 | 1.31 | 1.34 | 1.42 | 1.47 | 1.47 | 1.44 |
| ii) Non Tax Revenue | 2.78 | 2.77 | 3.13 | 2.60 | 2.96 | 3.06 | 3.20 | 3.16 | 2.91 |
| iii) Others | 0.15 | 0.19 | 0.15 | 0.02 | 0.12 | -0.11 | -0.15 | -0.03 | -0.22 |
| Overall Deficit (A - B) | 8.09 | 6.74 | 7.31 | 8.14 | 9.67 | 9.33 | 10.91 | 10.27 | 9.28 |

NOTES TO TABLE 1:

Source: Government of India (various issues): Indian Economic Statistics (Public Finance), Ministry of Finance.

GDP figures from Government of India (Central Statistical Organisation): National Accounts Statistics-New Series, 1989, Ministry of Planning.

\1 Includes: Estate duties, interest tax, wealth tax, gift tax, hotel receipts tax, tax on professions, expenditure tax, callings and employment and urban immovable property tax.

\2 Includes: Stamp duty, registration fees, taxes on vehicles, taxes on passengers and goods carried by road, electricity duties, cess on sugarcane etc.

\3 Includes: Profits of RBI, net contribution of public undertakings, railways, post and telegraph etc.

\4 Self balancing items and transfers from Funds.

**TABLE 2 : VAT Experiences in selected Federations**

| Country | When introduced and type of VAT | Taxes replaced and effect on revenue | Base setting | Rate setting | Collection of tax | Revenue sharing | Problems | Reforms of system |
|---|---|---|---|---|---|---|---|---|
| BRAZIL | Jan 1967<br>Origin | Federal VAT replaced federal wholesale tax, and state VAT replaced state turnover tax.<br>Decrease. | IPI: Industrial production.<br>ICM: Sales of goods at all stages of production.<br>Exemptions: services, minerals agriculture. | IPI:0-300%<br>ZFM,exports are zero-rated.<br>Alcohol and tobacco are taxed at 300%.<br>ICM:17%<br>Luxury:25%<br>Basics:12%<br>A complex set of rules on border trade apply since states have different rates. | Responsibility shared by the Federal, state and municipal governments. | Sharing is always downward. The State Participation Fund is made up of 21.5% each of federal income tax and VAT. Distribution by the Council of States.<br>Formula takes into account population and per capita income. | i) Complexity of administration due to the two-tier system.<br>ii) Federal and state, local and state tax bases overlap.<br>iii) States have little autonomy in setting rates and bases. | i) 1988: The new Constitution led to a decentralization drive.<br>ii) 1989: Introduction of new rates :<br>12% : basics<br>25% : luxuries. |
| MEXICO | Jan 1980<br>Destination | 30 federal and 400 state and municipal taxes.<br>Increase. | Acts and activities related to sales of goods, provision of services, imports.<br>Exemptions: housing,education medical,transport. | General:15%<br>Luxuries:20%<br>Food:6%<br>Agriculture and exports are zero-rated. | States and the Federal District collect the federal tax. | The General Revenue Sharing Fund is made up of 17.5% of all federal revenue. Formula takes into account previous state share and effort.<br>States are allowed to keep 30% of the VAT revenue that they collect. | i) Problem of disincentives for states to collect VAT as they cannot affect the rate structure and as there is a lag between collection and awards.<br>ii) Richer and poorer states both unhappy with formula. | i) 1983:General rate became 15%<br>ii) 1989-1991: period of fiscal reform<br>iii) 1991:General rate back to 10%<br>iv) Jan 1992: VAT rates in border regions changed to a single 10% rate. |
| GERMANY | Jan 1968<br>Destination | Cumulative all-stage turnover tax.<br>Constant. | Wide range of goods and services and imports.<br>Exemptions: Financial services, cross-border transport. | General:14%<br>Food, books and some raw materials at 7%<br>Exports are zero-rated. | States collect federal VAT at common rates and on a common base | Revenue split between federal and state governments varies between 70:30 and 68:32, and thereis some redistribution for weaker states. | System of rate and base setting and revenue sharing is rigid. | i) Jan 1981: VAT rates revised from 10% to 14% to conform with EC directives.<br>ii)Jan 1991:VAT also applied to 5 new (GDR) states. |
| CANADA | Jan 1991<br>Destination | Hybrid federal wholesale tax.<br>Most provinces still have a retail sales tax.<br>Unknown. | All supplies of goods and services and imports.<br>Exemptions: health,education, real property, public sector services. | General:7%<br>Agriculture, fishing, exports and some medical and financial services are zero-rated. | The federal government collects the federal VAT. | Some downward transfers. Federal transfers to provinces are almost 20% of provincial expenditures . Provincial transfers to the municipalities are about 45% of local government expenditure. | i) Provinces are reluctant to give up retail sales tax and hence their revenue generating autonomy.<br>ii) There is poor harmonization of federal and provincial tax bases.<br>iii) Problem of reaching a single rate and tax universality due to decentralized nature of the Canadian government. | Jan 1992:<br>Quebec has adopted a provincial type VAT, although the base is not harmonizedwith that of the federal VAT. There are proposals for two other provinces to adopt the provincial VAT. |

Sources: Brazil: Longo (1990), Shah (1991), World Bank (1990). Mexico: Gil Diaz (1987), Aspe (1992), World Bank (1989). Canada: Tait (1989), Ernst and Young (1991), Mintz and Wilson (1992). Germany: Ernst and Young (1991), Tait (1989).

TABLE 3 CURRENT EXPENDITURES OF THE CENTRE AND STATES (1987-88)

| | CENTRE | | STATES | | |
|---|---|---|---|---|---|
| | ( Rs million) | (% of total) | ( Rs million) | (% of total) | |
| Defence services | 100747 | 27.26 | - | 0.00 | Defence services |
| Interest payments | 112514 | 30.44 | 17394 | 4.34 | Interest payments |
| Major subsidies | 41638 | 11.27 | 57 | 0.01 | Major subsidies |
| Food | 20000 | 5.41 | 57 | 0.01 | Food |
| Fertilizers | 21638 | 5.85 | - | 0.00 | Fertilizers |
| General services | 26584 | 7.19 | 84514 | 21.10 | General services |
| Administration of justice | 189 | 0.05 | 2973 | 0.74 | Administration of justice |
| Tax collection | 4286 | 1.16 | 9263 | 2.31 | Tax collection |
| Police | N.A. | 0.00 | 24288 | 6.06 | Police |
| Others | 22109 | 5.98 | 47990 | 11.98 | Others |
| Social and community services | 43593 | 11.80 | 180073 | 44.95 | Social and community services |
| Scientific services and research | 7893 | 2.14 | 239 | 0.06 | Scientific services and research |
| Education, art and culture | 17563 | 4.75 | 92978 | 23.21 | Education, art and culture |
| Medical, Public health, sanitatio and water supply | 4315 | 1.17 | 38352 | 9.57 | Medical, Public health, sanitatio and water supply |
| Family welfare | 5747 | 1.56 | 5520 | 1.38 | Family welfare |
| Relief on natural calamities | - | 0.00 | 8756 | 2.19 | Relief on natural calamities |
| Social security & welfare | 2063 | 0.56 | 23855 | 5.96 | Social security & welfare |
| Others | 6012 | 1.63 | 10373 | 2.59 | Others |
| General economic services | 10634 | 2.88 | 5756 | 1.44 | General economic services |
| Agriculture and allied services | 10495 | 2.84 | 60408 | 15.08 | Agriculture and allied services |
| Crop & animal husbandry | 2221 | 0.60 | 15234 | 3.80 | Crop & animal husbandry |
| Food storage and warehousing | 970 | 0.26 | 1140 | 0.28 | Food storage and warehousing |
| Rural development | 3133 | 0.85 | 32332 | 8.07 | Rural development |
| Others | 4171 | 1.13 | 11702 | 2.92 | Others |
| Industry and minerals | 14886 | 4.03 | 7102 | 1.77 | Industry and minerals |
| Power, irrigation & flood control | 1218 | 0.33 | 18247 | 4.56 | Power, irrigation & flood control |
| Power projects | 376 | 0.10 | 6926 | 1.73 | Power projects |
| Irrigation | 613 | 0.17 | 10107 | 2.52 | Irrigation |
| Others | 229 | 0.06 | 1214 | 0.30 | Others |
| Transport and communication | 6257 | 1.69 | 14051 | 3.51 | Transport and communication |
| Roads and bridges | 3122 | 0.84 | 13104 | 3.27 | Roads and bridges |
| Others | 3135 | 0.85 | 947 | 0.24 | Others |
| Public works | 956 | 0.26 | 5152 | 1.29 | Public works |
| Others | 48 | 0.01 | 7816 | 1.95 | Others |
| **TOTAL** | **369570** | **100.00** | **400570** | **100.00** | **TOTAL** |

Notes: (1) The statistics relating to the States in the "Indian Economic Statistics (Public Finance)" include Union Territories.

(2) To avoid double-counting, the Centre's expenditure exludes grants to the States, and the States' expenditure excludes interest payments to th

Source: Jetha (1990), Indian Economic Statistics (Public Finance), 1989.

## TABLE 4: REVENUE RECEIPTS OF THE STATE

| Year | 50-51 | 55-56 | 60-61 | 61-62 | 62-63 | 63-64 | 64-65 | 65-66 | 66-67 | 67-68 | 68-69 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | |
| I. Direct Taxes (before sharing)=a+b+c | 55.33 | 87.91 | 110.01 | 112.47 | 137.37 | 143.02 | 142.98 | 135.84 | 110.40 | 125.21 | 141.72 |
| (a) Land Revenue | 49.56 | 78.01 | 97.19 | 99.52 | 123.84 | 130.19 | 128.33 | 119.92 | 94.92 | 107.71 | 125.44 |
| (b) Agricultural Income Tax | 3.59 | 7.68 | 9.71 | 9.44 | 9.60 | 9.42 | 10.79 | 9.91 | 10.34 | 12.09 | 9.94 |
| (c) Others \1 | 2.18 | 2.22 | 3.11 | 3.51 | 3.93 | 3.41 | 3.86 | 6.01 | 5.14 | 5.41 | 6.34 |
| Plus (d) Share in Central Taxes | 47.52 | 57.14 | 90.28 | 97.72 | 99.15 | 123.51 | 130.55 | 130.13 | 141.64 | 181.10 | 200.05 |
| Direct Taxes (after sharing) | 102.85 | 145.05 | 200.29 | 210.19 | 236.52 | 266.53 | 273.53 | 265.97 | 252.04 | 306.31 | 341.77 |
| II. Indirect Taxes = a+b+c+d | 166.35 | 194.52 | 344.89 | 376.97 | 442.66 | 547.68 | 635.13 | 725.08 | 844.28 | 977.63 | 1107.16 |
| (a) State Excise Duties | 47.79 | 45.09 | 53.08 | 58.59 | 62.82 | 73.53 | 86.06 | 98.50 | 111.66 | 134.50 | 163.59 |
| (b) Stamps and Registration Fees | 25.98 | 29.08 | 43.54 | 47.70 | 58.46 | 62.54 | 70.46 | 80.17 | 87.88 | 106.84 | 108.70 |
| (c) General Sales Tax | 55.37 | 79.90 | 142.44 | 163.14 | 188.91 | 245.89 | 295.20 | 341.44 | 410.96 | 480.78 | 540.25 |
| (d) Others \2 | 37.21 | 40.45 | 105.83 | 107.54 | 132.47 | 165.72 | 183.41 | 204.97 | 233.78 | 255.51 | 294.62 |
| Plus (e) Share of Union Excise Duties | | 16.57 | 75.10 | 80.65 | 124.92 | 136.04 | 127.35 | 145.90 | 230.90 | 230.73 | 287.15 |
| | | | | 178.37 | 224.07 | 259.55 | 257.9 | 276.03 | 372.54 | 411.83 | 487.2 |
| Indirect Taxes (after sharing) | 166.35 | 211.09 | 419.99 | 457.62 | 567.58 | 683.72 | 762.48 | 870.98 | 1075.18 | 1208.36 | 1394.31 |
| Direct + Indirect Taxes (before sharing) | 221.68 | 282.43 | 454.90 | 489.44 | 580.03 | 690.7 | 778.11 | 860.92 | 954.68 | 1102.84 | 1248.88 |
| Direct + Indirect Taxes (after sharing) | 269.20 | 356.14 | 620.28 | 667.81 | 804.1 | 950.25 | 1036.01 | 1136.95 | 1327.22 | 1514.67 | 1736.08 |
| Non Tax Revenue \3 | 75.72 | 134.28 | 188.1 | 197.64 | 225.55 | 267.78 | 282.62 | 334.78 | 360.78 | 413.63 | 497.04 |
| Grants from the Centre | 26.6 | 72.69 | 224.06 | 216.64 | 222.19 | 252.7 | 322.83 | 384.45 | 467.62 | 530.22 | 572.68 |
| **SHARE OF INDIVIDUAL TAXES IN TOTAL (AFTER SHARING) TAX REVENUE** | | | | | | | | | | | |
| I. Direct Taxes (before sharing) = a+b+c | 0.21 | 0.25 | 0.18 | 0.17 | 0.17 | 0.15 | 0.14 | 0.12 | 0.08 | 0.08 | 0.08 |
| (a) Land Revenue | 0.18 | 0.22 | 0.16 | 0.15 | 0.15 | 0.14 | 0.12 | 0.11 | 0.07 | 0.07 | 0.07 |
| (b)+(c) Agricultural Income Tax & Others | 0.02 | 0.03 | 0.02 | 0.02 | 0.02 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| II. Indirect Taxes (before sharing) = a+b+c+d | 0.62 | 0.55 | 0.56 | 0.56 | 0.55 | 0.58 | 0.61 | 0.64 | 0.64 | 0.65 | 0.64 |
| (a) State Excise Duties | 0.18 | 0.13 | 0.09 | 0.09 | 0.08 | 0.08 | 0.08 | 0.09 | 0.08 | 0.09 | 0.09 |
| (c) General Sales Tax | 0.21 | 0.22 | 0.23 | 0.24 | 0.23 | 0.26 | 0.28 | 0.30 | 0.31 | 0.32 | 0.31 |
| (b)+(d) Stamps, Registration Fees & Others | 0.23 | 0.20 | 0.24 | 0.23 | 0.24 | 0.24 | 0.25 | 0.25 | 0.24 | 0.24 | 0.23 |
| Share in Central Taxes | 0.18 | 0.21 | 0.27 | 0.27 | 0.28 | 0.27 | 0.25 | 0.24 | 0.28 | 0.27 | 0.28 |
| Direct + Indirect Tax (after sharing) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| **REVENUE AS A % OF GDP** | | | | | | | | | | | |
| GDP at current market prices | 9366 | 10258 | 16201 | 17177 | 18476 | 21237 | 24765 | 26145 | 29571 | 34611 | 36674 |
| I. Direct Taxes (before sharing) = a+b+c | 0.59 | 0.86 | 0.68 | 0.65 | 0.74 | 0.67 | 0.58 | 0.52 | 0.37 | 0.36 | 0.39 |
| (a) Land Revenue | 0.53 | 0.76 | 0.60 | 0.58 | 0.67 | 0.61 | 0.52 | 0.46 | 0.32 | 0.31 | 0.34 |
| (b)+(c) Agricultural Income Tax & Others | 0.06 | 0.10 | 0.08 | 0.08 | 0.07 | 0.06 | 0.06 | 0.06 | 0.05 | 0.05 | 0.04 |
| II. Indirect Taxes (before sharing) = a+b+c+d | 1.78 | 1.90 | 2.13 | 2.19 | 2.40 | 2.58 | 2.56 | 2.77 | 2.86 | 2.82 | 3.02 |
| (a) State Excise Duties | 0.51 | 0.44 | 0.33 | 0.34 | 0.34 | 0.35 | 0.35 | 0.38 | 0.38 | 0.39 | 0.45 |
| (c) General Sales Tax | 0.59 | 0.78 | 0.88 | 0.95 | 1.02 | 1.16 | 1.19 | 1.31 | 1.39 | 1.39 | 1.47 |
| (b)+(d) Stamps, Registration Fees & Others | 0.67 | 0.68 | 0.92 | 0.90 | 1.03 | 1.07 | 1.03 | 1.09 | 1.09 | 1.05 | 1.10 |
| Direct + Indirect Taxes (before sharing) | 2.37 | 2.75 | 2.81 | 2.85 | 3.14 | 3.25 | 3.14 | 3.29 | 3.23 | 3.19 | 3.41 |
| Share in Central Taxes | 0.51 | 0.72 | 1.02 | 1.04 | 1.21 | 1.22 | 1.04 | 1.06 | 1.26 | 1.19 | 1.33 |
| Direct + Indirect Tax (after sharing) | 2.87 | 3.47 | 3.83 | 3.89 | 4.35 | 4.47 | 4.18 | 4.35 | 4.49 | 4.38 | 4.73 |
| Non Tax Revenue | 0.81 | 1.31 | 1.16 | 1.15 | 1.22 | 1.26 | 1.14 | 1.28 | 1.22 | 1.20 | 1.36 |
| Grants from the Centre | 0.28 | 0.71 | 1.38 | 1.26 | 1.20 | 1.19 | 1.30 | 1.47 | 1.58 | 1.53 | 1.56 |

| Year | 69-70 | 70-71 | 71-72 | 72-73 | 73-74 | 74-75 | 75-76 | 76-77 | 77-78 | 78-79 | 79-80 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | |
| I. Direct Taxes (before sharing)=a+b+c | 136.45 | 139.55 | 124.18 | 112.75 | 176.75 | 183.88 | 287.28 | 256.39 | 274.37 | 322.67 | 278.03 |
| (a) Land Revenue | 115.93 | 120.60 | 101.93 | 94.32 | 159.22 | 162.00 | 233.76 | 187.17 | 178.14 | 201.06 | 164.61 |
| (b) Agricultural Income Tax | 14.09 | 10.53 | 12.90 | 12.26 | 11.82 | 13.89 | 28.48 | 34.55 | 61.96 | 80.38 | 58.36 |
| (c) Others \1 | 6.43 | 8.42 | 9.35 | 6.17 | 5.71 | 7.99 | 25.04 | 34.67 | 34.27 | 41.23 | 55.06 |
| Plus (d) Share in Central Taxes | 300.16 | 365.39 | 469.85 | 495.11 | 539.05 | 521.87 | 742.31 | 661.85 | 685.29 | 717.32 | 875.82 |
| Direct Taxes (after sharing) | 436.61 | 504.94 | 594.03 | 607.86 | 715.80 | 705.75 | 1029.59 | 918.24 | 959.66 | 1039.99 | 1153.85 |
| II. Indirect Taxes = a+b+c+d | 1240.49 | 1406.07 | 1578.57 | 1818.11 | 2142.27 | 2717.43 | 3285.66 | 3804.40 | 4104.43 | 4679.96 | 5431.40 |
| (a) State Excise Duties | 178.24 | 196.13 | 236.93 | 282.66 | 358.41 | 393.10 | 441.72 | 510.75 | 577.44 | 592.10 | 705.49 |
| (b) Stamps and Registration Fees | 113.85 | 127.57 | 137.48 | 145.05 | 172.55 | 205.75 | 217.73 | 232.74 | 287.68 | 334.81 | 369.34 |
| (c) General Sales Tax | 620.96 | 711.67 | 781.37 | 911.24 | 1067.24 | 1437.97 | 1820.89 | 2121.44 | 2261.58 | 2606.87 | 3028.58 |
| (d) Others \2 | 327.44 | 370.70 | 422.79 | 479.16 | 544.07 | 680.61 | 805.32 | 939.47 | 977.73 | 1146.18 | 1327.99 |
| Plus (e) Share of Union Excise Duties | 325.21 | 390.27 | 474.61 | 566.14 | 628.40 | 702.58 | 856.71 | 1019.99 | 1119.84 | 1242.10 | 2534.02 |
| | 625.37 | 755.66 | 944.46 | 1061.25 | 1167.45 | 1224.45 | 1599.02 | 1681.84 | 1805.13 | 1959.42 | 3409.84 |
| Indirect Taxes (after sharing) | 1565.70 | 1796.34 | 2053.18 | 2384.25 | 2770.67 | 3420.01 | 4142.37 | 4824.39 | 5224.27 | 5922.06 | 7965.42 |
| Direct + Indirect Taxes (before sharing) | 1376.94 | 1545.62 | 1702.75 | 1930.86 | 2319.02 | 2901.31 | 3572.94 | 4060.79 | 4378.8 | 5002.63 | 5709.43 |
| Direct + Indirect Taxes (after sharing) | 2002.31 | 2301.28 | 2647.21 | 2992.11 | 3486.47 | 4125.76 | 5171.96 | 5742.63 | 6183.93 | 6962.05 | 9119.27 |
| Non Tax Revenue \3 | 541.81 | 535.27 | 572.45 | 648.26 | 708.24 | 777.57 | 966.25 | 1181.91 | 1180.61 | 1335.51 | 1495.55 |
| Grants from the Centre | 606.29 | 583.37 | 873.15 | 947.7 | 969.6 | 1058.86 | 1284.85 | 1584.72 | 1907.45 | 2568.2 | 2200 |
| SHARE OF INDIVIDUAL TAXES IN TOTAL | | | | | | | | | | | |
| I. Direct Taxes (before sharing) = a+b+c | 0.07 | 0.06 | 0.05 | 0.04 | 0.05 | 0.04 | 0.06 | 0.04 | 0.04 | 0.05 | 0.03 |
| (a) Land Revenue | 0.06 | 0.05 | 0.04 | 0.03 | 0.05 | 0.04 | 0.05 | 0.03 | 0.03 | 0.03 | 0.02 |
| (b)+(c) Agricultural Income Tax & Others | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.02 | 0.02 | 0.01 |
| II. Indirect Taxes (before sharing) = a+b+c+d | 0.62 | 0.61 | 0.60 | 0.61 | 0.61 | 0.66 | 0.64 | 0.66 | 0.66 | 0.67 | 0.60 |
| (a) State Excise Duties | 0.09 | 0.09 | 0.09 | 0.09 | 0.10 | 0.10 | 0.09 | 0.09 | 0.09 | 0.09 | 0.08 |
| (c) General Sales Tax | 0.31 | 0.31 | 0.30 | 0.30 | 0.31 | 0.35 | 0.35 | 0.37 | 0.37 | 0.37 | 0.33 |
| (b)+(d) Stamps, Registration Fees & Others | 0.22 | 0.22 | 0.21 | 0.21 | 0.21 | 0.21 | 0.20 | 0.20 | 0.20 | 0.21 | 0.19 |
| Share in Central Taxes | 0.31 | 0.33 | 0.36 | 0.35 | 0.33 | 0.30 | 0.31 | 0.29 | 0.29 | 0.28 | 0.37 |
| Direct + Indirect Tax (after sharing) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| REVENUE AS A % OF GDP | | | | | | | | | | | |
| GDP at current market prices | 40387 | 43163 | 46257 | 51005 | 62007 | 73235 | 78761 | 84894 | 96067 | 104190 | 114356 |
| I. Direct Taxes (before sharing) = a+b+c | 0.34 | 0.32 | 0.27 | 0.22 | 0.29 | 0.25 | 0.36 | 0.30 | 0.29 | 0.31 | 0.24 |
| (a) Land Revenue | 0.29 | 0.28 | 0.22 | 0.18 | 0.26 | 0.22 | 0.30 | 0.22 | 0.19 | 0.19 | 0.14 |
| (b)+(c) Agricultural Income Tax & Others | 0.05 | 0.04 | 0.05 | 0.04 | 0.03 | 0.03 | 0.07 | 0.08 | 0.10 | 0.12 | 0.10 |
| II. Indirect Taxes (before sharing) = a+b+c+d | 3.07 | 3.26 | 3.41 | 3.56 | 3.45 | 3.71 | 4.17 | 4.48 | 4.27 | 4.49 | 4.75 |
| (a) State Excise Duties | 0.44 | 0.45 | 0.51 | 0.55 | 0.58 | 0.54 | 0.56 | 0.60 | 0.60 | 0.57 | 0.62 |
| (c) General Sales Tax | 1.54 | 1.65 | 1.69 | 1.79 | 1.72 | 1.96 | 2.31 | 2.50 | 2.35 | 2.50 | 2.65 |
| (b)+(d) Stamps, Registration Fees & Others | 1.09 | 1.15 | 1.21 | 1.22 | 1.16 | 1.21 | 1.30 | 1.38 | 1.32 | 1.42 | 1.48 |
| Direct + Indirect Taxes (before sharing) | 3.41 | 3.58 | 3.68 | 3.79 | 3.74 | 3.96 | 4.54 | 4.78 | 4.56 | 4.80 | 4.99 |
| Share in Central Taxes | 1.55 | 1.75 | 2.04 | 2.08 | 1.88 | 1.67 | 2.03 | 1.98 | 1.88 | 1.88 | 2.98 |
| Direct + Indirect Tax (after sharing) | 4.96 | 5.33 | 5.72 | 5.87 | 5.62 | 5.63 | 6.57 | 6.76 | 6.44 | 6.68 | 7.97 |
| Non Tax Revenue | 1.34 | 1.24 | 1.24 | 1.27 | 1.14 | 1.06 | 1.23 | 1.39 | 1.23 | 1.28 | 1.31 |
| Grants from the Centre | 1.50 | 1.35 | 1.89 | 1.86 | 1.56 | 1.45 | 1.63 | 1.87 | 1.99 | 2.46 | 1.92 |

| Year | 80-81 | 81-82 | 82-83 | 83-84 | 84-85 | 85-86 | 86-87 | 87-88 | 88-89 |
|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | |
| I. Direct Taxes (before sharing)=a+b+c | 270.64 | 347.16 | 353.34 | 408.92 | 531.82 | 631.68 | 652.79 | 693.59 | 851.90 |
| (a) Land Revenue | 156.54 | 227.71 | 225.83 | 255.05 | 318.41 | 353.12 | 374.39 | 414.64 | 520.53 |
| (b) Agricultural Income Tax | 46.40 | 38.25 | 30.22 | 44.02 | 91.33 | 126.92 | 103.76 | 70.90 | 99.45 |
| (c) Others \1 | 67.70 | 81.20 | 97.29 | 109.85 | 122.08 | 151.64 | 174.64 | 208.05 | 231.92 |
| Plus (d) Share in Central Taxes | 1014.75 | 1034.20 | 1147.75 | 1188.21 | 1251.67 | 1865.18 | 2170.17 | 2595.44 | 2773.18 |
| Direct Taxes (after sharing) | 1285.39 | 1381.36 | 1501.09 | 1597.13 | 1783.49 | 2496.86 | 2822.96 | 3289.03 | 3625.08 |
| II. Indirect Taxes = a+b+c+d | 6393.53 | 7947.75 | 9192.56 | 10394.50 | 11811.01 | 13964.84 | 16047.98 | 18267.67 | 20694.91 |
| (a) State Excise Duties | 838.33 | 1128.54 | 1355.66 | 1582.81 | 1857.36 | 2071.14 | 2426.66 | 2623.16 | 2851.62 |
| (b) Stamps and Registration Fees | 426.91 | 517.11 | 592.25 | 634.03 | 705.76 | 856.64 | 1011.68 | 1149.08 | 1249.09 |
| (c) General Sales Tax | 3697.65 | 4662.63 | 5257.06 | 6010.71 | 6756.38 | 8071.43 | 9204.61 | 10613.59 | 11998.83 |
| (d) Others \2 | 1430.64 | 1639.47 | 1987.59 | 2166.95 | 2491.51 | 2965.63 | 3405.03 | 3881.84 | 4595.37 |
| Plus (e) Share of Union Excise Duties | 2774.25 | 3220.44 | 3484.43 | 3823.28 | 4570.21 | 5477.52 | 6215.65 | 7020.48 | 7704.45 |
| | 3789 | 4254.64 | 4632.18 | 5011.49 | 5821.88 | 7342.7 | 8385.82 | 9615.92 | 10477.63 |
| Indirect Taxes (after sharing) | 9167.78 | 11168.19 | 12676.99 | 14217.78 | 16381.22 | 19442.36 | 22263.63 | 25288.15 | 28399.36 |
| Direct + Indirect Taxes (before sharing) | 6664.17 | 8294.91 | 9545.9 | 10803.42 | 12342.83 | 14596.52 | 16700.77 | 18961.26 | 21546.81 |
| Direct + Indirect Taxes (after sharing) | 10453.17 | 12549.55 | 14178.08 | 15814.91 | 18164.71 | 21939.22 | 25086.59 | 28577.18 | 32024.44 |
| Non Tax Revenue \3 | 1576.88 | 1776.50 | 2161.63 | 2422.07 | 2602.67 | 3040.17 | 3505.36 | 3812.44 | 4295.92 |
| Grants from the Centre | 2756.45 | 2840.08 | 3583.99 | 4292.44 | 5053.02 | 6555.1 | 7041.13 | 8576.7 | 8740.28 |
| SHARE OF INDIVIDUAL TAXES IN TOTAL | | | | | | | | | |
| I. Direct Taxes (before sharing) = a+b+c | 0.03 | 0.03 | 0.02 | 0.03 | 0.03 | 0.03 | 0.03 | 0.02 | 0.03 |
| (a) Land Revenue | 0.01 | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 | 0.01 | 0.01 | 0.02 |
| (b)+(c) Agricultural Income Tax & Others | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| II. Indirect Taxes (before sharing) = a+b+c+d | 0.61 | 0.63 | 0.65 | 0.66 | 0.65 | 0.64 | 0.64 | 0.64 | 0.65 |
| (a) State Excise Duties | 0.08 | 0.09 | 0.10 | 0.10 | 0.10 | 0.09 | 0.10 | 0.09 | 0.09 |
| (c) General Sales Tax | 0.35 | 0.37 | 0.37 | 0.38 | 0.37 | 0.37 | 0.37 | 0.37 | 0.37 |
| (b)+(d) Stamps, Registration Fees & Others | 0.18 | 0.17 | 0.18 | 0.18 | 0.18 | 0.17 | 0.18 | 0.18 | 0.18 |
| Share in Central Taxes | 0.36 | 0.34 | 0.33 | 0.32 | 0.32 | 0.33 | 0.33 | 0.34 | 0.33 |
| Direct + Indirect Tax (after sharing) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| REVENUE AS A % OF GDP | | | | | | | | | |
| GDP at current market prices | 136013 | 159760 | 178132 | 207589 | 231387 | 261920 | 291974 | 332616 | 394992 |
| I. Direct Taxes (before sharing) = a+b+c | 0.20 | 0.22 | 0.20 | 0.20 | 0.23 | 0.24 | 0.22 | 0.21 | 0.22 |
| (a) Land Revenue | 0.12 | 0.14 | 0.13 | 0.12 | 0.14 | 0.13 | 0.13 | 0.12 | 0.13 |
| (b)+(c) Agricultural Income Tax & Others | 0.08 | 0.07 | 0.07 | 0.07 | 0.09 | 0.11 | 0.10 | 0.08 | 0.08 |
| II. Indirect Taxes (before sharing) = a+b+c+d | 4.70 | 4.97 | 5.16 | 5.01 | 5.10 | 5.33 | 5.50 | 5.49 | 5.24 |
| (a) State Excise Duties | 0.62 | 0.71 | 0.76 | 0.76 | 0.80 | 0.79 | 0.83 | 0.79 | 0.72 |
| (c) General Sales Tax | 2.72 | 2.92 | 2.95 | 2.90 | 2.92 | 3.08 | 3.15 | 3.19 | 3.04 |
| (b)+(d) Stamps, Registration Fees & Others | 1.37 | 1.35 | 1.45 | 1.35 | 1.38 | 1.46 | 1.51 | 1.51 | 1.48 |
| Direct + Indirect Taxes (before sharing) | 4.90 | 5.19 | 5.36 | 5.20 | 5.33 | 5.57 | 5.72 | 5.70 | 5.45 |
| Share in Central Taxes | 2.79 | 2.66 | 2.60 | 2.41 | 2.52 | 2.80 | 2.87 | 2.89 | 2.65 |
| Direct + Indirect Tax (after sharing) | 7.69 | 7.86 | 7.96 | 7.62 | 7.85 | 8.38 | 8.59 | 8.59 | 8.11 |
| Non Tax Revenue | 1.16 | 1.11 | 1.21 | 1.17 | 1.12 | 1.16 | 1.20 | 1.15 | 1.09 |
| Grants from the Centre | 2.03 | 1.78 | 2.01 | 2.07 | 2.18 | 2.50 | 2.41 | 2.58 | 2.21 |

NOTES TO TABLE 4:

Source: Government of India (various issues): Indian Economic Statistics (Public Finance), Ministry of Finance.

GDP figures from Government of India (Central Statistical Organisation): National Accounts Statistics-New Series, 1989, Ministry of Planning.

\1 Includes: taxes on professions, callings and employment and urban immovable property tax and expenditure tax.

\2 Includes: taxes on vehicles, motor spirit sales tax, entertainment tax, cess on sugarcane, tax on passengers and goods, electricity duties, tobacco duties, inter-state transit duties, newspaper and advertisement tax, education cess, taxes on raw jute, betting etc.

\3 Does not include grants from the Centre.

Revenue Receipts = A + B + C + D

A. Tax Revenue (i+ii)
i) Direct Taxes
ii) Indirect Taxes

B. Non-Tax Revenue

C. Grants from the Centre

D. Transfer from Funds (famine relief fund, revenue reserve fund etc.)

TABLE 5: EXPENDITURE OF STATES & UNION TERRITORIES

| Year | 50-51 | 55-56 | 60-61 | 61-62 | 62-63 | 63-64 | 64-65 | 65-66 | 66-67 | 67-68 | 68-69 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | |
| REVENUE EXPENDITURE A+B+C | 373.79 | 613.97 | 1016.15 | 1140.04 | 1246.02 | 1396.52 | 1598.93 | 1901.23 | 2218.26 | 2468.56 | 2792.82 |
| A. Non-Development Expenditure | 188.29 | 275.76 | 438.61 | 470.53 | 513.28 | 597.78 | 660.51 | 796.73 | 977.13 | 1073.3 | 1213.29 |
| 1) Interest Payments | 9.04 | 32.98 | 86.73 | 103.26 | 114.86 | 148.71 | 157.24 | 208.31 | 251.32 | 274.35 | 320.11 |
| 2) Defence | | | | | | | | | | | |
| 3) Administrative Services | | | | | | | | | | | |
| 3) Others \1 | 179.25 | 242.78 | 351.88 | 367.27 | 398.42 | 449.07 | 503.27 | 588.42 | 725.81 | 798.95 | 893.18 |
| B. Development Expenditure | 182.32 | 328.81 | 565.68 | 649.17 | 715.44 | 781.07 | 907.49 | 1084.85 | 1204.75 | 1357.76 | 1542.4 |
| 1) Social and Community Services | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| 2) General Economic Services | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| 3) Agriculture and Allied Activities | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| 4) Others \2 | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| C. Others \3 | 3.18 | 9.40 | 11.86 | 20.34 | 17.3 | 17.67 | 30.93 | 19.65 | 36.38 | 37.5 | 37.13 |
| CAPITAL EXPENDITURE A+B+C | 99.22 | 269.01 | 452.01 | 452.51 | 499.08 | 602.61 | 710.48 | 982.46 | 714.06 | 831.15 | 859.74 |
| A. Non-Development Expenditure | 10.23 | 4.80 | 17.22 | 19.05 | 17.65 | 27.82 | 13.3 | 6.38 | 15.48 | 11.93 | 28.59 |
| B. Development Expenditure | 68.15 | 193.98 | 303.79 | 305.58 | 342.47 | 345.73 | 408.13 | 548.69 | 365.83 | 505.09 | 559.08 |
| C. Loans and Advances (net) | 20.84 | 70.23 | 131.00 | 127.88 | 138.96 | 229.06 | 289.05 | 427.39 | 332.75 | 314.13 | 272.07 |
| TOTAL EXPENDITURE | 473.01 | 882.98 | 1468.16 | 1592.55 | 1745.10 | 1999.13 | 2309.41 | 2883.69 | 2932.32 | 3299.71 | 3652.56 |
| AS A % OF GDP | | | | | | | | | | | |
| GDP at Current Market Prices | 9366 | 10258 | 16201 | 17177 | 18476 | 21237 | 24765 | 26145 | 29571 | 34611 | 36674 |
| REVENUE EXPENDITURE A+B+C | 3.99 | 5.99 | 6.27 | 6.64 | 6.74 | 6.58 | 6.46 | 7.27 | 7.50 | 7.13 | 7.62 |
| A. Non-Development Expenditure | 2.01 | 2.69 | 2.71 | 2.74 | 2.78 | 2.81 | 2.67 | 3.05 | 3.30 | 3.10 | 3.31 |
| 1) Interest Payments | 0.10 | 0.32 | 0.54 | 0.60 | 0.62 | 0.70 | 0.63 | 0.80 | 0.85 | 0.79 | 0.87 |
| 2) Defence | | | | | | | | | | | |
| 3) Administrative Services | | | | | | | | | | | |
| 3) Others | 1.91 | 2.37 | 2.17 | 2.14 | 2.16 | 2.11 | 2.03 | 2.25 | 2.45 | 2.31 | 2.44 |
| B. Development Expenditure | 1.95 | 3.21 | 3.49 | 3.78 | 3.87 | 3.68 | 3.66 | 4.15 | 4.07 | 3.92 | 4.21 |
| 1) Social and Community Services | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| 2) General Economic Services | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| 3) Agriculture and Allied Activities | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| 5) Others | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| C. Others | 0.03 | 0.09 | 0.07 | 0.12 | 0.09 | 0.08 | 0.12 | 0.08 | 0.12 | 0.11 | 0.10 |
| CAPITAL EXPENDITURE A+B+C | 1.06 | 2.62 | 2.79 | 2.63 | 2.70 | 2.84 | 2.87 | 3.76 | 2.41 | 2.40 | 2.34 |
| A. Non-Development Expenditure | 0.11 | 0.05 | 0.11 | 0.11 | 0.10 | 0.13 | 0.05 | 0.02 | 0.05 | 0.03 | 0.08 |
| B. Development Expenditure | 0.73 | 1.89 | 1.88 | 1.78 | 1.85 | 1.63 | 1.65 | 2.10 | 1.24 | 1.46 | 1.52 |
| C. Loans and Advances | 0.22 | 0.68 | 0.81 | 0.74 | 0.75 | 1.08 | 1.17 | 1.63 | 1.13 | 0.91 | 0.74 |
| TOTAL EXPENDITURE (REV + CAP) | 5.05 | 8.61 | 9.06 | 9.27 | 9.45 | 9.41 | 9.33 | 11.03 | 9.92 | 9.53 | 9.96 |
| TOTAL REVENUE (TAX + NON TAX) \4 | 3.18 | 4.06 | 3.97 | 4.00 | 4.36 | 4.51 | 4.28 | 4.57 | 4.45 | 4.38 | 4.76 |
| TRANSFERS FROM THE CENTRE | 0.79 | 1.43 | 2.40 | 2.30 | 2.42 | 2.41 | 2.34 | 2.53 | 2.84 | 2.72 | 2.89 |
| Grants | 0.28 | 0.71 | 1.38 | 1.26 | 1.20 | 1.19 | 1.30 | 1.47 | 1.58 | 1.53 | 1.56 |
| Tax Transfers | 0.51 | 0.72 | 1.02 | 1.04 | 1.21 | 1.22 | 1.04 | 1.06 | 1.26 | 1.19 | 1.33 |

| Year | 69-70 | 70-71 | 71-72 | 72-73 | 73-74 | 74-75 | 75-76 | 76-77 | 77-78 | 78-79 | 79-80 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | |
| REVENUE EXPENDITURE A+B+C | 3219.97 | 3439.7 | 4089.85 | 4660.82 | 5276.91 | 5601.86 | 6521.81 | 7555.12 | 8381.46 | 9872.49 | 11511.66 |
| A. Non-Development Expenditure | 1451.18 | 1526.86 | 1827.89 | 2037.05 | 2351.7 | 2155.71 | 2518.66 | 2738.79 | 2946.07 | 3303.24 | 3802 |
| 1) Interest Payments | 375.69 | 399.98 | 458 | 472.85 | 539.88 | 541.72 | 689.49 | 763.96 | 816.3 | 962.25 | 954.35 |
| 2) Defence | | | | | | | | | | | |
| 3) Administrative Services | | | | | | 687.09 | 777.14 | 861.16 | 916.88 | 1024.64 | 1182.66 |
| 3) Others \1 | 1075.49 | 1126.88 | 1369.89 | 1564.2 | 1811.82 | 926.9 | 1052.03 | 1113.67 | 1212.89 | 1316.35 | 1664.99 |
| B. Development Expenditure | 1717.63 | 1886.79 | 2231.9 | 2595.15 | 2925.21 | 3368.17 | 3919.41 | 4632.75 | 5217.38 | 6358.05 | 7400.79 |
| 1) Social and Community Services | .. | .. | .. | .. | .. | 2200.26 | 2574.98 | 2912.31 | 3289.17 | 3841.95 | 4372.78 |
| 2) General Economic Services | .. | .. | .. | .. | .. | 51.72 | 73.15 | 160.55 | 185.44 | 230.38 | 252.91 |
| 3) Agriculture and Allied Activities | .. | .. | .. | .. | .. | 664.36 | 797.77 | 952.49 | 1105.91 | 1399.85 | 1730.31 |
| 4) Others \2 | .. | .. | .. | .. | .. | 451.83 | 473.51 | 607.4 | 636.86 | 885.87 | 1044.79 |
| C. Others \3 | 51.16 | 26.05 | 30.06 | 28.62 | 0.00 | 77.98 | 83.74 | 183.58 | 218.01 | 211.2 | 308.87 |
| CAPITAL EXPENDITURE A+B+C | 800.48 | 905.57 | 1077.41 | 1327.44 | 1353.03 | 1669.43 | 2075.75 | 2641.43 | 3100.14 | 3832.67 | 4477.72 |
| A. Non-Development Expenditure | 26.41 | -9.25 | -19.09 | -12.4 | -10.44 | 9.52 | -1.45 | 1.61 | -0.82 | -0.92 | -0.33 |
| B. Development Expenditure | 517.89 | 588.62 | 704.89 | 868.85 | 993.3 | 1130.29 | 1405.98 | 1680.44 | 1893.64 | 2336.98 | 2728.33 |
| C. Loans and Advances (net) | 256.18 | 326.2 | 391.61 | 470.99 | 370.17 | 529.62 | 671.22 | 959.38 | 1207.32 | 1496.61 | 1749.72 |
| TOTAL EXPENDITURE | 4020.45 | 4345.27 | 5167.26 | 5988.26 | 6629.94 | 7271.29 | 8597.56 | 10196.55 | 11481.60 | 13705.16 | 15989.38 |
| AS A % OF GDP | | | | | | | | | | | |
| GDP at Current Market Prices | 40387 | 43163 | 46257 | 51005 | 62007 | 73235 | 78761 | 84894 | 96067 | 104190 | 114356 |
| REVENUE EXPENDITURE A+B+C | 7.97 | 7.97 | 8.84 | 9.14 | 8.51 | 7.65 | 8.28 | 8.90 | 8.72 | 9.48 | 10.07 |
| A. Non-Development Expenditure | 3.59 | 3.54 | 3.95 | 3.99 | 3.79 | 2.94 | 3.20 | 3.23 | 3.07 | 3.17 | 3.32 |
| 1) Interest Payments | 0.93 | 0.93 | 0.99 | 0.93 | 0.87 | 0.74 | 0.88 | 0.90 | 0.85 | 0.92 | 0.83 |
| 2) Defence | | | | | | | | | | | |
| 3) Administrative Services | | | | | | | | | | | |
| 3) Others | 2.66 | 2.61 | 2.96 | 3.07 | 2.92 | 1.27 | 1.34 | 1.31 | 1.26 | 1.26 | 1.46 |
| B. Development Expenditure | 4.25 | 4.37 | 4.82 | 5.09 | 4.72 | 4.60 | 4.98 | 5.46 | 5.43 | 6.10 | 6.47 |
| 1) Social and Community Services | .. | .. | .. | .. | .. | 3.00 | 3.27 | 3.43 | 3.42 | 3.69 | 3.82 |
| 2) General Economic Services | .. | .. | .. | .. | .. | 0.07 | 0.09 | 0.19 | 0.19 | 0.22 | 0.22 |
| 3) Agriculture and Allied Activities | .. | .. | .. | .. | .. | 0.91 | 1.01 | 1.12 | 1.15 | 1.34 | 1.51 |
| 5) Others | .. | .. | .. | .. | .. | 0.62 | 0.60 | 0.72 | 0.66 | 0.85 | 0.91 |
| C. Others | 0.13 | 0.06 | 0.06 | 0.06 | 0.00 | 0.11 | 0.11 | 0.22 | 0.23 | 0.20 | 0.27 |
| CAPITAL EXPENDITURE A+B+C | 1.98 | 2.10 | 2.33 | 2.60 | 2.18 | 2.28 | 2.64 | 3.11 | 3.23 | 3.68 | 3.92 |
| A. Non-Development Expenditure | 0.07 | -0.02 | -0.04 | -0.02 | -0.02 | 0.01 | -0.00 | 0.00 | -0.00 | -0.00 | -0.00 |
| B. Development Expenditure | 1.28 | 1.36 | 1.52 | 1.70 | 1.60 | 1.54 | 1.79 | 1.98 | 1.97 | 2.24 | 2.39 |
| C. Loans and Advances | 0.63 | 0.76 | 0.85 | 0.92 | 0.60 | 0.72 | 0.85 | 1.13 | 1.26 | 1.44 | 1.53 |
| TOTAL EXPENDITURE (REV + CAP) | 9.95 | 10.07 | 11.17 | 11.74 | 10.69 | 9.93 | 10.92 | 12.01 | 11.95 | 13.15 | 13.98 |
| TOTAL REVENUE (TAX + NON TAX) \4 | 4.75 | 4.82 | 4.92 | 5.06 | 4.88 | 5.02 | 5.76 | 6.18 | 5.79 | 6.08 | 6.30 |
| TRANSFERS FROM THE CENTRE | 3.05 | 3.10 | 3.93 | 3.94 | 3.45 | 3.12 | 3.66 | 3.85 | 3.86 | 4.35 | 4.91 |
| Grants | 1.50 | 1.35 | 1.89 | 1.86 | 1.56 | 1.45 | 1.63 | 1.87 | 1.99 | 2.46 | 1.92 |
| Tax Transfers | 1.55 | 1.75 | 2.04 | 2.08 | 1.88 | 1.67 | 2.03 | 1.98 | 1.88 | 1.88 | 2.98 |

| Year | 80-81 | 81-82 | 82-83 | 83-84 | 84-85 | 85-86 | 86-87 | 87-88 | 88-89 |
|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | |
| REVENUE EXPENDITURE A+B+C | 14135.83 | 16193.39 | 19353.87 | 22690.66 | 27117.97 | 31361.93 | 35959.96 | 43012.02 | 46621.88 |
| A. Non-Development Expenditure | 4699.28 | 5464.08 | 6807.63 | 7917.74 | 9320.77 | 11254.21 | 12818.07 | 15393.65 | 17391.78 |
| 1) Interest Payments | 1241.35 | 1458.44 | 1728.25 | 1992.62 | 2503.83 | 2975 | 4098.74 | 4960.97 | 5875.64 |
| 2) Defence | | | | | | | | | |
| 3) Administrative Services | 1470.69 | 1724.98 | 1993.41 | 2297.55 | 2632.68 | 3096.75 | 3411.84 | 4043.62 | 4735.26 |
| 3) Others \1 | 1987.24 | 2280.66 | 3085.97 | 3627.57 | 4184.26 | 5182.46 | 5307.49 | 6389.06 | 6780.88 |
| B. Development Expenditure | 9088.09 | 10347.14 | 12104.36 | 14324.64 | 17321.15 | 19570.8 | 22549.98 | 26880.53 | 28423.48 |
| 1) Social and Community Services | 5363.24 | 6246.89 | 7415.69 | 8704.44 | 10233.76 | 11640.9 | 13625.48 | 16018.54 | 17090.01 |
| 2) General Economic Services | 272.49 | 277.07 | 303.44 | 381.83 | 424.64 | 466.97 | 512.93 | 611.66 | 708.43 |
| 3) Agriculture and Allied Activities | 2085.54 | 2367.71 | 2812.85 | 3446.06 | 4501.1 | 5131.88 | 5777.93 | 6852.86 | 6618.47 |
| 4) Others \2 | 1366.82 | 1455.47 | 1572.38 | 1792.31 | 2161.65 | 2331.05 | 2633.64 | 3397.47 | 4006.57 |
| C. Others \3 | 348.46 | 382.17 | 441.88 | 448.28 | 476.05 | 536.92 | 591.91 | 737.84 | 806.62 |
| CAPITAL EXPENDITURE A+B+C | 5253.14 | 5599.52 | 5989.41 | 6699.82 | 7409.52 | 8350.07 | 9390.15 | 10575.99 | 11083.97 |
| A. Non-Development Expenditure | 1.63 | 5.83 | 3.45 | 6.42 | 6.52 | 5.12 | 10.56 | 20.08 | 40.24 |
| B. Development Expenditure | 3251.14 | 3666.17 | 3822.66 | 4382.73 | 5030.94 | 5580.83 | 6225.17 | 6880.75 | 7464.18 |
| C. Loans and Advances (net) | 2000.37 | 1927.52 | 2163.3 | 2310.67 | 2372.06 | 2764.12 | 3154.42 | 3675.16 | 3579.55 |
| TOTAL EXPENDITURE | 19388.97 | 21792.91 | 25343.28 | 29390.48 | 34527.49 | 39712.00 | 45350.11 | 53588.01 | 57705.85 |
| AS A % OF GDP | | | | | | | | | |
| GDP at Current Market Prices | 136013 | 159760 | 178132 | 207589 | 231387 | 261920 | 291974 | 332616 | 394992 |
| REVENUE EXPENDITURE A+B+C | 10.39 | 10.14 | 10.86 | 10.93 | 11.72 | 11.97 | 12.32 | 12.93 | 11.80 |
| A. Non-Development Expenditure | 3.46 | 3.42 | 3.82 | 3.81 | 4.03 | 4.30 | 4.39 | 4.63 | 4.40 |
| 1) Interest Payments | 0.91 | 0.91 | 0.97 | 0.96 | 1.08 | 1.14 | 1.40 | 1.49 | 1.49 |
| 2) Defence | | | | | | | | | |
| 3) Administrative Services | | | | | | | | | |
| 3) Others | 1.46 | 1.43 | 1.73 | 1.75 | 1.81 | 1.98 | 1.82 | 1.92 | 1.72 |
| B. Development Expenditure | 6.68 | 6.48 | 6.80 | 6.90 | 7.49 | 7.47 | 7.72 | 8.08 | 7.20 |
| 1) Social and Community Services | 3.94 | 3.91 | 4.16 | 4.19 | 4.42 | 4.44 | 4.67 | 4.82 | 4.33 |
| 2) General Economic Services | 0.20 | 0.17 | 0.17 | 0.18 | 0.18 | 0.18 | 0.18 | 0.18 | 0.18 |
| 3) Agriculture and Allied Activities | 1.53 | 1.48 | 1.58 | 1.66 | 1.95 | 1.96 | 1.98 | 2.06 | 1.68 |
| 5) Others | 1.00 | 0.91 | 0.88 | 0.86 | 0.93 | 0.89 | 0.90 | 1.02 | 1.01 |
| C. Others | 0.26 | 0.24 | 0.25 | 0.22 | 0.21 | 0.20 | 0.20 | 0.22 | 0.20 |
| CAPITAL EXPENDITURE A+B+C | 3.86 | 3.50 | 3.36 | 3.23 | 3.20 | 3.19 | 3.22 | 3.18 | 2.81 |
| A. Non-Development Expenditure | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.01 | 0.01 |
| B. Development Expenditure | 2.39 | 2.29 | 2.15 | 2.11 | 2.17 | 2.13 | 2.13 | 2.07 | 1.89 |
| C. Loans and Advances | 1.47 | 1.21 | 1.21 | 1.11 | 1.03 | 1.06 | 1.08 | 1.10 | 0.91 |
| TOTAL EXPENDITURE (REV + CAP) | 14.26 | 13.64 | 14.23 | 14.16 | 14.92 | 15.16 | 15.53 | 16.11 | 14.61 |
| TOTAL REVENUE (TAX + NON TAX) \4 | 6.06 | 6.30 | 6.57 | 6.37 | 6.46 | 6.73 | 6.92 | 6.85 | 6.54 |
| TRANSFERS FROM THE CENTRE | 4.81 | 4.44 | 4.61 | 4.48 | 4.70 | 5.31 | 5.28 | 5.47 | 4.87 |
| Grants | 2.03 | 1.78 | 2.01 | 2.07 | 2.18 | 2.50 | 2.41 | 2.58 | 2.21 |
| Tax Transfers | 2.79 | 2.66 | 2.60 | 2.41 | 2.52 | 2.80 | 2.87 | 2.89 | 2.65 |

NOTES TO TABLE 5:

Source: Government of India (various issues): Indian Economic Statistics (Public Finance), Ministry of Finance.

GDP figures from Government of India (Central Statistical Organisation): National Accounts Statistics-New series, 1989, Ministry of Planning.

\1 Includes: Administration of justice, elections, tax collection charges, food subsidy, releif on account of natural calamities (non-plan) etc.

\2 Includes: Industry and minerals, water and power development, transport and communications, public works etc.

\3 Transfer to funds.

\4 Excluding tax transfers and grants.

TABLE 6: The Centre's Tax Revenues (1989-90)

| Tax Type | Rs. Crore | Percent of Total |
|---|---|---|
| Main Direct Taxes | 6081 | 15.86 |
| Corporation Tax | 4729 | 12.33 |
| Personal Income & Capital Interest Tax | 1082 | 0.82 |
| Main Indirect Taxes | 31348 | 81.74 |
| Customs | 18036 | 47.03 |
| Union Excise Duties | 13096 | 34.15 |
| Others | 216 | 0.56 |
| Taxes on Union Territories* | 920 | 2.40 |
| Total Tax Revenue (before sharing) | 38349 | 100.00 |

Source: Reserve Bank of India Bulletin (January 1992).

* Net of assignments to local bodies.

TABLE 7: State Tax Revenues (1989-90)

| Tax Type | Rs. Crore | Percent of Total |
|---|---|---|
| Main Direct Taxes | 1161.5 | 4.47 |
| Land Revenue | 690.3 | 2.66 |
| Agricultural Income Tax | 92.6 | 0.36 |
| Others* | 378.6 | 1.46 |
| Main Indirect Taxes | 24833.6 | 95.53 |
| Stamps and Registration fees | 1844.8 | 7.10 |
| Sales Tax** | 15060.1 | 57.93 |
| State Excise Duties | 3864.4 | 14.87 |
| Taxes on Vehicles | 1414.8 | 5.44 |
| Taxes on Passengers & Goods | 905.2 | 3.48 |
| Electricity Duties | 1084.0 | 4.17 |
| Entertainment Tax | 341.8 | 1.31 |
| Others | 318.5 | 1.23 |
| Total Tax Revenue (before sharing) | 25995.1 | 100.00 |

Source: Reserve Bank of India Bulletin (October 1991).

* Includes taxes on professions, trades, callings and employment, and urban immovable property tax.
** Includes general sales tax, central sales tax and sales tax on motor spirit.

Figures for Bihar, Jammu & Kashmir, and Nagaland relate to revised estimates

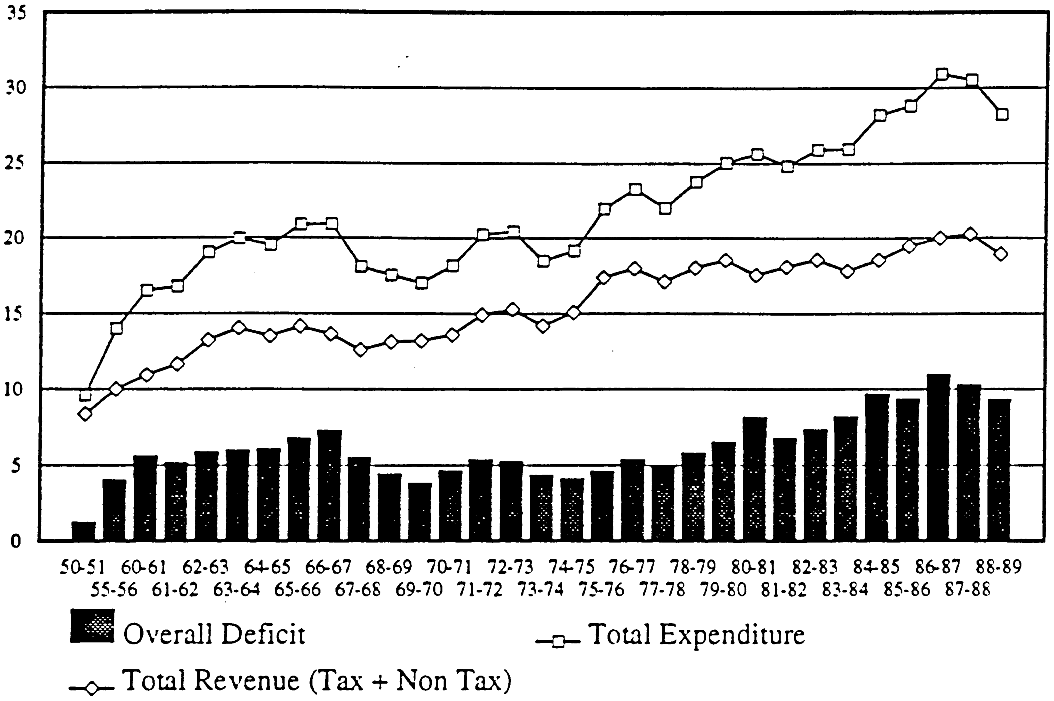
TABLE 8: IMPORTS AND CUSTOMS REVENUE

| Year | 60-61 | 61-62 | 62-63 | 63-64 | 64-65 | 65-66 | 66-67 | 67-68 | 68-69 | 69-70 | 70-71 | 71-72 | 72-73 | 73-74 | 74-75 | 75-76 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | | | | | | |
| Imports | 1122 | 1092 | 1131 | 1223 | 1349 | 1409 | 2078 | 2008 | 1909 | 1589 | 1634 | 1825 | 1867 | 2955 | 4519 | 5265 |
| Customs Revenue | 170.03 | 212.25 | 245.96 | 334.75 | 397.50 | 538.97 | 585.37 | 513.35 | 446.50 | 423.31 | 524.02 | 695.67 | 856.64 | 996.43 | 1332.90 | 1419.40 |
| GDP (at Current Market Prices) | 16201 | 17177 | 18476 | 21237 | 24765 | 26145 | 29571 | 34611 | 36674 | 40387 | 43163 | 46257 | 51005 | 62007 | 73235 | 78761 |
| Imports (% of GDP) | 6.93 | 6.36 | 6.12 | 5.76 | 5.45 | 5.39 | 7.03 | 5.80 | 5.21 | 3.93 | 3.79 | 3.95 | 3.66 | 4.77 | 6.17 | 6.68 |
| Customs Revenue (% of GDP) | 1.05 | 1.24 | 1.33 | 1.58 | 1.61 | 2.06 | 1.98 | 1.48 | 1.22 | 1.05 | 1.21 | 1.50 | 1.68 | 1.61 | 1.82 | 1.80 |
| Customs Revenue (% of Imports) | 15.15 | 19.44 | 21.75 | 27.37 | 29.47 | 38.25 | 28.17 | 25.57 | 23.39 | 26.64 | 32.07 | 38.12 | 45.88 | 33.72 | 29.50 | 26.96 |

Source:
(i) Foreign Trade Statistics Vol I & II, Ministry of Commerce, Govt of India.
(ii) Report on Currency and Finance
(iii) Statistical Abstract of India (annual), Central Statistical Organisation, Ministry of Planning, Govt of India.
(iv) Indian Economic Statistics (Public Finance)

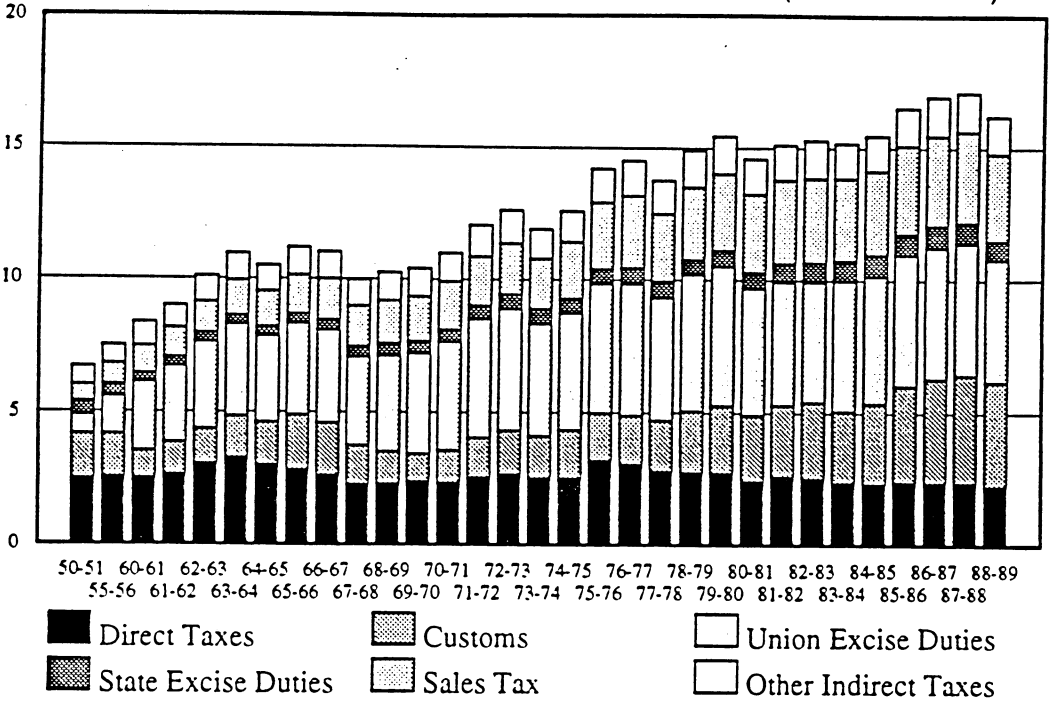
| Year | 76-77 | 77-78 | 78-79 | 79-80 | 80-81 | 81-82 | 82-83 | 83-84 | 84-85 | 85-86 | 86-87 | 87-88 | 88-89 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| (Rs. Crore) | | | | | | | | | | | | | |
| Imports | 5074 | 6020 | 6811 | 9143 | 12549 | 13608 | 14293 | 15831 | 17134 | 19658 | 20201 | 22399 | |
| Customs Revenue | 1553.70 | 1824.10 | 2423.51 | 2924.16 | 3409.28 | 4300.36 | 5119.41 | 5583.44 | 7040.52 | 9525.78 | 11475.03 | 13500.00 | 15626.31 |
| GDP (at Current Market Prices) | 84894 | 96067 | 104190 | 114356 | 136013 | 159760 | 178132 | 207589 | 231387 | 261920 | 291974 | 332616 | 394992 |
| Imports (% of GDP) | 5.98 | 6.27 | 6.54 | 8.00 | 9.23 | 8.52 | 8.02 | 7.63 | 7.40 | 7.51 | 6.92 | 6.73 | 0.00 |
| Customs Revenue (% of GDP) | 1.83 | 1.90 | 2.33 | 2.56 | 2.51 | 2.69 | 2.87 | 2.69 | 3.04 | 3.64 | 3.93 | 4.06 | 3.96 |
| Customs Revenue (% of Imports) | 30.62 | 30.30 | 35.58 | 31.98 | 27.17 | 31.60 | 35.82 | 35.27 | 41.09 | 48.46 | 56.80 | 60.27 | ERR |

Figure 1: Combined Centre and State Expenditure and Revenue (as % of GDP)




Source: Government of India (various issues): Indian Economic Statistics (Public Finance).
Note: See Table 1 for notes on data.

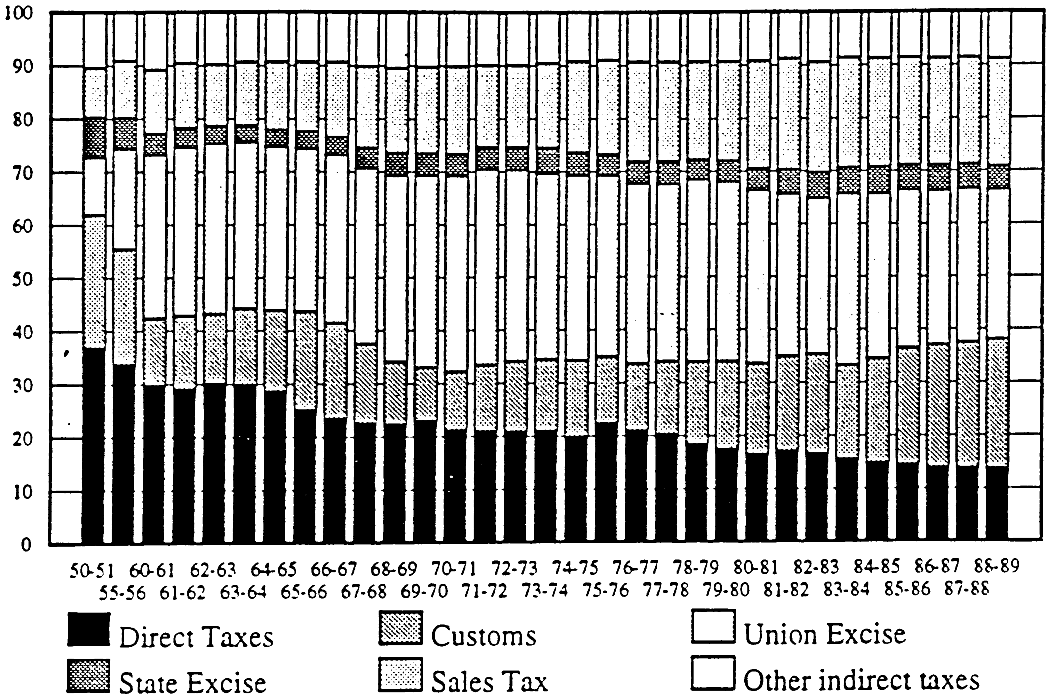
Figure 2: Combined Centre and State Tax Revenue (as a % of GDP)




Source: Government of India (various issues): Indian Economic Statistics (Public Finance).

Note: See Table 1 for notes on data.

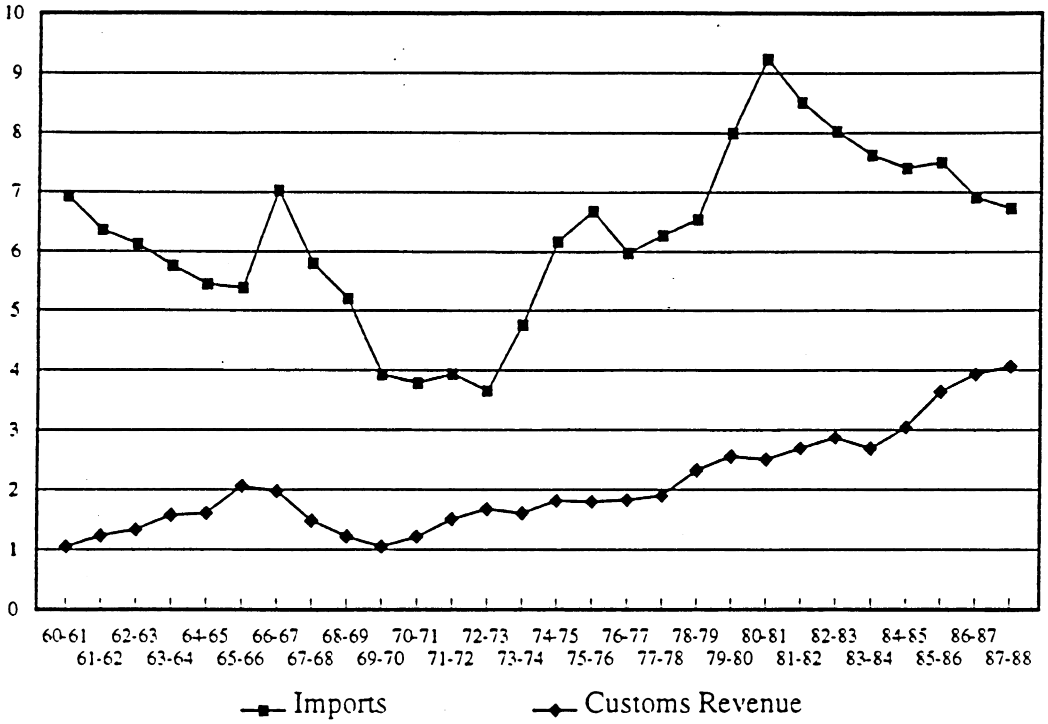
Figure 3: Individual Taxes as a % of Combined Tax Revenue




Source: Government of India (various issues): Indian Economic Statistics (Public Finance).

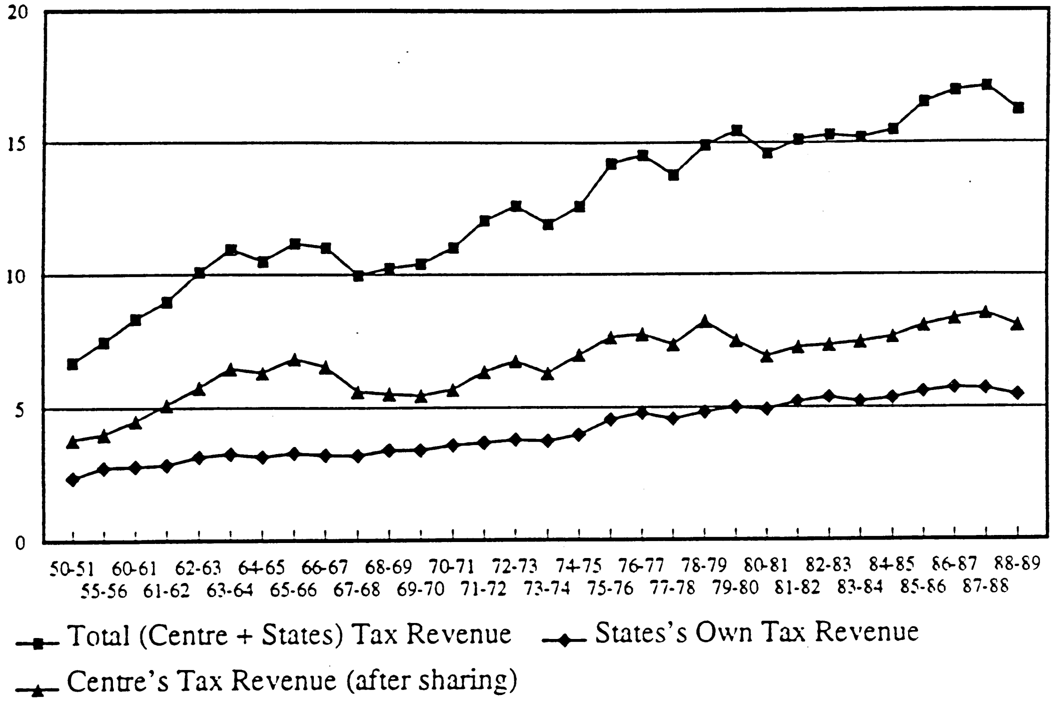
Note: See Table 1 for notes on data.

Figure 4: Imports and Customs Revenue (as a % of GDP)




Source: See Table 6

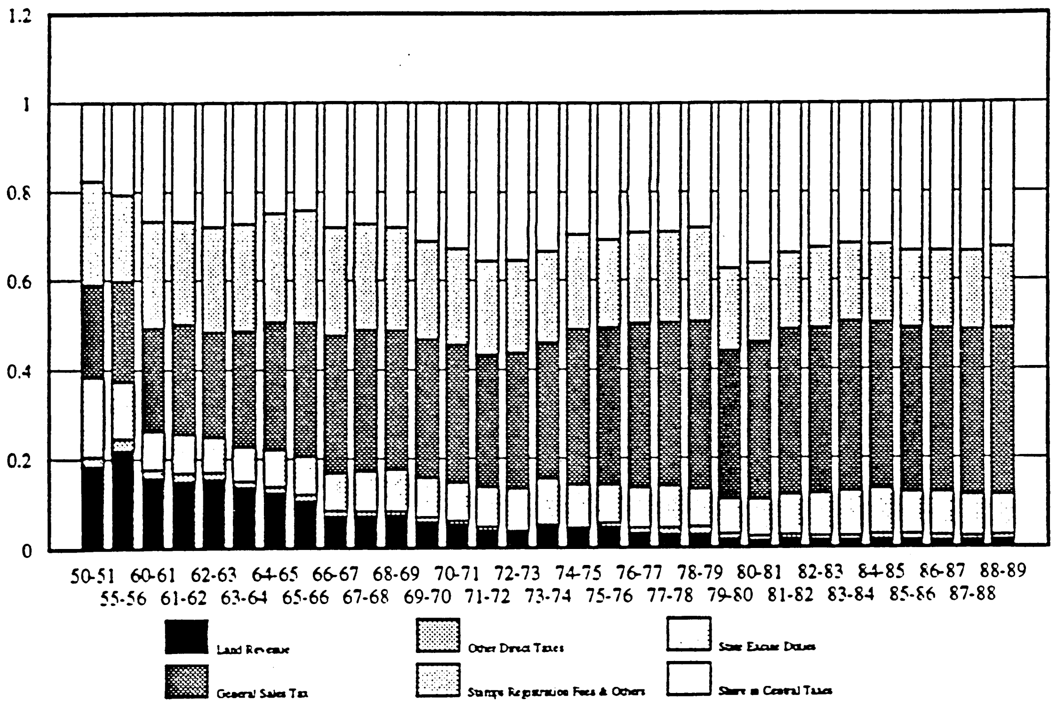
Figure 5: State and Central Tax Revenues (as a % of GDP)




Source: Government of India (various issues): Indian Economic Statistics (Public Finance).

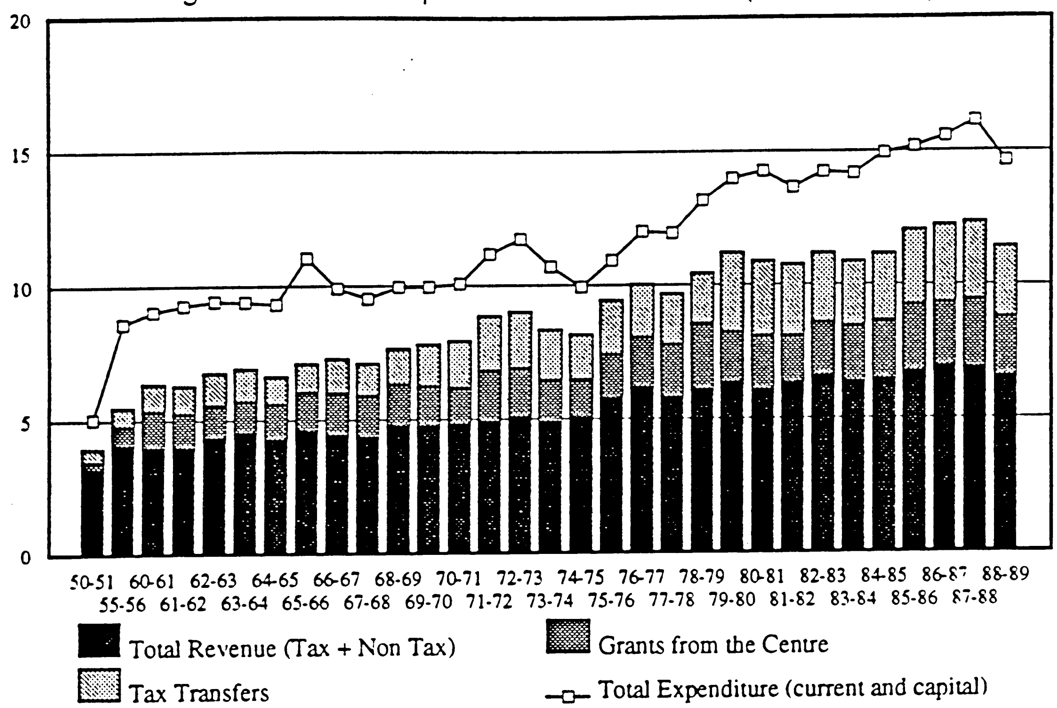
Note: See Table 4 for notes on data.

Figure 6: Composition of State Taxes




Source: Government of India (various issues): Indian Economic Statistics (Public Finance).
Note: Constructed from the data in Table 4.

Figure 7: States' Expenditure and Revenue (as % of GDP)




Sorce: Government of India (various issues): Indian Economic Statistics (Public Finance).

Note: See Table 5 for notes on data.