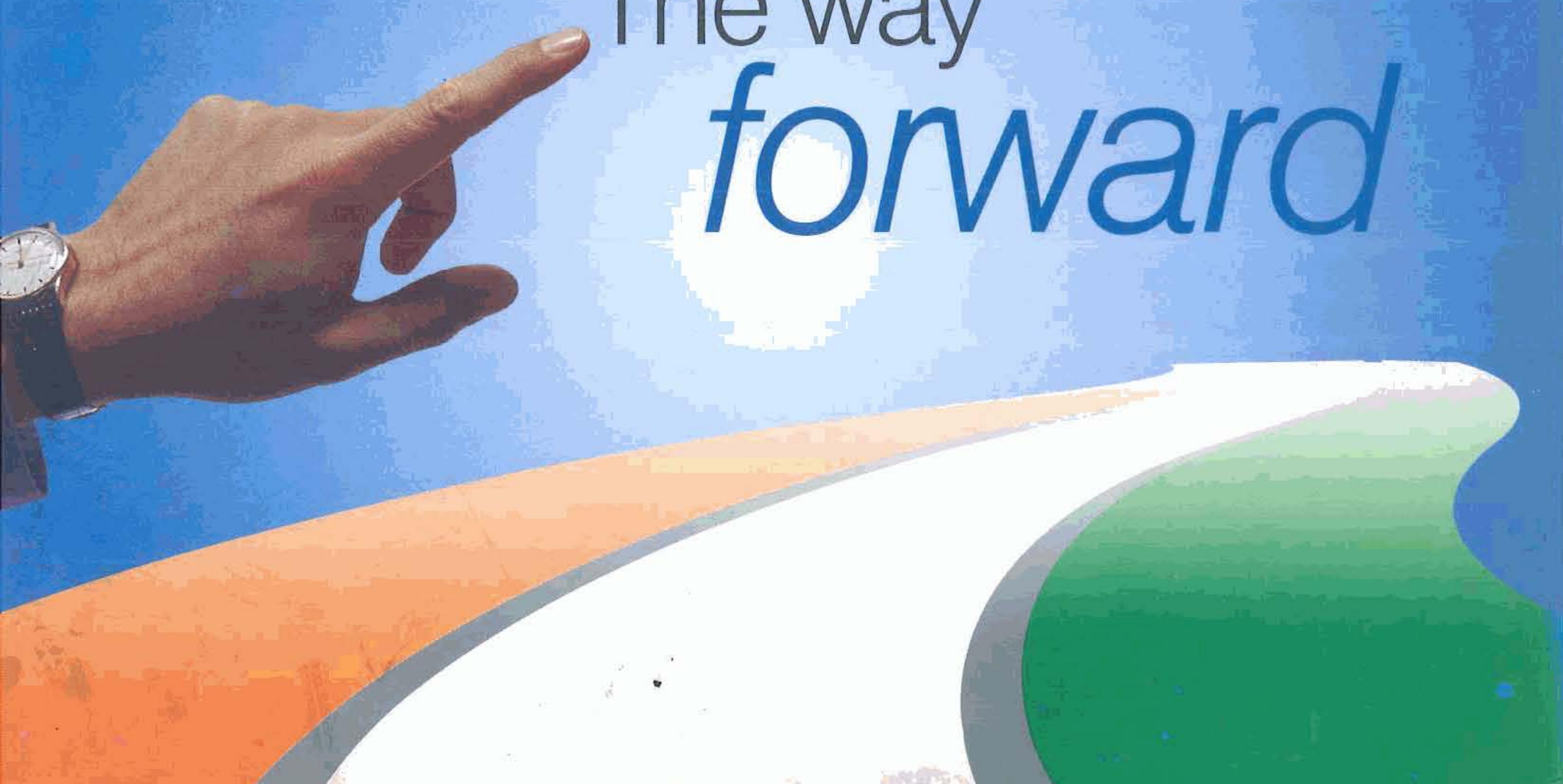
THE LIBERAL BUDGET

2005 - 06

The way *forward*



"I want an India where talent and energy can find scope for play without having to cringe and obtain special individual permission from officials and ministers, and where their efforts will be judged by the open market in India and abroad."

\- C. Rajagopalachari

THE LIBERAL BUDGET 2005-06

THE WAY FORWARD

FREEDOM WITH RESPONSIBILITY

INDIAN LIBERAL GROUP

PROJECT FOR ECONOMIC EDUCATION

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Preface

During the long years, of what political scientists described as the era of one-party dominance, we Indians had the opportunity to speed up economic growth by turning away from what had, by the early sixties, already became outmoded economic policies. The countries of South East Asia which soon acquired the epithet 'Asian Tigers' switched to open market economics and rapidly overtook India which lumbered along at an excruciatingly slow pace, enmeshed as it was in ideological dogma. Even communist China began jettisoning Marxist economic theories in the seventies and came out with something called 'market socialism' even while the Chinese Communist Party retained political monopoly. Capitalism was still the 'enemy' even if Communist Chinese helped themselves to liberal doses of capitalist economic medicine. They took over Hong Kong in the nineties, and wisely deciding not to kill the goose that laid the golden eggs i.e..Hong Kong with its capitalist economy, innovated yet another slogan: One country – two systems. And, while the hard core communists saw no difficulty in adopting a system that, not so long ago, was the enemy of the working class, India trundled along weighed down by Marxist baggage. It required the fall of the Soviet Union overseas and bankruptcy at home to compel the Indian establishment to finally abandon the permit-licence-quota recipe. If it took seventy years for communism to collapse in the Soviet Union, it took over forty years for the then Congress party then in power to realise the futility of statist economics.

The end of the era of one-party dominance almost coincided with the beginning of economic wisdom. Coalition politics, welcome and very relevant in a country of India's size and diversity, has yet to develop and mature. Meanwhile it has become a drag on the reforms process with compromise scoring over commonsense. Consequently the instruments required to renovate the economy are inefficient.

One of these instruments is the annual budgets of the Central and state governments. The Union Budget, in particular, continues to be so convoluted and complicated as to make it incomprehensible to the citizens at large. While economic compulsions forced policy makers to change economic policy in the direction of a free market system, the Union and state budgets remain as complicated as before, hiding failures and obfuscating real issues that cry for attention.

Liberal criticism in the past has generally been *post facto* – reacting after a policy has been formulated or after the Budget has been adopted. The need of the hour is not only to offer constructive criticism but also suggest alternatives. The Project for Economic Education in partnership with the Indian Liberal Group decided that we should participate in the budget making process. This could best be done by placing before the people in general and decisions makers in particular a budget which is reforms friendly and takes it forward.

> *“ The Liberal voice is the voice of reason and rationality and hence superior to criticisms based on obsolete ideologies which are not only irrelevant but counter-productive. ”*

And this is what we did when on June 23, 2004 we released the first model Liberal Budget and titled it "The Liberal Budget - "Building an Equitable Society". This was the Liberal alternative.

We were encouraged by the response; even those who were critical welcomed the idea in principle.They pointed out the absence of 'numbers', for instance. Others appreciated the fact that our target-based approach in the allocation of funds was the correct way. We therefore decided that even while dealing with the criticism, we would make this an annual feature and produce a Liberal Budget in advance of the official Union Budget to promote public debate and thus ensure greater public participation in the Budget making process.

Hence this Budget, which we have titled "The Liberal Budget 2005-06 – The Way Forward". For various reasons our hope to present this document a month ahead of the Union Budget did not materialise. However we did manage to bring out an 'Executive Summary', in January, which we sent out to the Prime Minister, the Finance Minister, the Deputy Chairman of the Planning Commission, the Governor of the Reserve Bank and several senior bureaucrats intimately involved in the Budget-making process. It will be our endeavour to ensure that from next year the Liberal Budget in full, and not only the summary is in their hands as well as the people outside the establishment at least a month before the government begins the budget-making process.

The secondary title to this year's Liberal Budget, as the following pages will show, is to remind policy makers that strident 'Left' criticism should not deter the government from going ahead with the reforms and to remind them that while the Liberal voice may not be strident it is supportive and qualified to speak on the merits of a market economy. The Liberal voice is the voice of reason and rationality and hence superior to criticisms based on obsolete ideologies which are not only irrelevant but counter-productive. At the same time the drafting group spent considerable time in preparing the chapter on 'Social Sector Initiatives'. The term 'social justice' is not a preserve of the so-called 'Left'. It is in keeping with the Liberal credo of individual liberty with dignity and there can be no dignity without the right of the individual citizen to primary education, basic health care and decent opportunities go earn a living.

In this year's edition of the Liberal Budget we have undertaken a lot more 'number-crunching' perhaps not enough to satisfy everyone but an indication that we listen to constructive criticism and agree that general statements without data and specifics in terms of targets are of little use.

Finally 'hard core Liberals' might look askance at our 'conceding' limited subsidies for the time being or not insisting on privatising all PSUs at one go! This is because the layers of statist grime have to be removed carefully without endangering the edifice! In this matter we would take shelter under Gandhiji's dictum 'one step at a time is enough for me'.

The Liberal Budget published last year was a year-long effort in which a large number of highly qualified persons were involved. The numbers involved and the time taken can be explained by the fact that what we prepared then was a basic document on which future Liberal Budget documents would be based as it sets out the Liberal philosophy underlying the Liberal Position both on matters economic and the political economy.

We invite those of you who may not have read this document to write to us. We shall be happy to send you a reprint of the Chapter entitled "Liberal Perspectives and Human Development."

The composition of the Drafting Group is listed on page 2. The Project for Economic Education and the Indian Liberal Group is grateful to them for finding the time, despite their busy schedules to produce this document. It is their expertise in their respective areas of specialisation that has lent quality and credibility to this document.

We are grateful to the Friedrich Naumann Foundation for their encouragement and assistance in enabling this publication.

S. V. Raju
Executive Chairman
Project for Economic Education

February 14, 2005

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Executive Summary

The Liberal Budget document released in June 2004 put forward a vision for our society based on liberal values. Even as that document was being given its finishing touches, there was a change of government in New Delhi. A new coalition, describing itself as the United Progressive Alliance or the UPA, assumed office replacing the National Democratic Alliance or the NDA coalition. The UPA released its own action programme calling it the "National Common Minimum Programme" or the NCMP. This was quickly followed by the first major policy framework of the new government in the form of the Union Budget for 2004-05.

The public and official response to "The Liberal Budget – Building an Equitable Society" led us to believe that our effort had been worthwhile in the formulation of economic and fiscal policy. This encouraged us to continue our efforts to provide a constructive critique of current economic policies and offering alternative liberal solutions. We therefore decided to undertake a similar exercise in anticipation of the forthcoming Union Budget 2005-06.

In the formulation of our Liberal Budget 2005-06, we are encouraged by the sustained high growth momentum, especially in the services sector and in exports, as well as by significant industrial recovery and corporate performance. Thus, despite a major setback to the growth of agricultural production and adverse impact of rising international crude oil prices, the economy is in a resilient mode. What has been achieved is, no doubt, heartening, but what needs to be done is formidable.

Indeed, what continues to be a source of major concern is the failure of the nation's fiscal management, and the consequent constraints on the growth momentum of the economy. What is particularly worrisome are the continuing acute inadequacies in the areas of physical and social sector development. In successfully dealing with these inadequacies lies the way forward in achieving a truly liberal economic environment.

> " *The public and official response to "The Liberal Budget – Building an Equitable Society" led us to believe that our effort had been worthwhile in the formulation of economic and fiscal policy.* "

A Critique of UPA Policy Initiatives

We begin with a critique of the policy initiatives of the UPA Government focussing essentially on two major policy documents, viz., (i) The National Common Minimum Programme; and (ii) the Union Budget 2004-05. We shall attempt to highlight the areas of convergence and divergence *vis-à-vis* the Liberal Position, as enunciated in The Liberal Budget (LB) document of June 2004. Undoubtedly, the NCMP is overtly political in its contents and stance. These need to be taken seriously since on the one hand the NCMP is the *raison d'etre* for the major policy initiatives of the present Government during its term of office and for the strategic and operational framework of the Union Budget 2004-05, on the other.

The following is a partial list of the areas of convergence between the Liberal Position and the NCMP:

Guaranteed employment of, at least, 100 days, to one individual in every family.

- Food for Work Programme (there may be serious concerns regarding the finances that would be required for this programme as well as for guaranteed employment, but as far as the objectives are concerned, there can be no dispute).
- Targeted levels of government expenditure on health and education.
- Encouraging FDI in areas of infrastructure, high-technology and exports.
- Acceptance of an important role for the private sector in infrastructure development
- Targeting subsidies to the poor.

> *"The NCMP makes clear mention about the introduction of reservations in the private sector. The Liberal position is that historically disadvantaged sections of society must be given a helping hand; the question is whether the policy of reservations has done that."*

Having considered the areas of convergence between the NCMP and the LB, we now highlight those areas where the position of the UPA government diverges from the Liberal position.

- The NCMP states: "the UPA government will ensure adequate protection to all farmers from imports particularly when international prices fall". However, the document is silent on how farmers will be protected and what precisely is meant by 'adequate protection'. It is also not explained, if any, and how much, burden will be imposed on the Central Government finances, if such protection is to be provided effectively.
- The NCMP makes clear mention about the introduction of reservations in the private sector. The Liberal position is that historically disadvantaged sections of society must be given a helping hand; the question is whether the policy of reservations has done that. Our position is that every policy must be evaluated from the point of view of its effectiveness.
- The NCMP states that the "railways constitute the core of our infrastructure", and it is assumed that railways will continue to be a public sector monopoly. The Liberal position is that only the natural monopoly component of railways i.e. tracks, signals, stations, should be considered as being not open to competition due to technological factors. Train services themselves are a legislated monopoly in India and this situation must change.
- The NCMP diverges very significantly from the Liberal position when it comes to the role of the public sector.

Let us now turn to the areas of convergence between the Central Budget 2004-05 and The Liberal Budget:

- It is encouraging to see that the Fiscal Responsibility and Budget Management Act, 2003 (FRBM) has now become operational.
- Likewise, as advocated in the Liberal Budget, we welcome the promise made in the Central Budget to consider and implement the recommendations of the Kelkar Task Force Report on direct and indirect taxes.
- The Central Budget also highlights the efforts towards a "third wave" of tax reforms (a) comprising the preparation of the ground for Value Added Tax (VAT); (b) a move towards integrated taxation of goods and services; and (c) reducing customs tariff rates to levels prevailing in ASEAN countries.
- The Liberal position also supports the need for raising the tax to GDP ratio of the Central Government from the present 9.2% in 2003-04 to 12.1% in 2006-07. In this connection, stronger initiatives for taxing services are called for.
- Even though the Central Budget had put forward the eminently desirable proposal to raise FDI cap in telecommunications, civil aviation and insurance, this has run foul of the 'Left' parties, which support the UPA government from outside. This is greatly disappointing.
- The Liberal view sees considerable commonality of goals in terms of various social sector initiatives, including specifics like Food for Work, Midday Meal Scheme, Provision of Urban Amenities in Rural Areas (PURA), safe drinking water and Accelerated Irrigation Benefit Programme, among others.
- There are some other policy initiatives, which mirror the goals of the Liberal Budget. Specifically, we welcome the steps to implement VAT by April 1, 2005; the proposal for special fiscal and regulatory regime for the development of Special Economic Zones; the proposed pilot scheme of distributing food stamps

as a part of the reform of the Public Distribution System; and the proposed formulation of the blue-print on targeting subsidies sharply at the poor and truly needy.

But there are vast areas of divergence. Illustratively:

- The Central Budget is silent on expenditure policy, including its quantitative dimensions, as well as its sectoral composition. There is no mention of the adoption of modern and innovative techniques of expenditure management.
- The Central Budget, far from raising non-tax revenues, in fact budgets for a decrease; the ratio of non-tax revenue to GDP will be lower at 2.4% as compared to 2.7% in the previous year. The Liberal Budget has laid great emphasis on raising the ratio of non-tax revenue to GDP. For this purpose, it advocates more vigorous efforts to improve the efficiency and profitability of PSUs and Departmental Undertakings, as well as to reform the system of user charges for public utilities and services.
- The Central Budget has taken a virtual U-turn with regard to the policy of disinvestment and privatisation. The Liberal criterion for privatisation or disinvestments is not whether a PSU is loss-making or profit-making, but rather, whether any socially useful purpose is being served by keeping an enterprise in the public sector.
- Even more worrisome is the proposal to provide budgetary support for restructuring some of the PSUs. The creation of the Board for Reconstruction of Public Sector Enterprises (BRPSE) though welcome in its intentions, will become an instrument of procrastinating the inevitable process of phasing out non-performing assets of the Government.
- The tall promises in the NCMP regarding improving allocations to the social and other neglected sectors do not find any reflection in the Central Budget numbers.

Social Sector Initiatives:

The Liberal Budget gives high priority to pressing social sector issues and has taken the position that special attention must be devoted to this sector. In this context, the internationally accepted Millennium Development Goals have set some international standards to be achieved by 2015. These include: (1) eradication of extreme poverty and hunger by halving the proportion of people living on less than $1 a day and of people suffering from hunger; (2) achieve universal primary education; (3) promote gender equality and empowerment; (4) reduce infant mortality by two-thirds; (5) reduce maternal mortality; (6) Combat HIV/AIDS, malaria and other diseases; (7) ensure environmental sustainability which includes safe drinking water and improvement in the lives of slum dwellers.

In this context The Liberal Budget of June 2004 dealing with the kind of targets relating to human development, set out the following nine-point objectives of a Liberal State:

1. Reduction of poverty ratio by 5 percentage points by 2007 and by 15 percentage points by 2012.
2. All children in school by 2005; all children to complete five years of schooling by 2009.

> *“The Liberal Budget gives high priority to pressing social sector issues and has taken the position that special attention must be devoted to this sector.”*

3. Increase in the literacy rate to 75 per cent by 2007.
4. Reduction of infant mortality rate (IMR) to 45 per 1000 live births by 2007 and 28 by 2012.
5. Reduction in maternal mortality ratio (MMR) to 2 per 1000 live births by 2007 and to 1 by 2012.
6. Improve infant and child feeding and caring practices to bring down the prevalence of underweight children under three years from 47 per cent to 40 per cent.
7. Reduce the prevalence of severe under-nutrition in children in the 0-6 years age group by 50 per cent.
8. Provide 100 per cent coverage of rural and urban population with safe drinking water.
9. Provide cost-effective means of safe and sanitary disposal of solid waste and waste water.

While looking at the quality of human life, The Liberal Budget recognises the importance of both the adequacy of financial allocations, as well as the qualitative dimensions of the social sector expenditure.

It has been found that in India, social services expenditures (both Central and State Governments together) over the years in relation to GDP have ranged from 4.9 per cent (1995-96) to 6.5 per cent (2001-02). The fluctuations indicate the fiscal constraints of the governments and the relatively low priority accorded to social services. Among them, education received around 3 per cent, as against the required rate of 6 per cent. Health received much less importance with less than 2 per cent of GDP, abysmally low for a country with a poor record of health status.

Based on our analysis of the available data on social services expenditure, the Liberal Budget makes following recommendations:

- Social Sector development has to be judged not by financial outlays alone, but by their outcome measured in physical terms.

" Social services fall in the realm of local bodies and are best left as their responsibility, with financial resources made available by the Centre and the respective states. "

- There should be better coordination among the several implementation agencies.
- Large outlays and allocations to social sector services do not reach the beneficiaries in full, because of the leakages in the transmission mechanism. This has to be plugged.
- There is urgent need to improve the delivery system of public services, by ensuring cost efficiency and effectiveness.
- Social services fall in the realm of local bodies and are best left as their responsibility, with financial resources made available by the Centre and the respective states.
- A system of monitoring has to be put in place to ensure proper utilization of resources.
- Wide variations in the delivery systems among states and within a state have led to differing levels of performance. A system of incentives has to be put in place, based on the objective criteria of results.
- To make the delivery system really effective, there must be active participation of both beneficiaries and stakeholders.

Administrative and Expenditure Reforms

Apart from the centrality of social sector initiatives, The Liberal Budget - 2005-06 gives the highest priority to administrative and expenditure reforms. We have carefully evaluated the composition and structure of the entire administration of the Central Government, which is endowed with a total staff strength of 34.49 lakhs as on March 1, 2004. After reviewing the changing profile and functions of the Government in the context of economic liberalisation over the past decade, The Liberal Budget - 2005-06 recommends that special efforts must be made to reduce this huge staff strength as listed below:

(1) As recommended by the Fifth Pay Commission and by the Expenditure Reforms Commission, some of the existing Ministries must be wound up and several of the smaller, fragmented Ministries should be brought together.

(2) The second requirement is a thorough overhaul of Acts, rules, regulations and procedures so as to keep compliance requirements to the minimum. Most of the Acts and regulations are a relic of British colonial rule when the emphasis was on control. The Income Tax Act is a classic example. Too many returns and reports are called for and filed in a mechanical manner. The volume of paper work is so large that very often critical information is never processed.

(3) The above suggestions would apply equally in the areas of administering projects and programmes and in overseeing enterprises in areas like Agriculture, Health, Education, Rural development and the like. Where the implementation responsibility vests with the state government, there are huge parallel outfits under the Government of India. These must be eliminated.

(4) There is need to hasten the introduction of computerisation and move towards paperless governance. One justification for the large army of support staff is the huge mass of correspondence handled and the maintenance of mountains of files. With the simplification of rules and regulations and the shedding of unnecessary supervisory powers on the one hand and the introduction of computerisation on the other, support staff requirements will come down drastically.

(5) It is our estimate that the total staff requirements at the Centre and the states Secretariats (and their field outfits) could come down to less then 50,000. This reduction can only be brought about by providing a liberal VRS scheme for all general categories of officials at all levels, from the IAS at the top to peons and drivers at the bottom even while providing for safeguards against an exodus of the more efficient officials at this level.

(6) The reduction of staff strength in field formations - tax agencies, GSI, ZSI, BSI etc. has to be given effect to on the basis of detailed studies of each organisation. There is therefore a case for introducing a VRS in these organizations aimed at a 50% reduction without waiting for a detailed study of the staff requirements.

(7) Restructuring of the staff strength in Public Enterprises calls for a totally different approach. The total staff strength of the government and quasi-government formations under the Central and state governments exceeds 9 million. An important aspect to be noted, in this connection, is that a reduction, substantially in excess of 1 million, has already taken plan in the last 13 years due to right sizing, VRS and the non-filling up of retirement vacancies. Railways, Posts and Banks account for a major share of this reduction. The reduction in staff strength in these enterprises should take place in tandem with measures for improving operational efficiency and induction of state-of-the-art technology and increased mechanisation – this may well call for a substantial injection of funds.

(8) Admittedly among the services, Defence stands apart. Nevertheless this does not mean that there is no scope for reducing expenditure or manpower in this service as well. Since the mid-eighties free rations are provided to all service personnel in all parts of the country. This is a perquisite, possibly without parallel anywhere in the developed countries. Less expensive civilians could be utilised in place of high cost military trained defence personnel in areas like the Military Engineering Service. As suggested in the case of other ministries, the feudal trappings (inherited from the British colonial era) - large complement of support staff in the office and at the residence of senior military personnel, fleet of escort vehicles etc. - needs to be done away with.

(9) These are the areas that require urgent attention, if the lot of the common men is to witness a marked improvement. All personnel need to be better trained, skills upgraded, and more importantly made people-friendly.

Public Enterprises and Privatisation

The Liberal Budget 2005-06, is much concerned with the lack of consistency and ambivalence of the various governments, on such important policy matters as disinvestments and privatisation of Public Sector Enterprises.

Some idea of the performance of, as well as the issues involved in these numerous enterprises, can be gained by looking at the data for the 227 enterprises (not including the 13 under construction) covered by the Public Enterprises Survey (2002-03). In 2002-2003, these 227 enterprises accounted for a total equity of Rs. 102,108 crores, total investment of Rs. 320,036 crores, total turnover of Rs. 544,390 crores, and total employment of 19.22 lakhs. Out of these, while 12 cognate groups recorded a total profit of Rs. 25,461 crores, 9 cognate groups recorded a loss of Rs. 6,678 crores.

“ The Liberal Budget 2005-06, is much concerned with the lack of consistency and ambivalence of the various governments, on such important policy matters as disinvestments and privatisation of Public Sector Enterprises. ”

Based on a detailed analysis, the Liberal Budget – 2005-06 makes the following specific recommendations:

1. Having regard to the need for providing increasingly larger space for the private sector, and also the large preemption of resources to the public sector that has taken place even after 1990, there should be a total ban on the setting up of new enterprises. The only exceptions could in the area of national security-Atomic Energy, Space and areas catering to critical defence requirements.

2. Of the 21 cognate groups referred to earlier only a very few can be considered to be of strategic importance in view of the size or the importance to the economy. Fresh investments should be permitted only in these enterprises and that too after exploring

the possibility of getting the requirements met through the private sector.

3. Of the other enterprises, those that are incurring losses, including those referred to BIFR ,should be fully disinvested forthwith.

4. The non-core, profit-making enterprises may be, for the moment, continued in the public sector so long as these are operated efficiently and profitably.

5. In the core sector, the enterprises should be encouraged to take in strategic partners – domestic or foreign – so as to bring in state of the art technology, and/or improved management methods, and/or fresh capital, either in the enterprise itself or at the unit level.

6. Selling of shares in small lots or inducting partners, without leading to change in management control and only with a view to generate resources for the government, should not be undertaken in future.

“It has been the experience in the past that tax laws are amended with a view to punish a small percentage of defaulters which, in the process, has made the tax laws very harsh and complex for the larger tax paying community.”

7. In the Railways and Posts, which will continue to be in the public sector in view of their strategic role, unbundling, on the lines adopted by the State Electricity Boards, should be undertaken. Wherever possible, items of works should be farmed out to the private sector. Even separate large investment projects like the Konkan Railway and the Delhi Metro to mention just two, could well have been left to the private sector.

8. The suggestion given above in respect of the Central sector enterprises would apply with equal force to those in the state, joint or cooperative sectors.

9. The practice of providing budget support to public enterprises in the form of interest and other subsidies, as well as non-plan grants and loans should be phased out over a two-year period. The Postal deficit and subsidy to the Railways for dividends and other concessions would also come under this category. The total provision for this purposes in the current years budget is nearly Rs.5,000 crores.

10. The net proceeds realised from the disinvestment process should be earmarked for improving the quality of life for the common man in areas like elementary education, basic health care and civic amenities, thus reducing the needs for raising additional resources for this purpose.

Tax Reforms and Administration

The Liberal Budget 2005-06 provides a specific focus on reforms of the tax structure, tax laws and tax administration. Undoubtedly, rationalising and simplifying direct and indirect tax laws and bringing them in line with the current needs of a liberalising and competitive global economy, is a long-standing and uphill but an urgent task nevertheless, especially considering the mindset of the people in tax administration at different levels.

In this context, The Liberal Budget 2005-06 has given full consideration to the Kelkar Task Force Report, which was submitted recently to the Government of India. This report has presented a detailed analysis of the Indian tax system and has also prepared a comprehensive set of recommendations, most of which are in conformity with the vision of a Liberal society. The suggestions for tax reforms given below are in keeping with the spirit of the Kelkar Task Force, whose recommendations apparently have met with approval even in the Central Budget 2004-05. Indeed, in his budget speech the Finance Minister promised: *"I am a votary of tax reforms but it would be unwise on my part to do reform in a hurried or piece-meal manner. Seven months from now there will be another Budget, and there will be an occasion to visit the subject of tax reform"*

The suggested tax reforms of The Liberal Budget 2005-06 are as under:

(1) The Income-tax Law provides for many distortions in the computation of income. While it may not be practical to eliminate completely all differences between taxable income and book income (real income), every effort needs to be made to match the two.

(2) Specific reforms in this direction to be carried out are:

(a) Depreciation allowance under the income-tax law be harmonised with the law under the Companies Act.

(b) If any incentive-depreciation is to be granted, it should be on condition that it be provided in the books of account.

(c) Provisions of section 115JB, Minimum Alternate Tax (MAT) be deleted.

(d) The 'Carry forward' of losses and depreciation should be merged together and be treated on par and be allowed to be set-off indefinitely.

(e) Both set-off in any year and carry forward in the subsequent year be not compartmentalised on the basis of heads of income but be treated as single block. However, items such as speculation loss or any similar item as exception to the general rule may be differently treated.

(3) In order to make the operation and the management of the tax-system simple both for the tax-collector and taxpayer, and to reduce compliance cost, it is suggested that the concept of presumptive tax be extended to many items of income. Such provisions already exist, for example, in computing profits and gains in the business of civil construction as well as in computing profits and gains of retail business

(4) We suggest that the combination of actuals and presumptive basis be tried in some cases as an experiment. Under this system, only gross-profit will have to be computed on actual basis and all overheads be allowed on a presumptive basis.

(5) We suggest that the "one-by-six" scheme should be further extended to cover all who are carrying on any activity of business, to earn income. However, to ensure that there is no mere filing of returns without any tax actually being paid, we suggest that all individuals and HUFs who file returns be required to pay a minimum tax of Rs. 1,000 per year. This proposal is likely to bring in revenue of Rs. 3,000 crores.

(6) Currently agricultural income is exempt u/s.10(1) of the Income-tax Act, 1961. However, an assesee, who has both agricultural and non-agricultural income, is taxed on non-agricultural income such that he pays tax slightly higher than what he would have paid on the same non-agricultural income if he had no agricultural income. This opens an opportunity for declaration of fictitious agricultural income. This needs to be dealt with urgently.

Direct and Indirect Tax Laws

Tax Laws and Tax Administration – Broad Framework

It has been the experience in the past that tax laws are amended with a view to punish a small percentage of defaulters which, in the process, has made the tax laws very harsh and complex for the larger tax paying community.

Therefore, tax laws should be amended bearing in mind the convenience of the large number of taxpayers (and not with a view to punish a few defaulters). This will have the added advantage of creating an atmosphere of trust on the one hand and substantial reduction in corrupt practices on the other hand.

> *"Bearing in mind the long-term interest of the country and its objective of increasing tax revenue by voluntary compliance, as a policy, no retrospective amendment should be made in the tax laws which will have an adverse effect on the tax payers."*

One of the basic tenets of a good tax policy is stability in the tax laws. This can be achieved by avoiding frequent amendments to the tax laws which have made present tax laws not only complex but also difficult to implement in a fair manner. To achieve this, the current practice of an annual exercise of amendments in the tax laws every year through the Union Budget should be given up. Amendments to tax laws should be made only by separate Tax Laws (Amendment) Act which should be enacted after a detailed public debate and after due consideration by a select committee having members who are conversant with the complexities in tax laws and the ground realities of tax administration.

Similarly, even the tax rates could be delinked from the Union Budget and the tax rates should be incorporated in separate tax laws. In case of urgency, the law concerned can be amended through an ordinance. To begin with, this policy can be adopted for direct tax laws and th[illegible] can be subsequently extended to indirect tax [illegible]

In the recent past, it has been the experience of the tax paying community that tax laws are amended with retrospective effect, in most cases to nullify the effects of judicial pronouncements. This creates an atmosphere of disrespect for the judiciary and it also affects all financial projections of the assesses. Therefore, bearing in mind the long-term interest of the country and its objective of increasing tax revenue by voluntary compliance, as a policy, no retrospective amendment should be made in the tax laws which will have an adverse effect on the tax payers.

> *"... it has been the experience of the tax paying community that tax laws are amended with retrospective effect, in most cases to nullify the effects of judicial pronouncements. This creates an atmosphere of disrespect for the judiciary."*

We make the following recommendations:

(i) To make the Right to Information Act effective and the tax administration instructed to strictly comply with the provisions of the Act;

(ii) Pending implementation of the Right to Information Act, which covers larger area of government administration, appropriate provisions should be made in the tax laws incorporating relevant provisions of the Right to Information Act which will be the first step in achieving transparency and accountability;

(iii) Some statutory monitoring mechanism with requisite powers independent of tax administration should be provided in the tax laws. Such mechanism should provide a forum to the tax paying community to approach them for unfair and discriminatory treatment being given to them.

(iv) Most of the amendments in the tax laws are made effective from the date on which they are notified and, in most cases, the affected people come to know the effective date of such amendment after a gap of a few days resulting in unintentional default. Therefore, a minimum period of about 15 to 30 days should be prescribed between the date of enacting the statutory provisions and their effective date, so that it becomes possible for the affected people to comply with the amended tax laws.◆

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Chapter 1

2004-05 Fiscal Policy – A Critique

For far too long policies designed to eliminate poverty have been confused with policies which are pro-poor. The distinction between the two kinds of policies is best captured by the adage that distinguishes between giving a poor person alms and giving him some education; the former will take care of his next meal while the latter will set him free from hunger. This confusion between policies has led us down the path to hell which was paved with good intentions: we subsidized the consumption of the poor[1] but did not do enough to guarantee them an assured and adequate income; we protected those who had employment without sparing a thought for those who hoped to get a job; we sought to divide the existing pie equitably but did not seek to increase its size. We were enamoured (rightly so!) by the so-called socialist dream of welfare enhancement, equity, elimination of poverty and social justice, but we, unfortunately, employed socialist means to achieve these objectives. It's a paradox but socialist means are the worst enemies of socialist ends! Many of the so-called socialist objectives are, of course, part and parcel of any liberal agenda, the difference lying in the means employed to attain those objectives.

The liberal position, as articulated in The Liberal Budget document (LB) released on June 23, 2004, recognizes a synergy between the State and the market, and believes that each has its legitimate area of efficient operation. Neither the State nor the market should attempt to do what the other can do. For the liberals, the State and the markets have instrumental value – to promote the welfare of all. Investing them with intrinsic value is a path that leads to ideology and dogma. It is our belief that for far too long the productive potential has been shackled in India and this needs to be torn asunder if the promise of improving the welfare of all is to be realised. It is our belief that welfare improvement is contingent on a superior growth performance and, for this, the government has to create the necessary environment by creating and nurturing market-enabling institutions and implementing growth-promoting policies. In addition, the government must take care of those who fall through the cracks since they are not in a position to take advantage of the opportunities offered by the market.

It is important to not view the government as a monolith and recognize that, in a federal set-up, there are different levels of government, each with its own constitutionally mandated rights and responsibilities. For some aspects of welfare promotion, it is the state governments that have to play a leading role. This is especially true of the areas of agriculture, basic education and basic health. The Liberals recognize this important role of the states and hopes to extend the concept of the LB to the level of the state governments. However, given that the capabilities of any organization are finite (and, though not adequately recognized, this is agonizingly true of the government!), we have chosen to focus on the Central Government with the hope that we will broaden our coverage in the foreseeable future.

“ It's a paradox but socialist means are the worst enemies of socialist ends! Many of the so-called socialist objectives are, of course, part and parcel of any liberal agenda, the difference lying in the means employed to attain those objectives. ”

In this Chapter we shall focus on two major issues. The United Progressive Alliance (UPA) government has unveiled its vision for India in the form of the National Common Minimum Programme (NCMP). This vision, though strongly and overtly political, needs to be taken seriously since it is expected to underlie the major policy initiatives of the government. We present a critique of the NCMP from a liberal perspective in the next section. The second issue

[1] It's another issue that these subsidies were badly targeted.

that we deal with relates to the major policy document unveiled by the government, viz. the Central Budget 2004-05. In a later section, we shall critically evaluate the budget in the light of the tenets of the liberal position.

A Comparison of the NCMP and the LB

The elections to the 14th Lok Sabha, held in May 2004 voted out the previous NDA government (with the BJP as the main party) and voted in the UPA (with the Congress as the main party but also supported by 14 other parties and the Left parties – CPM and CPI – offering support from the outside). It was hoped that neither the losers nor the winners would draw the *wrong* lessons from the poll results. Specifically,

> *“The United Progressive Alliance (UPA) government has unveiled its vision for India in the form of the National Common Minimum Programme (NCMP). This vision, though strongly and overtly political, needs to be taken seriously since it is expected to underlie the major policy initiatives of the government.”*

- The BJP would not view the loss as a call for return to the religious agenda.
- The Congress and other parties would not view the victory as a vote against economic reforms.

While the issues connected with what lessons the BJP would draw from the elections, though certainly important from a national perspective, are not germane to the discussion at hand viz., formulating the Liberal Budget 2005-06 (LB2). For the task at hand, it is more important to focus on what the stance of the new government for the future would be. This requires that we examine the philosophical underpinnings of the policies that the UPA government considers important. The next step is to critique these philosophical underpinnings from a liberal perspective.

We propose to examine the NCMP of the UPA government to get an inkling of the philosophy that will underlie its policy formulation. It has been suggested that the NCMP is a mere "political" document and will be strong on hyperbole and tall promises but will falter at the time of implementation. However, in the absence of any other pointer to the policy direction of the UPA government, we shall give due weight to this key document that has been made public. Secondly, at least some of the elements in the NCMP have been brought to the discussion table by the government, possibly as a preliminary step towards policy formulation. Finally, there are some seriously illiberal elements in the NCMP and these maybe foisted upon the nation by irresponsible illiberal elements in the UPA government. It is not clear whether the "practical men [in the UPA government]...are slaves [to the ideas of] of defunct economist",[2] but it certainly appears as if some are slaves to some defunct ideologies.

What we propose to do here is to list out but not dwell too much on the areas of convergence between what is listed in the NCMP and in the LB. On the other hand, we will elaborate on issues where there is divergence between what the LB believes and what the NCMP proposes.

A partial list of the areas of convergence are:

- The NCMP speaks about guaranteed employment of, at least, 100 days to one individual in every family.
- There is also commonality between the NCMP and the LB regarding the Food for Work Programme. However, there maybe concerns regarding the finances that would be required for this programme as well as for guaranteed employment.
- Related to health and education, there is again a reasonable amount of convergence between the LB and the NCMP. As far as education is concerned, the NCMP proposes an expenditure of, at least, 6% of GDP, of which half is to be spent on primary and secondary sectors. The LB document of 2004 had made the point that, by and large, higher education should go outside the ambit of subsidization i.e. it should pay for itself, and the major focus of expenditure from the public fund should be on the primary and, to a slightly lower extent, on the secondary sectors. The stand of the NCMP is not completely congruent with that of the LB since only half of the

[2] With due apologies to John Maynard Keynes and his wonderful quip: "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back..."

proposed expenditure of 6% of GDP would be on the primary and secondary sector, while the remainder would fund higher education. It is also not clear from the NCMP as to when the target of 6% spending will be achieved; all that it says is that "This will be done in a phased manner". The NCMP should have also made it clear that the major responsibility for education (and health) lies with the state governments and should have had proposals for incentivising state governments to increase their spending in these areas.

- The NCMP also points out that public spending on primary health will rise between 2 to 3% of GDP over the next 5 years. It refers to a National Scheme of Health Insurance. It also expresses concern regarding food and nutrition.

- The NCMP states: "FDI will continue to be encouraged and actively sought particularly in areas of infrastructure, high-technology and exports". The LB would like to express some concern at the selective adherence to commitments made in the NCMP: it is well known that already the introduction of FDI is being strongly resisted by the 'Left' parties in the UPA.

- Finally, the NCMP refers to the important role for the private sector in infrastructure development; it speaks about the need to make subsidies explicit and to route them through the budget; it suggests that all subsidies should be targeted to the poor; it even states that foreign direct investment would be encouraged.

Having considered the areas of convergence (even partial) between the NCMP and the LB, we now highlight those areas where the position of the UPA government diverges from the liberal position.

- The NCMP states: "The UPA government will ensure adequate protection to all farmers from imports particularly when international prices fall". The document is silent on how farmers will be protected and what precisely is meant by 'adequate protection'. It is also not stated if any, and how much, burden will be imposed on the public finances of the central government if such protection is to be given. In any case, the LB questions the very desirability of such protection which will inevitably be detrimental to the welfare of society.

- It is also stated that, "Farmers all over the country will receive fair and remunerative prices". If this is to take the form of minimum support price, as happens in the case of wheat and rice, this is a recipe for disaster and must be guarded against. Such interference with the market mechanism creates a perverse incentive for farmers, e.g. there is likely to be excessive risk-taking in anticipation of "fair and remunerative prices". The problems that have been experienced with setting of minimum support prices and the burden on the budget will get accentuated should such support be extended to all crops. It is also the liberal position that such interventions in the market by the government must have a sunset clause: such policies cannot be open-ended for an indefinite time period.

> *"The LB document of 2004 had made the point that, by and large, higher education should go outside the ambit of subsidization i.e. it should pay for itself, and the major focus of expenditure from the public fund should be on the primary and, to a slightly lower extent, on the secondary sector."*

- The NCMP states "The UPA government will take steps to ensure that dues to all farmers, including sugarcane farmers, will be cleared". There is no elaboration at all on the kind of dues that will be cleared nor is it indicated how much this will cost the exchequer.

- The NCMP makes clear mention about the introduction of reservations in the private sector: "The UPA Government is very sensitive to the issue of affirmative action including reservations in the private sector". We are already seeing the fallout of this announcement with the Prime Minister himself stating that the time for such reservations has come. The liberal position is that historically disadvantaged sections of society must be given a helping hand; the question is whether the policy of reservations has done that. Our position is that every policy must be evaluated from the point of view of its effectiveness. After more than fifty years of following the reservation policy, it is now time that a comprehensive review of the implementation of this policy be undertaken.

- The NCMP states that: "Railways constitute the core of our infrastructure. Public investment for its modernization, track renewal and safety will be substantially increased. Railways reforms will be pursued". In the light of the Report of the National Statistical Commission, all functions of the railway system should not be considered infrastructure. Only the "natural monopoly" component of railways i.e. tracks, signals, stations, should be considered as infrastructure and not open to competition *due to technological factors*. The liberal position is that train services themselves in India are a legislated monopoly and this situation must change: there are no technological factors that prevent competition in train services. One must also question why there needs to be a separate budget for the railways. Profligate behaviour by the railway ministry imposes an externality on the general budget.

> *" The liberal position is that train services in India are a legislated monopoly and this situation must change: there are no technological factors that prevent competition in train services. One must also question why there needs to be a separate budget for the railways. "*

- The NCMP diverges very significantly from the liberal position when it comes to the public sector. Here are some typical quotes from the NCMP:
  - "Public sector banks will be given full autonomy"
  - "The UPA government is committed to a strong and effective public sector..."
  - "The UPA is pledged to devolve full managerial and commercial autonomy to successful, profit-making companies"
  - "Generally profit-making companies will not be privatised".
  - The UPA will retain existing *"navaratna"* companies in the public sector while these companies raise resources from the capital market.

The liberal position is that units in the public sector should be aggressively privatised and that a rationale for privatisation is not required – what is required is a compelling reason for keeping any unit in the public sector. The liberal position does not subscribe to the notion of *"navaratna"* companies which need to be kept in the public sector: it is almost impossible to insulate public sector companies from political influence and the pledge to grant full managerial and commercial autonomy is not credible. It is also the liberal position that the mere fact that a public sector unit is profit making cannot be a reason for not privatising it since, more often than not, such profits have arisen out of exploiting its monopoly position.

The various proposals for action that have been put forward in the NCMP have fiscal implications. In most cases these have not been spelt out nor has the time frame, within which certain objectives will be achieved, been quantified. Taking only a few of the proposals – spending on education, health, assuring 100 days of employment and the associated administration and bureaucracy – a rough estimate suggests that an expenditure of about Rs.150,000 crores may be required. If this expenditure is spread over, say three years, and if we assume that GDP (in nominal terms) will grow at 12% per annum, then this expenditure level will be about 1.5% to 2% of the aggregate GDP over the next three years.

The LB has taken a position that there should be a check on the rampant growth in government expenditure, but this does not obviate, in fact it actively seeks, a re-orientation of expenditures towards welfare-oriented activities. Governments need to focus on their primary duties and vacate areas which are best left to the markets. So while the LB too envisages increased expenditure on welfare-oriented activities, it does not anticipate an increase in the overall size of the government. This allows the LB to promote fiscal prudence while at the same time encouraging spending on welfare improvement. This balanced approach is conspicuous by its absence in the NCMP. It remains a mystery how the UPA government will achieve its lofty objectives without violating the provisions of the FRBM Act.

An important aspect of fiscal rectitude is not merely curtailing expenditure, but also simultaneously raising tax and non-tax revenues. The LB has recommended a 3 percentage point increase in the tax-GDP ratio. The NCMP also calls for an increase in this ratio "by undertaking major tax reforms that expand the base of taxpayers, increase tax compliance and make the tax administration more efficient" but then, curiously, almost in the same breath, adds "Special schemes to unearth black money and assets will be introduced". There is no doubt that reducing the incentives to create black money and wealth is important and it is equally important that penalties for its generation must be heavy. However, why the NCMP should speak of unearthing black money in the paragraph which deals with tax-GDP ratio is not clear. Unearthing black money should not viewed as a source of generating additional revenues since, if that is done, amnesty schemes, which are so pernicious in their effect, are as inevitable as night follows day.

The Central Budget 2004-05 *vis-a-vis* The LB

The most significant policy document to come from the UPA government has been the Central Budget 2004-05. A study of the Central Budget and its comparison with the LB is important. One of the principal objectives of the LB was to provide a template (a benchmark) to evaluate the annual budgets of the Central Government. In this context, it is imperative that we bring out a comparison between these two policy frameworks, and reflect, objectively, on their areas of essential convergence and divergence, in terms of both policy as well as strategic formulations.

Areas of Convergence

To begin with, the Liberals recognize the fact that given the constraints of time, the Finance Minister could not have been expected to adopt a distinctly liberal fiscal stance, more so when the present Government is severely constrained by the compulsions of coalition politics as clearly reflected in the NCMP. Though the Finance Minister is aware of the delicate balancing act that needed to be performed it is heartening that he holds out hope for the future: "I am a votary of tax reforms but it would be unwise on my part to attempt to do reform in a hurried or piecemeal manner. Seven months from now there will be another Budget, and there will be an occasion to visit the subject of tax reform." Hence, we believe that the true test of whether the liberal ideas enunciated in the LB will at all make an impact on official economic and budgetary policies would become evident in a few months' time.

The following areas of convergence between the LB and the Central Budget are noteworthy:

- First, as advocated in the LB, the Finance Minister has promised to consider and implement the recommendations of the Kelkar Task Force Report on direct and indirect taxes. We hope that rationalization and simplification of tax policies, and radical changes in tax administration, will find their place in the next budget and form an integral part of the liberal economic policies of the government. Needless to stress, to accomplish this, the government will have to make sincere efforts to build national consensus, cutting across divergent political affiliations.

> *"Unearthing black money should not viewed as a source of generating additional revenues since, if that is done, amnesty schemes, which are so pernicious in their effect, are as inevitable as night follows day."*

- In the meantime, the changes in the tax structure, as well in tax concessions and incentives made in the latest budget reflect the immediate response of the Finance Minister to the needs of the economy and considerations of budgetary resources. Hopefully, this does not reflect a long-term fiscal strategy. The notable changes are (a) the package of changes in capital gains tax coupled with the introduction of tax on transactions in securities; (b) expansion of the net of service tax and enhancement of its rate from 8% to 10%; (c) some sector specific changes in customs and CENVAT, and tinkering with the corporate tax incentives. Some of these though welcome, do not conform to the tax strategy implicit in the LB. Specifically, the tinkering around of rates of customs and excise for a wide variety of goods smacks of lobbying pressures and not a well-thought modification.

- It is a welcome development that the Fiscal Responsibility and Budget Management Act, 2003 (FRBM) has now become operational. However, it is a matter of concern that in the very first year of its implementation, the FRBM rules envisage elimination of revenue deficit by 2008-09 - one year beyond the original target year 2007-08. It would have been much better for the government to stick to the originally announced schedule of reduction in deficits. This would have made its policy time consistent. It is regrettable that, the year in which Finn Kydland and Edward Prescott have been honoured with a

Nobel prize for their seminal work on time inconsistency of government policies, the Indian government should have behaved as predicted by the two economists!

The LB had given a road-map for a much speedier process of phasing out revenue deficit by 2006-07. Accordingly, the budget estimate of ratio of revenue deficit to GDP is placed at 2.5% in 2004-05 (exactly the same as suggested by the LB), and will be reduced further to 1.1% in 2006-07 (as against zero in the LB). The LB had also suggested a similar sharp reduction in fiscal deficit from 4.8% in 2003-04 to 2.5% in 2006-07, but the Statements laid before Parliament, as required by FRBM Act, 2003 projects higher fiscal deficit to GDP ratio of 3.6% by 2006-07. In substance, there is a welcome convergence in the direction towards fiscal discipline, but the envisaged action lacks the necessary strength and rigour.

> *“It is a welcome development that the Fiscal Responsibility and Budget Management Act, 2003 (FRBM) has now become operational. However, it is a matter of concern that in the very first year of its implementation, the FRBM rules envisage elimination of revenue deficit by 2008-09 - one year beyond the original target year 2007-08.”*

- These FRBM Statements also sets out the intentions of the Government with respect to essential elements of tax policy in the coming years. Among other things, it highlights the efforts towards "the third wave" of tax reforms comprising the preparation of the ground for Value Added Tax (VAT); a move towards integrated taxation of goods and services; reducing customs tariff rates to levels prevailing in ASEAN countries, etc. These proposals are generally in tune with the objectives of the LB.

- Further, the liberal position also supports the need for raising the tax to GDP ratio of the Central Government from the present 9.2% in 2003-04 to 12.1% in 2006-07. However, our major concern is the manner in which the policy makers strive for tax buoyancy in the Indian economy. Surely, the LB does not support the constant tinkering with the tax system for the purpose of incremental tax revenues. It wants tax buoyancy through long-term stability of the tax system and acceleration of growth momentum of the economy. Equally importantly, the incremental tax ratio must help in wiping out the revenue deficit of the government, and is not diverted to unproductive, non-developmental expenditure.

- Even though the Central Budget had put forward the eminently desirable proposal to raise the FDI cap in telecommunications, civil aviation and insurance, this has run foul of the 'Left' parties which support the UPA government. This, in spite of the fact that the NCMP vows to promote FDI giving room for fears that the NCMP will be used conveniently and selectively for political purpose. Also, very strangely, even though the sectoral cap on FDI in aviation has been raised, direct or indirect equity participation by foreign airlines is not allowed! It would have made sense for a domestic airline to invite equity participation by a foreign airline since this would have led to the introduction of advanced technology which in turn could have improved the efficiency of the airline. In the quirkiness of coalition politics in India, equity participation by, say an apparel manufacturer would be permitted but not by an entity that has expertise in aviation!

- The liberal view sees considerable commonality of goals in terms of various social sector initiatives, including specifics like Food for Work, Midday Meal Scheme, Provision of Urban Amenities in Rural Areas (PURA), safe drinking water, Accelerated Irrigation Benefit Programme, and the like. All these constitute the core of the liberal position. We strongly contend that building up of social infrastructure falls necessarily within a purview of the Government's basic role, along with its focus on law and order, defense, and development of some key physical infrastructure facilities. We welcome the efforts towards plan reorientation to generate an additional sum of Rs.10,000 crores for this purpose.

- However, Liberals would like to assert that these should not become mere symbolic gestures. Further, there must be constant monitoring of the underlying physical targets and regular evaluation in terms of Action Taken Reports to be made available to the public. More importantly, we would like to assert that the nine-point objectives set out in the LB (which are also spelt out in the official Tenth Plan document itself) must become the real guideposts, in as much as these spell out precisely the physical targets and their respective time-frames.

- Finally, there are some other policy initiatives, which mirror the goals of the LB. Specifically, we welcome the steps to implement VAT by April 1, 2005; the proposal for special fiscal and regulatory regime for the development of Special Economic Zones; the proposed pilot scheme of distributing food stamps as part of the reform of the Public Distribution System; and the proposed formulation of the blueprint on targeting subsidies sharply at the poor and truly needy. Our only hope is that these do not remain a mere statement of intentions. We wish to see the implementation of these measures in a time bound manner.

Areas of Divergence

Thus, while there are some areas where the Central Budget 2004-05 meets with the expectations of the LB, there are many crucial aspects wherein it has unveiled enormous variance with the liberal philosophy and strategy. We cover some of these below:

- First, the LB provides central focus on expenditure policy, envisaging its quantitative dimensions as well as sectoral distribution. It also proposed the adoption of modern and innovative techniques of expenditure management. This aspect is conspicuous by its absence in the budgetary strategy.

- Second, the LB lays great emphasis on raising the ratio of non-tax revenue to GDP. For this purpose, it advocates more vigorous efforts to improve the efficiency and profitability of PSUs and Departmental Undertakings, as well as to reform the system of user charges for public utilities and services. The Central Budget, far from raising non-tax revenues, in fact, budgets for a decrease: the ratio to GDP will be lower at 2.4% as compared to 2.7% the previous year.

- Third, the Central Budget has taken a virtual U-turn with regard to the policy of disinvestment and privatisation. In contrast, the Liberal position is very clear in its strategy: "the business of the government is governance and not business". Hence, our criterion for privatisation or disinvestments is not whether a PSU is loss-making or profit-making. Also, we are not convinced about the concept of *Navaratna* companies for the purpose of perpetuating the "commanding" position of PSUs. The real test for disinvestments and privatisation of PSUs will be governed by the consideration: "whether the State should be in the chosen field of activity in the first place". Proceeds from disinvestments which were Rs.14,500 crore in 2003-04 (RE) will be as low as Rs.4,000 crore. The NCMP seems to be casting its long, illiberal shadow on the Central Budget. It may be pointed out that the LB had proposed generating, at least, Rs.35,000 crores from disinvestments in the current year, and moving up progressively in subsequent years. Simultaneously, we had also envisaged a system of "ring-fencing" these resources and deploying these for well-conceived developmental purposes.

> *“ The liberal view sees considerable commonality of goals in terms of various social sector initiatives, including specifics like Food for Work, Midday Meal Scheme, Provision of Urban Amenities in Rural Areas (PURA), safe drinking water, Accelerated Irrigation Benefit Programme, and the like. All these constitute the core of the liberal position. ”*

- Fourth, even more worrisome is the proposal to provide budgetary support for restructuring some of the PSUs. For example, the Finance Minister has stated in his budget speech that "Hindustan Antibiotics Limited will be given financial support for its restructuring. A rescue package has been worked out for Indian Telephone Industries (ITI), and ITI will be given Rs.508 crore to remain out of the net of the BIFR". Such initiatives are not only going to be counter-productive, but drain away valuable budgetary resources. The solution surely lies in moving out of such enterprises as soon as possible. The creation of the Board for Reconstruction of Public Sector Enterprises (BRPSE) though welcome in its intentions, will become an instrument for procrastinating the inevitable process of phasing out non-performing assets of the Government.

- The tall promises in the NCMP regarding improving allocations to the social and other neglected sectors do not find any reflection in the Central Budget numbers. The expenditure on agriculture at 7.6% of total expenditure is no different from what it was in 2002-03; that on education, at 2.4%, is marginally higher than the figure of 2.3% in 2002-03; finally, the ratio for health at 1.2% of total expenditure compares poorly with the figure of 1% in 2002-03.

The UPA government had claimed for itself the moral high ground of promoting economic reforms with a human face. In pursuit of this, it promised to enhance spending on agriculture, rural development and social sectors. It is disappointing to find that the government's first budget was long on words but terribly short on action. Even worse, it has put in reverse the small gains that had been made in respect of disinvestments and pushing for opening up the economy to foreign competition. We hope that the Finance Minister delivers on his promise to introduce more reforms in his next budget.◆

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Chapter 2

Social Sector Initiatives

Poverty eradication has been the stated goal of India's planned development for several decades and is now the focus of the NCMP of the UPA government. There has been notable success in this regard since the initiation of economic reforms. This does not, however, mean that the current levels of poverty are acceptable. Not only is the national poverty ratio of about 26% too high by international standards but, equally importantly, it hides significant interstate disparities ranging from 42.6% in Bihar to 4.4 % in Goa (measured at 1999-2000 levels).

To make a further dent in the poverty ratio, as well as to improve the performance of the laggard states there needs to be better coordination of the large number of poverty alleviation and employment generation programmes. Among the important reasons for the poor effectiveness of poverty alleviation schemes, are the preemption of the bulk of the resources for the wages and salaries of the associated bureaucracy. Not only are there are leakages across the board, which are intensive and proliferating, but the service delivery mechanism is dismal.

The Liberal position is that poverty cannot be alleviated merely by throwing money at the poor. Any sustained poverty alleviation programme requires the augmenting of the capabilities of the poor and thereby empowering them. It is in this context that the provision of better health and education services becomes vital.

The rationale for social sector development is that it is at the root of mass poverty and closely related to human development and improvement in the quality of life. To help the vast masses of the poor, particularly in rural areas and to improve their economic status, the State has a crucial role in creating income generating activities and investing in primary health and education. Primary health and education are 'merit goods', since they enhance human capabilities and, in the process, benefit the economy.

Over the last five decades, large sums of money have been spent on primary health and education by various levels of government. Despite this, the delivery of services in these essential areas has been poor and the final outcome not commensurate with the monetary inputs.

Neglect of rural development was essentially due to an obsession with industrialisation in the past and the continuing severe constraints of fiscal resources. Priority attention to rural development arises from the fact that poverty eradication continues to be a challenging task. Poverty has to be viewed as a national disability hindering India's potential growth prospects. Any initiative to correct this disability will transform the complexion of the rural economy.

> *“ The Liberal Position is that poverty cannot be alleviated merely by throwing money at the poor. Any sustained poverty alleviation programme requires the augmenting of the capabilities of the poor and thereby empowering them. ”*

It is a welcome sign that there is growing realization in the Government that rural development, in all its aspects, is crucial for sustained economic growth and for bridging the urban-rural divide. A higher rate of growth in the primary sector on a sustained basis will significantly alter the rural scenario and strengthen the linkage with the other sectors.

A strategy of economic growth with social attainments is necessary to ensure enhanced quality of life. Such a strategy pre-supposes a two pronged attack on poverty through (a) economic growth, and (b) State involvement. The latter calls for the active participation of the State in employment generation, anti-poverty programmes, access to education and health, and social security for the aged.

The Millenium Development Goals 2000 have set international standards to be achieved by 2015. These include:

(1) Eradication of extreme poverty and hunger, by halving the proportion of people living on less than $1 a day and of people suffering from hunger;

(2) Achieving universal primary education;

(3) Promoting gender equality and empowerment;

(4) Reducing infant mortality by two-thirds;

(5) Reducing maternal mortality;

(6) Combating HIV/AIDS, malaria and other diseases;

(7) Ensuring environmental sustainability which includes safe drinking water and improvement in the lives of slum dwellers.

These goals involve financial outlay. It is not as though India has not been spending and investing in the social sector. However considering the magnitude of our problems, our expenditure on social services is far from adequate. Witness India's performance with reference to social sector expenditure. (See Table 1 alongside)

"There is urgent need for improving the delivery system of public services, by ensuring cost efficiency and effectiveness."

Table 1

Composition of the Social Sector Expenditure of Central and State Governments

	1995-96	2001-02	2002-03
As percentage of GDP:			
Total expenditure	24.2	29.5	29.6
Social services	4.9	6.5	6.2
Education	2.7	3.1	3.1
Health	1	1.4	1.4
Others	1.2	2.0	1.8
As percentage of total expenditure			
Social services	20.4	22.0	20.9
Education	11.3	10.5	10.3
Health	4.3	4.8	4.6
Others	4.8	6.7	6.0
As percentage of expenditure on social services			
Education	55	48	49
Health	21	22	22
Others	24	31	29

Note:

1. 'Health' includes Medical, Public Health, Family Welfare, Water Supply and Sanitation
2. 'Others' includes other Social Services except Education and Health.

Source: RBI Annual Reports.

Social services expenditure over the years in relation to GDP ranged from 4.9 per cent (1995-96) to 6.5 per cent (2001-02). The fluctuations indicate the fiscal constraints of the Governments and the consequential relatively low priority accorded to social services. Of the expenditure on social services, education received around 3 per cent, against the desired rate of 6 per cent. Health received even less importance, with expenditure levels less than 1.5% of GDP.

An analysis of the available data on social services expenditure brings out the following:

Social sector development must be judged not by financial outlays alone, but by their outcome.

Large outlays and allocations to social sector services do not reach the beneficiaries in full, because of leakages in transmission.

There is urgent need for improving the delivery system of public services, by ensuring cost efficiency and effectiveness.

Social services fall in the realm of local bodies and are best left to them, with financial resources made available by the Centre and the states.

Wide variations in the delivery systems among states and within a state have led to differing levels of performance.

A system of monitoring has to be put in place to ensure proper utilization of resources.

Public Health Care

The total expenditure of the Centre and the States on health services as percentage of GDP has been less than 1.5 per cent, over the last fifteen years. This level of expenditure is woefully inadequate to provide, both, preventive and curative health care to the poor particularly in the rural areas. Even this meagre expenditure on public health has not been effectively used with the result that the quality and delivery of health services are far below accepted standards. The existing public health system needs comprehensive revamping and overhauling, both in terms of utilization of financial and human resources.

The National Health Policy (NHP) 2002 has laid down the goals for health care up to 2015. These include:

(a) Expanding and improving health care facilities

(b) Restructuring the public health system to facilitate more equitable access to health care

(c) Better coordination among government, private sector, voluntary NGOs and other civic institutions.

Despite marked achievements by India in human development over the decades in regard to life expectancy, mortality, infant mortality, to name just a few, we are still far behind international standards in health status. In terms of UNDP's Human Development Index, India was ranked 124 among 173 countries in the year 2000, compared to 115 among 162 countries in the previous year. This underlines the magnitude of the problem.

In spite of considerable investment in Primary Health Centres (PHCs) by the Government, most of the centres are not meeting the basic needs of the population. Inadequate infrastructure, lack of basic equipment, absence of doctors and lack of accountability have made these institutions ineffective. Meeting the basic health needs of all and ensuring prompt delivery of services are issues that require not only policy pronouncements but also long term commitment and willingness to bring about major changes in health and development strategies. What is to be kept in mind is that for most rural poor, private health care facilities are beyond their means.

The Liberal position on PHCs is clear and unambiguous: There has to be growing participation of the private sector, including civil society, in strategising the role of PHCs in evolving an alternative model of public-private partnership. In such an arrangement, government provides the funds and the private sector provides supply management in the operation of PHCs. Such a partnership will enable the PHCs overcome the shortage of doctors and the disinclination of experienced doctors to work in rural areas. Private hospitals, being innovative, will induce doctors to offer their services for primary health care. What also needs to be examined is the introduction of a public health insurance scheme for the poor and delegating the responsibility of managing and supervising it to appropriate autonomous institutions.

> *"The Liberal Position on Primary Health Centres is clear and unambiguous: There has to be growing participation of the private sector, including civil society, in strategising the role PHCs involving an alternative model of public-private partnership."*

Primary Education

Liberals recognise the importance of the 93rd Constitutional Amendment (2002) to achieve the goal of "Education for All" by making free and compulsory elementary education a fundamental right for children in the age group of 6-14 years. This is a significant initiative. Following this, the Central Government, in partnership with the states, launched the Sarva Shiksha Abhiyan How effectively this initiative will be implemented, needs to be monitored.

The total expenditure on education has been less than 4 percent of GDP, as against the goal of 6 percent of GDP. Even this allocation gets dispersed over different layers of education – technical, engineering, management, universities, and other levels of higher education at the expense of primary education, as set out in the NCMP. Even if the level of literacy has improved from 18.3 percent in 1951 to 65.4 percent in 2001, this increase is not uniform across all Indian states.. The fact that as many as 360 million Indians cannot read or write is a tragic commentary on India's concern for social justice.

Since primary education is the stepping stone for higher education and career advancement, the government has to give high priority to it. What ails primary education in government schools are lack of proper infrastructure and poor quality of teaching. Primary education has to be given its due recognition by expanding access, raising learning standards and reducing gaps in education cutting cross states and gender. This will involve a strategy to increase the level of literacy and enrolment, reduce drop out rates and improve the quality of education.

Given the fact that primary education in public schools has failed to deliver quality education the Liberal Budget recommends :

- Free and compulsory quality education for all children for at least eight years;
- Increase in public expenditure from 4% of GDP to 6 per cent of GDP, with a substantial proportion (4% of GDP) for school education.
- Creating an independent regulatory authority both at the Centre and the states and, for this purpose, constituting an Expert Commission to formulate a supervisory mechanism to monitor the delivery of education in schools.

❝ The Liberal Position is that poverty cannot be alleviated merely by throwing money at the poor. Any sustained poverty alleviation programme requires the augmenting of the capabilities of the poor and thereby empowering them. ❞

Indicative Estimates of Expenditure

Indicative estimates of expenditure on health and education are given in Table 2 (Please see alongside). The Liberal position agrees with the NCMP that the current levels of expenditure on health and education at 1.5% and 3 % of GDP respectively should be doubled in the next five years. The following table indicates the absolute levels of expenditure, assuming a projected increase in GDP at market prices of 12% per annum.

What needs to be considered are also the annual incremental requirements of resource mobilisation to meet the estimated levels of expenditure given earlier. See Table 3

Table 2

Expenditure on Health and Education

(Rs. crores)

Year	GDP At current Market prices	Health	Education	Health+ Education
2005-06	3,528,500	70,570 (2.0)	1,23,497 (3.5)	1,94,067 (5.5)
2006-07	4,004,800	1,00,120 (2.5)	1,60,192 (4.0)	2,60,312 (6.5)
2007-08	4,485,376	1,34,561 (3.0)	2,04,085 ((4.5)	3,38,646 (7.5)
2008-09	5,023,621	1,50,709 (3.0)	2,76,299 (5.5)	4,27,008 (8.5)
2009-10	5,626,456	1,68,793 (3.0)	3,37,587 (6.0)	5,06,380 (9.0)

Note: Figures in brackets are percentages to GDP.

Table 3

Incremental Resource Requirements

(Rs. crores)

Year	Health	Education	Health + Education
2005-06	23,727	26,687	50,414
2006-07	29,550	36,695	66,245
2007-08	34,441	43,893	78,334
2008-09	16,148	72,214	88,362
2009-10	18,084	61,288	79,372

The following salient points emerge from the above tables:

- The incremental requirements are seen to be enormous and will certainly strain the revenue-generating capabilities of the governments at the Centre and the states.
- The current allocation of 4.5% of GDP on education and health needs to form the bases for future increments.
- Possible avenues for raising incremental revenues are proceeds from the disinvestment of PSUs as well as re-allocation of expenditure on subsidies from the better-off sections of society to the social sector.

- Even disinvestment receipts as high as Rs.30,000 crores and Rs.5,000 crores garnered from savings in misdirected subsidies will not be adequate to meet the incremental requirements even for 2005-06. This shortfall is likely to increase over the years.
- The recommendations of the Kelkar Task Force (which are discussed later in this document) if implemented, are also likely to increase tax collections substantially which could help fund social sector initiatives.
- A comprehensive health insurance scheme for the poor should be developed wherein service delivery could be in the hands of private providers as well as NPOs (Not for Profit Organisations).

Delivery of Public Services

The importance of the delivery of public services is being rediscovered. Over the fifty years of Indian development, awareness of the need for efficient and effective delivery of public services has surfaced intermittently but has not been followed zealously. A comprehensive and diagnostic view of the process of delivery has not been taken. Much of the conventional view of delivery has been confined to the problems of corruption and political interference and to the observation that only a fraction of the public expenditure reaches the beneficiaries. It has also been recognized that there is often a rush of expenditure at the end of a financial year and that spending the allotted amounts does not necessarily amount to effective delivery. More recently, attention has been called to the issues of accountability of the delivery agents and the need for transparency and information.

Valuable as these points are, it is necessary to remember that the subject of delivery of public services straddles the areas of fiscal management, policy and programme frameworks, timely and adequate transfers of funds, the capability and motivation of the delivery agents, the viewpoint of the beneficiary, evaluation and feedback and several other relevant considerations. It is necessary to view delivery as a process involving a chain of events and persons to identify the weak links. What follows is an attempt to provide a general overall view, which can be adapted to various services and sectors.

At the top of the chain is the triangle of policy, programmes and funding, whether by the Central or state governments. There has to be a well defined policy, a set of viable programmes and funding. The programmes must be well thought out and viable in terms of implementation, relevance and effectiveness but not too rigid to prevent local flexibility. The emphasis must be on outputs. The funding has to be adequate and assured for a period of years. Provisions must be made for carrying over unutilized funds from one financial year to the next.

“ Much of the conventional view of delivery has been confined to the problems of corruption and political interference and to the observation that only a fraction of the public expenditure reaches the beneficiaries. It has also been recognized that there is often a rush of expenditure at the end of a financial year and that spending the allotted amounts does not necessarily amount to effective delivery. ”

The flow of funds from the Central or state government to the implementing departments, local bodies or NGO's must be timely and adequate. The reporting from below must be output based and not limited to expenditure figures.

The real action starts with the delivery agent, whether an institution and/or individual as clearly seen in the following flow chart (Please see page 26).

The pricing of services can be a vexed issue, because the common man is by and large accustomed to several free services. Appropriate solutions have to be found for each type of service including some element of subsidisation though the element of subsidy should be explicitly stated.

Good delivery practices are a mark of good governance.◆

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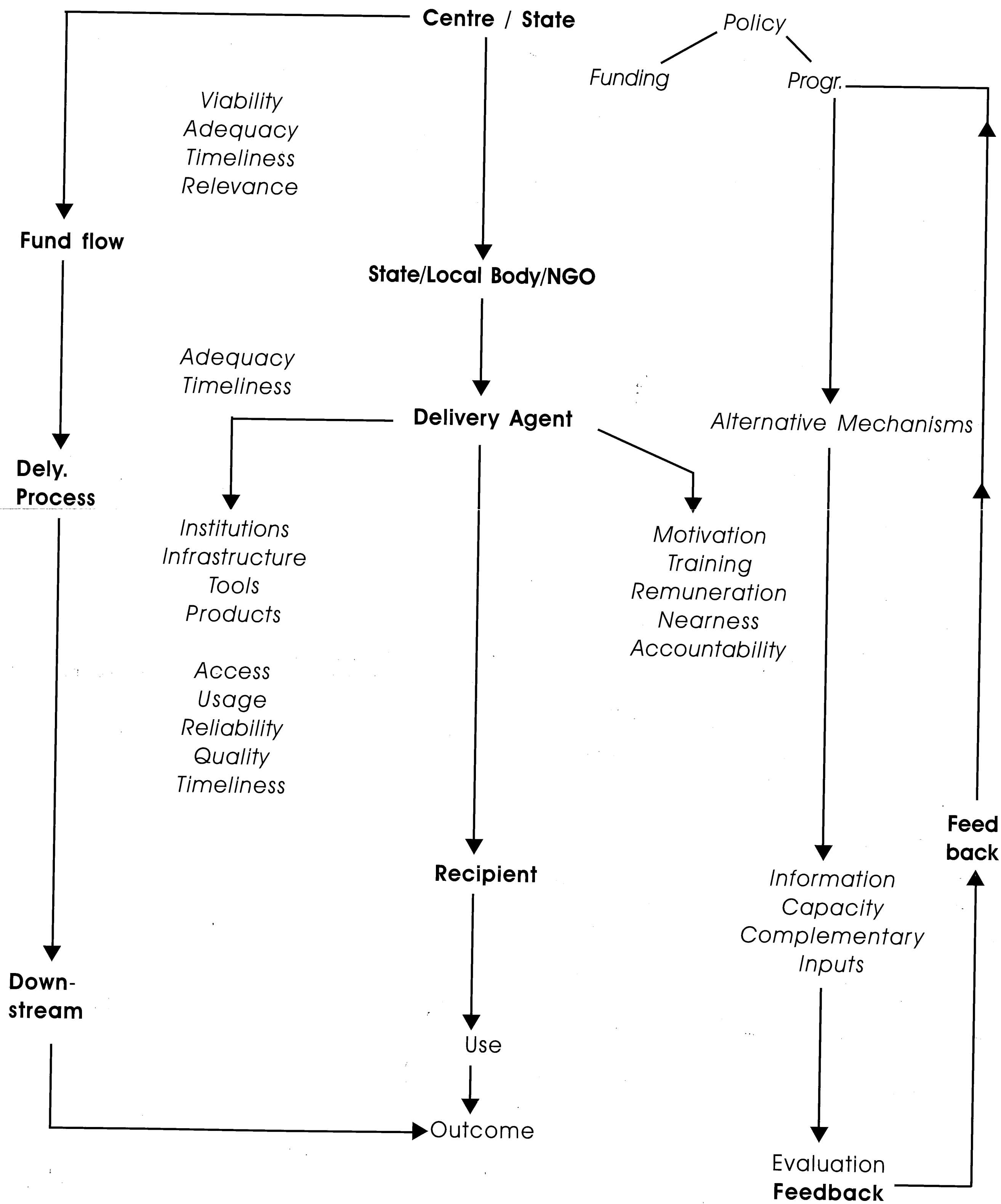
DELIVERY OF PUBLIC SERVICES: A FLOW DIAGRAM



Chapter 3

Administrative and Expenditure Reforms

I. ADMINISTRATIVE REFORMS

This Chapter seeks to examine two aspects of Government, namely, staffing and expenditure patterns and propose changes where necessary. The yardstick for this assessment comprises the two basic tenets enunciated in the Liberal Budget document of June 2004 – one, the Government must move towards a lean, supportive, regulatory regime and two, the Government should take responsibility to secure a substantial improvement in the quality of life of the common man.

The total staff strength of the 'general' Government - Central and state governments, all parastatals and other institutions fully funded/controlled by government - is over 2 crores compared to less then 80 lakhs in the organised private sector.

This total staff strength of over 2 crores can be divided into four broad categories:

(i) Ministries/Departments dealing with formulation and enforcement of the various Acts, Regulations, Rules etc.

(ii) Ministries/Departments dealing with the provision of essential/basic services as mentioned under item (iv) below as well as those administering public enterprises as mentioned under item (iii).

(iii) Public enterprises (Railways, Posts, Public Sector Undertakings, Border, LIC and General Insurance Companies etc. *et. al.*)

(iv) Organisations providing basic and essential services (Defence, Police, Health, Education, Local bodies, Civic amenities etc.)

The total staff strength of the Government of India as on 1.3.2004 is 34.49 lakhs. Excluding public enterprises (e.g. Railways, Posts, etc.), audit as well as direct and indirect tax departments, entities extending services (e.g. police and health), entities doing work in specialised areas (e.g. atomic energy and space) and the union territories, the staff strength of which will qualify as Ministries/ Departments discharging functions at items (i) and (ii) above total up to less than two lakhs. For all states and union territories taken together, the comparable number is unlikely to be more than two lakhs (illustratively, the total staff strength of the Secretariat in Tamil Nadu is only around 6000!) Thus, the staff strength involved in discharging functions (i) and (ii) above will be no more than four lakhs for the Central and state governments taken together.

> “ *The Government must move towards a lean, supportive, regulatory regime and two, the Government should take responsibility to secure a substantial improvement in the quality of life of the common man.* ”

The two functions, regulation on the one hand, and implementation of programmes and supervision of enterprises on the other, co-exist in most Ministries. For instance, the Ministry of Civil Aviation, which oversees the functioning of Indian Airlines and Air India, is also the regulator for the sector. Again the Finance Ministry which has the overall regulatory and development role for the Banking and Insurance Sectors, also discharges ownership functions over a large number of banks and insurance companies.

For reasons set out in the section on "Public Enterprises and Privatization", there will continue to be public enterprises for at least some activities in the foreseeable future, and consequently the need for supervision at ministry level. Government involvement in areas like primary education and basic health will also exist even in the long term. At the same time, from a liberal point of view, there is need to facilitate private initiatives in a steadily increasing manner in almost all sectors. For this to take place, there has to be a level playing field and this will be possible only if the regulatory functions are taken away from all those ministries, which have responsibilities for overseeing public enterprises, projects and programmes.

The first requirement for this is to have separate sets of ministries for the two sets of functions set out in (i) and (ii) above, in all areas requiring a level playing field. This will not necessitate more ministries if, as recommended by the V Pay Commission and by the Expenditure Reforms Commission, some of the existing ministries are wound up and several of the smaller, fragmented ministries are consolidated

> *"While it would be possible to effect economies in expenditure in some services and reduce staff strength in some areas, the starting point of the exercise has to be improvement in the quality of service provided."*

The second requirement is a thorough overhaul of Acts, rules, regulations and procedures so as to keep the compliance requirements to a minimum level. Most of the Acts and regulations are a relic of the colonial era when the emphasis was on control. Often the provisions are so complicated and with so many provisions, that neither the enforcer nor the persons who are to comply know the correct position.

The above suggestions would apply equally in the areas of administering projects and programmes and in overseeing enterprises. In areas like agriculture, health, education, rural development etc. where the implementation responsibility vests with the state government, there are huge parallel set-ups in the Government of India. There is an urgent need for ending this duplication of functions and operations. There is evidently considerable scope for greater delegation of authority and responsibility in the administration of projects and programmes.

The third requirement is computerisation and moving towards paperless governance. One justification for the large army of support staff is the huge mass of correspondence handled and files maintained. With the simplification of rules and regulations and shedding of unnecessary supervisory powers on the one hand and introduction of computerisation on the other, the support staff requirement will come down drastically.

The fourth requirement is the introduction of an office oriented system. This becomes feasible, once the requirements listed earlier are put in place. The hierarchy currently consists of Secretary, Special Secretary, Additional Secretary, Joint Secretary, Director, Deputy Secretary, Under Secretary and a host of support staff. Often the files initiated at the section officer level go through at least five levels. It should be stipulated that no file should go through more than three levels. These three levels could be the Secretary/Special Secretary, Additional/Joint Secretary, and Director/Deputy Secretary/Under Secretary, supported by a Section/Desk Officer with two or three Assistants each. All these officials should be fully trained in information technology.

With these arrangements the total staff requirements at the Centre and the states at the Secretariat (and their field set ups) would come down to less then 50,000, with a Group A and B personnel to Group C and D personnel ratio of no more than 1:1, compared to the present number of over 4 lakhs with a ratio of 1:4. In many ministries, Group C and D personnel is now, in fact, much in excess of 80%. This reduction can be brought about only by providing a liberal VRS scheme for all general categories of officials at all levels. While the VRS offers from Groups B, C and D officials could be accepted on a first come first accepted basis, till the required number is reached, in the case of Group A officials the right of acceptance could be reserved for the Government. This is to guard against an exodus of the more efficient officials at this level.

Restructuring of the staff strength in the public enterprises calls for a totally different approach. The total staff strength of the government and quasi-government formation under Central and state governments exceeds 90 lakhs. At the Centre alone, the number is over 50 lakhs spread over the railways, posts, central public enterprises, banking and insurance companies. One important aspect to be noted is that a reduction, substantially in excess of 10 lakhs, has already taken place in the last 13 years due to right sizing, VRS and non filling-up of retirement vacancies. The reduction in staff strength in these enterprises should take place in tandem with measures for improving operational efficiency and induction of state-of-the-art technology and increased mechanisation – this may well call for a substantial injection of funds for modernisation of managerial functions.

The last category of staff referred to above are spread over a large number of services - security (defence and police), health, education, civic amenities, local bodies, extension work in rural areas etc. The number involved would be of the order of 1.1 crores. While it would be possible to effect economies in expenditure in some services and reduce staff strength in some areas, the starting point of the exercise has to be improvement in the quality of service provided.

While the Liberal position recognises the crucial importance of defence services, this does not, however, mean that there is no scope for reducing expenditure or manpower. Since the mid-1980s free rations are provided to all service personnel in all parts of the country. This is a perquisite, possibly without a parallel anywhere in the developed countries. As in the earlier decades, this concession could be limited to those on the front line. Again the huge chain of canteen stores where consumer durables are made available, free of duties is a relic of the past and could be wound up. Today all these goods are available everywhere and tax rates have also been reduced considerably in the recent years. Further, less costly civilians could be utilised in place of high cost military trained defence personnel in many areas like the Military Engineering Service. As suggested in the case of other ministries, the feudal trappings - large complement of support staff in the office and at the residence, fleet of escort vehicles etc. now provided to top level officials - needs to be done away with.

Most other areas are of direct relevance to the common man, particularly in the rural areas, in his quest for improvement in the quality of life. Today, the number of schools in rural areas, which have teachers, but no buildings, no blackboards and no play facilities, are legion. There are any number of dispensaries and health centres which have neither doctors nor medicines nor any equipment like x-ray or lab testing facilities. In police stations, those who are to maintain law and order are a law unto themselves and honest people, particularly women, would hesitate to enter these institutions, however pressing their problems may be. Revenue offices and officers tend to be most impersonal and callous and the ordinary citizen often has to wait ages to get ration cards, or, having got the card, the ration itself! There are a host of extension services, where the personnel have a little rapport with the people concerned. Most benefits intended for the common man gets 'lost in transit'.

Services such as education, health, policing, etc. are areas that require urgent attention if the lot of the common man is to witness a marked improvement. All personnel need to be better trained, skills upgraded, and more importantly made people friendly. They need to be provided with all the facilities so that they are enabled to provide high quality service and the people feel encouraged to approach these facilities with confidence. All this will involve considerable effort, time and cost but will be well worth it, if only the end result - significant improvement in the quality of life of the common man - can be achieved quickly.

“ Revenue offices and officers tend to be most impersonal and callous and the ordinary citizen often has to wait ages to get ration cards, or, having got the card, the ration itself! ”

Thus, in this category of services, the scope for economy in expenditure and reduction in staff strength will be minimal. On the other hand, there will be need for substantial additional inputs, in the form of better training and better facilities, involving large additional expenditure. To the extent the private sector can be involved in the further expansion of the services the additional costs and operational efforts of the Government could be contained. This association of the private sector also becomes necessary for another reason, namely Government's poor track record in the last five decades.

The Liberal position is very clear. In whichever manner the delivery of services is shared, between Government, the private sector, the NGOs, and the local bodies, the overall responsibility for the achievement of the goals has to vest only with the Government if a significant improvement is to be achieved in the quality of life of the common man and that too within a period of five to ten years.

II. EXPENDITURE REFORMS

Fiscal consolidation, was, and continues to be an important element in the economic reform process launched in 1991. This was, however, seen largely as an exercise in expenditure compression. In fact, with tariff reforms resulting in a downward trend in the tax to GDP ratio, the pressures on the expenditure side got further accentuated. Thus, the movement of fiscal deficit since 1989-90[1] has been more or less in tandem with that of expenditure. The expenditure to GDP ratio witnessed a fall from 17.54 % in 89-90 to 13.98% in 1996-97, before reviving to 15.42% (2004-05, BE). The fiscal deficit moved down from 6.01% in 1989-90 to 4.12% in 1996-97 before moving to 4.20% in BE 2004-05. Considering that food, fertilisers and petroleum subsidies as also the revenue component of defense expense are all likely to end up at a much higher level than the budget provision, expenditure and fiscal deficit are likely to end up around 15.75% and 4.50% respectively this year.

> *" Some of the functions or ministries that have lost their relevance in a liberalized economy are Joint Parliamentary Committees in the steel sector, the I&B ministry and the Department of Public Enterprises In areas like Rural Development, Health and Education, where the implementation responsibility rests with the state governments. "*

Three important policy pronouncements made in recent months have major implications for the fiscal consolidation process. First, the commitment of the UPA to carry forward the reform of the economy The Liberal Budget brought out in June, 2004 - also makes a strong plea for accelerating the opening up process. Implied in this plea for 'opening up', i.e. larger space for private initiatives, is the need to bring down the fiscal deficit for the system as a whole from the present high level of over 9% of GDP for Central and state governments combined. Second, is the official recognition, in the form of an unequivocal assertion in the Fiscal Responsibility and Budget Management (FRBM) Report, that an increase in the tax to GDP ratio is an essential pre-requisite in the fiscal consolidation process. To this extent the burden on the expenditure side should get somewhat lessened. The third is the need for securing a substantial improvement in the quality of life of the common man – an aspect that has been accorded high priority in the Liberal Budget and which also forms the cornerstone of the CMP of the UPA. This will call for a substantial hike in expenditure in areas like primary education and basic health, among others. Thus, even with a sharp increase in the tax to GDP ratio, providing for such large additional outlays and also achieving a measure of fiscal consolidation, would require considerable restructuring in the existing expenditure allocations. Several clues on how this task is to be approached emerge clearly from the changes noticed in the expenditure patterns since 1989-93.

The first, and perhaps the most significant trend, is the steady and sharp fall in defense expenditure from 3.4% of GDP in 1987-88, to 3.0% in 1989-90 and to 2.2% in 1996-97. This is the level at which it would have remained in 2004-05 as well but for the doubling of the capital outlay over the previous year. In spite of this, its level is only at 2.6% of the GDP in 2004-05. It is largely the reduction in capital expenditure (barring its hike in the previous year) that accounts for the sharp fall in total defense expenditure, as a proportion of GDP. The second is the fall in the subsidy to GDP ratio from 2.11% in 1989-90 to 1.13% in 96-97, before increasing to 1.44% in 2004-05. The third is the drop in non-plan capital expenditure and loans (other than defense and loans to states and Union Territories) from 0.55% in 1989-90 to 0.16% in 2004-05. Under most items, including support to sick undertakings, there is only marginal increase in provisions over the years. The fourth item is interest payments which has witnessed a steady increase from 3.32% of the GDP in 1988-89 to 4.37% in 1996-97 before dropping to 4.15% in 2004-05 (BE). The increase in the earlier years reflects the movement away from the Government preempting a large part of banks' resources at artificially low interest rates, towards borrowings at market related rates. The sharp drop in the interest rates in the last few years, coupled with the fiscal deficit being below the GDP growth rates, has contributed to the decline in interest to GDP ratio in the last three years. The last area is "plan-capital" where the fall has been the largest – from 3.50% of the GDP in 1988-89 to 1.47% in 1995-96, though rising somewhat to 1.72% in 2004-2005.

[1] 1990-91, being the year before the commencement of the reform process, is not a suitable base for comparison purposes in view of the sharp fall in both tax receipts and total expenditure, as a proportion of GDP that year, in that year.

While there have been year to year fluctuations, there are no significant discernible trends in most other items. In other words, in this fifteen year period, there have been no sustained efforts at weeding out activities and programmes no longer necessary or, at least, do not r have to be performed by the government any longer or nor have there been efforts at better targeting of subsidies or weeding out those that have been outlived their utility. This then becomes the starting point for any meaningful expenditure reform exercise. The V Pay Commission , while recommending a hefty pay increase for all levels, had also visualized a 30 % reduction in the total staff strength. The latter was to be achieved by subjecting each and every activity undertaken by the Government – understood as a ministry or a Department or r an undertaking – to a rigid test viz. whether the activity is necessary at all; if yes, should it be done by government; – if it is, indeed, to be done by the Government, should it be done by the Government of India? The Expenditure Reforms Commission that was set up in 2000 had also identified a large number of activities, in over 30 ministries, that could well be abolished or downsized, but little or no action has been taken in the last four years.

A detailed zero-based budgeting exercise could lead to an enormous reduction in staff strength and in expenditure. For instance, if as suggested in the section on Public Enterprises and Privatisation, all loss making – non core enterprises numbering about 100 and with an employee strength of nearly 5 lakhs are closed down or privatized, then this would automatically lead to considerable downsizing in the concerned administrative ministries as well. More over, the bulk of non plan grants and loans (Rs.1574 crore in BE 2004-05) and interest subsidies (Rs.463 crores in BE 2004-05) relate only to such enterprises and, after downsizing, would not have to be provided any longer. Some of the functions or ministries that have lost their relevance in a liberalized economy are Joint Parliamentary Committees in the steel sector, the I&B ministry and the Department of Public Enterprises In areas like Rural Development, Health and Education, where the implementation responsibility rests with the state governments, it is not necessary to have large administrative ministries at the Centre as well. Likewise it would be sufficient if the Planning Commission functions more as a think tank rather than having a parallel set up in all sectors for determining in detail what each should Central ministry or the State should do.

As far as Defence is concerned, the near doubling of capital expenditure provision in 2004-05 (BE) compared to 2003-04 (RE) reflects a correction for the under-provisioning in earlier years. This trend may have to be continued for another year or two, after which capital provision, as a proportion of GDP, could be reduced by about 0.2% or so per annum. As far as revenue expenditure is concerned, the various suggestions, set out in Section1 on Administrative Reforms should, if implemented, help to contain it at a level somewhat lower than the present one. Thus, in two to three years time, it should be possible to visualise a defence expenditure to GDP ratio of no more than 2.2 to 2.3%

> “ *Debt swaps by state governments is a zero-sum game for the government system as a whole since the gains of the states result in a corresponding loss for the Centre to which the loans are repaid.* ”

Interest payments have come down from 4.37% in 1996-97 to 4.15% of GDP in 2004-05 (BE). Three factors could help to bring this percentage down even further to, say, 3% in four to five years. These factors are: continuance of the soft interest regime, which will reduce interest payments on fresh (gross) borrowings, a debt-swap scheme which will reduce interest payments on earlier borrowings, and a large positive gap between GDP growth rate and fiscal deficit. Of the three, the debt-swap may have only limited scope for the Central government, as it can be put through only if there is provision for such debt-swap in the loan agreement; if not, the penalty to be paid for such as swap could be quite high. In the case of the state governments, however, the scheme would have much greater scope. Substantial amounts have already been swapped by state governments in the last few years. However, debt swaps by state governments is a zero-sum game for the government system as a whole since the gains of the states result in a corresponding loss for the Centre to which the loans are repaid. Further, the soft interest regime, and the sustained high growth rate of, say, 8%, and reducing fiscal deficit levels will lead to a steady fall in the debt to GDP ratio. This should help to secure a reduction of at least 1% in interest payments even in the medium team.

Invoking the zero-based approach discussed earlier will allow schemes, which have lost their relevance, to be dropped. Those in the domain of the state governments should be transferred to them and all schemes that substantially overlap and address more or loss the same target groups should be integrated and made more focused. For instance, the funds required for the new guaranteed land based rural employment programme, estimated to cost about Rs.40,000 crore per annum, could be found to a large extent, by merging with this programme most of the rural development programmes, the MP's Local Area Development Scheme and the funds set apart for food and kerosene subsidies in the rural areas. Once employment is guaranteed, and sufficient family income is generated, what is necessary is easy availability of food grains and kerosene at the village level and not necessarily at a highly subsidized rate. Such an approach will help to keep to a minimum the net additional funds required for improving the quantity of services and extension of coverage in areas like security, health, education etc.

> *"While it would be possible to effect economies in expenditure in some services and reduce staff strength in some areas, the starting point of the exercise has to be improvement in the quality of service provided."*

The total subsidy expenditure (this includes explicit subsidies that figure in the Central budget as well hidden subsidies) has been placed at around 14.4% of the GDP in two studies made in the mid-1990s. The White Paper placed before the Parliament in May 1997 breaks this total down as 3.69% on merit goods and services (i.e. subsidies where the social benefits are greater than the sum of private benefits of the consumers) and 10.71% of GDP on non-merit subsidies. The White Paper argued for better targeting of subsidies, with a view to increasing efficiency and reducing wastage and for increasing recovery of charges from the then low level of 10% to at least 50%. The latter effort alone would reduce the subsidy level by 4.7%. Considering the difficulties in dismantling support systems on the one hand and also the need providing a safety-net to the weaker sections till such time as their quality of life improves, it would perhaps be appropriate to aim at a reduction in subsidies of no more than 1% per annum during the next five years. This target is to be achieved through a combination of increase in user charges and better targeting of direct subsidies.

III. PUBLIC ENTERPRISES AND PRIVATISATION

Public enterprises in India cover a wide spectrum in terms of size - employment and turnover, - profitability, range of activities and patterns of ownership and control. At one end are the Railways and Posts, the two largest enterprises in terms of employment (14.56 lakhs and 5.60 lakhs, respectively) which are directly 'administered' by the government through the Ministry of Railways and the Department of Posts. The State Electricity Boards would also fall in this category. At the other end are numerous sugar and spinning mills in different states, in the co-operative sector, but directly 'managed' by the state government through their official chief executives. In between, there are a very large number of undertakings, many set up *ab initio* by the government (of the Centre and the states) and quite a few nationalised/acquired undertakings. The total employment in these enterprises, at around 90 lakhs exceeds the total employment in the organized private sector.

Some idea of the performance of, as well as the issues involved in, these numerous enterprises can be gained by looking at the data for the 227 enterprises covered by the Public Enterprises Survey (2002-03). In the year 2002-2003, these 227 enterprises, with a total equity of Rs.102,108 crores and a total investment of Rs.320,036 crores had a total turnover of Rs.544,390 crores and a total employment of 19,22,472. While 12 cognate groups recorded a total profit of Rs.25,461 crores, 9 cognate groups recorded a loss of Rs.6,678 crores. Some of the important points that emerge from the Survey are set out below:

- First, the total investment of nearly Rs.300,000 crores in these enterprises (excluding that in BSNL, for comparison purposes) represents a three-fold increase over the investment of Rs.99,329 crores as on 31.3.1990 i.e. the year before the economic reform process started.
- Second, of the total turnover of Rs.544,390 crores, four companies in the petroleum sector accounted for over 58 per cent (Rs.317,883 crores).
- Third, out of the total profit of Rs.43,085 crores

recorded by 118 enterprises, just 10 enterprises (e.g. ONGC, IOC, NTPC, and 7 others) accounted for Rs.29,951 crores or nearly 70 per cent of the total profits.

- Fourth, 107 enterprises, incurred a total loss of Rs.10,994 crores. Of these 95 were in 13 cognate groups such as Minerals and Metals, Fertilizers, Chemicals and Pharmaceuticals; Heavy Engineering, etc. None of these enterprises can be termed as falling in areas that can be considered to be of strategic importance. Of the 33 units taken over from the private sector, 28 incurred losses totalling Rs.2,306 crores while five earned a profit of Rs.87 crores.
- Fifth, of the 107 loss-making enterprises, 68 enterprises in which the net worth has become negative, had been registered with the Board for Industrial and Financial Reconstruction. Winding up notices have been issued to 9 enterprises while for 20 more winding up has been recommended.
- Sixth, action for disinvestment in public enterprises was initiated as part of the economic reforms process launched in June 1991. While till 1999 disinvestment took the form of sale of minority share in small lots in select undertakings, in 1999 was started the process of strategic sale. Up to the end of 2003-04, a sum of Rs.30,823 crores has been realised by way of sale of shares, in part or in whole, in 48 enterprises.

The Liberal position, which is well-known, is that the business of the Government is governance and not business. The Government should have but a limited role in the area of business, that of ensuing a level playing field through a lean regulatory mechanism. But since, as of today, public enterprises have a dominant share in all strategic areas, and also account for more than half the universe of enterprises, it would not be feasible (even though desirable) that government should disinvest all its enterprises. This document, therefore, recommends the adoption of the strategy outlined below:

- First, having regard to the need for providing increasingly larger space for the private sector, and also the large pre-emption of resources for the public sector that has taken place even after 1990, there should be a total ban on setting up new enterprises. The only exceptions could be in the area of national security e.g. Atomic Energy, Space and areas catering to critical defence requirements. Even in such cases, the new enterprises should be set up only after a full debate in Parliament.
- Second, only enterprises such as Indian Rare Earths and Uranium Corporation Hindustan Aeronautics, and Konkan Railway Corporation could be considered to be of strategic importance in view of their size or importance to the economy. Fresh investments may be permitted only in these enterprises and that too after exploring the possibility of getting the requirements met through the private sector. In such cases, funds could also be raised directly through initial public offers of a small portion of the share capital of the company wherever possible. Every such investment should be subject to discussion in Parliament.

“Having regard to the need for providing increasingly larger space for the private sector, and also the large pre-emption of resources for the public sector that has taken place even after 1990, there should be a total ban on setting up new enterprises.”

- Third, of the other enterprises, those that are incurring losses, including those referred to the BIFR should be fully disinvested forthwith, with the Government taking full responsibility for meeting the VRS requirements of all the employees from the disinvestment proceeds (or from the Budget, should there be a shortfall).
- Fourth, the non-core, profit making enterprises may be continued in the short run in the public sector so long as these are operated efficiently and profitably.
- Fifth, in the core sector, the enterprises should be encouraged to take in strategic partners – domestic or foreign – so as to bring in state-of-the-art technology, and/or improved management methods, and/or fresh capital, either in the enterprise itself or at the unit level. This suggestion will apply to the public enterprises in the banking and insurance sectors as well.
- Sixth, in Railways and Posts, which may continue to be in the public sector for more some time, unbundling on the lines adopted in the State Electricity Boards should be undertaken.
- Seventh, the suggestion given above in respect of the Central Sector enterprises would apply with equal force to those in the state, joint or cooperative sectors.
- Eighth, while very few exceptional and core sector

enterprises would continue to exist in the public sector, all steps need to be taken to encourage private initiatives in a big way. Towards this end, the function of regulation, which will also include provision of level playing fields, will have to be taken away from the Ministries administering the public enterprises and entrusted to new Ministries. To illustrate, the Ministry for Regulation in the Civil Aviation sector should be different from that overseeing Air India, Indian Airlines etc. The ministers and the staff required for the new functions can be found by merging many of the small, fragmented Ministries and by downsizing some of the large Ministries which are merely replicating the functions which are being performed at the state level.

" ... the Liberal Budget will signal the exit of government investment in PSUs. In doing this, the test is not whether a PSU is making profits or losses, but, whether the State is required to provide those goods or services. "

- Ninth, the practice of providing budget support to public enterprises in the form of interest and other subsidies, as well as non-plan grants and loans should be phased out over a two year period. The Postal deficit and subsidy to Railways for dividend and other concessions would also come under this category. The total provision for this purposes in the current year's budget is as much as Rs.5,000 crores.

The net proceeds realised from the disinvestment process should be earmarked for improving the quality of life for the common man in areas like elementary education, basic health care and civic amenities, thus reducing the needs for raising additional resources for this purpose. It is interesting to note that this suggestion has already been mooted by the UPA government as a way of appeasing the 'left' parties which has shown a pathological aversion to any form of disinvestment.

Government investment in PSUs has proven to be a huge drain on resources. Over the years, a total of Rs.3,24,632 crores has been sunk into 240 central PSUs. However, the net profit to capital employed ratio has rarely been more than 5 per cent. Privatisation seems to be the only way of imparting efficiency to these PSUs. Since the Liberal credo is that the business of government is governance, not business, the Liberal Budget will signal the exit of government investment in PSUs. In doing this, the test is not whether a PSU is making profits or losses, but, whether the State is required to provide those goods or services.

Currently, only 35 PSUs have been identified for privatisation. However, a Liberal State should put up PSUs in the non-strategic sectors for privatization within the next three years. An indicative list of public sector companies which maybe privatised immediately is given in the appendix to this Chapter. Apart from ensuring that the tax payers' money is no longer wasted on these PSUs, the sale of government equity will also bring in much needed revenues into the exchequer.

The process should be speeded up substantially and extended to state-level public sector enterprises as well. While privatizing a PSU, care should be taken to ensure that the process is completely transparent and free from political interference and corporate lobbying. Also, there should be safeguards to ensure that a public sector monopoly is not replaced by a private sector monopoly. The best way to do this would be to open up all sectors to competition. Where this is not possible or may take time, privatization should be preceded by a strong independent regulator.

To sum up, the Liberal Budget 2005-06 envisions a comprehensive review and evaluation of administrative and expenditure reforms as well as of the central public sector enterprises. All this strengthens the Liberal viewpoint of really redefining the role of the State and releasing the energies, enterprise and initiatives of the private sector!◆

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Appendix

Public Sector Units which need to be privatised

(Rs. In Lakhs)

Sr.No.	Name Of The Company	Pre-Tax Profit	PBIT
1	Cotton Corpn. of India Ltd.	-116631	1331
2	J & K Mineral Development Corporation Ltd	-105890	-88
3	Orissa Drugs & Chemicals Ltd.	-65278	-54
4	Utkal Ashok Hotel Corpn. Ltd.	-50713	-66
5	Railtel Corporation India Ltd.	-40815	-116
6	Manipur State Drugs & Pharmaceutical Ltd	-38539	-21
7	North Eastern Handicrafts & Handloom Dev. Corpn	-37667	-181
8	Mishra Dhatu Nigam Ltd.	-35433	-210
9	Tungabhadra Steel Products Ltd.	-33878	125
10	Sambhar Salts Ltd.	-32996	-104
11	Hindustan Salts Ltd.	-32298	-43
12	Central Electronics Ltd.	-29275	-14
13	Maharashtra Antibiotics & Pharmaceuticals Ltd.	-28773	-230
14	Bharat Leather Corpn. Ltd.	-27636	-51
15	Hindustan Antibiotics Ltd.	-25631	1741
16	Tea Trading Corpn. of India Ltd.	-24993	-219
17	BBJ Construction Company Ltd.	-24008	296
18	Birds, Jute & Exports Ltd.	-21536	-114
19	Hindustan Fluorocarbons Limited	-21003	-35
20	India Tourism Dev. Corpn. Ltd.	-19656	-465
21	Bharat Wagon & Engg. Co. Ltd.	-18223	-202
22	HMT Chinar Watches Ltd,	-17382	-15
23	Andaman & Nicobar Isl. Forest & Plant . Dev . Corp .	-15353	-635
24	National Film Dev. Corpn. Ltd.	-14770	-650
25	Hindustan Newsprint Ltd.	-13914	-642
26	State Farms Corporation Of India Ltd.	-13635	684
27	Biecco Lawrie Ltd.	-12187	-731
28	Hindustan Prefab Ltd.	-11419	-599
29	National Instruments Ltd.	-11292	-1117
30	Triveni Structurals Ltd.	-10217	-577
31	Smith Stani Street & Pharmaceuticals Ltd.	-9071	-521
32	Bharat Pumps & Compressors Ltd.	-8260	-556
33	Nagaland Pulp & Paper Company Ltd.	-8129	-577
34	National Small Industries Corpn. Ltd.	-7450	553
35	Hindustan Insecticides Ltd.	-7374	-820
36	Tyre Corporation Of India Ltd.	-7083	4560
37	E T & T Ltd.	-6778	225
38	Bharat Immunological & Biologicals Corp. Ltd.	-6627	-290
39	Mineral Exploration Corpn. Ltd.	-6052	-964
40	NTC (Tamilnadu & Pondicherry) Ltd.	-5574	-219
41	Semi-Conductor Complex Ltd.	-5089	-1809
42	Bengal Immunity Ltd.	-5010	-773
43	Hooghly Dock And Port Engineers Ltd.	-4431	-11
44	Richardson & Cruddas (1972) Ltd.	-4312	-1436
45	Instrumentation Ltd.	-3947	-1240
46	Mazagon Dock Ltd.	-3769	-2572
47	Brahmaputra Valley Fertilizer Corpn.	-3759	-1824
48	Braithwaite & Co. Ltd.	-3750	-2827
49	Hindustan Vegetable Oils Corpn. Ltd.	-3566	-1347
50	HMT Ltd.	-3401	-2304

Appendix

Public Sector Units which need to be privatised (cont'd.)

(Rs. In Lakhs)

Sr.No.	Name Of The Company	Pre-Tax Profit	PBIT
51	Hotel Corpn. Of India Ltd.	-3392	-3071
52	Praga Tools Ltd.	-3355	-1404
53	Projects & Development India Ltd.	-3206	-2422
54	Bharat. Ophthalmic Glass Ltd.	-3089	-1567
55	Central Inland Water Transport Corpn. Ltd.	-2918	-2238
56	Hindustan Organic Chemicals Ltd.	-2819	207
57	Jute Corpn. of India Ltd.	-2430	762
58	Jessop & Co. Ltd.	-1876	-395
59	NEPA Ltd.	-1809	-3554
60	National Projects Construction Corpn. Ltd.	-1765	-1600
61	Andrew Yule & Company Ltd.	-1758	-3938
62	National Textile Corpn. (Holding Co.) Ltd.	-1748	64396
63	NTC (Delhi, Punjab & Rajasthan) Ltd.	-1709	-3137
64	Mecon Ltd.	-1691	-5950
65	Burn Standard Company Ltd.	-1548	-3134
66	Bharat Refractories Ltd.	-1295	-6625
67	Airline Allied Services Ltd.	-1294	-8129
68	State Trading Corpn. Of India Ltd.	-1292	-7742
69	Rashtriya Chemicals And Fertilizers Ltd.	-1290	-4222
70	HMT Machine Tools Ltd.	-1223	-5565
71	HMT Watches Ltd.	-1216	-7429
72	Pyrites, Phosphates & Chemicals Ltd.	-1101	-5710
73	NTC (West Bengal, Assam, Bihar & Orissa) Ltd.	-800	-4516
74	Hindustan Steel Works Costn. Ltd.	-755	-12076
75	NTC (A. Pradesh, Karnataka, Kerala & Mah.) Ltd.	-658	-8169
76	Hindustan Copper Ltd.	-639	-8813
77	NTC (South Maharashtra) Ltd.	-631	-3617
78	Heavy Engineering Corpn. Ltd.	-571	-10583
79	Indian Iron & Steel Co. Ltd.	-531	-17190
80	Indian Airlines Ltd.	-459	-9185
81	NTC (Madhya Pradesh) Ltd.	-447	-14113
82	Cement Corpn. of India Ltd.	-439	-4324
83	NTC (Gujarat) Ltd.	-380	-15354
84	NTC (Maharashtra North) Ltd.	-363	-10915
85	Hindustan Cables Ltd.	-310	17460
86	Indian Drugs & Pharmaceuticals Ltd.	-309	-9744
87	Fertilizers & Chemicals (Travancore) Ltd.	-298	-18049
88	Steel Authority Of India Ltd.	-280	104127
89	NTC (Uttar Pradesh) Ltd.	-266	-22788
90	Eastern Coalfields Ltd.	-263	-29651
91	National Jute Manufacturers Corporation Ltd.	-226	-14079
92	ITI Ltd.	-182	-22065
93	Hindustan Photo Films Manufacturing Corpn. Ltd.	-167	-4890
94	North Eastern Electric Power Corporation Ltd.	-116	-16556
95	Bharat Coking Coal Ltd.	-111	-40602
96	Mangalore Refinery & Petrochemicals Ltd.	-105	-8571
97	Hindustan Fertilizer Corpn. Ltd.	-88	-35172
98	Fertilizer Corpn. of India Ltd.	-83	-21227

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Chapter 4

Tax Reforms and Tax Administration

Reiterating the Basic Liberal Position

The Liberal Budget 2005-06 strongly contends that expenditure and administrative reform should be accompanied by consistent initiatives towards tax reforms and simplification of tax administration. India needs to raise its present inadequate tax to GDP ratio and mobilise increased tax revenues to finance public spending in essential areas. While doing so, it reiterates the basic principles and objectives of tax reforms and tax administration as stated in the earlier document released in June last year (*The Liberal Budget – Building an Equitable Society*). Rationalisation of direct and indirect tax rates, and simplification of tax administration in line with the current needs of a liberalising and competitive global economy, must continue to be accorded the highest priority.

In this context, it is, indeed, very reassuring that the Finance Minister has repeatedly proclaimed in the course of the last few months, his clear intention to push on with tax reforms. It may be worthwhile to recall his statement in the last budget speech: "I am a votary of tax reforms but it would be unwise on my part to attempt to do tax reform in a hurried or piece-meal manner. Seven months from now there will be another Budget, and there will be an occasion to visit the subject of tax reform". At the same time, it is also encouraging to note that the recommendations contained in the Kelkar Task Force Report, most of which The Liberal Budget of 2004 is already in agreement with, is being carefully evaluated by the Government.

Before setting out its specific proposals for the reform of tax policy and tax administration, the Liberal Budget 2005-06 stresses three basic principles of tax reforms:

- First, the urgency of long-term stability of tax rates and structure, involving among other things,
  - No change in direct tax rates, after the proposed changes to be effected in the forthcoming budget, at least for the next three years;
  - Unveiling of a Road Map for a well-defined rationalisation and reduction of all-inclusive domestic indirect taxes (CENVAT, the proposed State VAT, the Central Sales Tax, and the like); and
  - Eventual integration of all indirect taxes on goods and services into a General Sales Tax (or National VAT). This alone will help in aligning the domestic indirect tax structure matching comparable and competitive international levels and help promote a Common Market of India;

> *"India needs to raise its present inadequate tax to GDP ratio and mobilise increased tax revenues to finance public spending in essential areas."*

  - Clear direction of rationalisation of customs tariff so as to be in conformity with ASEAN standards, which means the peak tariff rate to be brought down to around 10 per cent over the next couple of years.

- Second, both direct and indirect tax rates have to become internationally compatible. While this will involve only moderate efforts in the area of direct tax structure, the tasks are going to be very substantive in the area of indirect taxes, if this is to be accomplished over the next two or three years.

- Third, relentless pursuit to simplify tax administration. This will involve a calibrated phasing out of the current 'exemption raj' which is manifest in numerous complex exemptions, allowances and incentives; prevention of tax evasion through transparent, efficient and assessee-friendly tax laws and tax administration; and harnessing of Information Technology to facilitate and achieve this objective.

Rates of Tax *versus* Incentives

Having said this, the Liberal position is very clear: If there are to be no tax incentives in general, the rates of tax must be significantly lower and *vice versa*. We suggest that a moderate approach to the granting of tax incentives is best suited in the present socio-economic environment. We suggest that only those incentives, which relate to the promotion of education, health, housing and savings, be retained. All other incentives such as for earning foreign exchange or for exports, backward area development, and the like as well to authors and sportsmen, most of which have lapsed need not retained

Undoubtedly, with the elimination of many such incentives, the overall tax rates have to be rationalised and reduced. Further, to bring simplicity in the tax structure, the Liberal Budget suggests:

> *"The Liberal position is very clear: If there are to be no tax incentives in general, the rates of tax must be significantly lower and vice versa."*

- First, no surcharge and cess, like education cess, be levied and the basic rate must absorb any such incidence of various surcharges and cesses;
- Second, in any case, such surcharge / cess should not be made applicable on tax rates of TDS to avoid cumbersome effective rates; for example, rates of tax like 1.0455, 5.2275, etc that are currently prevalent;
- Last, in any case, there should be no hikes in rates retrospectively. Illustratively, this year in the month of November 2004, rates of TDS etc. have been enhanced by introduction of education cess with effect from 1st April, 2004.

Further, the present Income-tax Law has created many distortions in the computation of income. Ideally, any businessman or tax assessee wants only the real income to be considered as income subject to tax. While it may not be practical to eliminate completely all differences between taxable income and book income (real income), every effort needs to be made to match the two. The Liberal Budget proposes the following specific changes in this direction:

1. Depreciation allowance under the income-tax law to be harmonised with the same under the Companies Act.
2. If any incentive-depreciation is to be granted, the same will be on the condition that it is correctly provided in the books of account.
3. Provisions of section 115JB, Minimum Alternate Tax (MAT) to be deleted.
4. Carry forward of losses and depreciation to be merged together, and to be treated on par and allowed to be set-off indefinitely.
5. Both set-off in any year and carry forward in a subsequent year and set-off, should not be compartmentalised on the basis of heads of income, but be treated as a single block. However, items such as speculation loss or any similar item, as an exception to the general rule, to be treated differently.

In order to make operation and management of the tax-system simple both for the tax-collector and taxpayer and to reduce compliance cost, the Liberal Budget suggests the extension of the concept of presumptive tax to many items of income. At present, such provisions in respect of income of the residents (so described under the Income Tax Act) are limited to:

(a) Computing profits and gains of business of civil construction, etc.;

(b) Computing profits and gains of business of plying, hiring or leasing goods carriages; and

(c) Computing profits and gains of retail business

The Liberal Budget suggests that a similar provision for computing income in case of different professions will have to be enacted at the earliest, and then extended to (a) wholesale business, (b) small scale undertakings, (c) various service provides like caterers, commission agents, beauty parlours, interior decorators, fashion designers and so on.

Further, without prejudice to the above, we suggest that a combination of actuals and presumptive bases will be tried in some cases as an experiment. Under this system, only gross-profit will have to be computed on actual basis, and all overheads be allowed on presumptive basis. The advantage of this scheme is that the tax officer will only have to verify items related to determination of gross profit such as sales, purchases, wages etc., and all the effort required to verify the genuineness of overhead expenditure will get eliminated, and so also consequent litigation that may arise. This will also help reduce, or eliminate altogether, unethical practices such as inflating overheads to reduce income.

The Liberal Budget has also evaluated the prospect of expanding the tax net to lower income levels without causing any major dislocation or pain to such tax-payers. For example, the Finance Minister in his last budget speech, while making a proposal to give rebate of full tax when total income is upto Rs.100,000, said: "Out of nearly 3.4 crore persons filing income tax returns, only 2.7 crore assesses are taxpayers. My proposal will give relief to 1.4 crore assessees". Thus, from 3.4 crore tax return filers only 1.3 crore will be tax-paying assessees, the balance 2.1 crore will pay no tax, but shall file a return of income.

The Liberal Budget suggests that the Government may consider it necessary that all persons covered under "one-by-six" scheme having income below the threshold limit (currently Rs.50,000) and all individuals having income between Rs.50,000 to Rs.100,000 under the new provisions of section 88D though may not have to pay any tax, they will have to file their return of income. Similarly, even a company that has no taxable income will be required to file its return of income. This is also applicable to charitable trusts, and the like who have taxable income. We estimate that such number could be not less than 3 crores as many covered under these provisions have not been filing returns. Such number shall continue to increase rapidly with India's economic progress, as is evident from the progressive growth of commercial and residential houses, cars and mobile telephone users.

We believe that such large number of return-filers cause considerable burden on the tax administration, and drains financial resources of the Tax Department. Yet we do believe that it is in the interest of revenue to have mandatory requirements of filing of such returns.

In fact, we suggest that the "one-by-six" scheme should be further extended to cover all those who are carrying on any activity of business to earn income, whether he is a road-side hawker in the metro cities or a member of any trade-union or holds any registration to carry on his activity however small with any authority, such as under Service Tax, Sales Tax, Shops and Establishments Act, etc.

Hence, to boost tax revenue as well as to instill a spirit of contributing some tax to the national exchequer in the case of tax return filers, we suggest that all such individuals and HUFs return-filers will be required to pay a modest tax of, say, Rs.1,000 per year. It may be presumed that the income of such class of tax returns filers is: (a) Rs.101,000 in case of individual; and (b) Rs.60,000, in case of HUF. We estimate that this proposal will bring in revenue of about Rs. 3,000 crores, and make all who are covered under this scheme proud citizens.

We are aware that the Finance Act, 1992 had brought the scheme under which a tax of Rs.1,400 per annum was payable to simplify the provisions for certain small-income earners. The scheme was, however, omitted with effect from April 1, 1998. We are of the opinion that that omission was because of improper administration of the scheme rather than any inherent demerit. The scheme suggested in the Liberal Budget above will not only serve the purpose envisaged for "one-by-six provisions" and garner revenue of Rs.3,000 crores and other attendant benefits, but also bring some unaccounted money into the main stream.

> *“While the Liberal Budget 2005-06 is in virtual agreement with the recommendations of the Kelkar Task Force Report, it is imperative to make some specific suggestions, especially on the introduction of State VAT.”*

Indirect Tax Reforms: A Word about State VAT

While the Liberal Budget 2005-06 is in virtual agreement with the recommendations of the Kelkar Task Force Report, it is imperative to make some specific suggestions, especially on the introduction of State VAT. While finalizing the tax reforms policy, we are, indeed, encouraged to see that a White Paper on State VAT has finally been released by the Empowered Committee of State Finance Ministers, constituted by the Finance Ministry. We fully endorse the broad framework of the State VAT as envisaged in the White Paper, and suggest that it be implemented without any further delay, with effect from April 1, 2005.

In his last budget speech, the Finance Minister sought to give comfort to the States by stating that he proposes to evolve a formula of compensation to them by determining the loss of revenue, if any, as a result of implementation of the State VAT. In this context, the Liberal Budget suggests that to ensure that the underlying objective of having uniformity of VAT laws across country is achieved, such compensation should be made on condition that similar legislation in all other states are uniform in critically specified aspects viz.:

- Definition of "Capital Goods"
- Eligibility period of purchase for allowing input credit on transitional stock
- Period during which such credit can be utilized
- Mandatory details for VAT/Retail Invoice, etc.

Such compliance by the states will help the smooth flow of business activities, especially for entities having operations across the country. More importantly, the Liberal Budget seeks to phase out the obstacle of the Central Sales Tax in the next two years by recommending that it be reduced from the present 4% to 1% immediately, and abolishing it altogether from April 2006.

> *"Rationalising and simplifying direct and indirect tax laws and bringing them in line with the current needs of a liberalising and competitive global economy is one of key objectives of the Liberal Budget."*

While on the subject of indirect taxes, the Liberal Budget is greatly concerned about the disproportionately large incidence of various domestic indirect taxes on the value of Indian manufacturing industries. Various studies have revealed that the combined burden of CENVAT (16% on most commodities), the proposed State VAT (the general rate of 12.5% on most commodities), the prevailing Central Sales Tax (14%) and various other local taxes like Entry Tax/Octroi, works out to as high as 25% to 30%, thereby making Indian industry high cost and affecting adversely, particularly manufacturing and export activities in the country by reducing their competitiveness globally.

Keeping this in view, the Liberal Budget strongly advocates the formulation of a Road Map for General Sales Tax (or integrated National VAT), combining the existing structure of CENVAT and the proposed State VAT on all goods and services, to be implemented over a period of next three to four years. Having regard to the enormity and complexity of this issue, the Liberal Budget suggests the setting up a High Power Indirect Tax Reforms Commission with participation of both the Centre and the states. In the ultimate analysis, a competitive and efficient national indirect tax system will truly promote the liberal economic environment, which is the principal objective of this Liberal Budget.

REFORM OF DIRECT & INDIRECT TAX LAWS

Rationalising and simplifying direct and indirect tax laws and bringing them in line with the current needs of a liberalising and competitive global economy is one of key objectives of the Liberal Budget. Accordingly, it sets out the following broad principles:

- First, any increase in tax revenues should be achieved not be by way of increase in tax rates, but by expanding the tax base through humane, fair, efficient, transparent and accountable tax administration and simplification of the tax laws;
- Second, tax reforms should take place through the creation of an appropriate atmosphere in tax administration, which ultimately ensures voluntary compliance of tax laws by the tax payers;
- Third, tax laws and procedures should promote speedy, efficient and fair mechanism to resolve genuine disputes in the interpretation and administration of tax laws; and
- Last, at the same time tax laws and procedures should aim at providing speedy and efficient mechanism to severely punish hardcore tax evaders on the one hand and give a fair deal to honest tax-payers, who sometimes, become victim of complex tax laws.

Tax Laws and Tax Administration – A Broad Framework

To achieve the objectives of tax reforms, certain basic parameters for making/amending tax laws and their administration have to be fixed. The Liberal Budget suggests that the tax policy must adhere strictly to the directive principles of the Constitution. The broad outline of such parameters is spelt out below.

It has been the experience in the past that tax laws are amended with a view to punish a very small proportion of defaulters. In the process, we have made tax laws very harsh and complex for the large tax paying community. This is also the main cause of complexities in the present tax laws. Therefore, tax laws should be amended bearing in mind the convenience and interests of large sections of tax-payers (and not with a view to punish a few defaulters). This will have the wholesome advantage of creating an atmosphere of trust on the one hand, and substantial reduction in corrupt practices on the other.

One of the basic tenets of a good tax policy is stability in the tax laws. This can be achieved by avoiding frequent amendments, which have made the present tax laws not only complex, but also difficult to implement in a fair manner. For this purpose, the annual exercise of amendments in the tax laws every year through the Union Budget should be given up. The annual budget and amendments to the tax laws should be de-linked. The Liberal Budget, proposes that the amendments to tax laws should be made through a separate Tax Laws (Amendment) Act, which should be enacted after a detailed public debate and after serious consideration by a Select Committee of Parliament comprising members who are conversant with the complexities in tax laws and the ground realities of the administration.

In the same manner, the Liberal Budget proposes that even the changes in tax rates could be de-linked from the Union Budget and such changes, if any, in tax rates be incorporated in the tax laws. In the event of national urgency, the law can always be amended through an appropriate ordinance. To begin with, this policy can be adopted for direct tax laws, and subsequently extended to indirect tax laws.

In the recent past, it has been the experience of the tax paying community that tax laws are amended with retrospective effect, in most cases to nullify the effects of judicial pronouncements. This has a dual effect, firstly, it creates an atmosphere of disrespect for the judiciary, which Liberals strongly consider as being deleterious in its effect on any civilized democratic country; secondly, it affects all the financial projections of the assesses, and in many cases, it adversely impact business and trade..

Also, this indirectly contributes to the creation of disrespect for tax laws, affects the basic spirit of the citizens to fight for the right cause, and breeds corruption in tax administration. In fact, this is one of the main causes for the large-scale corrupt practices prevalent in today's tax administration. Therefore, bearing in mind the long-term interest of the country, and the objective of increasing tax revenues by voluntary compliance, the Liberal Budget will not, as a policy, recommend any retrospective amendment to the tax laws, which will have an adverse effect on the tax payers. Therefore, all amendments to tax laws should be made prospective and wherever possible, there will be no retroactive effect of such amendments on the transactions entered into prior to the date of making such amendment.

The Liberal position is also guided by the basic principle that even a harsh law should be administered in a fair and humane manner, so that it does not have any adverse impact on majority of the tax paying community.

> *"It has been the experience of the tax paying community that tax laws are amended with retrospective effect, in most cases to nullify the effects of judicial pronouncements."*

This does not mean that the tax laws should be made harsh, but we mention this merely to emphasize the fact that the administration of tax laws is much more important than the tax laws *per se* from the view point of achieving the objective of mobilizing tax revenues. Accordingly, genuine reforms of tax administration are of paramount importance to provide humane, fair, efficient, and transparent tax administration with accountability. For this purpose, the Liberal Budget suggests a number of specific steps, such as:

- One, the Right to Information Act be made effective, and the tax administration required to strictly comply with the provisions of this Act;
- Two, pending implementation of the Right to Information Act, which covers a large area of government administration, appropriate provisions be made in the tax laws incorporating relevant provisions of the Right to Information Act. This will be a first step to achieve the object of transparency and accountability;
- Three, some statutory monitoring mechanism with

requisite powers independent of tax administration needs to be provided in the tax laws. Such mechanism will provide a forum to the tax paying community to approach them when they experience unfair and discriminatory treatment. Such forum will also have the power to take *suo moto* action against tax officials of the tax administration at all levels and conduct inquiry into any matter relating to tax administration. Such forum will ultimately provide for a speedy disposal of cases against erring officials and justice to honest officials who are victims of the present system. To begin with, such a forum will be created in each state

> *"Appointment of Members of the CBEC and CBDT must not be made merely on the basis of seniority. Members of such bodies should comprise of officers of very high integrity with a proven track record of being fair and efficient tax administrators."*

(to be headed by theChief Justice of the High Court in the state), which will be responsible to Parliament through the Finance Ministry (and not through the CBDT). This forum will not become a place for extension of service for tax officials as has been happening in the Settlement Commission..

- Four, appointment of Members of the CBEC and CBDT must not be made merely on the basis of seniority. Members of such bodies should comprise of officers of very high integrity with a proven track record of being fair and efficient tax administrators. There must be some strict guidelines for such appointments to be monitored by anindependent judicial forum. This is of utmost importance because this body is going to be ultimately responsible for tax administration. Indeed, the recent case of a former Chairman of CBEC who was exposed for corrupt practices ought to serve as an eye opener.

- Finally, under the existing practice, most of the amendments in the tax laws are made effective from the date on which they are notified and, in most such cases, the affected people come to know of the effective date of such amendment after the lapse of a few days. This has resulted often in the committing of unintentional defaults. Therefore, the Liberal Budget proposes that there ought to be a minimum period of about 15 to 30 days between the date of making the statutory provisions and their effective date, so that it becomes possible for the affected persons to comply with the amended tax laws.◆

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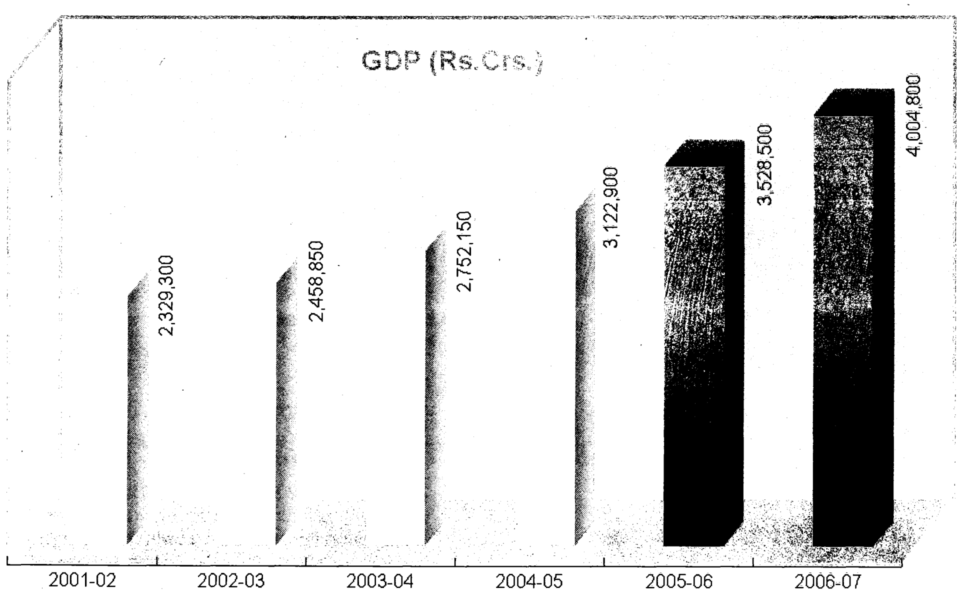
Appendix I

The Liberal Budget at a Glance

(Rs. Crores)

		2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Revised Estimate)	2004-05 (Budget Estimates)	2005-06 (Liberal Budget Estimate)	2006-07 (Liberal Budget Estimate)
1.	Revenue Receipts (2 + 3)	201,306	231,748	263,027	309,322	357,300	405,500
	(2) Tax Revenue (Net to Centre)	133,532	159,425	187,539	233,906	277,200	321,500
	(3) Non-Tax Revenue	67,774	72,323	75,488	75,416	80,100	84,000
4.	Capital Receipts (5 + 6)	162,500	182,414	211,228	168,507#	183,500	188,500
	(5) Loan Recoveries & Other Receipts	20,049	37,342**	79,125**	31,100**	60,000	70,000
	(6) Borrowings and Other Liabilities	142,451	145,072	132,103	137,407#	123,500	118,500
7.	Total Receipts (1 + 4)	363,806	414,162	474,255	477,829#	540,800	594,000
8.	Total Expenditure (9 + 10)	362,310	414,162	474,255	477,829	540,800	594,000
	(9) Revenue Expenditure	301,468	339,628	362,887	385,493	410,300	437,500
	(10) Capital Expenditure	60,842	74,535	111,368	92,336	130,500	156,500
11.	Revenue Deficit (9 - 1)	100,162	107,880	99,860	76,171	53,000	32,000
12.	Fiscal Deficit [8 - (1 + 5)]	140,955	145,072	132,103	137,407	123,500	118,500
13.	Primary Deficit @	33,495	27,268	7,548	7,907	(–) 17,650	(-) 32,000
	Deficit Ratios (%) :						
	a) Revenue Deficit to GDP	4.3	4.4	3.6	2.5	1.5	0.8
	b) Fiscal Deficit to GDP	6.1	5.9	4.8	4.4	3.5	3.0
	c) Primary Deficit to GDP	1.5	1.1	0.3	0.3	(–) 0.5	(-) 0.8
14.	Derived GDP at Current Market Prices	2,329,300	2,458,850	2,752,150	3,122,900	3,528,500	4,004,800



@ Fiscal Deficit *less* Interest Expenditure

(–) denotes generation of surplus position.

· Includes PSES' Disinvestment Proceeds

** Includes Receipts from States on account of Debt Swap Scheme

Does not include Rs.60,000 crore under Market Stabilisation Scheme, which will remain in the cash balance of the Central Govt. and will not be used for expenditure

Notes:

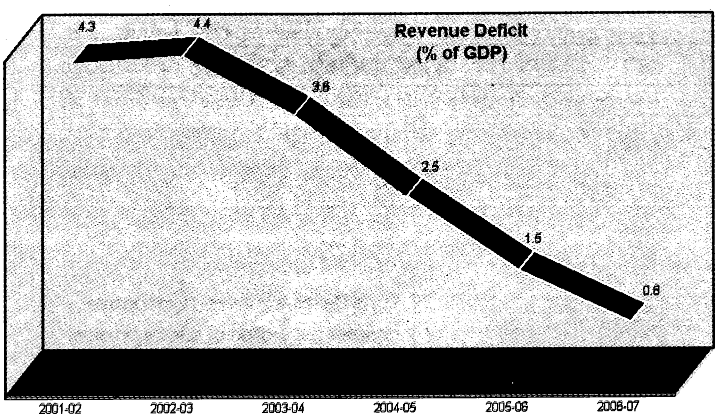
1. Figures for 2001-02, 2002-03, 2003-04 and 2004-05 are based on official budget documents of Government of India.
2. Please note that there is some discrepancy in the latest official budget document figures for 2001-02 between Total Receipts & Total Expenditure
3. Figures for 2005-06 and 2006-07 are Liberal Budget Estimates, based on various proposals set out in the text. GDP growth at current market prices are projected in nominal terms at 12 percent per annum for these two years.

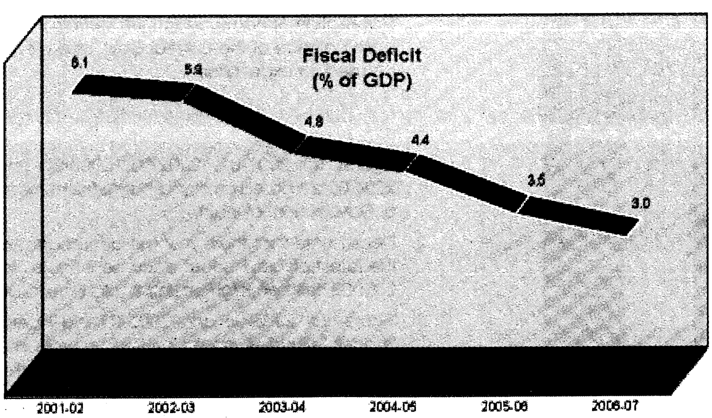
Appendix II

The Liberal Budget at a Glance

(% of GDP)

	2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Revised Estimate)	2004-05 (Budget Estimates)	2005-06 (Liberal Budget Estimate)	2006-07 (Liberal Budget Estimate)
1. Revenue Receipts (2 + 3)	8.6	9.4	9.6	9.9	10.1	10.1
(2) Tax Revenue (Net to Centre)	5.7	6.5	6.8	7.5	7.9	8.0
(3) Non-Tax Revenue	2.9	2.9	2.7	2.4	2.3	2.1
4. Capital Receipts (5 + 6)	6.9	7.4	7.7	5.4#	5.2	4.7
(5) Loan Recoveries & Other Receipts	0.9	1.5**	2.9**	1.0**	1.7	1.7
(6) Borrowings and Other Liabilities	6.1	5.9	4.8	4.4#	3.5	3.0
7. Total Receipts (1 + 4)	15.6	16.8	17.2	15.3#	15.3	14.8
8. Total Expenditure (9 + 10)	15.6	16.8	17.2	15.3	15.3	14.8
(9) Revenue Expenditure	13.0	13.8	13.2	12.3	11.6	10.9
(10) Capital Expenditure	2.6	3.0	4.0	3.0	3.7	3.9
11. Revenue Deficit Ratio (% of GDP)	4.3	4.4	3.6	2.5	1.5	0.8
12. Fiscal Deficit Ratio (")	6.1	5.9	4.8	4.4	3.5	3.0
13. Primary Deficit Ratio (")	1.5	1.1	0.3	0.3	(–) 0.5	(–) 0.8





@ Fiscal Deficit *less* Interest Expenditure

(–) denotes generation of surplus position.

* Includes PSES' Disinvestment Proceeds

** Includes Receipts from States on account of Debt Swap Scheme

\# Does not include Rs.60,000 crore under Market Stabilisation Scheme, which will remain in the cash balance of the Central Govt. and will not be used for expenditure

Notes:

1. Figures for 2001-02, 2002-03, 2003-04 and 2004-05 are based on official budget documents of Government of India.
2. Figures for 2005-06 and 2006-07 are Liberal Budget Estimates, based on various proposals set out in the text. GDP growth at current market prices are projected in nominal terms at 12 percent per annum for these two years.

Appendix III

The Liberal Budget – Revenue Receipts

(Rs. Crores)

	2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Revised Estimate)	2004-05 (Budget Estimates)	2005-06 (Liberal Budget Estimate)	2006-07 (Liberal Budget Estimate)
Gross Tax Revenue	187,060	216,266	254,923	317,733	374,600	434,400
Union Excise duties	72,555	82,310	92,379	109,199	125,600	142,900
Customs	40,268	44,852	49,350	54,250	57,600	61,500
Corporation tax	36,609	46,172	62,986	88,436	106,100	125,200
Income tax	32,004	36,858	40,269	50,929	60,100	69,700
Service tax	3,302	4,122	8,300	14,150	23,500	32,500
Others	2,322	1,952	1,639	769	1,700	2,600
Less: States' Share and Transfer to National Calamity Contingency Fund	53,528	56,841	67,384	83,827	97,400	112,900
1. Net Tax Revenue	133,532	159,425	187,539	233,906	277,200	321,500
Non-Tax Revenue						
Interest receipts	35,538	37,602	35,999	36,950	43,500	45,500
Dividend and profits	17,290	21,230	22,081	18,875	23,500	26,500
Others	14,946	13,491	17,408	19,591	19,040	24,000
2. Total Non-Tax Revenue	67,774	72,323	75,488	75,416	80,100	84,000
Total Revenue Receipts (1 + 2)	201,306	231,748	263,027	309,322	357,300	405,500

Notes:

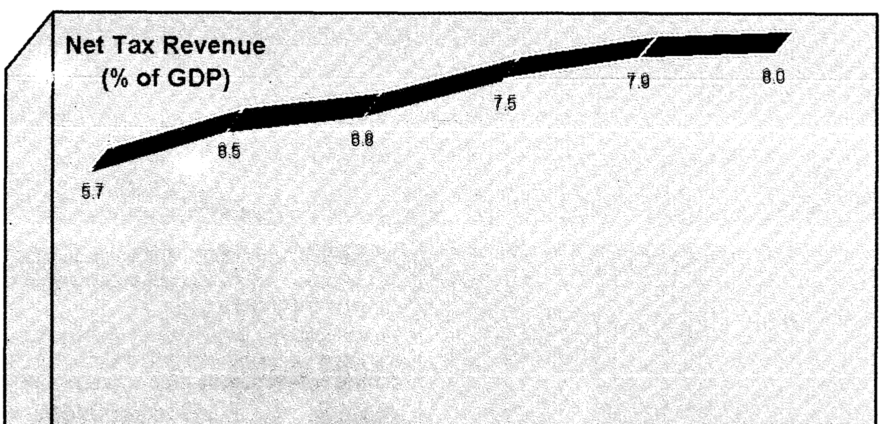
1. Figures for 2001-02, 2002-03, 2003-04 and 2004-05 are based on official budget documents of Government of India.
2. Please note that there is some discrepancy in the latest official budget document figures for 2001-02 between Total Receipts & Total Expenditure
3. Figures for 2005-06 and 2006-07 are Liberal Budget Estimates, based on various proposals set out in the text. GDP growth at current market prices are projected in nominal terms at 12 percent per annum for these two years.

Appendix IV

The Liberal Budget – Revenue Receipts

(% of GDP)

	2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Revised Estimate)	2004-05 (Budget Estimates)	2005-06 (Liberal Budget Estimate)	2006-07 (Liberal Budget Estimate)
Gross Tax Revenue	8.0	8.8	9.3	10.2	10.6	10.8
Union Excise duties	3.1	3.3	3.4	3.5	3.6	3.6
Customs	1.7	1.8	1.8	1.7	1.6	1.5
Corporation tax	1.6	1.9	2.3	2.8	3.0	3.1
Income tax	1.4	1.5	1.4	1.6	1.7	1.7
Service tax	0.1	0.2	0.3	0.5	0.7	0.8
Others	0.1	0.1	0.1	neg	0.1	0.1
Less States' Share and Transfer to National Calamity Contingency Fund	2.3	2.3	2.4	2.6	2.7	2.8
1. Net Tax Revenue	5.7	6.5	6.8	7.5	7.9	8.0
Non-Tax Revenue						
Interest receipts	1.5	1.5	1.3	1.2	1.2	1.1
Dividend and profits	0.7	0.9	0.8	0.6	0.7	0.7
Others	0.6	0.5	0.6	0.6	0.5	0.6
2 Total Non-Tax Revenue	2.9	2.9	2.7	2.4	2.3	2.1
Total Revenue Receipts (1 + 2)	8.6	9.6	9.5	9.9	10.1	10.1
GDP at current market prices (Rs. Crores)	2,329,300	2,458,850	2,752,150	3122,900	3,528,500	4,004,800



Notes:

1. Figures for 2001-02, 2002-03, 2003-04 and 2004-05 are based on official budget documents of Government of India.
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3. Figures for 2005-06 and 2006-07 are Liberal Budget Estimates, based on various proposals set out in the text. GDP growth at current market prices are projected in nominal terms at 12 percent per annum for these two years.

Appendix V

The Liberal Budget – Expenditure Pattern

(Rs. Crores)

	2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Revised Estimate)	2004-05 (Budget Estimates)	2005-06 (Liberal Budget Estimate)	2006-07 (Liberal Budget Estimate)
I. Non-Development Expenditure of which :	215,456	242,749	291,196	278,212	270,500	277,800
1. Defence	54,266	55,662	60,300	77,000	75,000	76,000
2. Interest Payments	107,460	115,663	120,475	129,500	131,500	133,500
3. Subsidies	31,210	43,515	44,709	43,516	44,500	45,000
II. Developmental Expenditure of which :	159,364	184,197	197,025	214,108	265,000	307,200
1. Economic Services	80,868	106,625*	106,392@	N.A.	135,000	158,600
2. Social Sector	44,538	58,606	61,428	59,811	68,500	78,800
Total Expenditure (I + II)	374,820	426,946	488,221	492,320	535,500	585,000
Ratio of Development Expenditure to Total Expenditure(%)	42.5	43.1	40.4	43.5	49.5	52.5

* Revised Estimates

@ Budget Estimates

Notes:

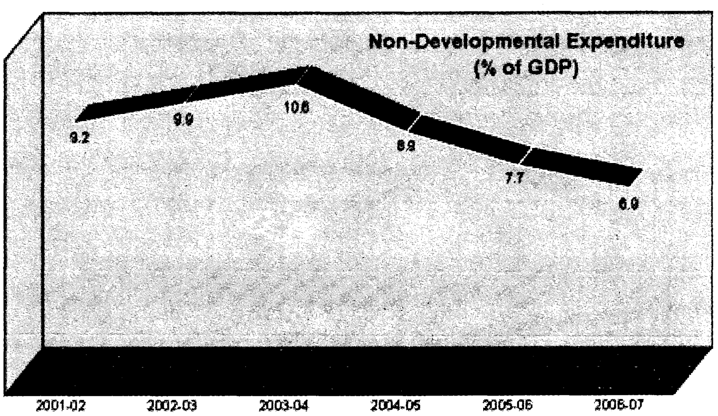
1. Figures of Non-Development and Development Expenditure (including those for Social Sector) for 2001-02, 2002-03, 2003-04 and 2004-05 are compiled from the Reserve Bank of India's Annual Report 2003-04 (Page No.275). Figures of Economic Services are from the RBI's Handbook of Statistics on Indian Economy, 2002-03 (Page No.147)
2. Data for 2005-06 and 2006-07 are estimates for the Liberal Budget based on various assumptions set out in the text.
3. Total expenditure in this table is inclusive of transaction of Commercial Departments in the Revenue Account. Hence, these figures do not tally with figures in Appendix I & II.

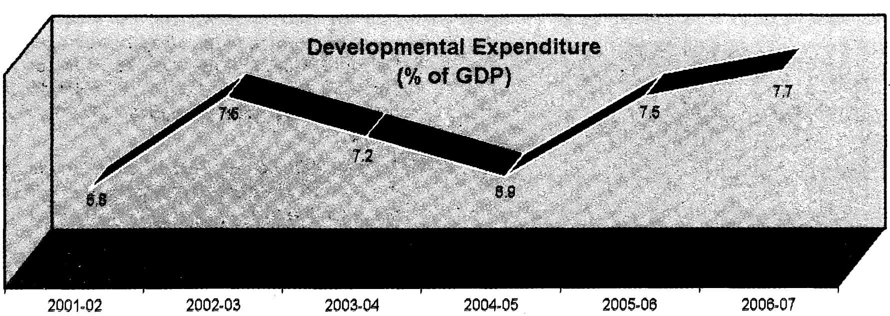
Appendix II

The Liberal Budget – Expenditure Pattern

(% of GDP)

	2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Revised Estimate)	2004-05 (Budget Estimates)	2005-06 (Liberal Budget Estimate)	2006-07 (Liberal Budget Estimate)
I. Non-Development Expenditure of which :	9.2	9.9	10.6	8.9	7.7	6.9
1. Defence	2.3	2.3	2.2	2.5	2.1	1.9
2. Interest Payments	4.6	4.7	4.4	4.1	3.7	3.3
3. Subsidies	1.3	1.8	1.6	1.4	1.3	1.1
II. Developmental Expenditure of which :	6.8	7.5	7.2	6.9	7.5	7.7
1. Economic Services	3.5	4.3	3.9	NA	3.8	4.0
2. Social Sector	1.9	2.4	2.2	1.9	1.9	2.0
Total Expenditure (I + II)	16.1	17.4	16.5	15.8	15.2	14.6
GDP at current market prices (Rs. Crores)	2,329,300	2,458,850	2,752,150	3,122,900	3,528,500	4,004,800





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3. Total expenditure in this table is inclusive of transaction of Commercial Departments in the Revenue Account. Hence, these figures do not tally with figures in Appendix I & II.

"Liberals in our part of the world have two big handicaps. We have illiteracy on one side and poverty on the other and these make for irrational and anti-democratic forces to get strong. The important thing is to try and hold the scales even and not to lean too heavily one way or another."

- Minoo Masani

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