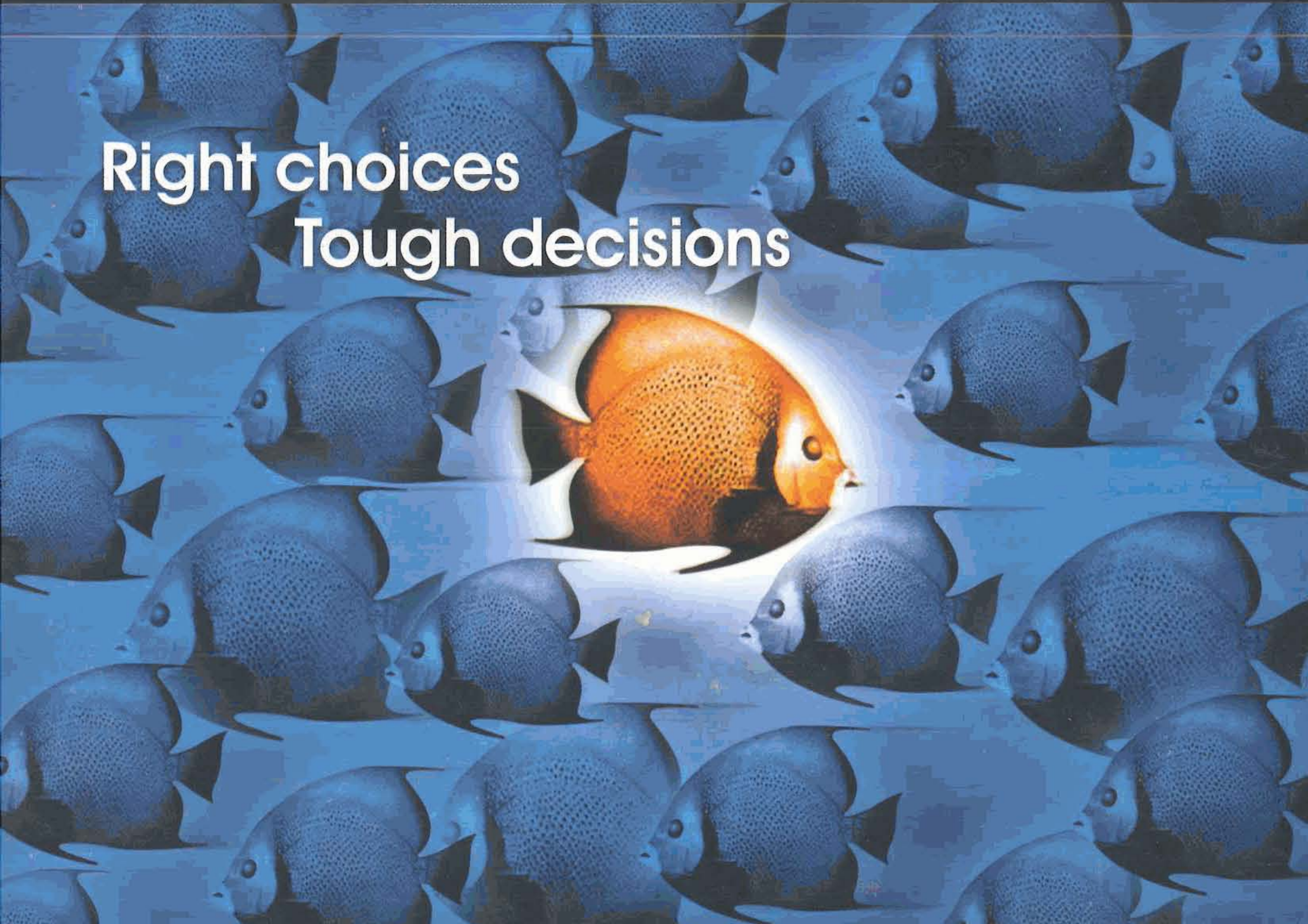
THE LiBERAL BUDGET

2006 - 2007



The Liberal Philosophy

Man is the measure of all things. This about sums up the Liberal credo. Liberalism has no dogma except one - the centrality of the human being; what is good for him - or her - is acceptable. What is not, is not. Since the world consists of billions of human beings, this principle would be applicable to these billions.

Philosophically speaking the Liberal position on matters relating to the economy is very clear. The business of the State is not business but government. In a liberal State, the individual is supreme and the State must work to further his or her potential. Therefore, it will focus its activities on maintaining law and order, defence, physical and social infrastructure, health, education and a social safety net.

Liberalism like Socialism aims at promoting the welfare of all. As Ludwig von Mises the noted Liberal philosopher put it, where the two differ is *"not by the goal at which it aims, but by the means that it chooses to attain the goal"*.

The means are dictated by contemporary situations. And herein lies the uniqueness of Liberalism. In feudal times the emperor, the king, the dictator owned all and decided who shall produce what; and even prescribed societal norms. In modern times the socialist state took over this 'right'. Liberalism overthrew feudalism and gave people the opportunity to decide not only their rulers but also how they shall be ruled. Modern liberalism has triumphed over the socialist state and once again provides people the opportunity to decide for themselves how and by whom they shall be ruled – witness the fall of the Soviet Union and the disastrous failure of Marxist economics.

India's great Liberal Gopal Krishna Gokhale spelt out the Liberal dream when he said: *"I recognise no limits to my aspiration for my motherland. I want our people to be in their country what other people are in theirs. I want our men and women, without distinction of caste or creed, to have opportunities to grow to the full height of their stature, unhampered by cramping and unnatural restrictions. I want India to take her place among the great nations of the world."*

Another great Liberal D. V. Gundappa cautioned: *"It has been India's habit all through history to turn to every corner of the globe for the light of truth and blessedness of wisdom. But she must be selective in taking things from others; and her selection must be strictly in relation to the ingredients of her nature."*

The role of the Indian State which has jettisoned State Capitalism of the communist variety and embraced Market Economics is, on the one hand, to create an enabling environment for growth by unshackling the remaining vestiges of control, eliminating regulations that stifle development and do away with *'the inspector raj'* , and on the other, to build the confidence of the nation in the rule of law and in the legislative and legal systems.

The main focus of a liberal budget (apart from defence, law and order, and creating public institutions and public works, will be on issues concerning human development or human capital formation – health, education and a social safety net for those who are not capable of looking after themselves.

We have kept these in mind when preparing this Liberal Budget.

THE LIBERAL BUDGET 2006-07

RIGHT CHOICES TOUGH DECISIONS

FREEDOM WITH RESPONSIBILITY

INDIAN LIBERAL GROUP

PROJECT FOR ECONOMIC EDUCATION

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The work of the Drafting Group was considerably facilitated by these gentlemen who readily responded with their inputs on a number of issues. Some of them even took time off to send us well-thought out essays and write-ups. Even if we have not been able to include these in this volume, they provided useful background material to the Drafting Group for their work.

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Preface

We have pleasure in presenting this, the third Liberal Budget for the budget year 2006-07. Unlike the first and second Liberal Budgets which were released on the eve of the Union Budgets in 2004 and 2005, we place before you the third Liberal Budget (LB3) three months ahead of the 2006-07 Union Budget. Actually, while we were in the last stages of crafting LB3, came news reports that the Finance Ministry intended to begin the exercise of ascertaining the views of various sections of the public beginning November, close the discussions in December and get to work on the Union Budget for 2006-07 in January. We are therefore very much on time, this time.

We thus have a fair chance of engaging public attention and placing the Liberal point of view before the public, the planners and policy-makers. We would like to assert that our views are based on a commitment to the reforms process. The demand for the opening up of the economy has been on the Liberal agenda from the time the Second Five Year Plan way back in 1957, when the then Planning Commission decided to embrace State Capitalism and perch the State on the 'Commanding Heights of the Economy'.

Unmindful of the fact that their brand of development only led to the pauperisation of nations and peoples including India the communist 'Left' has been working overtime to scuttle the reforms process, to fulfil their own political agenda.

In our preface to the second Liberal Budget (LB2) we had given expression to our fears about the Left's designs. Pointing to the secondary title to LB2 "The Way Forward", we wrote *inter-alia* "The secondary title to this year's Liberal Budget ...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 the criticisms based on obsolete ideologies which are not only irrelevant but counter-productive."

We therefore demand that we be taken seriously!

Our fears have been borne out by the obstructive tactics of the so-called 'Left' which has, time and again held the United Progressive Alliance (UPA) and its government to ransom and much needed reforms have gone abegging. But neither the Left nor anybody can stop the enterprising Indian from going ahead, so much so that our entrepreneurs are everywhere; our educated young men and women are in demand across a wide spectrum of business and industry within the country and abroad. All that was needed was for the fetters of socialism to be removed. And when that happened there was no stopping us.

India's objective say many, is to be a global power. These persons are looking at the wrong end of the stick. For the Liberals the objective is a prosperous India. If the Reforms process translates itself into a better life for our people particularly those in rural India where 70% of India live; if our farmers are no longer compelled to contemplate suicide as a way out of their indebtedness; if we no longer have starvation deaths; if India enjoys medical care of world standard; if our education is not only universal but of high class quality; if we have world-class infrastructure, then we can say with some degree of legitimacy that we are indeed on the road to become a global power. LB3's suggestions are a few steps in that direction.

We shall be happy to receive your critical comments on this document. The Liberal has an open mind and thrives on discussion and debate. If you find LB3 not meeting with your approval then tell us why and how we should improve this effort. If you approve of what is contained in this document then spread the good word and introduce us to your friends.

The composition of the Drafting Group and the many who pitched in with their contribution are listed on page 2. The Project for Economic Education and the Indian Liberal Group are 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. For them it has been a labour of love.

We are grateful to the Friedrich Naumann Foundation and the Press Institute of India for their encouragement and assistance in the task of producing LB3.

S. V. Raju
Director, Project for Economic Education
President, Indian Liberal Group

Chapter 1

Assessment of Economic Reforms

By the time the Union Budget 2006-07 is discussed, publicly debated and passed by Parliament, the Indian economy would be moving into the fifteenth year of Economic Policy Reforms (EPR), which began in June 1991. This decade and half of EPR provides us an excellent vantage point for evaluating its impact on the Indian economy and also factor in the experiences of this period into the policy formulations of this Budget.

The political and economic background of the EPR, its rationale, and the role of multilateral agencies therein have been extensively debated, both within the polity and outside. More significantly, the debate within the polity and outside, tempered by the electoral processes at constitutionally mandated intervals have in essence captured the mood and response of the nation vis-à-vis these reforms. The intensive and extensive debates on the EPR over the last fifteen years have been possible because of the plural nature of Indian society and is widely seen as the triumph of her democracy, both of which combine to provide a fertile ground for the EPR to succeed.

> *“India's Economic Policy Reforms have been widely held to be a unique global experience, especially for a democratic and pluralistic country like ours for successfully making the transition from a 'planned' to a 'market-oriented' economy.”*

In fact, India's EPR have been widely held to be a unique global experience, especially for a democratic and pluralistic country like ours for successfully making the transition from a 'planned' to a 'market-oriented' economy. While conceding the fact that the debate has not concluded and is truly and very much on – it is imperative that the attempt to build a national consensus on this crucial issue needs to be carried on to the satisfaction of the entire population.

In continuation of the national debate on the EPR, the Liberal Budget takes a lead in voicing the concerns of Liberals within the country. This is the third attempt of the Indian Liberal Group in providing an alternative approach to budgeting in India; the first two were in the years 2003-04 and 2004-05. The response to the earlier initiatives were heart-warming and encouraging, and have by themselves provided the much needed impetus to carry out the current exercise for this year.

The Principal Message of the Reforms

- From the Liberal economic perspective, the experience of the nation with the EPR till date can be captured in three strands: (They have been termed elsewhere as the 'LPG' Doctrine: "Liberalization – Privatisation–Globalization").
- Greater Market-Orientation of Economic decision-making, as opposed to the erstwhile gamut of government controls, interventions, regulations and restrictions of various kinds.

As a corollary to the above, greater reliance has to be placed on the private sector, to carry on the economic activities but with the state playing the important role of a regulator as well as being responsible for the overall improvement of the investment climate. While the idea that the private sector should have a greater role in the national economy is well understood and appreciated, there are several contentious issues with respect to disinvestment programmes of even the Central Government

- Opening-up of the Indian Economy and integrating it into the world economy by allowing foreign investments (both FDI as well as FII), lowering import-barriers, greater export-thrust, and other liberalization-measures on External account.

Consequent to the introduction of the EPR, there have been significant changes of policies and procedures in the *industrial, financial, taxation, infrastructure, and investment spheres, to* mention *only* the main areas. The policy changes in these areas have brought about tremendous changes in the performance of the Indian economy. Apart from the opening up the economy to competition and subjecting it to competition, the EPR has altered the psyche of the nation. The net effect: The new India dreams of becoming a global economic super power, an unthinkable idea even a decade back.

In order to evaluate the EPR in the present context. anappropriate method could be to divide the EPR into 'Domestic', and 'External' and to indicate the *Achievements* and *Short-comings/Failures* therein.

I. The Domestic Sector

Turning to the domestic Sector of the economy, the results of EPR have been a 'mixed bag'. As far as the positive aspects/achievements are concerned, the following stand out:

- Relatively Higher GDP Growth, despite significant fluctuations in agricultural growth rates - which seem to have a "drag effect" on the general growth rates of the Indian economy. More importantly, with the services sector and, of late, the manufacturing sector having become the drivers of the economy, the growth of the Indian economy has become drought-proofed. However, the growth of the economy, bypassing the farm sector, is leading to iniquitous growth, which is not acceptable in the Indian context.
- The Corporate sector displaying high growth and dynamism – Indian Corporates seems to have come of age in the matter of adherence to international accounting, ethical and governance standards. This directly means that Indian Corporates have become an attractive destination for global investments as witnessed by the significant flows of foreign investors into the Indian stock markets in the past couple of years.
- Coming of Age of India's Services Sectors viz., – Financial Services; IT; and Healthcare: With other services like Retail, Tourism, Accounting, Legal and Telecommunications set to boom in the next few years, India is most likely to emerge as a favourite services destination for investments.
- Stabilization of inflation at a lower level indicates the economy is reasonably insulated from major macroeconomic gyrations, both in India and abroad; the impact of oil-price rise, has also been felt much less now, compared to earlier years, because of the resilience acquired in the last 15 years.
- Maturing of the Indian manufacturing sector, by achieving global competitiveness and manufacturing standards in key segments as well as in some industries;
- Direct Taxes to GDP ratio is rising, as also the contribution of direct taxes in total tax-collection;

However, there have simultaneously been, *some stark failures* in addressing the vexatious issues of unemployment, regional imbalance, and infrastructural constraints, to name the more significant areas.

The following can be considered as the main shortcomings so far:

- Extremely weak position of Central Government finances, coupled with still weaker State government finances. More importantly, states are yet to usher in reforms at the states level.
- Growing Regional Imbalances – the prosperous South-West vis-à-vis the poor North-Central-East. This economic divide is having a telling impact on economic growth and is significantly slowing down the progress of the county.

" The employment situation is threatening to become a socio-economic time-bomb. Reforms, critics argue, have resulted in jobless growth. This is a crucial area of the economy, which has not been addressed by the Economic Policy Reforms as yet. "

- The employment situation is threatening to become a socio-economic time-bomb. Reforms, critics argue, have resulted in jobless growth. This is a crucial area of the economy, which has not been addressed by the ERP as yet.
- Energy and Infrastructural constraints are hampering rapid and widespread growth. The reforms are yet to focus on energy security and we need to bring about national alternatives to our over-dependence on hydrocarbons. The extraordinary price hikes of crude oil in the past two years is bound to have a telling impact on the Indian economy, sooner rather than later. We need to develop appropriate technologies of developing and harnessing solar and nuclear power.
- Inadequate Social Sector Expenditures on Health, Education, Housing. With the poor financial

position of the states, unless drastic steps are taken to remedy the situation, it is virtually impossible to have even a marginal impact in these areas.

- The Public Sector, is still in an obstructive mode with consensus on disinvestment continuing to elude the polity; and its (public sector's) unwarranted return as an instrument of economic development in an increasing number of spheres such as banking and manufacturing to mention just two.
- Administrative reforms are still not within the reforms radar of the Central and state governments and we seem to carry the new economic thoughts with an age-old administrative system and mindset.

> *"Administrative reforms are still not within the reforms radar of the Central and state governments and we seem to carry the new economic thoughts with an age-old administrative system and mindset."*

II. The External-Sector

The EPR of 1991 were primarily a response to the then-prevailing acute Balance of Payments (BoP) crisis. This was the result of the policy fixation towards artificial exchange rates; high external debt as a percentage of the GDP and Reserves; excessive high-cost-short-term debt within the total external debt and the dangerously low-level of foreign exchange (Forex) reserves (lowest at $ 900 million in May 1991, equivalent to less than two weeks of import cover).

From such a precarious situation, the Indian economy has come a very long way and can today legitimately boast of a healthy, sustainable and vibrant eternal sector.

The principal Achievements of External Sector EPR have been:

- The Foreign Exchange Reserves (FE) of the country are well in excess of $ 140 billion – currently covering 14-15 months of the country's imports.
- The trade to GDP index (that is the total of imports and exports as a percentage of GDP – indicating the extent of India's global intercourse) stands at a healthy 30% - much above the paltry 10% at the commencement of the EPR.
- Exports have clocked a healthy 20% for over three years and 'Brand India' and 'Made in India' are slowly but surely emerging as forces to reckon with in the international arena.
- A secular decline in the debt ratios - The ratio of external debt to FE Reserves is less than 0.8% and the short term debt to total external debt is at an historic low with India's debt servicing, quite comfortable.
- Increased FII-FDI flows into India
- Secular decline in Debt ratios – External Debt to GDP and Short term Debt

- **Qualitative Dimension:** A far better improved image of the Indian economy abroad, than what it was 15 years ago, and more importantly, India along with China, is reckoned to be an emerging globally recognized economic powerhouse.)

However, there have been shortcomings or inadequacies too:

- Traditional Exports with thrust on raw materials still dominate Indian exports with very few competitive products in world-markets;
- Actual inflow of FDI – much less than potential and much less than competing nations.

Nevertheless, the Indian economy today, is far more globally integrated than it ever was, and the remarkable turnaround of the external sector within the span of a decade, is hailed to be a major success of the Economic Reforms Process.

III. The Unfinished Agenda...

It can be said with reasonable justification that the crisis-ridden Indian economy (as of 1990-91) has been transformed, into an economy, which is recognized globally as a major emerging economic powerhouse. Indeed, it is our own lack of single-minded pursuit or resolve to push forward the EPR with vigour and boldness, which has so far prevented us from realising our "true potential".

While the EPR has certainly given hope for the attainment of a rightful place for India in the global economy, this is by no means a *'guaranteed outcome'*. There is a host of sectors/areas crying out for comprehensive reforms, not undertaken hitherto. Select key-sectors, so far untouched by EPR and which necessitate further action are:

- Administrative Reforms including the crucial areas of improving the interface of the state with the citizen.

- Agricultural reforms
- Legal reforms;
- Labour reforms with particular reference to labour legislation;
- Investment-climate reforms;
- Financial sector reforms
- Increasing the FDI ceiling in all the remaining crucial sectors
- Urban Economic reforms;
- Reforms in key infrastructure areas – Power and Transport; Ports, Airports, Water and Roads
- Fiscal reforms – PSUs, Subsidies, and Tax-administration.

The Current Impasse and the Role of the Left-Parties

The greatest danger today is the 'Left' Parties' strong resistance to any (significant) policy-reform. It is ironic that while countries swearing by the communist ideology have prospered in recent years by abandoning the basic economic principles of their ideology, the Indian communist parties are bent upon stalling the on-going EPR, and thereby greatly hampering India's progress towards economic prosperity and improving the standard and quality of life of the Indian people.

The latest 'surrender' to the 'Left' parties by the UPA government on the issue of sealing the fate of disinvestments of the 13 profit-making PSUs is unfortunate, to say the least. One of the most important reasons why the present government had the goodwill and good wishes of the economic and investor community was the 'hope' that with the presence of the present Prime Minister and Finance Minister, the reformist credentials of the government were impeccable and safe.

However, on the issues of infrastructure (oil-pricing, power) and on the issue of the Role of the Public Sector, the UPA government. is wilting under the pressure of the Left parties (comprising CPM, CPI, and other smaller parties) and thus questioning her own, original policy-programme. This is widely seen to be unsettling domestic and foreign investors' confidence, and more importantly , constitutes a regressive step backwards, almost reminding everyone of the heydays of the disastrous '*commanding heights*' policy of the 50's and 60's.

The Common Minimum Programme (CMP) of the UPA government, (signed both by the Congress and the Left) has laid down the 'principles', which will govern the actions of the Central Government on disinvestments, foreign investments, labour reforms, etc.

Illustratively, on Foreign Investment, the CMP States, "FDI will continue to be encouraged and actively sought particularly in areas of infrastructure, high technology and exports and where local assets and employment are created on a significant scale. The country needs and can easily absorb at least two to three times the present level of FDI inflows..."

"It is squarely the UPA Government's responsibility to call the bluff of the Left, recognize their concerns for the social sector and forge ahead relentlessly on the path of reforms."

On this basis, FDI whether in Telecom, Retail or Insurance easily qualify. Yet, the resistance of the Left ranges from preventing the raising of FDI-ceiling in specific sectors to banning the FDI in other sectors, altogether!

It is squarely the UPA Government's responsibility to call the bluff of the Left, recognize their concerns for the social sector and forge ahead relentlessly on the path of reforms. It is in this connection that the Indian Liberal Group draws attention to the following comparisons in some of the indices between 1990-91 and 2004-05 highlighting the success of reforms.

Table I : Post-Reform Domestic Sector Profile (Select Indicators)

Sr. No.	Item	Unit	1990-91/ 1991-92	2005-06 (E)
1	GDP	% Change	1.3	7.5
2	Industrial Growth	% Change	0.6	8.5
3	Inflation	% Change	13.0	5.0
4	Fiscal Deficit	% of GDP	5.6	4.5
5	Employment in Organised	Million	26.7	27.2

Table II : Post-Reform External-Sector Profile (Select Indicators)

Sr. No.	Item	Unit	1990-91/ 1991-92	2004-05 (E) Latest
1	Exports	$ Bln.	18.5	80
2	Current A/c Balance	% of GDP	(-) 3.4	(+) 1.2
3	Forex Reserves	$ Bln.	0.900	135
4	External Debt/GDP	%	29	16
5	FDI Inflow	$ Mln.	100	5,500

Table III : Recent Economic Performance: Select Macro Economic Indicators

Sr. No.	Item	Unit	2003-04	2004-05	2005-06 (E)
1	GDP Growth	% Change	8.1	6.9	7.0
2	Manu-facturing Growth	% Change	7.4	9.0	10.8
3	Exports	% Change	24.4	32.0	28.2
4	Inflation	% Change	5.1	6.6	4.5
5	Fiscal Deficit	% of GDP	4.5	4.3	4.3 (BE)

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Chapter 2

Retrospect on the Central Budget 2005-06

Presenting the first full budget of the UPA Government on July 8, 2004, the Finance Minister Mr. P. Chidambaram stated *"I am a votary of tax reforms but it would be unwise on my part to attempt to do reforms 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"*. The next Budget for the financial year 2005-06 was presented on February 28, 2005. Knowing the reputation of the Finance Minister and the many declarations of the Union Government, there were high hopes of an acceleration of economic reforms and this would influence budgetary strategy and tax reforms.

But the Budget of 2005-06 had to contend with factors like the National Common Minimum Programme (NCMP); the sharp hike in international crude oil prices and uncertainties about its future trend; a setback in agricultural performance during 2004-05; the Tsunami tragedy; the growing economic distress of farmers leading to suicides and malnutrition deaths in some parts of the country, only served to increase inequalities, and further widening the rural-urban divide.

Impressive Economic Performance ...

Despite these difficulties, the Indian economy could achieve impressive real GDP growth during 2004-05 thanks to a strong industrial recovery, inspiring corporate performance, high equity returns and primary market revival, sustained high growth in the services sector, healthy export growth, strong balance of payments, build up of forex reserves, easy liquidity, steady interest rates, and incremental development of roads and telecom infrastructure. The economy was able to sustain its resilient mode.

Even more striking features of the economy were the overall improvement in productivity, the emergence of manufacturing competitiveness and a welcome turnaround in the investment outlook. Also, there has been increasing global recognition of India's potential for high economic growth. Sensing all such positives in the economic situation, the *Economic Survey of 2004-05* pointed out that *"The growth performance of the Indian economy during 2003-04 and 2004-05 indicates a possible ratcheting up of the trend rate of growth of the economy, from around 6% to about 7% per year. Developments in the current year provide supporting evidence."*

> *“The Budget of 2005-06 had to contend with factors like the National Common Minimum Programme (NCMP); the sharp hike in international crude oil prices and uncertainties about its future trend; a setback in agricultural performance during 2004-05; the Tsunami tragedy; the growing economic distress of farmers leading to suicides.”*

Evidently, the main growth drivers especially in the industrial and corporate sectors on the eve of the Central Budget 2005-06 were:

- Lowering of taxes
- Declining interest rates
- Easy access to capital for quality borrowers
- Widespread demand improvement (domestic and external)
- Turnaround in public investment in select sectors
- Gaining of fundamentals of manufacturing competitiveness

... But Continued Pressures of Fiscal Constraints

All these positive features did not, however, make an adequate positive impact on the fiscal health of the Central Government. Thus, fiscal constraints continued to be reflected in the impairment of fiscal discipline despite explicit norms of the FRBM legislation. Besides, the Central Budget of 2005-06 had to reckon with the impact of the recommendations of the 12th Finance Commission, which placed an additional burden of Rs.26,000 crores on the Central Government in 2005-06 - equivalent of 0.75% of GDP. More importantly, there were continued distortions in the long-term fiscal strategy manifesting in lack of buoyancy of tax revenues; tinkering with tax reforms and administration; persistent huge gaps between revenue expenditure and revenue receipts with capital receipts largely being diverted to meet revenue expenditure.

“ The Liberals are in agreement with the diagnosis of the economic and fiscal health, as reflected in the Economic Survey as also the substantive part of its policy prescriptions. ”

Against this backdrop of economic and fiscal developments, even the *Economic Survey* had to highlight the following imperatives:

- First, reconciling fiscal consolidation with appropriate tax reforms
- Second, simplifying procedures and relaxing entry-exit barriers
- Third, reforming the financial sector to perform the task of intermediation of enormous resource flows
- Fourth, converting domestic and foreign savings into optimal investment by firms and sectors
- Fifth, infrastructure development policy framework enabling public-private participation
- Sixth, promoting foreign investment through both FDI and FIIs
- Last, providing entitlement and empowerment to the poor

Thus, the Central Budget 2005-06 began with major challenges of:

- Sustaining the high growth momentum (7-8% real GDP growth)
- Containing inflation to median single digit level
- Bringing about rural and agriculture resurgence
- Speeding up the expansion of industry (to, at least, a 10% rate of annual growth)
- Fiscal consolidation and phasing out of the revenue deficit
- Sustained nurturing of the investment climate to strengthen the growth process

Liberal Perspective Supports Substantive Reforms

The Indian Liberal Group is in agreement with the diagnosis of the economic and fiscal health, as reflected in the Economic Survey as also the substantive part of its policy prescriptions. However, we are disappointed by the fact that neither the Economic Survey's prescriptions nor the frequent declarations by the Prime Minister and his Finance Minister at various public forums are really reflected in the strategic framework of the Central Budget 2005-06, despite its well articulated key objectives viz.

- Assault on poverty and unemployment
- *Bharat Nirman* – rural connectivity and resurgence
- Agriculture diversification roadmap
- Infrastructure development
- Manufacturing Competitiveness Programme
- Investment initiatives
- Financial sector deepening and strengthening
- Fiscal consolidation through tax reforms and a "calibrated" implementation of FRBM.

Distortions in Key Budgetary Data

The key parameters of budgetary data for 2005-06 are set out in the Appendix tables I to VI, along with the corresponding figures for previous years from 2001-02 to 2004-05, *as well the Liberal Budget Estimates for 2006-07.*

Before making any specific observations on the Central Budget, it must be emphasized that the comparability of budget figures, especially relating to capital receipts and capital expenditure over the last three years, has been greatly distorted mainly on account of the impact of the Debt Swap Scheme. This makes it extremely difficult to draw any meaningful conclusions on the changing pattern and structure of the Central Budget. Illustratively, capital receipts in 2003-04 (Actuals) were Rs.207,490 crores, but contracted to Rs.163,144 crores in 2004-05 (Revised Estimates) and were expected to drop further to Rs.145,300 crores in 2005-06 (Budget Estimates). Likewise, capital expenditure during these respective years, after rising from Rs.109,228 crores to Rs.119,722 crores, was estimated to decline sharply to Rs.67,832 crores.

Does this mean that on creation of capital assets, the Government is going to spend about 44% less in 2005-

06 than in the previous year? There could be *prima facie* no better interpretation of such data!

The Liberal Position has always been that our budgetary documents are highly complicated, replete with variations and changes that are not understood easily even by professional economists and experts, leave alone common citizens. There are often difficulties of reconciling complex 'swings' in certain components of expenditure, especially capital expenditure and its impact on the overall economy.

There is no point in making tall claims about the expected transparency in Government transactions as a result of the recently enacted Right to Information Act, if the primary source of budgetary data is riddled with complexities, as illustrated above.

Further, in our earlier documents, we have suggested the need for presenting the expenditure pattern under clearly designed and defined heads viz., (a) Non-Developmental and (b) Developmental Expenditure, thereby doing away with the conventional descriptions of Non-Plan and Plan Expenditure methods of identifying resource deployment. With the initiation of newer schemes under social sector expenditures (for example, the National Rural Employment Guarantee Scheme and Bharat Nirman, to mention just two), there is also the problem of evaluating the economic impact of such spending.

We strongly believe that given the challenges of dealing with economic liberalization, continuous refining and releasing of data on sectoral and functional classification of budgetary expenditure are desirable and more relevant. We have also argued the case for a Fund Based System of Accounting, which is increasingly coming into vogue in matters of government budgets.

Having said this, the Indian Liberal Group is concerned with the estimated huge size of the revenue deficit of Rs.95,312 crores or 2.7% of estimated GDP at current market prices in 2005-06. In the total expenditure (Revenue *plus* Capital) of Rs.514,344 crores, revenue receipts were estimated to contribute about Rs.351,200 crores or about 68.2%. Thus, out of every Rs.100 of Central Government expenditure, almost Rs.30 represents deficit financing which means borrowed or printed money.

Even more worrisome is the fact that revenue receipts can support only 78.7% of revenue expenditure. In effect, out of every Rs.100 of day-to-day spending, as much as Rs.22 comes from borrowings. Surely, this is a continuation of the deplorable practice over the past many years of an inefficient unsustainable management of the budget. All the relevant budgetary indicators suggest that there would be the usual spill-over in the realization of key targets. Not surprisingly, the Finance Minister has admitted his inability to manage the original target of the FRBM Act to phase out revenue deficit by 2007-08. It has now been postponed by one more year.

Welcome Features ...

The Central Budget 2005-06 has several welcome features too. These are, for example: (a) increased allocations in the Central Plan Outlay for rural development (Rs.24,480 crores in 2005-06 up by 34.4% over 2004-05); Bharat Nirman – the Rural Infrastructure Development Fund (Rs.8,000 crores corpus) encompassing six important programmes covering assured irrigation, road connectivity, drinking water, 60 lakh houses for the poor, electrification of 1.25 lakh villages and 2.3 crore households and telephone connection to over 66,000 villages; and (b) total outlay of Rs.93,200 crores or a hike of 43% in various physical infrastructure projects.

> *"The compulsions of coalition politics is taking its toll on the pace and quality of economic reforms and distorting the philosophy and rationale of economic liberalisation."*

We also appreciate the bold initiative to progress with the system of Value Added Tax (VAT) by incentivising the States as well as the innovative concepts of the Special Purpose Vehicle and "Viability Gap Funding" mechanism of Rs.10,000 crores to promote private investment in infrastructure development. The underlying strategy of the Budget is also to achieve growth with stability and equity by leveraging investments in infrastructure through public-private partnership initiatives; enlarging the entitlement for low income groups through social security measures; confidence building of industry through reduction and rationalization of the tax regime, some sector-specific thrusts, reduction in transaction costs and improving productivity through financial sector reforms.

... But a Real Toll on Pace of Liberalisation

What is missing in the Central Budget is the strategy of implementation of the many existing and new initiatives. The compulsions of coalition politics is taking its toll on the pace and quality of economic reforms and distorting the philosophy and rationale of economic liberalisation. In this context, we entirely agree with the Government's own *Economic Survey*, when it points out: *"The outlook for the industrial sector will further brighten if constraints like infrastructure bottlenecks and shortages, labour market rigidities, entry and exit barriers and land acquisition, and multiple stages and levels of approvals/clearances are removed. Further, there is also a need for improved Centre-*

State interface for better coordination between the Centre and State governments".

These distortions are becoming roadblocks in enabling real "transformational" changes in other areas, particularly reforms in the agricultural sector and in social sector development! While the effort to introduce "Outlay-Outcome Budget" is most welcome, we are concerned with the persistent fear of leakages in social sector expenditures

Besides, the Central Budget has also failed by not providing a clear and conclusive stance on FDI, labour reforms and privatisation or disinvestment of PSUs. Further, while reforming the tax structure moderately in the area of personal taxation, CENVAT and customs tariff, the Central Budget has foisted several minor and major irritants (e.g. Fringe Benefits Tax, Banking Cash Transaction Tax, and a proposal to move from EEE to EET system for tax incentives on savings).

In substance, the Central Budget 2005-06 is good in some respects as it converges with economic perspectives that take forward the process of opening up the economy. But it is retrograde when it departs from the path of economic liberalization. Surely, it has failed in becoming a "watershed budget" in the true spirit of The Liberal Budget!

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Chapter 3

The Strategic Framework of the Liberal Budget 2006-07

In the context of the Liberal Position held by the Indian Liberal Group for the past many years, we have objectively evaluated the progress of economic reforms, drawn up the balance sheet of our economic performance of the last about fifteen years and highlighted specifics of current issues and priorities in the previous Chapter. It is imperative now to set out the strategic and operational framework of the Liberal Budget 2006-07. We need to reiterate that the central objective of the Liberal Budget will continue to be on how to strategize India as a global economic power over the period of next ten years, while at the same time coping with the challenges of achieving an equitable society.

There is already growing recognition from the world over that India is a fast growing free market economy with dynamic entrepreneurship, professionalism, scientific and engineering ethos, growing skilled work culture, an emerging competitive manufacturing sector and slowly, but surely, a modernizing farming community. The record of India's economic policy has been remarkably consistent, albeit struggling and slow, in the context of managing the conflicts and contradictions of coalition governance. There is confidence about the stability of the financial system and in the independence of our judicial and regulatory institutions.

Further, the experience of economic reforms abundantly proves that by unleashing initiatives, efforts and enterprise of the private sector there could be radical improvisation of the growth momentum as well as its qualitative dimensions. It must be stressed that the private sector that is implicit, and envisaged in our liberal framework, is not just of corporate enterprises, but also encompasses a whole host of individuals, households and firms, whether in the industrial, farming or services sectors.

Growth, Poverty Reduction and Employment Generation

The Liberal Budget believes in harnessing and synergizing this vast potential, by strengthening the liberal economic environment, to achieve:

- Long-term trend rate of growth of 8 percent in real GDP;
- Reduction in India's poverty ratio to less than 15% by 2015-16 (against the present ratio of 26%); and
- Sustained absorption of the incremental addition to the labour force through the creation of at least 8 million new jobs every year. In fact, this is the most crucial aspect of the entire reforms process at this point in time in the Indian context.

We are firmly convinced these are achievable targets and that over the next ten-year period (i.e. by the end of 2015-16), the underlying strategy of the Liberal Budget is to substantially change the socio-economic profile of the

" The experience of economic reforms abundantly proves that by unleashing initiatives, efforts and enterprise of the private sector there could be radical improvisation of the growth momentum as well as its qualitative dimensions. "

country, reflecting positively on India's social sector and quality of life indicators. Consequently, India will also gain recognition in her international comparison of the Human Development Index, along with her achievements on the current dimensions of a knowledge-based economy, and emerging manufacturing and farming competitiveness.

Action Agenda : A Seven-Point Strategic Framework

Having said this, the key basic tenets of the Liberal Budget will continue to be (i) effective fiscal governance; (ii) fiscal consolidation and stabilization; (iii) promotion of efficiency and productivity; (iv) acceleration of growth; and (v) promotion of an equitable society. Keeping in view these basic tenets of fiscal policy, as well as the goals of high growth, poverty reduction and employment generation, the Liberal Budget 2006-07 sets out, among other things, a Seven Point Strategy for Growth:

- First: Setting up an Economic Reforms Implementation Authority for facilitating cohesive, participative and speedy implementation of critical economic reforms in a time-bound manner;
- Second: Accelerating investments in infrastructure, core manufacturing and agriculture sectors;
- Third: Widening considerably public-private partnership in key sectors through the mechanism of Special Purpose Vehicles (SPVs);
- Fourth: Further rationalization of the tax structure, with a focussed thrust on a radical reform of indirect taxation;
- Fifth: Significant streamlining and simplification of the tax administration;

" The strategic framework of the Liberal Budget 2006-07 is driven by the conviction that India's growth momentum, as well as its efforts towards securing balanced development, are bogged down by a lack of investment buoyancy for over a decade. "

- Sixth: Substantive shift in expenditure management with a view to freezing the growth of revenue expenditure and releasing more resources for employment generating social sector spending; and
- Seventh: Aggressive disinvestment and privatization of public sector undertakings (PSUs)

Economic Reforms Implementation Authority

The Indian Liberal Group is greatly concerned with the slow and halting pace of economic reforms in several major areas that are already highlighted in the previous chapter. We have seen continuous confrontation by the Leftists parties on vital initiatives of economic liberalization be it disinvestment of PSUs, reforms of the administrative pricing mechanism of petroleum products (not just on issues of minimizing the burden of LPG and kerosene subsidies, but also of legitimate imperatives of raising prices of diesel and petrol) or inviting foreign direct investment in insurance, pension funds, organized retail business, etc.

Equally distressing is the lack of coordination and cohesion among some of the key Ministries - for example, the Finance Minister vs. Commerce Minister on some key foreign trade policy issues (Duty Exemption Pass Book (DEPB) scheme, or tax incentives for operationalising Special Economic Zones, etc); the Finance Minister vs. Petroleum Minister (on excise and customs duties applicable to petroleum products and their pricing structure). Likewise, there is lack of co-ordination between the Centre and the States on a number of issues, especially on infrastructure development, labour and land policies, judicial and administrative reforms. Besides, there is growing apprehension of increasing confrontation between the Legislature and the Executive on the one side and the Judiciary on the other, on matters of interpretation in some crucial policy areas.

As we strive in the pursuit of intensive economic reforms, such confrontations are going to be far more acrimonious. Therefore, the Liberal Budget recommends the setting up of an Economic Reforms Implementation Authority (ERIA) as a statutory body. ERIA will have to be headed by the Prime Minister and operationally managed by a Minister with Cabinet rank with powers similar to those available to a Managing Director in a Corporate enterprise. Its structure, composition and design can be left to the Prime Minister. However we would like to emphasise that this should have teeth.

The rationale for setting up ERIA is based on the need to give focus and thrust towards the implementation of economic reforms. This body will not merely be the think tank of but will also be responsible for accelerating the actual implementation strategy of reforms. It can

(a) take speedy decisions on economic policies;

(b) set out the framework of Action Plans for implementation by the authorities concerned, both in the Central and State Governments;

(c) make the Action Plan mandatory and subject to continuous review;

(d) regularly generate Action Taken Reports from the respective Central Ministries and State governments; and

(e) in doing all these be free to draw upon the expertise of the corporate world and NGOs. Thus, the implementation of economic reforms will be the main task of the ERIA.

Acceleration of Investment

The strategic framework of the Liberal Budget 2006-07 is driven by the conviction that India's growth momentum, as well as its efforts towards securing balanced development, are bogged down by a lack of investment buoyancy for over a decade. Fortunately, there are now some positive signs of improvement in the investment climate in recent months. Also, at the macro level, official data tends to suggest that the ratio of savings to GDP has risen sharply from 23.5% in 2001-02 to 28.1% in 2003-04. Granting the validity of this official data, it is the most opportune time to leverage the trend of rising savings ratio to generate the momentum of accelerated investment, especially in infrastructure, core manufacturing and agriculture sectors. The real challenge is to put forth appropriate economic policies that convert financial savings into productive assets.

The Tenth Plan (2002-07) had emphasized the importance of all these sectors. However, it is now evident from the Mid-term Appraisal of this plan that fiscal constraints have stifled public sector driven investment growth. The Liberal Position on public investment is very clear. Its three distinctive facets are:

- A progressive retreat of the Government from **all** the areas of activities, which are best left to the private sector. "The business of the State is Government and not business", continues to be the driving principle of the Liberal Budget.
- Government must create a regulatory and institutional environment for private initiative and enterprise to flourish.
- The public sector may have to take on transitional shortfalls and inadequacies in critical sectors like power, irrigation, railways, port development, rural communications, and concentrate on employment guarantee schemes, but with a clear cut exit strategy in favour of the private sector as and when it acquires the necessary financial muscle to do so.

Let us also recall that over the last ten budgets every single Finance Minister has stressed key role of infrastructure development in accelerating the overall growth of the economy. It may be worthwhile in this context to recall the observations of the various Finance Ministers:

- "The state of our infrastructure – particularly power and roads – is very poor. We cannot sustain a 7 percent growth unless we can revitalize these infrastructures. Huge funds are also required for telecom, railways and ports." Mr. P. Chidambaram, Budget Speech, 1996-97
- "The next 10 years will be India's decade of development. To achieve this objective our strategy must encompass the following elements ... ... a sustained assault on infrastructure bottlenecks in power, roads, ports, telecom, railways and airways." Mr. Y. Sinha, Budget Speech, 2000-01
- "But neither in agriculture, nor in industry, shall we be able to attain our objective, if infrastructure, both physical and social, is not rapidly and efficiently developed." Mr. Jaswant Singh, Budget Speech, 2003-04
- "The importance of infrastructure for rapid economic development cannot be overstated. The most glaring deficit in India is the infrastructure deficit." Mr. P. Chidambaram, Budget Speech, 2005-06

The gaps between the official proclamations and actual performance in the area of infrastructure has been anything but inspiring. We continue to churn out the same "wisdom" about the importance of infrastructure and causes of our failure in meeting with challenges of its development without any concrete action programme. Therefore, along with sector-specific initiatives, the instrumentality of ERIA will help the process of acceleration of investment in the infrastructure areas as well as in core manufacturing sectors like steel, aluminium, coal mining, cement, capital goods, etc.

" In the area of agriculture, the Liberal Budget will give focus on expanding the scope of commercialization and modernization of farming activities, water management and rural connectivity. "

In the area of agriculture, the Liberal Budget will give focus on expanding the scope of commercialization and modernization of farming activities, water management and rural connectivity. However, the fact remains that agriculture, the main stay of Indian economy, has been neglected. The Indian Liberal Group would soon come out with its position on agriculture.

Public Private Partnership and Mechanism of SPVs

Given the slow progress of investments in major infrastructure, manufacturing and agricultural activities, this Liberal Budget envisages promotion of public private partnership, especially in infrastructure projects. For this purpose, there have already been various models that have become operational in India. What is now necessary is to push them more vigorously.

Having recognized the limitations of public financing in undertaking large investments in infrastructure areas, the Finance Minister Mr. P. Chidambaram had announced in the last budget the conceptual framework of Viability Gap Funding. Also, a detailed formulation of this was announced in July 2005, and is christened as 'Scheme for Support to Public Private Partnerships in Infrastructure' (SPPI). We welcome the broad structure and the thrust of the scheme, intended to promote investment in identified areas like roads and bridges, airports, seaports, urban infrastructure, convention centres and Special Economic Zones, etc.

However, for vigorous participative implementation of SPPI, the Liberal Budget envisages strengthening of this institutional mechanism through the following measures:

- First, promoting the SPPI across the country with the active participation of the states. For this purpose, the Central Government will have to sell the scheme to all the states, and call upon them to create their own structure of funding with their own budgetary resources. Central funding can then be used in catalyzing more investments at the decentralized levels of infrastructure development. To induce the States, there can be a system of shared contributions – 15% coming from the Centre and 10% from the States. Viability Gap funding could cover 25% of the financial outlay of identified and approved projects.
- Second, Viability Gap Funding should not be restricted to domestic private or public sector investors, but should be made available also to FDI sponsored infrastructure projects.

" Substantive and enduring contribution to the competitiveness of the Indian economy in general, and manufacturing in particular, can only be accomplished, if the combined incidence of all indirect taxes, are aligned with global benchmarks. "

- Third, the coverage of SPPI should include some core high investment in agriculture and major manufacturing projects, provided the objective project evaluation reveals the gap in their economic or financial viability.
- Finally, the success of the SPPI will be judged in terms of how actual disbursements exceed budgetary provisions, and the quality of investments catalysed by the Viability Gap Funding mechanism. With a sound system of evaluation and monitoring of such projects, there is unlikely to be any leakages or misuse of resources.

Radical Reform of the Indirect Tax Structure

Liberals recognize the fact that India's current structure of direct taxes (namely, both personal income tax and corporate tax rates) is realistic, reasonable and comparable with widely prevailing international benchmarks. What is, however, necessary is to overcome some of the anomalies, correct distortions and build confidence in the long-term stability of the tax policy by preventing retrospective amendments that hurt the interests of tax payers. The Liberal Budget hastens to add, at this point in time, that the Fringe Benefit Tax brought in by the 2005-06 Budget is seen as a retrograde piece of legislation and strongly suggests that this be dropped forthwith.

In the area of indirect taxes, the Liberal Budget proposes definitive and radical reforms with a view to

(i) rationalizing the incidence of indirect taxes on manufacturing costs;

(ii) enhancing the competitiveness of the manufacturing sector;

(iii) reducing the transaction costs of industry and trade; and

(iv) improving the affordability of manufactured goods to the consumers. Keeping these objectives in view, the Liberal Budget has set out the following specific proposals:

- First, we must move to a single flat rate of customs tariff at 10 percent on all products with only a few exceptions. There will be two separate negative lists – one with zero duty rate applicable to special items like life saving drugs or medical equipment, capital goods imported by the units in the Special Economic Zones, etc; and the second comprising of high duty rates ranging from 50% to 150% applicable to sensitive goods typically agricultural products, wherein non-tariff barriers are converted into tariffication of such goods.
- Second, the Liberal Group is convinced that substantive and enduring contribution to the competitiveness of the Indian economy in general, and manufacturing in particular, can only be accomplished, if the combined incidence of all indirect taxes, both of the Centre (CENVAT) and the States (VAT, and other related taxes, including the local level levies like entry tax and octroi), are aligned with global benchmarks. Various studies have shown that a significant part of the difference between the domestic and international cost structure of most industries is accounted for by high and distorting indirect tax rates. The Liberal Group strongly recommends that the Government should move to a GST regime as proposed by the Kelkar committee on meeting FRBM targets.
- Third, the Liberal Group is also convinced that with the implementation of strategic framework of Liberal Budget and consequent acceleration of long-term economic growth to about 8% per annum, there will not only be a restoration of tax buoyancy, but even a substantial increase in tax revenues to GDP ratio of at least 3 to 4 percentage points to, say, around 13 to 14 percent in the coming years from the present levels of approximately 10% at the Central Government level.

Concerted Vigorous Disinvestments and Privatisation

The Liberal Group is greatly concerned with ambivalent and hesitant Government's policy of disinvestments and privatization of Public Sector Enterprises (PSEs). Indeed, the process of its implementation has a very chequered history ever since its initiation in 1991-92. It has invariably stumbled and wavered; and it has progressed only by "fits and starts". This is not surprising given the gradualistic approach to economic reforms on the one hand, and inherent resistance, initially even to the basic conceptual framework of disinvestments of PSEs from various vested interest groups on the other.

Now things are becoming even more complicated thanks to the well-entrenched coalition governance at the Centre, which is greatly undermining the progress on this front. The present UPA Government is faced with the so-called "ideological confrontation" with the Leftists parties.

Even otherwise, the PSEs disinvestments policy pursued by various Governments has essentially been a budgetary exercise. It does not reflect a strategic policy direction, as was the case with Britain under Prime Minister Margaret Thatcher in the eighties, marking a decisive and significant shift in the ownership and management of public sector businesses.

The Liberal Group is distressed by the fact that even this modest objective of raising resources has been virtually suspended by the present Government. Witness: in 2003-04, the Central Government mobilized highest ever revenues of Rs.16,953 crores from PSEs' disinvestments, equivalent of as much as the total of such collections in the previous five years. In 2004-05, revenues from PSEs' disinvestments were reduced to a mere Rs.4,091 crores.

In fact, the Liberal Budget 2004-05 had suggested the strategy of generating at least Rs.35,000 crores and moving up progressively in the subsequent years. Alongside, it also envisaged a system of "ring-fencing" these resources and deploying them for improving the quality of life for the common man in areas , like elementary education, basic health and civic amenities thus reducing the need for raising additional resources for this purpose.

The Liberal Budget 2006-07 stresses that even with such realistically modest targets for the forthcoming year, there would be significant gains in the budgetary outlook, provided there are *pari passu* efforts to "ring-fence" at least one third of such revenues largely for incremental investments in critical infrastructure projects. This would help in stimulating economic growth, thereby facilitating the process of widening the tax base.

> *" The creation of a Board for Reconstruction of Public Sector Enterprises (BRPSE) has become an avenue for delaying what is bound to be an inevitable process of phasing out non-performing assets of the Government. The Liberal Budget is of the view that the BRPSE is an outmoded idea. "*

Simultaneously, the Liberal Budget is opposed to the UPA Government's strategy of providing continuing budgetary support for restructuring of financially weak and loss-making PSEs, such as Hindustan Antibiotics, Indian Telephone Industries, as these will not only be counter-productive, but drain valuable budgetary resources. The real solution in respect of such enterprises lies in full-scale divestment or privatisation as soon as possible. The creation of a Board for Reconstruction of Public Sector Enterprises (BRPSE) has in our view become an avenue for delaying what is bound to be an inevitable process of phasing out non-performing assets of the Government. The Liberal Budget is of the view that this BRPSE is an outmoded idea. The time for state sponsored reconstruction and rehabilitation is long past.

Concluding Observations

The Liberal Budget 2006-07 seeks to send a message that the Indian economy can be steered towards a sustained high growth path of 8% real GDP that will make a decisive impact not only on the health of the fiscal system of the country through radical improvement of investment climate, but also towards achieving our goal of an equitable society by accelerating poverty alleviation and employment creation. ❖

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Chapter 4

Structure of Central Government Expenditure

At a very broad summary level, the best way to look at the structure of government expenditure is to examine the division of total expenditure between revenue expenditure and capital expenditure. From the time the economic reforms began, there has been a tendency to suppress capital expenditures in the face of the inability to control revenue expenditure. This state of affairs could not but raise extreme concern about the future growth prospects of the economy.

While disapproving spiralling revenue expenditures and bemoaning the decline in capital expenditures, it is being assumed that all capital expenditure is developmental in nature. Even though this standpoint may be generally true, it is important to remember that there can be, and has been, wasteful capital expenditure. Grandiose projects to satisfy the whims and fancies of the satraps in charge of ministries can be equally debilitating to the finances of the government.

Table 1 gives the details of total as well as revenue and capital expenditures of the current fiscal and the previous year.

It is evident from this data that

- The percentage of Revenue Expenditure to Total Expenditure (excluding State Plans) which, as per the revised estimates (RE) of 2004-05, was, at 76%, lower than the Budget Estimates (BE) of 81%, had once again risen sharply to 87% in 2005-06(BE).
- The residual share of Capital Expenditure has been languishing at 13% of Total Expenditure
- It is quite likely that the BE of 2005-06 will change as the year progresses and, if the previous fiscal is any indication, the share of Capital Expenditure may well rise. Of course, this raises a different issue: how much faith should one have in the BE if these are subject to wide fluctuations as the year progresses? The

"While disapproving spiralling revenue expenditures and bemoaning the decline in capital expenditures, it is being assumed that all capital expenditure is developmental in nature, it is important to remember that there can be, and has been, wasteful capital expenditure."

TABLE 1: TOTAL EXPENDITURE

(Rs. Crore)

	2004-05 (BE)	**2004-05 (RE)**	**2005-06 (BE)**
TOTAL EXPENDITURE	477829	505791	514344
REVENUE EXPENDITURE	385493 (81%)	386069 (76%)	446512 (87%)
CAPITAL EXPENDITURE	92336 (19%)	119722 (24%)	67832 (13%)

Note: Figures in brackets give the percentage of expenditure to total expenditure.

divergence of the RE from the BE is an instance of poor fiscal marksmanship and destroys the credibility of the budgetary process.

- The relative importance of revenue and capital expenditure will not change unless significant expenditure reforms are carried out. The Liberal Budget 2004-05 had made a number of suggestions towards this end. These included reforms on the administrative side, which would involve consolidation of some ministries and winding up of others.

  That this is not such a dramatic reform is evident from the fact that it has been suggested by the last Pay Commission and the Expenditure Reforms Commission. These reforms will also lead to a much "flatter" administrative process by which the movement of files from the lowest rung to the highest echelons will be much faster. Such reforms will save on administrative and salary expenditure.

- Aggressive restructuring of public enterprises through 'right-sizing' and privatisation can also cut down on revenue expenditures. At the same time vital revenues can be raised for use in productive purposes.

Important Components of Expenditure

Having examined the overall structure of government expenditure, we now look at some of its important components. This essentially involves looking at the quality of expenditure. In the first instance, we wish to look at how much of the total available revenue receipts are captured by committed expenditures. Committed expenditures are to be understood as those over which the government has little discretion. Such expenditure often arises as a legacy of the past. To illustrate: Debts raised in the past commit the government of the day to pay interest. There is some expenditure that must be incurred to provide protection to the country. Government cannot unilaterally change such expenditure and, consequently, the solution to reining in such expenditure is not in the realm of fiscal issues. Finally, a government committed to providing for the welfare of the poor is compelled to spend on subsidies. Table 2 shows such expenditure as a proportion of the total.

Table 2 shows the stranglehold that three items of expenditure – interest payments, defence and subsidies – have on the fiscal position of the Central Government. If one considers such expenditures as essentially non-developmental, an assumption that is not unreasonable, then barely 30% is left over for developmental purposes out of the revenue account.

> *"The Liberal Budget 2004-05 had made a number of suggestions including reforms on the administrative side, which would involved consolidation of some ministries and winding up of others...*
>
> *Aggressive restructuring of public enterprises through 'right-sizing' and privatisation can also cut down on revenue expenditures. At the same time vital revenues can be raised for use in productive purposes."*

From the point of view of total expenditure, almost 50% is devoted to the three items in Table 2. Assuming (unrealistically) that there are no other non-developmental expenditures, we can see that only about 50% of the expenditure is devoted for developmental purposes. Reforms to rectify this situation calls for bold and ruthless reforms, and these are necessary if the government is serious about helping development and not hindering it viz.,

TABLE 2: COMMITTED EXPENDITURE

(%)

	2004-05 (BE)	2004-05 (RE)	2005-06 (BE)
TOTAL EXPENDITURE (Rs. Crore)	477829	505791	514344
INTEREST PAYMENT + DEFENCE + SUBSIDIES	70.00 (45.32)	71.76 (42.69)	65.49 (44.72)
INTEREST PAYMENT	41.87 (27.10)	41.84 (24.89)	38.14 (26.04)
DEFENCE	14.07 (9.11)	14.46 (8.60)	13.85 (9.45)
SUBSIDIES	14.07 (9.11)	15.46 (9.20)	13.51 (9.20)

Note: In columns 2, 3 and 4 the numbers *outside* brackets are ratios to Revenue Receipts; numbers *inside* brackets are ratios to Total Expenditure.

- Curtailing interest payments requires a reduction in current deficits so that interest payments reduce in the future. Technically, only if the government is able to generate what are called *primary* surpluses can there be a reduction in debt and future interest payments. Unfortunately, the government has been running up primary deficits each year so that the debt levels continue to increase. Only if some of the reforms suggested above are implemented will the debt stop growing.

- Subsidies represent a different problem altogether. The difficulty with reducing subsidies is that it's political dynamite. Subsidies are dispensed not only explicitly i.e. through the budget, but also in a covert form by providing subsidised public sector services to the people. The numbers given in Table 2 refer only to explicit subsidies. Naturally, the level of implicit *plus* explicit subsidies will be much higher. The problem with most subsidies is that they are not well-targeted. The government had recently commissioned a study on subsidies, which offered certain suggestions to start to chipping away at the problem. It is a matter of great disappointment that the Finance Minister did not even refer to this study in his Budget speech in February this year.

Burden of Debt

The debilitating effect of debt is clear from the Table 3.

Table 3 gives a truer picture of the capture of revenue and expenditures for non-developmental purposes. Almost 80% of total expenditure (excluding state plans) is hostage to past "sins" i.e. deficits created in the past, which now hang like a mill-stone around the neck of governments past, present and future.

Composition of Government Expenditure

Total Expenditure is one measure of the size of the government. Table 4 gives the ratio of expenditure to GDP.

The numbers in Table 4 do not show any alarming rise in the size of the government. In fact, compared to many developed countries, which exhibit the above ratio in excess of 25%, the size of the government in India is more modest.

However, what is disturbing about India's expenditures is not so much its total level as its distribution across sectors.

" Curtailing interest payments requires a reduction in current deficits so that interest payments reduce in the future. Technically, only if the government is able to generate what are called primary surpluses can there be a reduction in debt and future interest payments. "

TABLE 3: BURDEN OF DEBT

(Rs. Crore)

	2004-05 (BE)	2004-05 (RE)	2005-06 (BE)
TOTAL EXPENDITURE	477829	505791	514344
Repayment of debt	198380	224075	247984
Total Interest Payments (IP)	129500	125905	133945
Total debt servicing (TDS)	327880	349980	381929
Revenue Receipts (RR)	309322	300904	351200
IP as % of RR	41.90	41.80	38.10
TDS as % of Total Expenditure	68.62	69.20	74.26

TABLE 4: SIZE OF GOVERNMENT : RATIOS TO GDP

(%)

	1999-2000	2003-04	2004-05	2005-06
Total Expenditure	13.46	15.30	14.51	13.62
Revenue Expenditure	11.86	12.17	11.45	11.70
Capital Expenditure	1.60	3.13	3.06	1.92

TABLE 5: COMPOSITION OF GOVERNMENT EXPENDITURE
Ratios to GDP at Market Prices

	1999-2000	2003-04	2004-05 (RE)	2005-06 (BE)
Agriculture & Cooperation	0.31	0.09	0.11	0.13
Rural Development	0.37	0.57	0.45	0.52
RURAL SECTOR	**0.68**	**0.65**	**0.55**	**0.65**
Food & Public Distribution	0.51	0.93	0.84	0.76
Health	0.10	0.10	0.10	0.11
Family Welfare	0.16	0.16	0.17	0.18
Elementary Education	0.17	0.20	0.26	0.36
Secondary & Higher Education	0.26	0.17	0.17	0.17
Drinking Water Supply	0.09	0.10	0.11	0.14
WELFARE	**1.29**	**1.66**	**1.65**	**1.71**
Urban Development	0.08	0.13	0.10	0.09
Petroleum & Natural Gas	0.01	0.25	0.12	0.10
Power	0.14	0.07	0.08	0.09
Roads & Highways	0.30	0.26	0.25	0.35
Civil Aviation	0.01	0.01	0.01	0.02
Telecom	0.00	0.04	0.18	0.08
Railways	0.13	0.25	0.27	0.19
INFRASTRUCTURE	**0.67**	**1.01**	**1.01**	**0.92**
Other Expenditure	**10.83**	**11.97**	**11.30**	**10.34**

Table 5 gives some ratios of various categories of expenditures to GDP at market prices. In the appendices, we also give the ratios of these categories of expenditures to total expenditures.

The Indian Liberal Group believes that governments must intervene in a market economy only if there are market failures and if welfare concerns demand such intervention. Table 5 has identified those sectors of the economy in which the active role of the government can, not only be defended, but actively sought. The results reported in this table are disappointing, to say the least. The Rural sector, Welfare sector and Infrastructure stand at under 3% of GDP while other expenditure – some of which may be important, such as law and order, defence, etc. – are as high as almost 11% of GDP. In terms of total expenditures (see Annexure Table), the same ratios are 20% and 80% For all the grandiloquent verbiage in the last year about emphasising rural development, reforms with a human face (as if the reforms *needed* a human face!) and pushing for infrastructure, the reality is quite different.

Efficiency of Government Expenditure

For far too long, there has been a tendency to measure the efficiency of government machinery in terms of the amount that has been spent on specific activities. It must, however, be remembered that expenditures are inputs that must lead to desirable and measurable output. It is this that we seek to emphasise in this section.

In this connection, we have taken up two aspects in the social sector: Literacy Rates (L.R. – Table 7) and Infant Mortality Rate (I.M.R. – Table 8). An effort is made to examine if any pattern emerges in the levels of government expenditure on elementary education and L.R. as well as between expenditure on public health and I.M.R.

“ It must, however, be remembered that expenditures are inputs that must lead to desirable and measurable output. It is this that we seek to emphasise in this section. ”

Table 6 considers L.R. at three points of time to see if any pattern emerges vis-à-vis government expenditure on education.

Table 6 shows that the ratios to expenditures have remained more or less constant over the decade 1991-2001 and yet L.R. has risen by 13 percentage points giving a growth rate of 25% over ten years. An optimistic assessment of this situation would state that for the same ratio of

TABLE 6: EXPENDITURE ON EDUCATION Ratio of Expenditure to GDP (%)				
	L.R. %	Centre: Elementary Education	Centre: Total Education	Centre + States: Education, etc.
1991	52.2	0.04	0.29	3.06
1996	58.4	0.12	0.31	2.74
2001	65.4	0.14	0.38	2.98

expenditure to GDP, the L.R. has risen significantly i.e. government expenditure is efficient. However, this would be misleading. If one looks at the actual levels of expenditure for the Centre and States combined, we find that the level was Rs.17401 crore in 1991 which had risen to Rs.62267 crore in 2001. This yields a growth of 3.5 times over 1991 or a growth rate of 257% over the decade. Now it is not so clear that there is efficiency in government's provision of elementary education. Lest it be misunderstood this is not a call for privatisation of elementary education.

The Liberal Position is that while the government will have to be the main provider of elementary education, private initiatives must also actively encouraged. What our analysis calls for is greater accountability and transparency in the way elementary education is funded by the government. As for the quality of such education that is another though crucial issue.

We also look at a similar table for health expenditure. Table 7 reports some data for one measure of public health namely Infant Mortality Ratio (I.M.R.).

A more or less similar picture to that in Table 6 emerges once again. I.M.R. has dropped from 80 to 66, which is a sign of improvement in health, but the ratios of health expenditure to GDP have remained stagnant. However, the levels of health expenditure have been rising continuously. Total expenditure on public health and water supply by the Centre plus states has risen from Rs.6,539 crores in 1991 to Rs.24,447 crores in 2001. This represents a fourfold increase of about 275% while I.M.R. has fallen by 14 points.

Reforms that emanate from our analysis are:

- Bearing in mind that most social expenditure is the responsibility of state governments, there should be no duplication of such expenditure at the level of states. Even centrally initiated/implemented schemes must be handed over to state governments for better targeting. We also strongly suggest that much of these social sector spending be left to the states and preferably to the Panchayats for the efficient and effective management of these programmes.
- There must be a re-orientation of expenditure on education from higher education to basic and primary education. A strong rationale exists for subsidisation of elementary education but not higher education. The subsidy element in higher education

“ It has to be forcefully pointed that the stand of the 'Left' parties is definitely anti-poverty reduction. By continuing to insist on keeping public enterprises free of any private participation they are depriving welfare-oriented activities much needed resources. ”

TABLE 7: EXPENDITURE ON HEALTH Ratio of Expenditure to GDP (%)				
	I.M.R. (per 1000)	Centre: Health	Centre: Public Health	Centre + States: Public Health + Water Supply
1991	80	0.08	0.03	1.15
1996	72	0.09	0.04	1.05
2001	66	0.09	0.04	1.17

must be reduced and diverted to elementary education.

- Similarly, emphasis must be placed on preventive health rather than curative health.
- Resources for such social sector activities must be garnered through the privatisation process.

It has to be forcefully pointed that the stand of the 'Left' parties is definitely anti-poverty reduction. By continuing to insist on keeping public enterprises free of any private participation they are depriving welfare-oriented activities much needed resources. Further, the opposition to privatisation betrays a bowing to the most important constituency of the 'Left', viz., organised labour, which is a mere 3% of the total labour force of the country. The Left's obsession with organised labour has meant that unorganised labour and those without a job have been deprived of any chance to improve their lot.

The UPA government which is in thrall of the 'Left' would do well to aggressively privatise/disinvest public enterprises, especially in view of the fact that proceeds from disinvestments could well be earmarked for social sector spending.

Summing Up

The analysis in this chapter has shown the extremely parlous state of the public finances of the central government from the perspective of the expenditure side of the budget. While it is true that in order to get a complete picture, we have to look at the expenditure *and* revenue sides of the budgets, this chapter's focus on expenditure has at least indicated the rigidities and inefficiencies that exist in government expenditures. The major points to emerge from our discussion are:

- The percentage of Revenue Expenditure to Total Expenditure (*excluding State Plans*) is at an alarming level and needs to be curtailed if India's public finances are to be restored to health.
- The problems with revenue expenditures also manifest themselves in the burgeoning and debilitating revenue deficits. It seems well-accepted that the major cause of India's fiscal problems is the inability to control revenue deficits. These deficits have to be hammered down to zero; in fact, prudence demands that there should be revenue surpluses. The preceding two Liberal Budgets have constantly drawn attention to this fact and have called for drastically reducing revenue deficits.
- The flip side of revenue deficits is the problem being experienced on the capital side of the budget. The residual share of Capital Expenditure has been languishing at less than 10% of Total Expenditure. In fact, revenue deficits have been funded for almost the last two decades by generating surpluses on the capital account. India has been borrowing to pay for the annual cost of running the government: the "grocery bill" is being paid for by borrowing ever more.
- The most significant drag on the finances of the government is interest payments and subsidies. The former is the direct outcome of past "sins" of profligacy and the latter is the outcome of political economy considerations. Interest payments will fall only if budgets from now on start to generate primary surpluses. Subsidies will not be reduced so long as the government is hostage to powerful interest groups clamouring for undeserved subsidies. It should be clarified that the Liberal position does recognise the need to promote genuine, subsidised welfare enhancing activities, such as basic education and basic health. What is being opposed is the dispensing of subsidies to those who do not deserve these.
- The current position of public finances has so constrained central and state governments that they are unable to meet their social obligations. Ideally, the Liberal position would advocate a re-orientation of subsidies from the undeserving to the deserving. This will generate resources for welfare improvement without an expansion in the size of the government. But a government that is not autonomous of interest groups would be hard-pressed to enforce the desired re-orientation of expenditures.
- The recommendation of the Liberal Budget is two-fold: One, an increase in the efficiency of government expenditures directed towards to the social sector so that the country "gets more bang for its bucks". Two, there should be aggressive privatisation so that the revenues so generated could be deployed for welfare improvements.
- Obviously, we have reached a point where there are no easy options left. The UPA government which seems to be so completely in thrall of its communist allies will have to distance itself from these so-called "messiahs" of the poor and honestly commit itself to work for the welfare of those who need it the most.

“The most significant drag on the finances of the government is interest payments and subsidies. It should be clarified that the Liberal position does recognise the need to promote genuine, subsidised welfare enhancing activities, such as basic education and basic health. What is being opposed is the dispensing of subsidies to those who do not deserve these.”

ANNEXURE TABLE

COMPOSITION OF GOVERNMENT EXPENDITURE

Ratios to Total Expenditure

	1999-2000	2003-04	2004-05 (RE)	2005-06 (BE)
Agriculture & Cooperation	2.31	0.58	0.73	0.95
Rural Development	2.77	3.70	3.09	3.84
RURAL SECTOR	**5.08**	**4.28**	**3.82**	**4.79**
Food & Public Distribution	3.77	6.07	5.82	5.56
Health	0.71	0.63	0.69	0.80
Family Welfare	1.19	1.06	1.19	1.35
Elementary Education	1.25	1.29	1.78	2.62
Secondary & Higher Education	1.95	1.13	1.16	1.21
Drinking Water Supply	0.69	0.66	0.74	0.99
WELFARE	**9.56**	**10.84**	**11.38**	**12.53**
Urban Development	0.58	0.87	0.69	0.66
Petroleum & Natural Gas	0.04	1.64	0.79	0.77
Power	1.01	0.45	0.55	0.64
Roads & Highways	2.21	1.73	1.71	2.59
Civil Aviation	0.07	0.06	0.08	0.13
Telecom	0.01	0.23	1.21	0.60
Railways	0.99	1.65	1.88	1.36
INFRASTRUCTURE	**4.92**	**6.63**	**6.91**	**6.75**
Other Exp.	**80.43**	**78.24**	**77.87**	**75.93**

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Chapter 5

Reforms in Tax Policy and Tax Administration

PART I – DIRECT TAXES

Steps to remove leakages in government expenditure and control of wasteful expenditure are necessary to manage the ever-growing government spending in essential areas. At the same time steps to increase revenue i.e. the Tax-GDP ratio are also necessary. The main source of income for the government being tax revenues (direct & indirect taxes) sincere efforts are needed to meet the demands of high levels of growth through diligent tax administration. The Liberal Budget is based on the belief that tax revenues can be enhanced without making any changes in the current tax structure or rates of taxes. How this can be done is the subject matter of this chapter on tax policy and tax administration.

Principles and Objectives

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 an urgent though uphill task especially considering the mind set of the people involved in tax administration at different levels. Accordingly, in the areas of tax reforms, the liberal budget would be guided by the following broad principles:

i. Any increase in tax revenue would not be by way of increase in tax rates, but by increasing the tax base to be achieved by humane, fair, efficient, transparent and accountable tax administration on the one hand and rationalisation and reasonable simplification of the tax laws on the other;

ii. Tax reforms would be through the creation of an atmosphere in tax administration resulting in voluntary compliance with tax laws by tax payers;

iii. Tax reforms would be through the creation of a simplified tax policy with rational and globally competitive tax rates;

iv. Tax reforms should also be aimed at providing a fair, speedy and efficient mechanism to resolve genuine disputes in the interpretation and administration of tax laws;

v. Tax reforms should also be aimed at providing a speedy and efficient mechanism to severely punish habitual tax evaders and corrupt officials on the one hand, and give a fair deal to those tax payers who sometimes become victims of complex tax laws which are difficult to simplify beyond a point considering their basic nature. Likewise, such mechanism should also provide an opportunity for forthright officials to get a fair deal in the event of their becoming victims of the present system of tax administration;

vi. Tax policy should aim at offering a lighter burden on earned income as compared to unearned income, by making proper and appropriate adjustments in the tax structure and tax rates; and

> *“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 an urgent though uphill task.”*

vii. Tax reforms should also be aimed at achieving a minimum number of tax rates even for individuals/HUFs by adopting a flat rate tax system (with an appropriate adjustment in the threshold limit) or by adopting not more than two rates of taxes, with appropriate adjustments in the level at which the second rate of tax should apply.

Tax Laws & Tax Administration and Broad Framework

To achieve the objectives of tax reforms, certain basic parameters for making/amending tax laws and their administration should be fixed and should be adhered to strictly as has been the case with the Directive Principles of State Policy in the Constitution. The broad outline of such parameters is as follows:

i. It has been the experience in the past that tax laws are amended with a view to punish a small percentage of defaulters. Unfortunately in the process, the tax laws turn out to be very harsh and complex for the large tax paying community. This is also the main cause for complexities in the present tax laws. 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.

> *❝ The annual budget and amendments to the tax laws should be de-linked. Amendments to tax laws should be made only by a separate Tax Laws (Amendment) Act. ❞*

ii. One of the basic tenets of a good tax policy is stability in tax rates for a period of at least five years. Therefore, frequent changes in tax rates should be avoided. Unfortunately, in the recent past, experience shows that while keeping the schedule of tax rates unchanged or while marginally reducing them, various 'clever' methods are adopted to indirectly increase tax rates. A classic example is the increase in surcharge for most of the assessees, introduction of Education Cess, introduction of Health Cess in a limited sector. Apart from this, the introduction of the Fringe Benefit Tax (FBT), has resulted in a substantial increase in the effective rates of tax in most cases.

iii. Another basic tenet of a good tax policy is stability in tax laws. For this, there is need to formulate a long term tax policy for a period of at least five years. Once such a policy is formulated after public debate, it should not be tampered with except under extraordinary circumstances. This will avoid the need for frequent amendments in the tax laws, which have made present tax laws not only complex but also difficult to implement in a fair manner. Towards this end, the annual exercise of amendments in the tax laws through the Union Budget should be given up. The annual budget and amendments to the tax laws should be de-linked.

Amendments to tax laws should be made only by a separate Tax Laws (Amendment) Act. This should be enacted only after detailed public debate and after due consideration by a Select Committee of Parliament having members who are conversant with the complexities in tax laws and the realities of their administration. In the same manner, even tax rates should be de-linked from the Union Budget and incorporated in the tax laws. In an emergency, of course, the law can always be amended through ordinance. To begin with, this policy can be adopted for direct tax laws and then be subsequently extended to laws relating to indirect taxes.

iv. For the purpose of raising tax revenues, it is necessary to widen the tax base rather than increase the tax burden of existing taxpayers. This is the only way to achieve real growth in tax revenue. The main hurdle in increasing the tax base is the perception of the people at large about tax administration. Unless this changes, it is unlikely that the tax base will increase in real terms. This can be achieved only by gaining the confidence of the citizens in the tax administration. For this, some permanent statutory provisions should be made whereby the small assessees can be asked to pay a fixed amount of tax in absolute terms upto a certain level of income with the assurance that their declaration of income will be accepted at face value without further enquiries except in cases where the Revenue Department has concrete evidence in its possession about the incorrectness of the declaration made by an assessee. For this, a simple scheme can be worked out in the Act itself to provide safeguards against the abuse of such a scheme.

v. As stated earlier, it is the fear of harassment at the hands of the tax administration, which has kept a number of small potential tax-payers outside the tax net. Another way to persuade this large number of potential taxpayers is to assure them that by filing returns of income they will have some advantage.

vi. It has been the experience that the present scheme of assessment of income by the Tax Department at various levels has also raised a number of practical issues with regard to harassment of the tax payers and an increasing resort to unethical practices. One way to combat this and also to create a proper atmosphere, is to encourage people to file their returns of income by eliminating many of the discretionary powers vested in Assessing Officers while assessing income. This can be done by providing a scheme of presumptive income for all medium level assessees on the lines of the present provisions of Sec.44AF, while simultaneously increasing the basic limits of Tax Audits to Rs.100 lakhs from the present Rs.40 Lakhs for Business and Rs.25 lakhs from the present Rs.10 lakhs for professionals. The earlier limits were fixed almost two decades ago and need revision.

vii. 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 is not a good sign in the long term in any civilised, democratic country and secondly, it affects all financial projections of the assessees and in many cases, it has a severe impact on the business community. This, indirectly, contributes to the creation of disrespect for the tax laws and affects the basic spirit of the citizens to fight for their rights. In fact this is one of the main causes for large-scale corrupt practices so prevalent in the tax administration.

Therefore, bearing in mind the long-term interests of the country and its object 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 taxpayers. All amendments to the tax laws should be made prospective and wherever possible, retroactive effect should be given to such amendments on transactions entered into prior to the date of making such amendments.

viii. The Liberal Budget is guided by the basic principle that if a harsh tax law is administered in a fair and humane manner it does not have any impact on the large tax paying community but the reverse is not true. This does not mean that the tax laws should be made harsh but an acknowledgement of the fact that the manner of administration of tax laws is more important than the tax laws themselves from the point of view of achieving the objectives of tax revenue. Accordingly, genuine reforms in tax administration are paramount to provide humane, fair, efficient, transparent tax administration with accountability. Major reforms are required in this area. For this, a number of genuine steps need to be taken such as:

1. 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 redressal of unfair and discriminatory treatment. Such a forum should also have the power of taking *suo moto* action against tax officials at all levels of tax administration. Such forum should ultimately provide for speedy disposal of cases against erring officials and justice to honest officials who have, unfortunately, become victims of the present system. To begin with, such a forum can be created in each State (to be headed by the Chief Justice of the High Court in the State) and responsible to Parliament through the Finance Ministry (and not the CBDT). Such a forum should have representatives from tax profession and respectable citizens as its members in addition to retired judges of High Court and/or Supreme Court. This forum should not become a place for extension of service, after the age of retirement, for tax officials as is the case with the Settlement Commission.

2. All instructions issued by the CBDT that affect the rights and duties of the tax payers should be made public.

3. Now that the Right to Information Act has become operative, appropriate steps should be taken to see that the tax administration strictly complies with the provisions of the Act and gives appropriate publicity to the manner of its implementation.

> *“Amendments to the tax laws should be made prospective and wherever possible, retroactive effect should not be given to such amendments on transactions entered into prior to the date of making such amendments.”*

4. We understand that recently the Prime Minister has taken the initiative to adopt the policy of performance-based promotion. For this, the method of evaluation of performance should be transparent and should be made known to citizens. At the same time, while adopting such a policy, merely higher collection of tax revenue should not be regarded as good performance unless such collection is proved to have been made in a fair and equitable manner and without being unduly harsh to the tax payer. For this, an appropriate scheme should be worked out to check if tax officials concerned have, in their over-enthusiasm, indulged in unjustifiable and harsh actions. This can be done by assessing their performance with reference to the ultimate result in terms of approval of their actions at the first two Appellate levels. Apart from this, to be fair to the tax officials, the targets fixed for collection should not be too high or unrealistic and should also be flexible by taking ground realities into consideration.

5. Appointment of Members of CBEC/CBDT should not be made merely on the basis of seniority. Members of such body should be of high integrity with proven track record with regard to fair and efficient tax administration. There should be some strict guidelines for such appointments to be monitored by an independent judicial form. This is of utmost importance because these bodies

are ultimately responsible for tax administration. The recent exposure involving the Chairman, CBEC involved in corrupt practices should be an eye opener.

Rates of Tax *vs.* Incentives

The Government has accepted the proposal that instead of the policy of having many tax incentives and high rates of tax, it is better to have fewer incentives which are absolutely essential and lower rates of tax. The Finance Act, 2005 has taken forward this policy. In this connection and to encourage compliance and reduce the cost of compliance which is quite high for tax-payers, it is suggested that:

i. To bring simplicity, no surcharge and cess like education cess be levied and the basic rate must absorb such cess.

ii. In any case, such surcharge/cess should not be made applicable on tax rates of TDS to avoid cumbersome rates like 1.0455, 5.2275.

iii. Further, no rates be enhanced retrospectively e.g. in the month of September 2004, rates of TDS etc. enhanced by education cess w.e.f. 1st April, 2004.

> *"We understand that recently the Prime Minister has taken the initiative to adopt a policy of performance-based promotion. While adopting such a policy, merely higher collection of tax revenue should not be regarded as good performance unless such collection is proved to have been made in a fair and equitable manner and without being unduly harsh to the tax payer."*

Real Income *vs.* Taxable Income

The Income-tax law contains many distortions in the computation of income which ideally should be one which is the real income, which any businessman would consider as 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. Specific reforms in this direction to be carried out are:

i. Depreciation allowance under the income-tax law be harmonised with the same under the Companies Act.

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

iii. The provisions of section 115JB, Minimum Alternate Tax (MAT) be deleted.

iv. Carry forward of losses and depreciation be merged together and be treated on par and be allowed to be set-off indefinitely.

v Carry forward of losses under all heads of income be permitted. Currently it is not allowed for income from house-property, and income from other sources etc.

vi. Both 'set-off in any year' and 'carry forward in subsequent year and set-off', be not 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 exception to the general rule may be differently treated.

vii. All expenses that are incurred for business purposes but are neither revenue in nature nor result in acquisition of a depreciable fixed asset should be allowed as deduction over a period of three to five years by way of amortisation.

Presumptive Computation of Income (optional)

1. In order to make the operation and management of the tax-system simple both for the tax-gatherer and taxpayer and to reduce compliance cost, it is suggested that the concept of presumptive tax be extended to many items of income at the option of the tax-payer.

2. To-day such provisions for income of the residents are for (a) Computing profits and gains of business of civil construction (b) Computing profits and gains of business of plying, hiring or leasing goods carriages (c) Computing profits and gains of retail business

3. We suggest that similar provision for computing income in cases of different professions 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 the like.

4. Without prejudice to the above, we suggest 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 presumptive basis. The advantage of this scheme would be 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 genuineness and allowability or otherwise of overhead expenditure will get eliminated and become

litigation free. Also, unethical practices of inflating overheads to reduce income and the official's temptation for indulging into corruption will get eliminated.

Minimum tax payable by all filers of income-tax returns

It is our estimate that of the 4 crore persons filing income tax returns, nearly two thirds i.e. 2.6 crores pay no tax, yet have to file the return of income under various provisions of the Income-tax Act. In the light of this we suggest:

1. The Government considers it necessary that all persons covered under the "one-by-six" scheme having incomes below the threshold limit (currently Rs.100,000) though may not have to pay any tax, they are required to file their return of income. Similarly every company and partnership firm even though it has no taxable income is required to file the return of income and so also many charitable trusts and similar institutions. Despite the existence of such provisions, we believe that crores of persons covered under these provisions do not file their return of income. We suggest that the department's efforts to bring such non-filers on record need to be strengthened. Such number is likely to increase rapidly with the growth of the economy, with the number of homes, cars and numbers of persons travelling abroad multiplying.

2. We realise that such a large number of return-filers add considerably to the volume of work of the tax administration and constitute a drain on the financial resources of the tax-department. Yet we do believe that it is in the interest of revenue to have mandatory requirement of filing of such returns.

3. However, to boost revenue, and to instil a spirit of pride in the tax return filers that they are contributing some tax to the national exchequer, we suggest that all individual and HUF return-filers other than senior citizens be required to pay tax of Rs.1,000 per year assuming their income in the case of women is Rs.1,45,000 and in other cases Rs.1,10,000.

   This proposal, assuming the number is around 3 crores, will bring in revenue of Rs.3,000 crores and make all those who are covered proud citizens.

4. We are aware that the Finance Act, 1992 had introduced a scheme to enable certain small income earners to pay their tax without having to undergo the cumbersome task of computing their income and furnishing their returns. Under the scheme, a fixed annual tax of Rs.1,400. ie. The scheme was dropped with effect from 1.4.1998. We are of the opinion that this was because of improper administration of the scheme rather than any demerits in the scheme itself.

   The scheme suggested here will not only serve the purposes envisaged in the "one-by-six provisions" and garner revenue of Rs.3,000 crores and other benefits but also bring some part of unaccounted money, into the main stream as individuals who furnish returns of income under this scheme shall account for their income at Rs.1,45,000/Rs.1,10,000 as the case may be.

5. The revenue collected by the Government under this scheme will be additional revenue. We recommend that it be appropriated into a new fund to be called "old age security/pension fund" a long needed requirement of providing old age pension to citizens. Initially, only those individuals who have paid income-tax for 10 years, be covered, then progressively more and more individuals can get covered.

Tax on Non-agricultural Income When the Person also has Agricultural Income

At present agricultural income is exempt u/s.10(1) of the Income-Tax Act, 1961. However, in the case of an assessee who has both agricultural and non-agricultural income, he should be taxed on non-agricultural income in a manner under which he pays tax slightly higher than what he would have paid on the same non-agricultural income if he had no agricultural income. Often it is believed that the agricultural income declared by such assessees is fictitious and is usually black money camouflaged. We suggest

" To boost revenue, and to instil a spirit of pride in the tax return filers that they are contributing some tax to the national exchequer, we suggest that all individual and HUF return-filers other than senior citizens be required to pay tax of Rs.1,000 per year. "

1. that tax on non-agricultural income in cases of persons also having agricultural income be higher than in the method at present being prescribed in the Finance Act each year.

2. that in cases where agricultural income is higher than non-agricultural income, the rate of tax for non-agricultural income for all assesses should be at a flat rate of 40%. Where agricultural income is lower than non-agricultural income, tax should be at the rate of 30% multiplied by the ratio of total of agricultural income and non-agricultural income to non-agricultural income, or at 40% whichever is lower.

Illustration: Rate of tax on non-agricultural income

	1	2
Agricultural income	Rs.2 lakhs	Rs.1 lakh
Non-agricultural income	Rs.5 lakhs	Rs.7 lakhs

1. Rate of tax 30% x 7/5 = 42% (Restricted to the instant case to 40%).

2. Rate of tax 30% x 8/7 = 34% (rounded)

Section 80 CCA of the I.T. Act

Section 80 CCA of the I.T. Act was in operation from 1.4.1988 to 31.3.1992 providing for deduction in respect of deposits under National Savings Scheme or payment to a deferred annuity plan. We suggest

1. that the scheme similar to the above provisions be revived. It is very essential to encourage citizens to honestly pay their tax especially in cases when the earning-life is short or substantial additional income is earned in certain years. Citizens should be given the option to defer payment of tax on some portion of their income if they are prepared to block that income with such authority as may be prescribed.

> *" In the case of an assessee who has both agricultural and non-agricultural income, he should be taxed on non-agricultural income in a manner under which he pays tax slightly higher than what he would have paid on the same non-agricultural income if he had no agricultural income. "*

2. We suggest that an individual or HUF be allowed to deposit out of the annual income
   - 20% of his returned income equivalent to or less than as returned in the earlier year
   - 60% of his incremental income over and above as returned in the earlier year.

3. Such deposits shall be for the purpose of national infrastructure projects to be managed by any nationalised bank or as may be decided by the Government. Terms of the deposit will be:
   a) Period of the deposit to be freezed / locked for a minimum 5 years with no limit for its continuity.
   b) Interest at the rate of 8% p.a. (taxable) to be credited to the deposit account for the period after the freezed / locked period or till the deposit is withdrawn
   c) Any amount withdrawn, principal and interest shall be taxable in the year of withdrawal.

4. This scheme shall be an extension of the policy of EET (exempt-exempt-tax) which the Government is planning to introduce for investments referred to under section 80C of the Income-tax Act.

5. This scheme has win-win benefits:
   a) Creation of black money will be minimised
   b) Infrastructure projects will have resources
   c) Government gets the tax as and when the deposits are encashed
   d) Scheme shall work as pension in old age or to meet additional expenditure on occasion of marriage, sickness etc.
   e) It will act like insurance,with money available to the family after the death of the earning member.

PART 2 - INDIRECT TAXES

Rate structure

1. Significant stability has been achieved over the past few years as far as the CENVAT (Central Excise Duty) and Customs Duty rates are concerned. In line with the road map already drawn by the Government, median Customs duty rate for majority items can now be brought down to 10% from the existing level of 15% leaving aside sensitive items like agricultural and petroleum products. In Budget 2005-06, Additional Duty of Customs to countervail local taxes at the rate of 4% was levied on specified IT products under Section 3(5) of the Customs Tariff Act, 1975. Similar add-on duties should not be introduced in Budget 2006-07. This is to avoid the cascading effect of duties and to eliminate complexity in duty computations.

2. Inter-sectoral credit between CENVAT and service tax that has been allowed since 10 September 2004 is working well. It is also an accepted fact that as soon as possible, the CENVAT rates and service tax rates should be on par. As a step in that direction, median CENVAT rate of 16% shoulkd be reduced in Budget 2006-07 to 14%. Rates of CENVAT for other items may continue at their current levels.

3. State-level VAT introduced in a majority of states from 1 April 2005 has been a great success. As recommended by the Empowered Committee of State Finance Ministers, Central Sales Tax (CST) should

be phased out as soon as possible and as a step in that direction, the current rate of CST at 4% should be reduced to 2% from 1 April 2006.

Dispute Resolution Mechanism Under Service Tax

1. The benefit of seeking Advance Ruling is available only to joint ventures with non-residents or wholly owned subsidiaries of foreign companies. This facility should be extended to all non-residents (whether or not they have joint ventures or wholly owned subsidiaries in India) and also to residents. Further, in most cases, this facility is available only for proposed business activities. However, with expansion in the service tax net on a selective basis year after year, there is need to extend this facility to such newly introduced services as well, irrespective of the fact that the activities in such cases, are already being undertaken by the applicant.
2. To reduce litigation and help early recovery of dues, the Settlement Commission on the lines of that under the income tax law should be put in place even under the service tax law for persons who have not been issued show cause notices and who are ready to pay the tax *suo moto* on becoming aware of their liabilities.

Coverage of Service Tax

The time has come for extending the levy of service tax to all services except a specified negative list of services like medical services, social services, educational services, defence services etc. This would avoid classification disputes and also provide smooth mechanism for claiming input tax credits.

Administration of Service Tax Department

It is observed that lately, the power of issuing summons is being indiscriminately used by the Service tax Department. Summonses have been issued without first issuing routine enquiry letters and even in cases where the objective is merely gathering routine data from the assessees. This causes significant hardship to the management of the assessees and undue harassment by the Department. Detailed internal guidelines must be framed to avoid such misuse of power by prescribing existence of conditions precedent and steps to be followed, before issuing summons.

“It is observed that lately, the power of issuing summons is being indiscriminately used by the Service tax Department. Summonses have been issued without first issuing routine enquiry letters and even in cases where the objective is merely gathering routine data from the assessees.”

On the lines of CEBC's Central Excise Manual, a Manual of Service Tax should be prepared and made available to the public for a better understanding of the service tax law and its administration by the assessees. ❖

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Appendices

Explanatory Notes on Appendices I to VI

The Liberal Budget has set out its budgetary estimates for 2006-07, based on the conventional pattern of the Central Budget documents. Given the need for like to like comparison of crucial budgetary data, it is inevitable that we do not disturb the existing structure and composition of the budgetary figures.

However, the Liberal Budget recommends a comprehensive reform of the budgetary structure, based on the system of Fund Based Accounting system, outlined in the Liberal Budget 2004-05. In this context, we are happy that the Finance Ministry has begun the efforts to formulate "Outlay-Outcome" framework in respect of the last budget. Even this system calls for fine-tuning with a view to make it more comprehensible and analysis-friendly.

The Liberal Budget has also been making a consistent case for doing away with the existing classification of expenditure as Plan Expenditure and Non-Plan Expenditure. This does not serve any useful purpose, and often gives a distorted picture of the budgetary transactions.

The most appropriate approach is to have well-defined economic and functional classifications of all Budget transactions, especially government expenditure. From this point of view, it will be necessary to undertake a comprehensive activity-wise classification of the expenditure pattern under a broad-based framework of Developmental and Non-Developmental Expenditure. While doing so, the Government must appoint a Statutory Expert Committee to review the existing budgetary data and recommend reforms therein, including the prevailing classification of Revenue and Capital Budgets.

Having said this, the Liberal Budget highlights the following key features of its estimates for the year 2006-07:

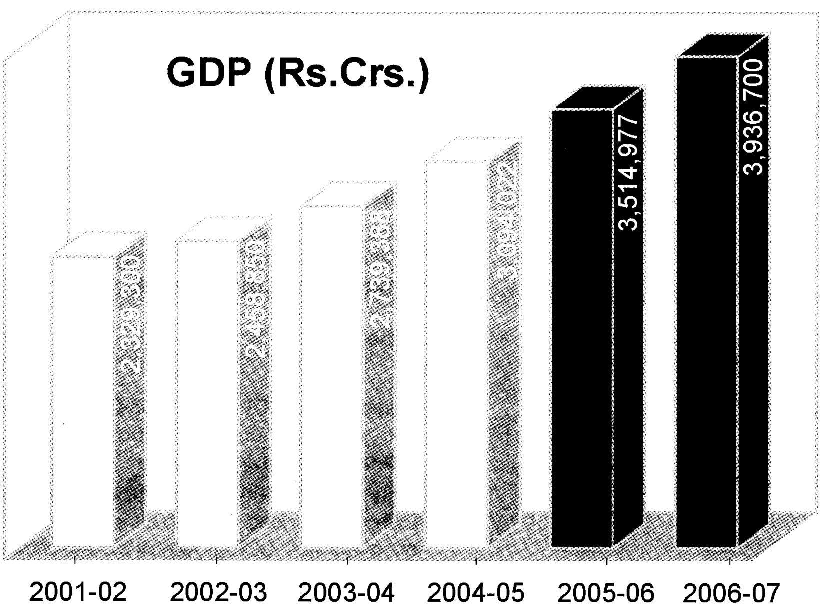
- First, the Liberal Budget 2006-07 envisages total expenditure (Revenue + Capital) of Rs.555,000 crores, representing an increase of 8% over the budget estimates of 2005-06. The comparable increase in the previous Central Budget was a meagre 1.7%. It must, however, be stressed that in the last two or three years the budgetary data has become virtually non-comparable thanks primarily to the substantive impact of the Debt Swap Scheme.
- Second, this total expenditure will be funded through revenue receipts of Rs.410,200 crores (or 73.8% of the total) and capital receipts of Rs.145,300 crores (or 26.2% of the total). It is the aim of the Liberal Budget to reduce progressively the dependence on the funding of total expenditure from capital receipts. The purpose is to reduce fiscal deficits substantially.
- Third, the revenue deficit is projected to fall from 2.7% of GDP at current market prices in 2005-06 to 1.5% in 2006-07. Likewise, the ratio of fiscal deficit is projected to decline from 4.3% to 3.3% during this period. The Liberal Budget recommends more aggressive phasing out of the revenue deficits as compared to the prevailing stance of fiscal discipline, enunciated by the Finance Ministry in the last budget.
- Fourth, in terms of resource efforts, the emphasis of the LIberal Budget is on raising the gross tax to GDP ratio from 10.6% in 2005-06 to 11.2% in 2006-07. There are limitations on raising the non-tax revenues given the fact that a large number of Central Public Sector Enterprises are loss-making. The increase in tax ratio is evidently going to be accomplished through better tax administration and the overall buoyancy in tax revenues.
- Fifth, it has been the mission of the Liberal Budget to bring about a sharp cutback in non-Plan Expenditure and raise correspondingly the allocations for Developmental Expenditure. Accordingly, the ratio of Development Expenditure to Total Expenditure will increase from 49.5% in 2005-06 to 52.5% in 2006-07. In particular, the spending on Defence, Interest Payments and Subsidies – the three predominant items of Non-Development Expenditure – will together drop from 7.7% of GDP to 6.6% of GDP. This is the most challenging task in expenditure management.
- Lastly, the Liberal Budget believes in a holistic management of the fiscal system, and strongly of the view that budgetary arithmetic is not an end in itself. What is most important is that the objective criteria of the Liberal Philosophy must be reflected not only in the budget figures, but also in the overall stance and substance of the fiscal policy.❖

Appendix I

Liberal Budget at a Glance

(Rs. Crores)

		2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Actuals)	2004-05 (Revised Estimates)	2005-06 (Budget Estimates)	2006-07 (LBE)
1.	**Revenue Receipts (2 + 3)**	**201,306**	**230,834**	**263,878**	**300,904**	**351,200**	**410,200**
	(2) Tax Revenue (Net to Centre)	133,532	159,425	186,982	225,804	273,466	324,100
	(3) Non-Tax Revenue	67,774	72,323	76,896	75,100	77,734	86,100
4.	**Capital Receipts (5 + 6)**	**162,500**	**180,531**	**207,490**	**204,887#**	**163,144**	**145,300**
	(5) Loan Recoveries & Other Receipts*	20,049	37,342**	84,218**	65,656**	12,000	16,500
	(6) Borrowings and Other Liabilities	142,451	145,072	123,272	139,231#	151,144	128,800
7.	**Total Receipts (1 + 4)**	**363,806**	**411,365**	**471,368**	**505,791#**	**514,344**	**555,500**
8.	**Total Expenditure (9 + 10)**	**362,310**	**413,248**	**471,368**	**505,791**	**514,344**	**555,500**
	(9) Revenue Expenditure	301,468	338,713	362,140	386,069	446,512	468,800
	(10) Capital Expenditure	60,842	74,535	109,228	119,722	67,832	86,700
11.	**Revenue Deficit (9 - 1)**	**100,162**	**107,880**	**98,262**	**85,165**	**95,312**	**58,600**
12.	**Fiscal Deficit [8 - (1 + 5)]**	**142,451**	**145,072**	**123,272**	**139,231**	**151,144**	**128,800**
13.	**Primary Deficit @**	**33,495**	**27,268**	**(-)816**	**13,326**	**17,199**	**(-) 3,800**
	Deficit Ratios (%) :						
	a) Revenue Deficit to GDP	4.3	4.4	3.6	2.7	2.7	1.5
	b) Fiscal Deficit to GDP	6.1	5.9	4.5	4.5	4.3	3.3
	c) Primary Deficit to GDP	1.5	1.1	0.0	0.4	0.5	(-) 0.1
14.	**Derived GDP at Current Market Prices**	**2,329,300**	**2,458,850**	**2,739,388**	**3,094,022**	**3,514,977**	**3,936,700**



LBE Liberal Budget Estimates

@ 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 Government and will not be used for expenditure

Notes:

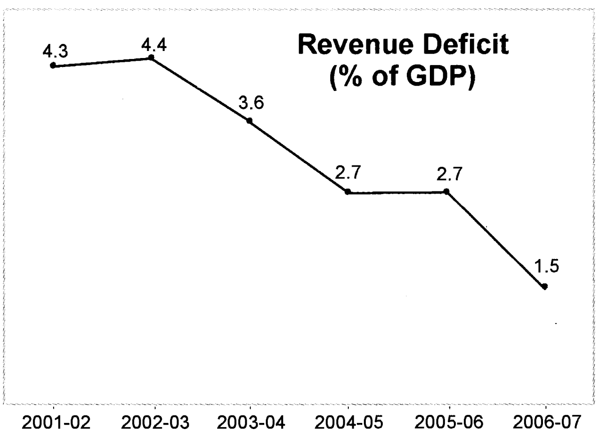
1. Figures for from 2001-02 to 2005-06 are based on official budget documents of Government of India
2. Figures for 2006-07 are Liberal Budget Estimates, based on various proposals set out in the text. GDP growth at current market prices are projected in nominal terms at 12 per cent per annum

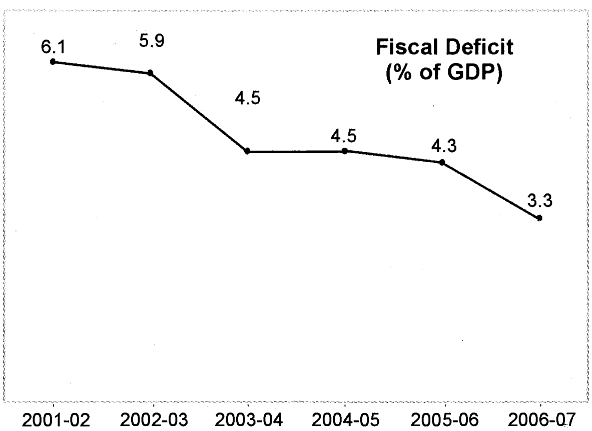
Appendix II

The Liberal Budget at a Glance

(% of GDP)

		2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Actuals)	2004-05 (Revised Estimates)	2005-06 (Budget Estimates)	2006-07 (LBE)
1.	**Revenue Receipts (2 + 3)**	**8.6**	**9.4**	**9.6**	**9.7**	**10.1**	**10.5**
	(2) Tax Revenue (Net to Centre)	5.7	6.5	6.8	7.3	7.9	8.3
	(3) Non-Tax Revenue	2.9	2.9	2.8	2.4	2.2	2.2
4.	**Capital Receipts (5 + 6)**	**7.0**	**7.3**	**7.6**	**6.6**	**4.7**	**3.7**
	(5) Loan Recoveries & Other Receipts	0.9	1.5**	3.1**	2.1**	0.4	0.4
	(6) Borrowings and Other Liabilities	6.1	5.9	4.5	4.5#	4.3	3.3
7.	**Total Receipts (1 + 4)**	**15.6**	**16.7**	**17.2**	**16.3#**	**14.8**	**14.2**
8.	**Total Expenditure (9 + 10)**	**15.6**	**16.8**	**17.2**	**16.3**	**14.8**	**14.2**
	(9) Revenue Expenditure	12.9	13.8	13.2	12.5	12.8	12.0
	(10) Capital Expenditure	2.6	3.0	4.0	3.9	2.0	2.2
11.	**Revenue Deficit Ratio (% of GDP)**	**4.3**	4.4	3.6	2.7	**2.7**	**1.5**
12.	**Fiscal Deficit Ratio (")**	**6.1**	5.9	4.5	4.5	**4.3**	**3.3**
13.	**Primary Deficit Ratio (")**	**1.4**	1.1	0.0	0.4	**0.5**	**(–) 0.1**





LBE Liberal Budget Estimates

@ 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 Government and will not be used for expenditure

Notes:

1. Figures from 2001-02 to 2005-06 are based on official budget documents of Government of India
2. Figures for 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 2006-07

Appendix III

The Liberal Budget - Revenue Receipts

(Rs. Crores)

	2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Actuals)	2004-05 (Revised Estimates)	2005-06 (Budget Estimates)	2006-07 (LBE)
Gross Tax Revenue	**187,060**	**216,266**	**254,348**	**306,021**	**370,025**	**438,000**
Union Excise duties	72,555	82,310	90,774	100,720	121,533	141,050
Customs	40,268	44,852	48,629	56,250	53,182	57,500
Corporation tax	36,609	46,172	63,562	83,000	110,573	137,200
Income tax	32,004	36,866	41,379	50,929	66,239	78,500
Service tax	3,302	4,122	7,891	14,150	17,500	22,500
Others	2,322	1,944	2,113	972	998	950
Less: States' Share and Transfer to National Calamity Contingency Fund	**52,842**	**56,122**	**65,766**	**78,617**	**94,959**	**113,900**
1. Net Tax Revenue	**133,532**	**158,544**	**186,982**	**225,804**	**273,466**	**324,100**
Non-Tax Revenue						
Interest receipts	35,538	37,622	38,517	31,538	25,500	30,100
Dividend and profits	17,290	21,230	22,081	20,799	23,500	27,500
Others	14,946	13,438	16,298	22,763	28,734	28,500
2. Total Non-Tax Revenue	**67,774**	**72,290**	**76,896**	**75,100**	**77,734**	**86,100**
Total Revenue Receipts (1 + 2)	**201,306**	**230,834**	**263,878**	**300,904**	**351,200**	**410,200**

LBE Liberal Budget Estimates

@ Fiscal Deficit *less* Interest Expenditure

(–) denotes generation of surplus position

** 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 Government and will not be used for expenditure

Notes:

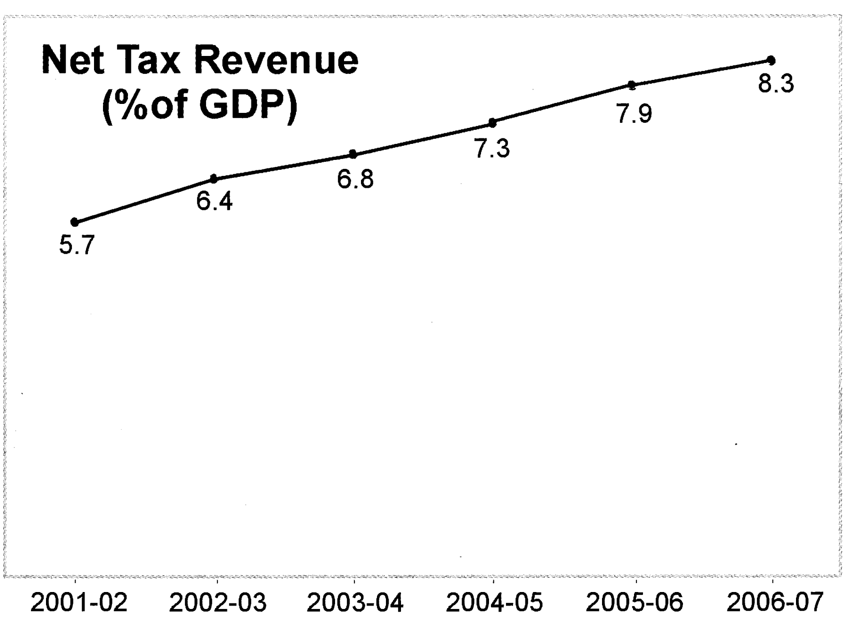
1. Figures for from 2001-02 to 2005-06 are based on official budget documents of Government of India
2. Figures for 2006-07 are Liberal Budget Estimates, based on various proposals set out in the text. GDP growth at current market prices are projected in nominal terms at 12 per cent per annum for these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

Appendix IV

The Liberal Budget - Revenue Receipts

(% of GDP)

	2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Actuals)	2004-05 (Revised Estimates)	2005-06 (Budget Estimates)	2006-07 (LBE)
Gross Tax Revenue	**8.0**	**8.8**	**9.3**	**9.9**	**10.6**	**11.2**
Union Excise duties	3.1	3.3	3.3	3.3	3.5	3.6
Customs	1.7	1.8	1.8	1.8	1.5	1.5
Corporation tax	1.6	1.9	2.3	2.7	3.2	3.5
Income tax	1.4	1.5	1.5	1.6	1.9	2.0
Service tax	0.1	0.2	0.3	0.5	0.5	0.6
Others	0.1	0.1	0.1	0.0	0.0	0.0
Less States' Share and Transfer to National Calamity Contingency Fund	**2.3**	**2.3**	**2.4**	**2.5**	**2.7**	**2.9**
1. Net Tax Revenue	**5.7**	**6.4**	**6.8**	**7.3**	**7.9**	**8.3**
Non-Tax Revenue						
Interest receipts	1.5	1.5	1.4	1.0	0.7	0.8
Dividend and profits	0.7	0.9	0.8	0.7	0.7	0.7
Others	0.6	0.5	0.6	0.7	0.8	0.7
2. Total Non-Tax Revenue	**2.9**	**2.9**	**2.8**	**2.4**	**2.2**	**2.2**
Total Revenue Receipts (1 + 2)	**8.6**	**9.4**	**9.6**	**9.7**	**10.1**	**10.5**
GDP at current market prices (Rs. Crores)	**2,329,300**	**2,458,850**	**2,739,388**	**3,094,022**	**3,514,977**	**3,936,700**



LBE Liberal Budget Estimates

@ Fiscal Deficit *less* Interest Expenditure

(-) denotes generation of surplus position

** 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 Government and will not be used for expenditure

Notes:

1. Figures for from 2001-02 to 2005-06 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 and 2002-03 between Total Receipts & Total Expenditure
3. Figures for 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 per cent per annum for these two years

Appendix V

The Liberal Budget - Expenditure Pattern

(Rs. Crores)

		2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Actuals)	2004-05 (Revised Estimates)	2005-06 (Budget Estimates)	2006-07 (LBE)
I.	**Non-Development Expenditure** ***of which***	**215,456**	**242,749**	**274,343**	**278,212**	**270,500**	**263,900**
	1. Defence	54,266	55,662	60,300	77,000	83,000	87,150
	2. Interest Payments	107,460	117,804	124,088	125,905	133,945	125,000
	3. Subsidies	31,210	43,533	44,256	46,514	47,432	47,000
II.	**Developmental Expenditure** ***of which :***	**159,364**	**184,197**	**197,025**	**214,108**	**265,000**	**291,600**
	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**	**471,368**	**505,791**	**514,344**	**555,500**
Ratio of Development Expenditure to Total Expenditure(%)		42.5	43.1	40.4	43.5	49.5	52.5

LBE Liberal Budget Estimates
* Revised Estimates
@ Budget Estimates

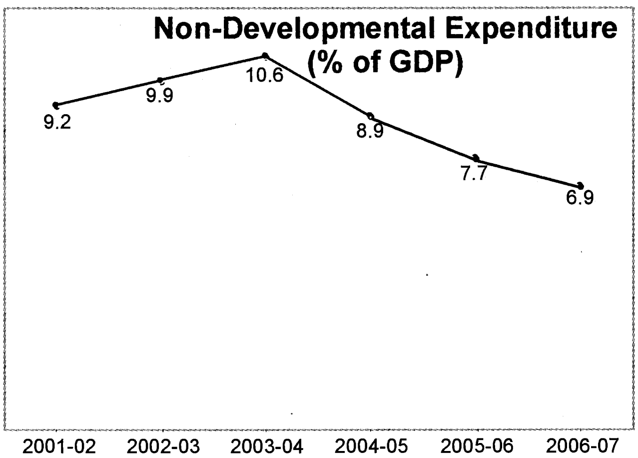
Appendix VI

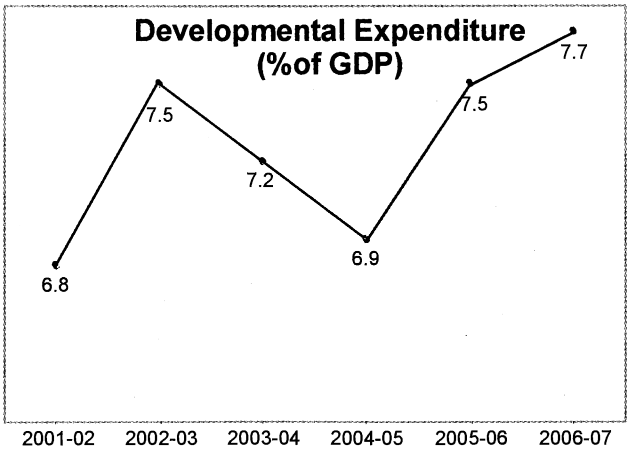
The Liberal Budget - Expenditure Pattern

(% to GDP)

		2001-02 (Actuals)	2002-03 (Actuals)	2003-04 (Actuals)	2004-05 (Revised Estimates)	2005-06 (Budget Estimates)	2006-07 (LBE)
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	2.4	2.2
	2. Interest Payments	4.6	4.8	4.5	4.1	3.9	3.2
	3. Subsidies	1.3	1.8	1.6	1.5	1.4	1.2
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)		**15.6**	**16.8**	**17.2**	**16.3**	**14.8**	**14.2**
GDP at current market prices (Rs. Crores)		**2,329,300**	**2,458,850**	**2,739,388**	**3,094,022**	**3,514,022**	**3,905,437**

LBE Liberal Budget Estimates





PROJECT FOR ECONOMIC EDUCATION

PROJECT FOR ECONOMIC EDUCATION is a non-profit organisation founded in 1985 by Mr. Minoo Masani. The PROJECT stands for a free economy in a free and liberal society. Its primary objective is to offer critical support to the process of economic liberalisation and to make it both understood by and acceptable to the people. Towards this end, the PROJECT has held a large number of seminars and workshops and sponsored numerous publications on subjects relating to the economy, economic reforms and the importance of a secular and liberal environment based on the Rule of Law.

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* Allied Organisations are: Democratic Research Service, Freedom First Foundation, Rajaji Foundation and the Indian Liberal Group.

INDIAN LIBERAL GROUP

The INDIAN LIBERAL GROUP (ILG) is an organisation founded in 1964, by the late Minoo Masani, author and parliamentarian, to promote the Liberal point of view on issues of the day. and to educate the public on the concept of Liberalism so that it is understood and accepted by the people, not merely as a method of economic engineering but also as a philosophy of governance that promotes a civil society.

The ILG seeks to emphasise the fact that a market economy by itself does not ensure an open society; that a free economy and a free society are two sides of the same coin; and that a free and liberal democratic society alone will ensure a satisfying standard of life for the people.

The ILG firmly suppports the economic reforms process, even while being critical of erroneous policies and decisions which give liberalisation a bad name. The ILG perceives its role not in negative terms of opposing the opponents of liberalisation but a positive one of promoting a free market system and strengthening a free society.

The primary objective of the ILG is to defend the fundamental liberal belief in the right of individuals to personal liberty, liberty of thought, expression, belief, faith and worship; the right of free association; the right to private property; the free choice of occupation; the right to information.

The INDIAN LIBERAL GROUP

- believes that the business of the State is goverment, not business.
- is opposed to any kind of monopoly.
- believes that technology is needed to promote human development and draws attention to the fact that the growth of Liberalism has been contemporaneous with the development of science and technology.
- affirms that active and participatory citizenship at all levels is essential for sustaining a liberal and democratic society.

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“In the age of liberalisation and globalisation and in the age of market-driven development, we need to be mindful of the basic existence of the ordinary people who are constantly facing the challenges to safeguard their very survival.”

- K. R. Narayanan
President of India (1997-2002),
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