Chapter 8

Gujarat State Finances

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While Gujarat, one of India's most developed states, cannot be characterized as typical, the main issues of its public finances are of general concern. The primary purpose of this study is to review the structure of and trends in Gujarat's state finances, with a view to identifying some of the main issues of state finances. The first section of this chapter examines the structure of Gujarat's state finances, while the second explains the different types of central transfers to Gujarat. Trends in Gujarat's state finances are reviewed in the following section. The fourth and fifth sections then discuss the structure of the state's taxes. The final section draws together the earlier analysis and discusses some of the major issues of state finances in India. These include rapidly rising expenditures; growing indebtedness of the states, particularly to the center; increasing difficulties in identifying new sources of revenues; widespread taxation of inputs under sales tax; inadequate resource mobilization through public enterprises; and underutilization of user charges.

THE STRUCTURE OF GUJARAT'S FINANCES

This section, following a brief description of the Gujarat economy, describes the main features of Gujarat's expenditures and their financing. The discussion is based on the state's revised budget estimates for 1986-87.

The Gujarat Economy[1]

The State of Gujarat (1981 census population 34.1 million)

1. For a good introduction to the Gujarat economy see Lakdawala (1983).

accounts for about five percent of India's population and six percent of its area. With a literacy rate of 43.7 percent, Gujarat ranks fourth among the states in terms of this indicator. About 31 percent of the population resides in urban areas, making Gujarat the country's third most urbanized state. Other vital statistics are less favorable: the state has among the highest infant and general mortality and crude birth rates. Gujarat ranks fifth in terms of per-capita income. Its per-capita state domestic product (SDP) of Rs. 2,985 (1985/86) is about 10 percent higher than the average for India as a whole.

Agriculture dominates the economy, accounting for about 35-40 percent of SDP and providing livelihood to more than 60 percent of the population. The principal crops are rice, wheat, jowar, bajra, pulses, groundnut and cotton. Low and highly variable rainfall is a major constraint to agricultural development. With only 20 percent of the cultivable area under irrigation, the state is vulnerable to the vagaries of monsoons. Gujarat's ultimate irrigation potential, allowing for completion of the World Bank assisted Sardar Sarovar (Narmada) Project, is estimated at about one-half of the cultivable area.

Gujarat is the second most industrialized state in India; value added in manufacturing accounts for over 20 percent of SDP. The state's long-established industries produce goods such as textiles, dairy products, edible oils, leather products and cement. The industrial structure has been gradually diversifying with the development of industries such as petrochemicals, pharmaceuticals, fertilizers, engineering goods and electronics. However, Gujarat's largest organized industry, the textile industry, has been passing through a severe crisis.

Gujarat's growth slowed in the 1970s -- from 4.5 percent annually in the 1960s to 3.3 percent per year -- largely because of the poor performance of agriculture, which recorded growth of value added of under one percent p.a. By contrast, manufacturing value added achieved growth of five percent p.a. during the decade. The early 1980s saw considerable improvement in growth performance. Between 1980-81 and 1984-85, reflecting the better performance of agriculture (growth rate of three percent p.a.) and more rapid growth of manufacturing (7.6 percent p.a.), SDP increased by an estimated 4.5 percent p.a.[2] Persistence of drought or near-drought conditions from 1985-86 to 1987-88 seriously retarded growth, reducing per-capita income in these years below the 1984-85 level.

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2. Growth rates given here are derived from estimates of SDP issued by the Central Statistical Organization (Government of India).

The state's Seventh Five-Year Plan (1985-90) provided for outlays of Rs. 60 billion. The largest allocations were for agriculture and irrigation (33.4 percent of the total), power (24.4 percent), social and community services (15 percent), and the mid-day meals program (9.2 percent). Since the introduction of Decentralized District Planning in 1980, District Planning Boards have been playing a growing role in the formulation and implementation of projects.

Overview of Gujarat's Finances

Gujarat's current expenditures and revenues in 1986-87 were estimated at Rs. 25.2 billion and Rs. 23.3 billion, respectively, giving a current account deficit of Rs. 1.9 billion (Table 8.1). The state used to achieve current budget surpluses, often sizable, until the emergence of a modest deficit (of Rs. 699.1 million) in 1985-86, which was expected to persist in 1987-88. The budget proposals for that year implied a deficit of Rs. 1.9 billion before taking account of new revenue proposals. The budget proposed to raise Rs. 1.25 billion in additional taxes (through higher sales taxes, an increase in the rate of surcharge on sales taxes from 10 to 20 percent, and the substitution of the annual tax on some vehicles by a one-time lump-sum tax) and to introduce economies in current expenditures of Rs. 232.5 million. Taking account of these measures, the budgeted deficit amounted to about Rs. 425 million (Table 8.1).[3]

The state's capital disbursements reflect all capital outlays undertaken by the Government of Gujarat, including budgetary support in the form of share capital contributions and grants and loans to state enterprises. Capital outlays by non-departmental enterprises are not part of the state budget, except those financed through transfers from the state government. A significant proportion of capital disbursements by the state takes the form of loans and advances. These go mostly to state enterprises, which play an important role in the provision of goods and services. There are about fifty statutory undertakings and government companies in Gujarat.[4]

With capital disbursements expected to amount to Rs. 5.9 billion, the overall budgetary deficit for 1986-87 worked out to Rs. 7.8 billion. The financing pattern for current expenditures and for the overall

3. More recent data show actual current account budget deficits of Rs. 3.1 billion in 1986-87 and Rs. 2.9 billion in 1987-88. There has been some improvement since then.
4. Details of their activities and financial performance can be found in annual reports of Bureau of Public Enterprises, Finance Department, Government of Gujarat.

deficit has several interesting features.

Nearly three-quarters of current receipts are derived from taxes and nontax levies imposed by the state government, with the rest coming from tax revenues transferred by the central government and central grants. The state's own taxes account for about four-fifths of total tax receipts (receipts from own taxes and from central taxes received under revenue sharing).[5] The state government's reliance on the central government for financing capital disbursements is greater. Nearly 50 percent of the overall deficit is financed through central loans. Domestic borrowing, the next main source of financing, was expected to meet about 20 percent of the 1986-87 deficit (a much higher proportion than in a normal year). Recoveries of past loans and advances are also a significant source of financing, as are net contributions from the various state provident funds. The remaining resources come mainly from reserve funds, use of cash balances, and borrowing from the Reserve Bank of India (RBI). External resources pass through the Union budget and are then passed on to the states through central loans and grants.

The State's Own Taxes

Gujarat, like other states, levies about ten different taxes. Indirect taxes provide most of the revenues, mainly the sales tax, electricity duties, taxes on goods and passengers, taxes on motor vehicles, stamp and registration fees, and the entertainment tax. State excise duties on alcoholic beverages play a lesser role in Gujarat than in most other states. Income and capital are each taxed through a single tax, the former through the tax on trades, professions, callings and employment, the latter through a land tax. The sales tax dominates the state's tax structure, providing two-thirds of total revenue from the state's taxes (Table 8.2). The next major tax -- electricity duties -- accounts for just over 10 percent of revenue.

Current Nontax Receipts

The state's nontax revenues are derived mainly from interest receipts, dividends, sale of goods, and user charges (Table 8.3). Major commercial services are provided by autonomous corporations and do

5. The states in India have greater independent sources of revenue (taxes and other levies they can impose and vary) than the states/provinces in most developing countries. In Pakistan, for example, the position is reversed: the provinces' own tax receipts account for only one-fifth of their total tax receipts, and own current receipts only one-quarter of total current receipts. See Jetha and Akhtar (1986, p.10).

not contribute directly to the state's budget. However, taxes levied on services provided by corporations such as the State Electricity Board (electricity duties) and the State Road Transport Corporation[6] (the passenger tax) make a sizable contribution to state revenues.

Most dividend and interest receipts come from state public enterprises. A large proportion of interest receipts are notional (imputed), arising in connection with irrigation expenditures. Although irrigation is a departmental service, accounts are kept on a commercial basis, requiring that interest charges be imputed for capital investment in irrigation. So as not to distort the overall state budget (which is kept on a cash basis), the imputed interest payments of the irrigation department are also shown as the state government's interest receipts.

As is the case in other states, Gujarat has not relied extensively on user charges. Such charges make only a limited contribution in social and community services. In education, receipts come from fees for university and other higher education and to a lesser extent for secondary and technical education; dispensary and hospital charges and medical college fees account for most health receipts. In economic services, most nontax revenues are derived from mining (royalties)[7] and forests (from sale of timber), but the user charge for irrigation water also is a significant revenue source. The various state levies on the transport sector (motor vehicle taxes, taxes on goods and passengers, and sales tax on motor spirits), some of which could be regarded as user charges, bring in substantial revenues (not shown in Table 8.3). In addition, revenues from tolls for bridges on national highways levied by the central government accrue to the state.

Current Expenditures

Education is the single most important current expenditure at the state level, absorbing about one-fifth of total current expenditures (Table 8.4). Health, which absorbs about 3.5 percent, and other services such as social security and welfare, bring the total share of social

6. Passenger road transport has been nationalized in Gujarat.
7. Rates of royalties for major minerals are fixed under central government legislation -- Mines and Minerals (Regulation and Development) Act, 1957 and Oil Fields (Regulation and Development) Amendment Act, 1984 -- which also provides for their revision at least every three years. Some states have levied cesses and surcharges on the royalties determined by the central government. The rate of royalty on crude oil, Gujarat's main mineral resource, in the late 1980s was Rs. 192 per ton until 1989/90, when an interim increase of Rs. 100 per ton took place.

and community services to 41.8 percent. Economic services account for 35 percent of current expenditures. These mainly comprise irrigation (10.5 percent including imputed interest payments), roads and bridges (6.5 percent), agriculture (6.1 percent), water and power development services (4.1 percent) and community development (3.6 percent). Miscellaneous expenditures such as debt servicing and general administration account for the remaining 23.2 percent of the total. Interest payments (nearly two-thirds of which represent payments to the central government) claim 9.5 percent of the budget.

Capital Expenditures

Since the bulk of spending on social and community services consists of current expenditures, economic services have a greater weight in capital expenditures (Table 8.5). The relative shares of economic and social (including community) services are about 80 and 20 percent respectively. Significant proportions of capital expenditures are devoted to irrigation (45.7 percent of total capital expenditures), industry and minerals (12.4 percent), forests (8.3 percent), and road and water transport services (eight percent). Agriculture, on the other hand, claims only 0.7 percent of the total, due in part to the importance of public corporations and other autonomous bodies like Gujarat Agriculture University, whose capital spending is not fully reflected in state budget statistics. About half of the allocation for social services is absorbed by water supply and sanitation. The relatively low share of education -- under one percent of total capital expenditures -- reflects, *inter alia*, the major role played by the private sector in the provision of secondary education and the autonomous nature of the universities.[8]

Because of the importance of the loans and advances made by the state government to public enterprises for capital investment, direct budgetary capital expenditures give only a partial picture of the state's total capital spending. Even the concept of capital disbursements, which includes loans and advances in addition to the state's direct

8. Another reason is that a large proportion of current expenditure takes the form of transfers to local bodies and private secondary schools, which may be used for both current and capital purposes. This tends to overstate current expenditures and understate capital expenditures. In 1984-85 grants to local bodies for primary education accounted for about 80 percent of the state's current expenditures on primary education, and grants to private secondary schools about 90 percent of its current expenditures on secondary education. See Finance Accounts, Government of Gujarat (1986).

capital expenditures, has a limitation: it does not reflect capital expenditure of non-departmental state public enterprises and other autonomous institutions that are financed from internally generated resources and from borrowing (from sources other than the state government). For a more complete picture of the development program, one must look at the state's annual plan.

Gujarat's Annual Plan for 1987-88

Gujarat's five-year development program, which is part of the national five-year plan, is implemented through annual plans. The annual plan includes most capital disbursements, since the bulk of such expenditures are for plan schemes. For example, it includes all capital expenditures of the Gujarat Electricity Board and the Gujarat State Road Transport Corporation. The plan also includes all recurrent expenditures on plan projects during the plan period. The state's annual plan does not, however, reflect central assistance for centrally sponsored plan schemes. This convention has probably been adopted to avoid double counting, since the central government's annual plan does include its contribution to centrally sponsored plan schemes. The state's annual plan can therefore be thought of as consisting of outlays on all state plan schemes and the state's contribution (but not the center's) to centrally sponsored schemes.

Gujarat's annual plan for 1987-88 proposed outlays of Rs. 11.6 billion, including Rs. 8.4 billion of capital outlays and Rs. 3.2 billion of current outlays (Table 8.6). The total development program amounted to Rs. 13.1 billion if account is taken of the expected central assistance of Rs. 1.5 billion for centrally sponsored plan schemes. The major claimants for the annual plan's resources were irrigation (27.3 percent of the total), energy (26.7 percent), and social and community services (21.6 percent).

The implementation of Gujarat's total Seventh Plan outlays of Rs. 60 billion (excluding central assistance for centrally sponsored plan schemes) was satisfactory. Gujarat is likely to have spent Rs. 54 billion, or 90 percent of the proposed plan outlays.[9] Strictly speaking, the pace of progress is somewhat less, since planned outlays are in 1984-85 prices.

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9. The annual plan outlays (in million rupees) were as follows:

1985/86	8,250 Actual
1986/87	9,650 Actual
1987/88	11,020 Revised Outlay
1988/89	10,750 Approved Outlay
1989/90	14,000 Approved Outlay

CENTRAL TRANSFERS TO GUJARAT

While central assistance takes many forms, most central resources come to Gujarat in the form of plan assistance, revenue sharing and small savings loans. This section discusses the different types of transfers received by Gujarat and outlines the present arrangements based on the recommendations of the Ninth Finance Commission.

Gujarat's budget for 1987-88 envisaged central transfers of Rs. 11.9 billion (Table 8.7), of which plan assistance amounted to Rs. 4.8 billion (40 percent of the total) and nonplan assistance Rs. 7.1 billion (60 percent). Transfers of tax revenues have tended to account for about one-half of nonplan transfers and just under one-third of total transfers. Small savings loans have greatly increased in significance in recent years.

In broad terms, nonplan assistance (with the major exception of small savings loans, which the central government has provided on its own initiative) is based on the recommendations of Finance Commissions, whereas plan assistance is determined by the Planning Commission. Finance Commissions not only make recommendations on the total amounts of tax revenues and grants that should be transferred but also on their distribution among the states. Plan assistance, by contrast, is provided under Article 282 of the Constitution, which permits both the central and state governments to make grants for any public purpose. This has meant that the center has greater discretionary powers over plan assistance -- both its volume and distribution -- than over nonplan assistance. The inauguration of five year plans in 1951-52 and the setting up of the Planning Commission therefore added a new dimension to center-state financial relations.

Shared Taxes

The revenue from Union excise duties and income tax is shared with the states. Although additional excise duties are not strictly a shared tax, it is convenient to discuss them here as well. The revenue from estate duties, until their recent abolition, was wholly assigned to the states.

Union excise duties. The states have been assigned 45 percent of the net proceeds from Union excise duties. The distribution of 83.5 percent of this amount among the states is based on population, the inverse of per-capita income, an index of backwardness,[10] and the

10. The index of backwardness is based on the relative shares of a state in the total populations of Scheduled Castes and Scheduled Tribes and of agricultural labourers, with both elements receiving equal weight.

difference between a state's per-capita income and the highest per-capita state income (that of Punjab).[11] The first factor received a weight of 0.25, the next two factors a weight of 12.5 each and the last one 0.50. Gujarat's share worked out to 3.186 percent of the proceeds. The remaining 16.5 percent of the net proceeds from excise duties are distributed to the deficit states in a specified manner. Gujarat does not qualify for any such transfer.

Income tax. The states have been assigned 85 percent of the net proceeds from income tax (but not corporation tax). Ten percent was distributed among the states on the basis of their contribution to income tax revenues, defined as the income assessed for income tax in a state as a proportion of the total income assessed (for all states). The remaining 90 percent of the proceeds were distributed in the same manner as shared Union excise duties. This formula gave Gujarat a share of 4.55 percent in the income tax revenues distributed to all states.

Additional excise duties. Under an agreement between the central and state governments in 1956, the latter agreed to avoid levying sales taxes on certain commodities, in return for which they received the revenues from additional excise duties levied on those commodities by the center. The agreement applies to textile fabrics, sugar and tobacco, including manufactured tobacco. This can be regarded as a tax-rental arrangement between the central and state governments, since the states retain the right to reimpose sales taxes on these commodities.[12] The distribution of receipts from additional excise duties among the states was based on population and SDP, with both factors receiving equal weight. Gujarat's share worked out at 5.941 percent of the total.

Other Nonplan Assistance

Aside from shared taxes, the main forms of nonplan assistance received by Gujarat are grants in lieu of tax on railway passenger fares, grants from the Central Road Fund, grants and loans for the relief of natural calamities (when needed) and the small savings loans. Of these, the small savings loans are by far the most significant.

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11. Punjab's per capita SDP was retained in the formula, although Goa has the highest per capita SDP.
12. In practice, it will not be in the interests of a state to tax these commodities because, as "declared goods" under the Central Sales Tax Act they cannot be subjected to sales taxes at rates higher than four percent.

Gujarat does not qualify for nonplan revenue gap grants-in-aid, (under Article 275 of the Constitution) paid to the states expected to have current budget deficits after taking account of Finance Commission recommendations.

Grant in lieu of tax on railway passenger fares. A tax on railway passenger fares is leviable by the central government, but the entire proceeds accrue to the states. The tax, introduced in 1957, was merged with basic fares in April 1961. To compensate the states for the loss of revenue, a grant has been payable to them since 1961-62. An annual grant of Rs. 1500 million was distributed among the states on the basis of their relative shares in the railways' total non-suburban passenger earnings. Based on its relative share of 5.72 percent, Gujarat received Rs. 86 million annually.

Grants from the Central Road Fund. At present, five percent of the revenues from the Union excise duty on diesel and petrol, which are earmarked for road development, are credited to the Central Road Fund. About 64 percent of this sum is earmarked for state roads and 35.5 percent for national highways, with the balance being used for administering the fund.

Relief for natural calamaties. Under the present arrangements for financing relief expenditures, the central and state governments contribute annually to a calamity relief fund set up in each state. The central government contribution for Gujarat amounts to Rs. 638 million p.a.

Small savings loans. Small savings schemes are operated by the central government, but proceeds are shared with the states. These consist of deposits and other savings instruments provided by the Post Office Savings Bank. Since 1952 the central government has provided loans on concessional terms to the states based on net collections of small savings. The loan provided to each state amounts to three-quarters of net receipts from small savings in that state. Such loans carry an interest rate of 12 percent and are repayable over 25 years, including a five-year grace period when only interest is payable. This arrangement seems to be aimed at securing the cooperation of the states in mobilizing domestic savings.

Plan Assistance

Plan assistance is provided in the form of block loans and grants, assistance for specific centrally sponsored schemes, and transfers related to external assistance for state projects. While the overall level of plan assistance is determined by the Planning Commission, assistance for centrally sponsored schemes is administered by central ministries.

Block loans and grants. General purpose assistance for state plan schemes has been provided under the so-called modified Gadgil formula. The formula, first adopted in 1969, was modified in 1980 for the Sixth Plan; the modified formula continued to be used during the Seventh Plan. The needs of the special category states (the five northeastern states of Assam, Meghalaya, Nagaland, Manipur and Tripura together with Sikkim, Jammu and Kashmir and Himachal Pradesh) had first claim on central allocations for state plan schemes. The balance of the allocation was distributed to the other states as follows: (1) 60 percent on the basis of population; (2) 20 percent on the basis of per-capita income, only to those states below the national average; (3) 10 percent on the basis of tax effort in relation to state income; and (4) 10 percent for tackling special problems such as droughts, floods and relatively underdeveloped tribal areas. Block assistance, thus determined, is provided in the form of 30 percent grants and 70 percent loans.[13] The loan finance is provided for 15 years at an interest rate of nine percent per annum.[14]

Further modifications in the Gadgil formula were adopted by the National Development Council in October 1990. Briefly, the weighting pattern was changed, "fiscal management" replaced "tax effort" in the formula, and special problems were more broadly defined. The new weights (in percentages) were: population-55, per capita SDP-25, fiscal management-5, and special development problems-15.

Assistance for centrally sponsored plan schemes. Block grants and loans are supplemented by assistance for specific schemes and programs regarded to be of national importance by the central government -- ranging from malaria eradication to the Rural Landless Employment Guarantee Program (RLEGP). While most assistance is for schemes that are fully funded by the center, a significant proportion of schemes receive assistance on a matching basis. For these latter schemes, most commonly the central government finances one-half of the cost of a project. The bulk of the assistance for centrally sponsored plan schemes is provided as grants.

The conditions that a state must satisfy to be eligible for assistance under a centrally sponsored scheme vary widely from scheme to scheme. The assistance to a state for a particular service often

13. The special category states receive 90 percent of the assistance as grants and 10 percent as loans.
14. The gross rate of interest is 9.25 percent p.a., but a rebate of 0.25 percent is granted for timely payments of principal and interest.

depends on the level at which the service is provided in the state in relation to the plan target for its national development. The likely level of assistance for centrally sponsored schemes (for a five-year period) for each state is determined during the preparation of the national and state five-year plans. The assistance for each state in a particular year is then decided during the extensive consultations that take place between the state and central governments on state annual plans. In recent years, central assistance for centrally sponsored plan schemes has accounted for 25-30 percent of total plan central assistance to the states.

External assistance for state projects. Transfers related to external assistance for state projects do not form part of block transfers or of those related to centrally sponsored schemes; hence they are often referred to as "additionality." Until recently, however, only a portion of external assistance for state projects was transmitted to the states. Seventy percent of the proceeds from external assistance for a state project were passed on to the relevant state (for financing the project concerned), with the central government retaining the balance. The proceeds so transferred are subject to the same lending terms as block assistance, irrespective of the terms on which external assistance was obtained (30 percent of such transfers in the form of grants and 70 percent as loans, with the latter repayable over 15 years at the rate of interest of nine percent p.a. net of rebate).

Partial additionality was probably meant to moderate the effect of aid resources on the pattern of inter-state allocations secured through the Gadgil formula and transfers for centrally sponsored schemes. The adoption of full additionality was certainly intended to increase the incentive for the states to mobilize external resources.

TRENDS IN GUJARAT'S FINANCES

There has been great expansion in Gujarat's expenditures. Total state expenditures in 1984-85 were about five times higher than in 1973-74 (Table 8.8). Even with the population growing by nearly 30 percent during the period and prices rising rapidly, per-capita real expenditures rose by two-thirds.[15] Greater resource mobilization

15. In this paper, where data have been given in real terms, current expenditures (and revenues) have been deflated by consumer price index for industrial workers (all India), and capital expenditures by the price index for gross domestic capital formation (all India). Suitable state-level price indices are not available. The implicit SDP deflator seems to behave erratically and cannot be used.

efforts contributed to the expansion of the state's activities. The share of the state's own current revenues (from state taxes and own nontax sources) in total current receipts (including central transfers) has remained stable at about three-quarters despite the rapid growth in current expenditures. There was, however, much greater reliance, in relative terms, on central loans for financing capital expenditures. Overall, central transfers (net) came to finance about one-third of the state's total expenditures, compared to one-quarter in the mid-1970s. These trends are examined in further detail below.

Expenditures

Between 1973-74 and 1984-85 Gujarat's total expenditure rose from 14 percent to 22 percent of state domestic product (SDP). Capital expenditure, which amounted to 3.4 percent of SDP in 1973-74, rose to about six percent of SDP (Table 8.9). Current expenditures increased from 10.6 percent to 16 percent of SDP. Capital expenditure, following its strong expansion in the 1970s, seems to have stabilized both in relation to SDP and in real terms. The main reason for the slowdown seems to be the resource constraints faced by the state. Current expenditure, by contrast, has grown rapidly throughout the period. Real per-capita current expenditures in 1984-85 were about 70 percent higher than in 1973-74. The growth of current spending has been accompanied by a large measure of stability in the relative share of social and community services and a sizable increase in the share of economic services (Tables 8.10 and 8.11).

In Gujarat, as in most other states, rapid growth of current expenditure seems to have been the result of adoption of ambitious development plans; salary revisions and automatic adjustments in cost of living ("dearness") allowances (based on movements in the consumer price index for industrial workers);[16] rising interest payments (which came to absorb nearly 10 percent of Gujarat's current expenditures); and increased emphasis on programs aimed at poverty alleviation and employment generation. With the states supplementing the centrally sponsored anti-poverty programs (such as Integrated Rural Development Program and National Rural Employment Program) with their own schemes, welfare programs have been making growing claims on state budgets. For example, Gujarat's mid-day meal scheme (under

16. Gujarat has roughly the same salary scale as the central government (though similar positions may be graded differently), and it pursues a similar policy with respect to cost of living allowances.

which children in standards 1-7 of primary schools are provided cooked meals) and the food-for-all scheme (which provides wheat and other grains to households below the poverty line at subsidized prices) alone involve annual expenditures of Rs. 1.2 billion (equivalent to five percent of total current expenditures).

The State's Own Taxes

Receipts from taxes levied by the state government have grown substantially (Table 8.12). Their share of the state's total tax revenues rose from 72 percent in 1973-74 to 76 percent in 1984-85; the increase in the share of own taxes in current receipts was from about 45 percent to 55 percent. The share of SDP captured by the state's taxes rose from 4.8 percent to 9.2 percent. Per-capita receipts from the state's taxes also grew significantly in real terms. There are indications, however, that the growth of own tax receipts has slackened somewhat in the 1980s.

The structure of revenue from the state's taxes underwent only limited changes between 1973-74 and 1986-87. This was due largely to the fact that the sales tax -- the mainstay of the state's tax structure -- maintained its share at over 60 percent (Table 8.13). Aside from the sales tax, the only major tax that gained ground was the electricity duty (which accounted for about 11 percent of total own tax revenue in the 1980s); revenue from most remaining taxes declined in importance.

Buoyancy coefficients are in line with these trends. The buoyancy coefficient for revenues from the state's own taxes was found to be 1.37 -- that is, for every one percent increase in SDP, the corresponding increase in revenue from the state's taxes was 1.37 percent (Table 8.14). This impressive overall buoyancy reflected buoyancy coefficients of substantially above unity for most taxes. The buoyancy coefficient for the sales tax was identical to the overall buoyancy of the state's taxes. Electricity duties recorded the highest buoyancy coefficient (1.81), land revenue the lowest (0.74). The relatively low buoyancy of revenue from motor vehicle taxes (1.11) was due to virtually unchanged specific rates of tax (with a consequent decline in average tax rates in ad valorem terms).[17]

Current Budget Balance

Gujarat managed to achieve current budget surpluses amounting

17. This problem was acknowledged and the rates of tax raised in the 1986-87 budget.

to 1-2 percent of SDP until the emergence of a moderate deficit in 1985-86. The deficit widened considerably in the following year when, budgeted at Rs. 1.9 billion, it was equivalent to about 10 percent of the state's own current receipts. The budget for 1987-88 proposed to reduce the deficit to a modest Rs. 425 million. Actual outcomes were much worse, however: budget deficits (actual figures) of Rs. 3.1 billion and Rs. 2.9 billion were realized in 1986-87 and 1987-88, respectively. Preliminary data show deficits of Rs. 2.9 billion (Revised Estimates) for 1988-89 and Rs. 2.3 billion (Budget Estimate) for 1989-90.

The difficulties experienced by Gujarat in financing its expenditure are symptomatic of the deterioration in state finances generally in recent years. The substantial combined current budget surplus for all states of Rs. 15.5 billion in 1979-80 dwindled to Rs. 2.1 billion in 1983-84; in 1984-85, for the first time in many years, there was a current budget deficit of Rs. 9.2 billion. There were modest surpluses in the next two years, but deficits re-emerged from 1987-88 onward.

Central Transfers

Gujarat's relative dependence on central transfers increased moderately over the past decade (Table 8.15). As indicated above, the share of central transfers (net) in total state expenditures increased from about one-quarter in 1974-75 to about one-third in 1986-87, reflecting the growth of central loans for the state's capital expenditures. The share of central tax revenues and grants in the state's current receipts (and expenditures) has remained relatively stable at one-quarter.

The increase in the central government's relative contribution to financing the state's expenditures appears to have been due more to the large expansion in central transfers than to a slackening in resource mobilization by the state. The state's resource contribution to its total expenditures in 1978-79, for instance, was 125 percent higher than in 1973-74, and a similar percentage higher in 1983-84 compared to that in 1978-79. By contrast, central transfers expanded rather slowly until 1978-79, when they were only 35 percent above their level in 1973-74, but they gained momentum thereafter, with their level in 1983-84 reaching 170 percent above that in 1978-79. The more rapid growth in central transfers coincided roughly with the inauguration of the Sixth Plan and the implementation of the recommendations of the Seventh Finance Commission.

Certain trends in central transfers are worth noting (Table 8.16). The most striking development was the spectacular growth of loans against Gujarat's share of small savings, which expanded twenty-fold between 1973-74 and 1987-88. On a per-capita basis, small savings in Gujarat are among the highest in the country,[18] greatly benefiting the state. The impact of the growth of small savings on loans to states was reinforced by the central government's adoption of progressively higher loans/small savings collection ratios.[19] Second, there has been considerable stability in the relative shares of transfers within the jurisdiction of Finance Commissions and those determined by the Planning Commission. At the national level, transfers determined by Finance and Planning Commissions each accounted for about 40 percent of total central transfers between 1974-75 and 1983-84 (the periods covered by recommendations of the Sixth and Seventh Finance Commissions). The proportions for Gujarat changed, but not appreciably. Overall, the Planning Commission is as important in the determination of central transfers to the states as the Finance Commission. Another feature worth noting is that although the proportion of plan assistance received by Gujarat in the form of assistance for centrally sponsored schemes has remained constant at about one-third of the total, such assistance has expanded greatly in absolute terms. Despite the importance of matching grants in state finances, hardly any empirical work has been done on their possible effects on the structure and growth of state expenditures. Such work as has been done on assistance for centrally sponsored schemes has concentrated on its equity aspects.[20]

Financing of Capital Expenditure

The increasing contribution of central loans to financing Gujarat's capital disbursements, especially over the last three to four years, has been a most significant development. Central loans now finance three-quarters of capital disbursements, compared to one-fifth in 1974-75 and two-fifths as recently as 1983-84. While the increasing role of central loans is due in part to the growth of plan loans, a more important factor has been the growth of central loans related to small savings collections in the state. More resources now come to Gujarat through small savings loans than as plan loans.

The contribution of the current budget surplus -- the next main source of finance for capital outlays -- has varied widely from year to

18. They were the fourth highest in the country at the end of 1983/84. See *Report of the Eighth Finance Commission*, p. 103.
19. The steady extension of incentives for savings under Sections 10, 80C and 80L of the Income Tax Act, 1961 also contributed to the growing popularity of national savings instruments.
20. See, for example, Gulati and George (1985) and George (1986).

year. Its ratio to total capital outlays declined from an average of about one-third in the 1970s to one-fifth in 1979-84. The situation worsened in 1985-86 and 1986-87, when a total (combined) budget deficit equivalent to nearly one-quarter of capital outlays was realized. The relative importance of other sources of finance -- net contributions to the state provident funds, recoveries of loans and advance, and market borrowing -- also decreased.

Since 1975-76 each state has been permitted to increase its net market borrowing by 10 percent per year.[21] Additional borrowing powers have been provided to the relatively less developed states. The limited scope for borrowing allowed to the states accounts for the sharp decline in net market borrowing as a source of financing for Gujarat's capital outlays -- from nine percent in 1973-74 to a mere four percent in 1984-85. The past policy with respect to market borrowings by the states was continued during the Seventh Plan period.

The central government's new policy on unauthorized overdrafts by state governments from the Reserve Bank of India (RBI) seems to have brought under control a longstanding problem. Unauthorized overdrafts arise when state governments' short-term borrowings from RBI exceed their agreed borrowing limits for ways and means advances. On October 1, 1985, the central government extended to the state governments medium-term loans of Rs. 16.28 billion, an amount equal to 90 percent of their unauthorized overdrafts as on January 28, 1985. These loans, supplemented by their own resources, enabled the states to repay all unauthorized borrowings. Henceforth RBI was to stop payments whenever unauthorized overdrafts remained beyond seven consecutive working days. The new Overdraft Regulation Scheme seems to have been effective; during 1988-89, for instance, no state government was in an overdraft position beyond the prescribed limit.

Concluding Remarks

Recent trends in Gujarat's state finances pose many difficult questions concerning state expenditures, the state's own resources and intergovernmental transfers. For example, are there significant possibilities for raising revenues from existing taxes? Can sufficient resources be mobilized in support of reasonable levels of expenditures without greater reliance on user charges and surpluses of state

21. Exceptions were made in 1983-84 and 1984-85, when increases of 20 percent and 15 percent, respectively, were permitted.

enterprises? A look at major revenue sources in the next two sections should assist in an assessment of such issues.

SALES TAX

This section describes the three main components of the sales tax -- the general (or state) sales tax, the central sales tax (on interstate sales), and the sales tax on motor spirits. The state's other main taxes are discussed in the next chapter. The recommendations of a major taxation commission (Government of Gujarat, 1980) will be noted where appropriate.

The State Sales Tax

Main features. The sales tax is primarily levied at a single stage (at the manufacturer, importer or wholesale level), though some commodities are taxed at two stages. The commodities subject to tax at a single stage are mostly taxed at the point of first sale (on sale by a manufacturer or by an importer) rather than at the point of last sale (that is, in the Indian context, on sale by a wholesaler). The tax is collected from registered dealers (manufacturers, importers and resellers). All dealers above a prescribed turnover are required to register. A registered dealer satisfying certain conditions may apply to be licensed. Licensing has been introduced, *inter alia*, to avoid the collection of tax from a large number of small producers, especially farmers.

The state sales tax imposed under the Gujarat Sales Tax Act, 1969 had four components: (1) a sales tax levied at the first point of sale on a large number of commodities; (2) a general sales tax levied at the last point of sale (that is, when a licensed dealer, generally a wholesaler, sells to an unlicensed dealer) on a limited number of commodities; (3) both sales tax and general sales tax levied on the remaining commodities; and (4) a purchase tax to supplement the sales tax and general sales tax. The 1988-89 budget introduced a 1.5 percent turnover tax on dealers whose turnover exceeded Rs. 2.5 million per annum, excluding turnover relating to goods exempt from sales tax, interstate and export sales and "declared goods" (see below). The tax is payable on net turnover exclusive of the sales tax and surcharge.

The *sales tax* or the first-point levy applies to a wide range of goods, from industrial raw materials and inputs to consumer durables. It accounts for an estimated three-quarters of the total revenue from the sales tax. The tax is imposed on sales by manufacturers, importers and resellers of goods purchased from unregistered dealers. All subsequent sales of a good subject only to the sales tax and for which tax has been paid are exempt. This exemption is ensured by permitting resellers of tax-paid goods to claim deduction of the sale value of all goods purchased from registered dealers.

The *general sales tax* is levied on agricultural products such as cotton, hides and skins, oilseeds and butter, many of which are produced by a large number of producers but marketed by a few dealers. The tax is normally payable at the last point of sale -- that is, when licensed dealers sell to unlicensed dealers (or consumers). No tax is levied when producers sell goods subject to the general sales tax to licensed dealers, because such dealers are entitled to purchase goods free of tax. Since licensed dealers are generally wholesalers, the tax can be thought of as being levied at the wholesale stage. However, the tax is also payable when producers sell directly to unlicensed dealers, so that in this instance it becomes, in effect, a first stage levy.

The *two-point levy* arises when "goods which by and large do not pass through controlled and identifiable channels of trade and/or on which a high tax rate at single stage is considered undesirable, are subject to both the sales tax and the general sales tax". (Government of Gujarat, 1980, p. 63). Goods subject to the two-point levy include articles of gold, foodstuffs, toilet articles, perfumes, lamps, pressure cookers, hair oils, suitcases and cutlery. Goods not otherwise specified also are subject to tax at two points. The first-stage tax is levied on sales by a manufacturer, importer or a reseller (on sale of goods purchased from unregistered dealers), whereas the last point tax is levied on the last licensed dealer. If the purchaser at the first stage is an unlicensed dealer, both the sales tax and the general sales tax become payable. If, on the other hand, the purchaser is a licensed dealer, only the sales tax is payable; the general sales tax becomes payable later, when the licensed dealer sells to an unlicensed dealer.

The *purchase tax* is payable at the appropriate rate for the sales tax or the general sales tax or both when taxable goods are bought from unregistered dealers and are not resold in the state.

Exemptions. All goods are taxable unless specifically exempted. Exempted goods can be classified into the following broad categories: necessities (e.g. bread, cereals, salt); perishable goods (e.g. eggs, milk, meat); goods of educational or cultural merit (e.g. books and periodicals); and goods used by low-income households (e.g. cheap footwear). In addition, exemptions have been granted to provide fiscal incentives to certain industries or activities (e.g. handlooms, bullock carts).

Tax rates. There are about 15 different rates of tax. The tax rates for most goods subject to the sales tax vary from four to 15 percent. The rate of general sales tax for most goods is four percent. For goods subject to the two-point levy, the rate of sales tax for most commodities varies in the range of 3-12 percent; the rate of general sales tax for these goods is four percent. Broadly, luxury goods such as consumer durables are taxed at relatively high rates, while nonluxury consumer goods and raw materials are taxed at low rates (Table 8.17). Taxable goods for which tax rates are not specified are subject to a two-point levy consisting of a sales tax of eight percent and a general sales tax of three percent.

For selected goods, some states, including Gujarat, had at one point adopted the practice of levying higher sales taxes on goods imported into the state than on similar goods manufactured in the state, a practice subsequently discontinued. For example, electronic goods manufactured in Gujarat carried a sales tax rate of one percent, compared to 10 percent for comparable goods imported into the state; similarly, scooters manufactured in the state were exempt from the sales tax, whereas imported scooters were subject to a tax of four percent. Such higher tax rates on "imports" were clearly equivalent to import duties (at the state level).

A surcharge at the rate of 10 percent has been levied on all prevailing rates of sales tax. Forty percent of the proceeds are transferred to the Narmada Development Fund for support of the Narmada project; the remaining 60 percent of the proceeds are allocated to a natural calamities fund. The 1987-88 budget raised the surcharge to 20 percent, earmarking receipts from the increment in the surcharge for expenditures on natural calamities. The 1988-89 budget raised the surcharge further to 25 percent.

Tax treatment of inputs. For the purpose of tax relief, inputs are divided into two categories -- "prohibited" goods and other goods (which will be referred to as "non-prohibited" goods).[22] The latter receive partial relief, whereas the former do not. Purchases of non-prohibited goods by manufacturers receive relief in one of two ways. The goods may be purchased free of tax and the tax liability discharged later at the concessional rate of two percent. Or alternatively, the tax paid on inputs in excess of two percent may be set off against the tax payable on the output. The extent of relief for

22. The expression "prohibited goods" is somewhat confusing; in the context of the Gujarat Sales Tax Act, it simply denotes goods that do not qualify for tax relief.

input taxation has been reduced in recent years. Until a few years ago there was complete relief for taxes paid on non-prohibited inputs. In 1983-84 a one percent tax was imposed on such goods, increased to two percent in 1985-86. Input tax relief does not apply when inputs are used in the manufacture of exempt commodities. Nor does it apply to taxes paid on capital goods used in the process of production and on petroleum products (which are classified as "prohibited" goods).

Treatment of exports. Goods exported outside India are exempt from the sales tax. (The exemption also applies when an exporter does not export directly but through an intermediary.) In every other respect they are treated in the same manner as other goods produced in the state. No tax relief is available for taxes paid on "prohibited" inputs used in export production, and the relief for taxes paid on non-prohibited inputs is available only with respect to tax rates in excess of two percent. Thus for all goods produced in the state, including exports, only partial relief is available for input taxation.[23]

Sales tax incentives for industries. In 1986, the Government of Gujarat introduced comprehensive incentives for industrial development of the state, particularly in the less developed areas, including investment subsidies and sales tax concessions. Under the latter, an eligible firm is exempt from sales taxes on both inputs and outputs. Alternatively, the firm may opt for sales tax deferment, under which the sales tax liability must be discharged over six years following the expiry of the deferment period. The extent of concessions (timing, magnitude, etc.) for both types of sales tax incentives depends on the size and location of a firm and the amount of fixed investment.

Recommendations of the Gujarat Taxation Commission. Of the many recommendations made by the Taxation Enquiry Commission on the sales tax (see Government of Gujarat, 1980), the following were the most significant:

(1) There should be a tax at the first stage on almost all commodities subject to the sales tax.
(2) Relief for taxes paid on inputs should be greatly expanded.
(3) A two-point levy should be imposed on certain goods where there is evidence of evasion at the first stage or where the value-added after the first point is substantial. The object

23. It is worth mentioning, in passing, that inputs and machinery imported directly by a manufacturer will not come within the purview of sales taxation unless they are resold.

should be to levy the tax at the same rate at both stages and to permit set-off of the tax paid at the first point against that payable at the second point.[24]

The Central Sales Tax

Sales taxation of interstate trade is governed by the Central Sales Tax Act, 1956, which limits states' powers to levy sales taxes on interstate sales. Only the Central Sales Tax (CST) may be levied on the first interstate sale of all goods other than newspapers, actionable claims, stocks, shares and securities and electrical energy.[25] The CST is administered by the states, which also retain the revenues from it. The revenue from the CST benefits the relatively developed and industrialized states like Gujarat more than other states -- CST revenues account for about 20 percent of total sales tax revenues in Gujarat, compared to 10 percent for all states.

Certain goods considered to be of special importance in interstate trade have been designated as "declared" goods. Aside from the three commodities subject to additional excise duties (textile fabrics, sugar and tobacco and tobacco products), the "declared" goods consist of coal (excluding charcoal), iron and steel, crude oil, cotton and cotton yarn, jute, hides and skins, cereals, oilseeds and pulses.[26] "Declared" goods are treated somewhat differently from other goods under CST.

The rate of CST, currently four percent,[27] applies to all interstate sales (of both "declared" and undeclared goods) to governments and registered dealers (unless the rates of sales taxes in the exporting state are lower than four percent, in which case these lower rates apply). For all internal sales of "declared" goods as well as their interstate sales to governments and registered dealers, the CST rate is the *maximum* rate. This means that domestic sales of "declared" goods cannot be subjected to sales taxes in excess of four percent.

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24. Two members of the Commission, including the chairman of the 1977 study team on sales tax, did not see the need for the continuance of the two-point levy. They favored exclusive reliance on a single-point levy at the first stage of sale for administrative reasons.
25. In other words, goods exported in the course of interstate trade cannot be taxed more than once in the exporting state. If goods that have borne a state sales tax are subsequently sold in interstate trade (without undergoing further manufacturing), the state sales tax is refundable.
26. All "declared" goods are also "prohibited" goods under the Gujarat Sales Tax Act.
27. The initial rate of 1% was raised to 2% in 1963, 3% in 1966 and 4% in 1975.

Moreover, interstate sales of "declared" goods that have already borne CST at four percent in the exporting state cannot be taxed further through sales taxes in the importing state.

The CST system can be summarized[28] as follows:

(1) where a good, whether "declared" or undeclared, is sold to a government or a registered dealer, the rate of CST is four percent or the rate applicable to internal sales within the exporting state of the good concerned, whichever is lower;
(2) where a "declared" good is sold to other entities, the rate of CST is twice the rate applicable to the internal sales of the good concerned (i.e. the tax rate can rise up to eight percent);
(3) where an undeclared good is sold to other entities, the rate of CST is 10 percent or the rate applicable to the internal sales of the good concerned, whichever is higher; and
(4) where a good is generally and unconditionally exempt from the sales tax within a state, it is also exempt from the CST.

In Gujarat, relief for sales taxes paid on inputs embodied in interstate sales is no different from that for other sales. "Prohibited" inputs used in interstate sales do not qualify for tax relief, and the relief for taxes paid on nonprohibited inputs is available only for tax rates exceeding two percent.[29] Furthermore, no tax relief is provided to manufacturers within the state for CST paid on inputs.

Evasion has been a longstanding problem in the operation of the CST. There has been a growing tendency for firms to transfer goods to their branches and commission agents in other states to take advantage of interstate differences in tax rates. Until recently such consignment transfers did not constitute a "sale" for the purposes of the CST and no tax was payable on such transactions.[30] This anomaly was rectified by the Forty-Sixth Amendment to the Constitution, which extended the definition of a "sale" to include, *inter alia*, consignment transfers. This wider definition was adopted by the state

28. For details of the evolution and structure of CST, see Government of India, (1954, pp. 1-76) and Government of India (1978, Part II).
29. Many other states do not provide any input tax relief with respect to interstate sales.
30. More precisely, in the absence of a definition of the expression "sale of goods" in the Constitution, the Supreme Court had consistently held that the expression had the same meaning as in Section 4 of the Sale of Goods Act, 1930, under which consignment transfers do not constitute a sale.

through the Gujarat Sales Tax (Amendment) Act, 1985. The 46th Amendment has not yet become effective because further legislation needed to operationalize it remains to be enacted by the central government.[31]

Some states withdraw input relief when goods are consigned. In Gujarat, a manufacturer can only set off that part of the tax paid on inputs which is in excess of four percent of the sale price of the goods consigned. The rationale for this is that had the goods been sold in the course of interstate trade instead of being consigned, CST at the rate of four percent would have been payable. To improve the enforcement of this provision, the state has recently imposed a purchase tax of two percent (in addition to other state taxes that are payable) on all inputs (other than "declared" goods) utilized in the manufacture of taxable goods which are dispatched outside the state (but within India) by way of transfers to branches or commission agents.

Sales Tax on Motor Spirits

This tax is levied on aviation fuel, gasoline and diesel. The tax rate for gasoline and diesel is 20 percent of the sale price. A surcharge of 10 percent is levied on these rates with, as in the case of the sales tax, the proceeds allocated to the Narmada and famine relief funds.

Concluding Remarks

Both state and central sales taxes in India affect the allocation of resources by changing relative prices of intermediate goods (thereby inducing changes in factor proportions in production) and by modifying levels of protection. Input taxation not only changes relative prices of inputs but also affects costs of production (or effective protection) of industries using taxable inputs. The protective effects of the CST become obvious as soon as it is recognized that the CST can be viewed as an export tax levied by states on interstate sales. Possible reforms with a view to reducing the distortionary effects of sales taxes are discussed in the last section.[32]

31. Consignment transfers are to be taxed at the same rate as the CST. Fifty percent of the proceeds are to be distributed to the states on the basis of the origin of goods and the other 50 percent according to the formula governing the distribution of Union excise duties.
32. Comments will be confined to distortions in production. Good discussions of distortions in consumption will be found in Ahmad and Stern (1984) and Ray (1986).

THE STATE'S OTHER MAIN TAXES

Land Revenue (Tax)

Powers to tax agricultural income and property have been conferred upon the states under the Constitution. The income tax levied by the central government consequently excludes agricultural incomes from its scope. Neither agricultural income nor property has been adequately taxed at the state level, though some states levy an unsophisticated agricultural income tax (frequently confined to plantations) and most states tax agricultural property through a land tax.

The land tax is probably the oldest tax in India. In Gujarat it is levied at a fixed rate per acre, with the rate of tax varying with the class of land (rainfed, irrigated, rice land, gardens, etc.). The rates of tax vary widely, from 37.5 paise to Rs. 13 per acre. Holdings of agricultural land up to 3.5-8.25 acres in size (depending on the class of land) are exempt.

The Taxation Enquiry Commission found two major defects in the land tax. First, the impact of the tax on lands of comparable productivity was dissimilar because assessments were carried out in different areas using different methods and at different times. Second, the assessments, which were guaranteed to remain in effect for thirty years to encourage farmers to make improvements on their lands, have not been revised for decades. To overcome these problems, the Commission recommended the replacement of the land tax by a graduated agricultural holdings tax, similar to that proposed by the Committee on the Taxation of Agricultural Wealth and Income (Raj Committee).[33] In Gujarat, as in other states, an agricultural holdings tax has not found acceptance.[34]

The Professions Tax

Article 276 of the Constitution permits the states to levy a tax on "professions, trades, callings and employments", provided that the maximum rate of tax does not exceed Rs 250 per annum. Gujarat has levied the tax since April 1976, and the ceiling has recently been raised to Rs. 2,500 by a Constitutional amendment. The tax is broad-based but has not been applied to agriculturalists for administrative reasons. Employers have the responsibility for collecting the tax from

33. The Taxation Enquiry Commission's recommendations were based on a modified agricultural holdings tax suggested by Bagchi (1978).
34. A farm holdings tax is levied in West Bengal but has not yielded much revenue.

wage and salary earners.

The tax applies to (1) salary and wage earners whose monthly emoluments are above Rs. 1,000; (2) doctors, lawyers, accountants and other professionals with annual incomes above Rs. 10,000; (3) employers employing an average of more than five employees per day during a year; (4) partners of registered firms with annual incomes above Rs. 10,000; (5) dealers (as defined for the purposes of the Gujarat sales tax) with annual gross turnover of above Rs. 50,000; and (6) companies, hotels, theatres, gas stations, banks, moneylenders, estate agents and building contractors.

Tax rates ranged from Rs. 50 to Rs. 250 per year. Employees' rates varied with their salaries, those for professionals with their "standing in the profession" (those with less than five years of working experience being exempt), and those for dealers with their turnover. The rates for employers under (3), moneylenders and professionals varied with the size of the urban area; those in localities with populations of under 20,000 were exempt.

Stamp Duties

Stamp duties are levied by both the center and the states. The central government sets uniform national rates for stamp duties under its jurisdiction.[35] All duties levied within a state are, however, collected by the state, which also retains all revenues. In Gujarat, stamp duties are levied at specific or ad valorem rates depending on whether or not the assets to which documents refer are amenable to valuation. Instruments relating to conveyances, mortgages, gifts and sales transactions account for most of the revenue.

The Taxation Enquiry Commission found that undervaluation of properties was widely resorted to with a view to evading the proper payment of stamp duties.[36] The Commission recommended that stamp duties for conveyances should be based on the market values of the properties concerned and suggested the setting up of valuation machinery for this purpose. The Gujarat state government implemented this proposal during 1982-83, replacing at the same time the various duties on conveyances, which varied between six and 12 percent, with a single rate of eight percent. The amendment in

35. It determines stamp duties for bills of exchange, checks, promissory notes, bills of landing, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.
36. Undervaluation of property sales helps both the seller and the buyer to evade several other taxes as well. See Acharya and associates, (1985).

legislation permitting the levy of stamp duties with reference to market values of properties has been challenged in the courts, however.

State Excise Duties

State excise duties (not to be confused with Union excise duties) are confined to alcoholic beverages and medicinal and toilet preparations containing alcohol. They are a minor source of revenue in Gujarat because of prohibition.

Taxes on Vehicles

All owners of motor vehicles were until recently subject to an annual tax. The 1987-88 budget replaced the annual levy with a single lumpsum payment for all vehicles except commercial vehicles engaged in the transport of goods and passengers and the heaviest category of private cars. Exemptions from the tax include motor vehicles designed and used solely for agricultural purposes, tractors, ambulances, school buses and government vehicles used for non-commercial purposes.

The tax base consists of registered laden weight for trucks, seating capacity for buses and other vehicles plying for hire and used for the transport of passengers, and unladen weight for private cars (except the heaviest category of cars, which are taxed on the basis of permissible seating and standing capacity), motorcycles and tricycles. A surcharge of 50 percent on the normal rates -- both annual and lumpsum -- is levied on diesel vehicles. Imported vehicles are subject to twice the rates applicable to other vehicles.

The introduction of one-time payment of the motor vehicle tax on private vehicles was meant to simplify administration. The lump-sum tax for new motor vehicles varies from Rs. 1,500 (for vehicles with unladen weight not exceeding 750 kg) to Rs. 3,250 (for vehicles with unladen weight exceeding 1,500 kg, but not exceeding 2,250 kg). The annual tax continues to apply for motor vehicles with unladen weight above 2,250 kg. The lump-sum tax for new motorcycles varies from Rs. 160 to Rs. 600, depending on weight, while that for new three wheelers is fixed at Rs. 600. For previously registered vehicles, the lump-sum tax is lower, varying inversely with their age. These rates apply to individuals, local authorities, public trusts, and educational and social welfare institutions; other taxpayers are liable at twice the rates indicated above. This scheme is expected to lighten the administrative burden by removing 700,000 two-wheelers and 100,000 four-wheelers from the purview of annual (or quarterly) tax collection.

Taxes on Goods and Passengers

Road travel by passengers (except by taxis) in most areas is taxed at the rate of 25 percent of the gross-of-tax fare payable. Travel in certain areas (e.g. within the state capital of Gandhinagar and municipalities) is taxed at the rate of one percent of the fare. All goods transported by road are subject to tax. The basis of taxation for goods carried by public and private goods vehicles is different, the former being taxed on the freight charged and the latter on tons carried per kilometer. However, all transport operators have the option to pay a lump-sum amount in lieu of the goods tax.

The Taxation Enquiry Commission's recommendations included a lump sum levy on contract vehicles (vehicles that carry passengers under a contract). Such vehicles tended to evade the passenger tax by not correctly disclosing the number of passengers carried, the fares charged, and the number of trips undertaken. The state government implemented the recommendation during 1981-82 by taxing contract vehicles on the basis of weight.

Electricity Duties

Electricity duties are levied on the consumption of electrical energy. Some uses of electricity are either exempt or taxed at concessional rates. A major concession applies to new industrial undertakings, which are exempt from the payment of duties for five years. The duties are collected by the Gujarat Electricity Board and other licensees. The rates of duty applicable to purchases of electricity are shown in Table 8.18. The rates, mostly ad valorem in nature, vary according to the type of consumption, with residential consumers generally subject to higher rates than other consumers. Electricity for irrigation purposes is taxed at the relatively low rate of five percent of power charges. Electricity generated for own use is taxed at lower rates than that purchased from power companies. The Taxation Enquiry Commission was broadly in agreement with the structure of electricity duties but suggested that the number of different rates might be reduced to two (10 percent and 20 percent).

Entertainment Tax

This tax applies to any exhibition, performance, amusement, game or sport to which persons are admitted on payment. Certain types of entertainment are, however, exempt (e.g. Indian dramatic performances and dancing). Screenings of Gujarati films produced in the state bear a concessional rate of 30 percent of the rates applicable to other films. Screenings of films through video cassette recorders became taxable in 1984-85. The tax, which is levied on gross-of-tax admission charges, varies progressively with admission charges; it also varies with the size of the locality (Table 8.19).

User Charges

User charges play a minor role in state finances in India. Table 8.20 shows Gujarat's receipts from user charges in the four main sectors (agriculture, irrigation, education and health) in which user charges could be expected to be levied.[37] The smallest contributions in 1987-88 came from agriculture and education. The budgeted contribution of health was higher, with the bulk of receipts taking the form of payments by the state government's Employees' Insurance Scheme for use of government medical facilities by its contributors. Receipts from irrigation met only a small fraction of current expenditures on irrigation as defined in the budget. However, if interest payments (which form most of current expenditures on irrigation) are excluded, current expenditures on irrigation equalled irrigation receipts. In other words, if no account whatsoever is taken of capital costs, receipts from irrigation (mainly from water charges) covered expenditures on operation and maintenance of the irrigation system.

In Gujarat's 1987-88 budget, receipts from user charges from the above sectors were budgeted at Rs. 357 million, compared with corresponding current outlays of about Rs. 9.3 billion, giving a ratio of user charge receipts to current outlays of about four percent. This ratio rises to five percent if current outlays on irrigation are taken net of interest payments.

SELECTED ISSUES

The durability of fiscal federalism and its responsiveness to rapidly changing needs in a populous and heterogeneous country constitute one of the major accomplishments of independent India. The retention by the states of greater fiscal independence than in most countries is an important aspect of this achievement. However, the assumption of growing expenditure obligations by the states, though accompanied by notable tax effort, has tended to increase their dependence on the central government in recent years. Containing this trend will be difficult under the present division of functions and resources between the center and the states, unless greater reliance is

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37. As already indicated, user charges levied by autonomous state enterprises are not reflected in state budgets.

placed on sources of revenues inadequately utilized in the past.

The overriding issues of public finance in Gujarat include (1) high growth of current expenditures; (2) growing claims on resources by poverty alleviation, employment generation, and other welfare-type programs; (3) increasing constraints on the use of tax policy for revenue purposes, given the present intensive use of major taxes; (4) widespread taxation of inputs under sales tax; (5) inadequate resource generation by public enterprises; and (6) underutilization of user charges.[38]

State Expenditures

The most critical fiscal issue in Gujarat, as in most other states, is the rapid growth of current expenditures. The estimated buoyancy coefficient for Gujarat's current expenditures for the period from 1973-74 to 1984-85 was 1.30. This compares with a buoyancy coefficient of 1.28 for total current revenue. Given that current expenditures presently exceed current revenues, persistence of these coefficients would mean growing current budget deficits. Achievement of moderate surpluses would require both restraint in the growth of current expenditures and greater resource mobilization. The growth of current expenditures in recent years of about 20 percent annually cannot be sustained over the long term.

Though still comprising a modest portion of Gujarat's expenditures, outlays on programs for poverty alleviation and employment generation have increasingly contributed to the growth of current expenditures. Not only have the states enthusiastically adopted centrally sponsored schemes in these areas but they have also supplemented these with a wide range of welfare measures of their own. The major state-sponsored welfare programs in Gujarat include mid-day meal and food-for-all programs, an old-age pension scheme and a scheme for financial assistance to destitute widows. Unless the growth of welfare-type expenditures can be restrained, serious inroads into the resources available for basic infrastructure and services will be difficult to avoid. In this connection, better targeting of beneficiaries and more cost-effective ways of assisting them need to be explored.

Little or no detailed quantitative work has been done on the main factors underlying the growth of state expenditures. The state expenditure data published by RBI, though valuable, are too

38. The issue of state transfers to local authorities, though very important in Gujarat, will not be addressed.

aggregated. Consequently, detailed analyses of expenditures have to rely on state budget documents; the fact that the annual budget documents of each state consist of nearly twenty volumes gives some idea of the magnitude of the task. To make matters worse, only a few states undertake an economic classification of expenditures. The growing use of microcomputers and the change in the classification of government budgets from 1987-88, which gives a clearer picture of some of the more rapidly growing expenditure categories such as rural development and nutrition, should make the task more manageable. Detailed work on state expenditures is needed both at an aggregate level and at the level of individual states.

The State's Own Taxes

The maintenance of the share of receipts from the state's own taxes in total tax receipts in Gujarat constitutes a remarkable achievement. It implies that the rate of growth of revenues from state-controlled taxes was comparable to that of tax revenues received from the central government under revenue sharing. The high buoyancy of own tax receipts that made this possible could only have been achieved through substantial increases in tax rates, since the elasticity of tax revenues (i.e. the automatic response of tax receipts to changes in GDP) of Indian states is thought to be low.[39] There are indications, however, that sustaining the high rate of growth of revenues from own taxes will be difficult.

A major reason why tax revenues may not be as buoyant as in the past is the concentration on a narrow range of taxes. The rapid growth in receipts from the state's own taxes since the early 1970s stemmed largely from the four main taxes (sales tax, electricity duties, taxes on vehicles and taxes on goods and passengers), which contribute over four-fifths of own tax receipts. In the process, most of the revenue potential of these taxes appears to have been utilized.

There are major limitations on the flexibility of even the sales tax. The large overlap between the tax bases of state sales taxes and Union excise duties has already been mentioned. The prevailing rates of sales tax in Gujarat are high relative to Union excise duties, so trends in rates of excise duties significantly affect revenue potential from the state's sales tax.[40] This was less of a problem in the past, when sales

39. Further work on elasticities of state taxes is needed. Estimates of elasticities per se are of lesser interest than analysis of possible causes of their relatively low magnitudes.
40. The use by the central government of administered prices instead of excise duties has been a source of irritation to the states.

tax rates were generally low and could be regarded as minor supplements to excise duties. Tax rates in neighboring states also circumscribe a state's independence with respect to tax rates. A state that levies higher tax rates than nearby states will encourage consumers to make direct purchases from other states and dealers to transfer goods on a consignment basis to other states, especially high-value goods. It was to combat these related problems of evasion and trade diversion that Gujarat reduced tax rates for items such as utensils, television sets, air conditioners, refrigerators and motor vehicles in the 1986-87 budget. Another constraint on the revenue potential of sales tax is the heavy reliance on revenues from taxation of intermediate goods and machinery, which provide an estimated one-third of sales tax receipts.

The proposals for new taxation in the 1985-86, 1986-87 and 1987-88 budgets illustrate the growing difficulties of raising additional tax revenues within the prevailing tax structure. All three budgets raised new revenues from sales tax, while the 1987-88 budget raised substantial revenues from the motor vehicle tax as well. Sales tax changes during this period included an increase in the rate of general sales tax from three to four percent, increases in tax rates for individual commodities, an increase in the rate of surcharge on sales taxes from 10 to 20 percent, and an increase in the rate of tax on non-prohibited inputs from one to two percent. The additional revenues from the motor vehicle tax came mainly from the substitution of a lifetime tax for annual license fees. These measures all reflect increasing difficulties in obtaining more revenue from an already well-utilized tax base.

Identification of desirable directions of tax reform is a complex matter requiring much more detailed analysis than can be undertaken in a general review of this kind. Fortunately such an analysis is already available in the report of the Gujarat Taxation Enquiry Commission (Government of Gujarat, 1980), some of the main conclusions of which were mentioned in the previous two sections. The brief comments on taxation that follow are meant to supplement the discussion in that report.

The single most important measure Gujarat could take to improve the efficiency of the tax system would be to relieve raw materials and intermediate goods from sales taxation.[41] The objective should be to

41. This issue is discussed in the national context in Government of India (1978), and in Chelliah (1980). A more recent discussion of this and other issues of state and inter-state sales taxes can be found in Govinda Rao and Tulasidhar (1986).

abolish the distinction between "prohibited" and non-prohibited inputs and to permit the set-off of all sales taxes paid on inputs against tax payable on outputs. This would free inputs from sales taxes, thereby converting the sales tax into a form of value added tax. The adverse revenue impact of this measure could be moderated by suitably increasing tax rates on final goods.[42] Now that Union excise duties are being converted into a value added tax (MODVAT), the continued taxation of inputs under state sales taxes seems anomalous.

Extensive taxation of intermediate goods together with only partial relief for input taxation has several undesirable features. First and foremost, the relative prices of intermediate products are distorted. Second, the task of determining tax incidence is greatly complicated, thereby making it difficult to spread the burden of the tax in the desired manner. For the same reason, the tax element in exports is difficult to calculate for the purpose of rebate. Furthermore, vertical integration of production processes is encouraged even when economic considerations do not justify integration.

The increasingly common practice of differentiating between state-produced and other goods for sales tax purposes is highly undesirable.[43] Protective policies by states distort the national allocation of resources. At present taxation of inputs is the main source of protection in state sales taxes. As relief for taxes paid on inputs is expanded, the protective element would decline. To take an extreme case, transformation of state sales taxes into value added taxes, which would in effect free inputs from taxation, would divest sales taxes of protective elements, transforming them into purely revenue taxes. This desirable development will not be realized if differential sales taxes based on origin are utilized.

Turning to the Central Sales Tax (CST), there does not seem to be a consensus on the desirability of a consignment tax. The protagonists of the tax, prominent among which are the states, argue that since the purpose of the CST was to tax all interstate trade, albeit lightly, the loophole created by consignment transfers should be closed. Others believe that consignment transfers have helped to attenuate the CST's distortionary effects on the allocation of resources and should not be made taxable. This lack of consensus may well be the reason behind

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42. It is not intended to suggest that this would be easy to do; constraints imposed by tax rates in neighboring states have already been noted.
43. Since this was written, the Supreme Court has ruled, in the Weston Electroniks case, that this practice is *ultra vires* under provisions of Articles 301 and 303(1) of the Constitution.

the delay by the central government in making the consignment tax effective. Irrespective of how this matter is resolved, there is a need to consider how the adverse effects of the CST might be minimized.

Probably the best way of coordinating state sales taxes would be to abolish the CST and to adopt the destination principle of taxation (instead of the prevailing mixed origin/destination system) for interstate trade. Under the destination principle, goods would be taxed in the state in which they are consumed, irrespective of where they are produced. The operation of this arrangement would require a comprehensive system of tax credits that cuts across state boundaries.[44] In other words, the existence at the state level of broadly similar value added taxes (though not necessarily levied at the same rates) is a precondition for this solution.[45] Given that at present the states allow partial and widely varying levels of relief for taxes paid on inputs, imposition of the destination principle can only be viewed as a long-term possibility. For the immediate future, the frequently made proposal that the ceiling rate of CST should be reduced, perhaps to the original level of one percent, is the most relevant. A phased reduction in the rate of CST, combined with enforcement of the consignment tax, would help to minimize the adverse revenue impact of the measure. A lower CST would significantly reduce tax-induced distortions in the location of production and the pattern of trade.

The profession tax is capable of yielding much higher revenues, now that the ceiling of Rs. 250 per annum prescribed in the Constitution has been raised to Rs. 2,500. The steady increase in the personal exemption from income tax in recent years has reduced tax liability at all income levels, as well as excluding many taxpayers from the scope of income tax. This provides an opportunity to capture part of the gains accruing to taxpayers through higher rates of tax on professions and trades. These should be accompanied by greater efforts to expand coverage of the self-employed, who are much more difficult to tax than employees.

The structure of motor vehicle taxes appears to be broadly

44. Such an arrangement has been proposed in the context of the EEC. See Sijbren Cnossen, "Harmonization of Indirect Taxes in the EEC", in Charles E. McLure, Jr. (ed.), *Tax Assignment in Federal Countries* (The Australian National University, Canberra, 1983), pp. 150-168.

45. In the absence of full relief for taxes paid on inputs, exporting states, prevented from taxing exports, will tend to extract as much revenue as possible from taxes on inputs utilized in export production. This is probably among the main reasons why the previous attempt to introduce the destination principle was unsuccessful.

satisfactory, but the introduction of a one-time lump-sum motor vehicle tax for most private vehicles, notwithstanding its administrative convenience, seems to be a step in the wrong direction.[46] Such measures bring sizable immediate gains, but often at the expense of future revenues. The appropriate levels of motor vehicle taxes in a given year depend presumably on revenue requirements, the cost of road maintenance, the expected rate of inflation, the tax rates prevailing in neighboring states and other considerations, most of which cannot be predicted with confidence. The main shortcoming of the measure is therefore that it reduces control over a major tax. The conversion of the annual tax for commercial vehicles into a one-time tax would not be advisable.

Three aspects of tax administration are worth noting. First, the problem of arrears in tax collections seems to be manageable in Gujarat.[47] The Taxation Enquiry Commission found that recovery proceedings (ranging from preliminary investigations to court actions) were underway for the bulk of arrears. Second, there is considerable evasion, especially of the sales tax, but there is no evidence to suggest that the problem is more serious than in other states. Third, information necessary for making proper assessments of the working of the state tax system as well as tax administration is lacking. Compilation of basic tax statistics requires early attention in all states.

Neither the analysis of the Taxation Enquiry Commission nor the description of state taxation in the previous two sections indicates major possibilities for broadening the tax bases of individual taxes or for effecting significant changes in their structures for revenue purposes.[48] Most additional tax revenues would have to come from the normal growth of receipts in response to economic growth, improvements in tax administration and higher tax rates.

Own Nontax (Current) Receipts

The assignment of most major taxes to the central government and of most economic and social functions to the state governments makes user charges a highly suitable form of revenue mobilization at the state level. Nevertheless, user charges have not been adequately

46. Fortunately, passenger vehicles accounted for no more than 20 percent of receipts from motor vehicle taxes at the time of the reform.
47. Arrears of tax collections in Gujarat amounted to Rs 353 million at the end of March 1985.
48. Nonetheless, a careful review of exemptions under the sales tax could be worthwhile. Consideration might also be given to reducing the number of sales tax rates (from the present 15 to 5-8) to simplify administration.

utilized. It is the Government of Gujarat's policy to seek full cost recovery from all services except for those subsidized for social reasons. But, as in the rest of India, the gap between policy objectives and practice is wide. Additional resource mobilization in support of plan expenditures will be increasingly difficult unless user charges play a larger role.

The problems of the two main state enterprises -- the State Electricity Boards (SEBs) and State Road Transport Corporations (SRTCs) -- have been so frequently studied and the problems faced by these enterprises in different states are so similar that only a few general comments need be made.[49] The low or negative returns realized by SEBs have been the subject of two official enquiries. The Venkatraman Committee (1964) proposed that SEBs should achieve a return of 11 percent, made up of six percent interest on capital, 0.5 percent for appropriation to reserves, a notional 1.5 percent for electricity duty and net profit of three percent. The Rajadhyaksha Committee (1980) suggested a gross return of 15 percent, including an average composite rate of interest of seven percent to be paid by SEBs on state government loans. Adoption of these guidelines was not mandatory.

Concerned by the continued unsatisfactory performance of SEBs, the Union Government amended Section 59 of the Electricity (Supply) Act of 1948 in 1983. It now requires SEBs to adjust their tariffs "so as to ensure that the total revenues in any year of account shall, after meeting all expenses properly chargeable to revenues, including operating, maintenance and management expenses, taxes (if any) on income and profits, depreciation and interest payable on all debentures, bonds and loans, leave such surplus as is not less than three percent....." This corresponds roughly to the 11 percent return envisaged by the Venkatraman Committee. There has been very little progress toward achieving this legislated objective, however.

The Eighth Finance Commission assumed, for the purposes of projections, that the SEBs would pay interest on loans from state governments (at the average of the applicable rates, which worked out to seven percent), but no net profits would be realized.[50] The

49. Other enterprises will not be discussed because policy information is not readily available. On the SEBs and SRTCs, see, especially, reports of various Finance Commissions and periodic reports by the Planning Commission on SEBs and SRTCs. A recent discussion of problems of SEBs is Thapar and Nanjudiah (1987).

50. The "norms" adopted by Finance Commissions form the basis of their projections of outlays for the maintenance of different types of assets (e.g., irrigation works, roads); the states are not obliged to adopt them.

calculations disregarded loans and subsidies provided by state governments for rural electrification, and electricity duties payable by SEBs to state governments were netted out against their projected interest payments.[51] The Ninth Finance Commission proposed that the rate of return should rise from three percent in 1990-91 to seven percent in 1990-95; interest payments on loans outstanding for rural electrification were disregarded for this purpose.

The Eighth Finance Commission was even more cautious in its projections for SRTCs. Its belief that there was considerable scope for improvement in the performance of SRTCs was tempered by the knowledge that most SRTCs were not able to achieve the modest norms assumed by the Seventh Finance Commission. It assumed that the SRTCs would yield a return of three percent to the state governments after providing for depreciation. The Ninth Finance Commission recommended that a return of 6.5 percent should be achieved by 1994-95.

On irrigation, noting the losses incurred by irrigation projects, the Eighth Finance Commission did not propose any rate of return target, recommending instead that the states should, as a minimum, ensure that receipts from water charges cover the cost of maintaining irrigation systems. For the purposes of projecting the states' receipts from and expenditures on irrigation (major and medium irrigation works), the Commission decided on the figure of Rs. 100 per hectare of gross irrigated area for the maintenance of irrigation works (including normal repairs, special repairs and regular establishment); the cost of maintaining unutilized irrigation potential was taken as Rs. 30 per hectare. Noting that the situation had worsened since the review by the previous Finance Commission, the Ninth Finance Commission adopted that Commission's recommendation. Gujarat's irrigation receipts, as already explained, roughly cover the cost of operating and maintaining (O&M) its irrigation system. States that are recovering the O&M costs need to begin to recover capital costs of irrigation systems.

Detailed information on user charges in the social sectors is not readily available. Broadly, the situation in Gujarat is similar to that in most states, where education up to secondary level (up to standard 10) is free,[52] basic health services are provided at nominal charges,

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51. For Gujarat, the projection implied that the SEB would not pay interest to the state government, since payments of electricity duties were likely to exceed projected interest payments.
52. Girls' education is free throughout the secondary level in Gujarat.

and higher education and medical facilities at government hospitals are heavily subsidized. Early attention is needed to securing more realistic pricing, especially of higher education and specialized medical services.

Studies on state finances have increasingly come to the conclusion that greater reliance on nontax receipts is necessary for adequate resource mobilization. For example, a major taxation review commission appointed by the Government of Karnataka recommended that (1) a rate of return of at least 10 percent should be earned on investments made in public enterprises; (2) the pricing policy for irrigation works should provide for a return of at least 5% on investments made in irrigation projects; (3) bus fares should be adjusted to improve the financial position of the State Road Transport Corporation; and (4) higher education should not be heavily subsidized. (Karnataka Taxation Review Committee, 1983). Similarly, a study on Tamil Nadu stressed the need for increasing nontax revenues by reducing indirect subsidies and improving cost recovery (especially in irrigation) and for increasing the efficiency of and returns from public sector enterprises, including the SEB (see Guhan, 1986).

A critical question of a long-term nature is whether the states will be able to raise adequate revenues if they continue to neglect user charges and the taxation of agricultural incomes? Gujarat's experience seems to suggest that unless the revenue base is substantially expanded, the states will be forced to rely increasingly on revenue measures with serious adverse economic effects. Greater use of revenue sources underutilized in the past is needed to reduce the cost, in terms of tax-induced distortions, of raising revenue.

Concluding Remarks

The main problems of Gujarat's public finances -- rapidly rising expenditure obligations; increasing difficulties in identifying new sources of tax revenue; substantial reliance on sales taxes on raw materials and intermediate and capital goods; meager or negative contributions by public enterprises to resource mobilization; and underutilization of user charges -- are common to most states. Because the Finance Commission and the Planning Commission must necessarily confine themselves to the areas of their respective responsibilities, many critical issues of state finances do not receive sufficient attention. Hence it may be desirable to set up a joint state/ central commission to look comprehensively at state finances. A national commission, by contributing to the development of consensus on major issues of state finances, could help hasten the adoption of desirable policies at the state level.

Examples of issues where broad agreements between state governments and the central government would be beneficial are the desirable directions of change for state sales taxes and user charges. Increasing input taxation under state sales taxes, unless checked, could greatly attenuate the benefits of MODVAT. There is now clearly a greater need for coordination of state sales taxes and Union excise duties than in the past. National guidelines of some form are equally important for user charges, since it will be politically difficult for a state to institute higher charges for services if similar services are more heavily subsidized in other states. National committees and commissions that have studied the question of appropriate levels of user charges for individual services have tended to prescribe certain rates of return without, for example, reviewing the feasibility and implications of marginal cost pricing. A comprehensive examination of user charges in the broader context of efficient pricing would be useful.

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Table 8.1

Summary of Gujarat's Public Finances, 1986-87 and 1987-88

(million rupees)

	Revised Estimates 1986-87	*Budget Estimates 1987-88*[a]
1. *Current Revenue*	23,367.7	26,120.4
Tax receipts	15,358.3	17,933.5
State's own taxes	(12,051.4)	(14,415.1)
Share in central taxes	(3,306.9)	(3,516.4)
Non-tax receipts	8,009.4	8,186.9
Grants from the Centre	(2,958.7)	(2,675.5)
Own non-tax receipts	(5,050.7)	(5,511.4)
2. *Current Expenditure*	25,244.3	26,544.8
3. *Current Account Surplus* (1 minus 2)	-1,876.6	-434.4
4. *Capital Disbursements*	5,914.5	6,622.7
Capital expenditure	2,952.7	4,025.6
Loans and advances	2,961.8	2,597.1
5. *Financing* (4 minus 3)	7,791.1	7,047.1
Loans from the Centre	3,815.6	4,362.3
Domestic loans	1,498.0	566.8
Recoveries of loans and advances	684.5	615.0
Provident Funds	370.0	400.0
Other	1,423.0	1,103.0

[a]Including effects of new budget proposals.
Source: Gujarat State Budget documents.

Table 8.2

Receipts from the State's Own Taxes

	(percent of total)
Tax on professions, trades, etc.	1.7
Land Revenue	1.8
Stamp and Registration fees	4.1
State Excise	0.5
Sales Tax	66.4
General sales tax (including tax on motor spirits)	(53.5)
Central sales tax	(12.9)
Taxes on vehicles	3.7
Taxes on goods and passengers	5.5
Electricity duties	10.8
Entertainment tax	3.1
Other	2.4

Source: Gujarat State Budget documents.

Table 8.3

Current Nontax Revenues, 1986-87

		(percent of total)
Interest Receipts		40.5
Dividends		6.9
Social and Community Services		5.6
of which:	Education	(1.9)
	Health	(2.1)
Economic Services		42.4
of which:	Irrigation	(1.9)
	Forests	(3.8)
	Mines and Minerals	(31.3)
Other		4.6

Source: Gujarat State Budget documents.

Table 8.4

Current Expenditures by Function, 1986-87

		(percent of total)
Social and Community Services		41.8
of which:	Education	(20.5)
	Health	(3.5)
	Water Supply and Sanitation	(5.0)
	Social Security and Welfare	(5.0)
Economic Services		35.0
of which:	Agriculture and Allied services[a]	(6.1)
	Community Development	(3.6)
	Water and Power Development Services	(4.1)
	Irrigation	(10.5)
	Roads and Bridges	(6.5)
Interest Payments		9.5
Other		13.7

[a]Excluding forests, community development and irrigation.
Source: Gujarat State Budget Documents.

Table 8.5

Capital Expenditures by Function, 1986-87

(percent of total)

Social and Community Services		19.4
of which:	Education	(0.8)
	Health	(1.0)
	Water Supply and Sanitation	(9.8)
	Social Security and Welfare	(1.2)
	Housing	(3.3)
	Urban Development	(1.9)
Economic Services		79.5
of which:	Agriculture and Allied services[a]	(0.7)
	Irrigation	(45.7)
	Forests	(8.3)
	Industry and Minerals	(12.4)
	Roads and water transport services	(8.0)
Other		1.1

[a]Excluding forests, community development and irrigation.
Source: Gujarat State Budget Documents.

Table 8.6

Annual Plan, 1987-88

(million rupees)

	Capital Disbursements	*Current Expenditures*	*Total*
Agriculture and Allied Services	376.8	355.7	732.5
Rural Development	--	294.4	294.4
Irrigation and Flood Control	2,943.0	222.0	3,165.0
Energy	3,058.0	42.0	3,100.0
Industries and Minerals	383.3	233.7	617.0
Transport	691.1	50.5	741.6
Science, Technology and Environment	1.6	2.9	4.5
General and Economic Services	56.2	385.2	441.4
Social Services	851.2	1,652.4	2,503.6
of which: General Education			(182.2)
Technical Education			(48.6)
Health			(205.0)
Water Supply and Sanitation			(520.0)
Housing			(290.0)
Urban Development			(120.0)
Welfare of Scheduled Tribes, etc.			(240.0)
Mid-day Meals Program			(600.0)
Total Annual Plan	8,361.2	3,238.8	11,600.0
Central Assistance for Centrally Sponsored Plan Schemes			1,530.0
Total Development Program			13,130.0

Source: Government of Gujarat (1987).

Table 8.7

Central Transfers to Gujarat 1987-88[a]

(million rupees)

Shared Taxes	3,518.4
Union Excise Duties[b]	2,371.4
Income Tax	1,147.0
Other Nonplan Assistance	3,566.1
Grant in lieu of railway passenger fares	63.4
Grants from the Central Road Fund	9.0
Reflief for natural calamities	--
Small Savings Loans	3,300.0
Other (Grants and Loans)	193.7
Plan Assistance	4,845.4
State Plan Schemes	3,203.3
Loans	(2,022.7)
Grants	(1,180.6)
Centrally sponsored schemes	1,642.1
Loans	(243.1)
Grants	(1,399.0)
Total	11,929.9

[a]Budget Estimates.
[b]Including additional excise duties.
Source: Gujarat State Budget Documents.

Table 8.8

Summary of Gujarat's Public Finances, Selected years

(million rupees)

	1973-74	*1978-79*	*1984-85*	*1986-87*[a]
Current Receipts	3,363.9	6,743.9	17,694.6	23,367.7
Tax receipts	2,098.6	4,696.6	12,862.1	15,358.3
State's' Taxes	(1,511.9)	(3,726.2)	(9,800.2)	(12,051.4)
Share in central taxes	(586.7)	(970.4)	(3,061.9)	(3,306.9)
Own non-tax receipts	699.4	1,241.3	3,319.5	5,050.7
Grants from the Centre	565.9	806.0	1,513.0	2,958.7
Expenditures	*4,439.0*	*8,406.6*	*23,414.6*	*31,158.8*
Current	3,366.8	6,033.6	17,012.0	25,244.3
Capital[b]	1,072.2	2,373.0	6,402.6	5,914.5
Current Budget Surplus/Deficit[b]	-2.9	710.3	682.6	-1,876.6
as percentage of SDP				
Current Receipts	10.6	13.5	16.6	
Tax receipts	6.6	9.4	12.1	
State's taxes	(4.8)	(7.5)	(9.2)	
Share in central taxes	(1.8)	(1.9)	(2.9)	
Own non-tax receipts	2.2	2.5	3.1	
Grants from the Centre	1.8	1.6	1.4	
Expenditures	14.0	16.9	22.0	
Current	10.6	12.1	16.0	
Capital[b]	3.4	4.8	6.0	
Current Budget Surplus[c]	--	1.4	0.6	

[a]Revised Estimates.
[b]Including loans and advances.
[c]Current receipts less current expenditures.
Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table 8.9

Trends in the Gujarat's Expenditures

	Capital Expenditure[a]		Current Expenditure		
	As percent of SDP	In 1973-74 Prices (Rs. million)	As percent of SDP	In 1973-74 Prices (Rs. million)	Per capita in 1973-74 prices (Rs.)
1973-74	3.4	1,072.2	10.6	3,366.8	118.1
1974-75	5.4	1,299.4	11.6	2,772.0	95.3
1975-76	3.3	903.0	10.3	3,044.5	102.2
1976-77	4.4	1,377.1	11.2	3,971.1	130.2
1977-78	4.9	1,652.3	10.3	3,800.1	121.4
1978-79	4.8	1,563.2	12.1	4,557.1	142.4
1979-80	6.0	1,947.8	13.1	5,168.5	157.6
1980-81	6.1	2,049.4	13.6	5,631.3	167.6
1981-82	5.3	1,924.0	12.9	5,760.3	167.0
1982-83	6.0	2,101.2	15.0	6,599.9	187.0
1983-84	5.9	2,209.5	14.3	6,517.9	180.1
1984-85	6.0	2,197.9	16.0	7,307.6	197.5
1985-86	N.A	1,529.8	N.A	7,953.2	N.A

[a]Including loans and advances.

Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table 8.10

Composition of Current Expenditures, Selected Years

(percent of total current expenditures)

	1973-74	1978-79	1984-85	1986-87[a]
General Services	30.4	30.2	23.3	22.6
of which: Interest payments	(7.3)	(7.8)	(8.6)	(9.5)
Socidl and Community Services	43.9	40.6	43.9	41.8
of which: Education, Research, etc.	(17.8)	(24.0)	(24.5)	(20.6)
Health, Water Supply, etc.	(8.0)	(9.7)	(8.8)	(10.0)
Social Security and Welfare	(3.1)	(3.7)	(4.7)	(5.0)
Economic Services	24.2	28.5	32.3	35.0
of which: Agriculture and allied serives[b]	(3.9)	(8.3)	(5.8)	(6.1)
Irrigation	(8.1)	(5.3)	(7.1)	(10.5)
Transport and Communications	(5.9)	(2.5)	(5.9)	(6.5)
Other	1.5	0.7	0.5	0.6
Per capita Expenditures in 1973-74 prices (Rs.)				
Education, Research, etc.	21.0	34.2	48.4	
Health, Water Supply, etc.	9.5	13.9	17.3	
Agriculture	4.6	11.9	11.4	
Irrigation	9.6	7.5	13.9	
Transport and Communications	7.0	3.5	11.7	

[a]Revised Estimates.
[b]Excluding forests, community development and irrigation.
Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table 8.11

Growth of Current Expenditures, 1984-85 to 1986-87

(million rupees)

	1984-85	*1986-87*[a]	*Annual rate of increase (%)*
General Services	*3,961.2*	*5,711.7*	*20.1*
Administration of Justice	118.0	147.8	11.9
Tax collection	245.0	282.1	7.3
Police	989.0	1,363.0	17.4
Interest Payments	1,463.5	2,388.8	27.7
Other	1,145.7	1,530.0	15.6
Social and Community Services	*7,470.2*	*10,551.9*	*18.8*
Education	4,147.2	5,179.5	11.8
Public Health (Medical)	692.6	888.7	13.3
Family Welfare	295.8	389.0	14.7
Sanitation and Water Supply	502.7	1,259.6	58.3
Housing and Urban Development	331.3	358.1	4.0
Labor and Employment	395.8	544.8	17.3
Social Security and Welfare	801.8	1,264.9	25.6
Relief of Natural Calamities	202.3	528.5	61.6
Other	100.7	138.8	17.4
Economic Services	*5,491.2*	*8,834.3*	*26.8*
Agriculture and allied services	2,459.6	3,938.3	26.5
of which: Minor Irrigation	(241.9)	(1,303.8)	132.2
Industry	120.5	421.3	87.0
Water and Power Development	1,604.1	2,395.6	22.2
of which: Multipurpose River projects	(133.2)	(207.8)	24.9
Irrigation, drainage, etc.	(843.6)	(1,137.2)	16.1
Transport and Communications	1,010.3	1,648.9	27.8
of which: Roads and Bridges	(998.1)	(1,631.5)	27.1
Other	296.7	429.7	20.3
Other	*89.4*	*146.3*	*27.9*
TOTAL	17,012.0	25,244.3	21.8

[a]Revised Estimates.

Source: Gujarat State Budget documents.

Table 8.12

Trends in Receipts from the State's Own Taxes

	1973-74	*1978-79*	*1984-85*	*1986-87*
Receipts from the state's own taxes:				
Percent of tax receipts	72.0	79.3	76.2	78.5
Percent of current receipts	44.9	55.3	55.4	51.6
Percent of SDP	4.8	7.5	9.2	N.A
Receipts in current prices (Annual rate of growth)	--	19.8	17.5	10.9
Receipts in 1973-74 prices (Rs. million)	1,511.9	2,814.4	4,209.7	N.A
Per-capita receipts in 1973-74 prices (Rs.)	53.0	87.9	113.8	N.A

Source: Reserve Bank of India Bulletin.

Table 8.13

Composition of Gujarat's Tax Revenues, Selected Years

(percent of total)

	1973-74	*1978-79*	*1984-85*	*1986-87*[a]
Major Direct Taxes	5.2	3.6	3.3	3.5
Land Revenue	5.2	1.9	1.7	1.8
Profession tax	-	1.7	1.6	1.7
Major Indirect Taxes	93.7	94.4	93.3	94.1
Stamps and Registration fees	5.6	5.8	4.5	4.1
Sales Tax	62.2	63.1	62.2	66.4
State Excise Duties	0.6	0.7	0.5	0.5
Taxes on Vehicles	5.9	4.7	4.0	3.7
Taxes on goods and passengers	8.5	7.6	6.9	5.5
Electricity duties	6.4	8.0	11.0	10.8
Entertainment tax	4.5	4.5	4.2	3.1
Other	1.1	2.0	3.4	2.4

[a]Revised Estimates.

Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table S.14

Buoyancy of the State's Taxes and Other Current Receipts

	Buoyancy Coefficient	*t Value*	R^2
State's own taxes	1.37	22.11	0.98
Share in central taxes	1.25	13.05	0.94
Total tax revenue	1.34	23.05	0.98
Own non-tax revenues	1.17	21.88	0.98
Grants from the Centre	1.12	8.26	0.86
Total non-tax revenue	1.15	20.12	0.97
Total current revenues	1.28	33.67	0.99
Own current revenues	1.32	25.33	0.98
Different state taxes			
Stamps and registration fees	1.31	14.27	0.95
Land Revenue	0.74	7.45	0.83
Sales Tax	1.37	18.01	0.97
General (state) sales tax	(1.31)	(18.63)	(0.97)
Central sales tax	(1.38)	(11.78)	(0.93)
Sales tax on motor spirits	(1.83)	(13.19)	(0.94)
State excise duties	1.33	8.85	0.88
Taxes on vehicles	1.11	23.72	0.98
Taxes on goods and passengers	1.09	4.38	0.62
Electricity duties	1.81	21.05	0.98
Profession tax[a]	1.40	10.50	0.93
Entertainment tax	1.34	23.83	0.98

[a]Based on data for 1976-77 to 1984-85.

Note: Buoyancy coefficients were estimated from the double-log function log x = log a + b log y, where x represents receipts, y represents SDP, and b is the buoyancy coefficient. Unless otherwise stated, data for 1973-74 to 1984-85 were used.

Table 8.15

Trends in Central Transfers to Gujarat

(percentages)

	1974-75[a]	*1978-79*	*1984-85*	*1986-87*[b]
As a percentage of the State's current receipts				
Receipts of central tax revenues	16.9	14.4	17.3	14.1
Central grants	9.3	12.0	8.6	12.7
Total	26.2	26.2	25.8	26.8
As a percentage of the state's capital disbursements				
Central Loans (gross) as % of the state's capital disbursements[c]	35.2	41.5	50.0	97.9
Central Loans (net) as % of the state's capital disbursements[c]	19.5	20.5	38.2	75.9
As a percentage of the state's total expenditures				
All central transfers (gross)	30.3	32.9	33.2	38.7
All central transfers (net)	25.3	26.9	30.0	34.5

[a]1974-75 has been used as the base year because central transfers were unusually high in 1973-74.
[b]Revised Estimates.
[c]Capital disbursements include loans and advances.
Source: Reserve Bank of India Bulletin.

Table 8.16

Composition of Central Transfers to Gujarat, Selected Years

(million rupees)

	1973-74	*1978-79*	*1984-85*	*1987-88*[a]
Share in Central Taxes	586.7	970.4	3,061.9	3,518.4
Income Tax	272.0	392.2	736.9	1,147.0
Estate Duty	8.7	50.0	18.5	--
Union Excise Duty	306.0	573.2	2,306.5	2,371.4
Nonplan Assistance	758.3	413.5	1,994.3	3,566.1
Grants	265.0	73.6	43.7	95.9
Grants for Natural Calamities	(227.5)	(--)	(--)	(--)
Other	(37.5)	(73.6)	(43.7)	(95.9)
Loans (gross)	493.3	339.9	1,950.6	3,470.2
Loans for Natural Calamities	(335.0)	(--)	(--)	(--)
Share of Small Savings	(153.4)	(283.8)	(1,843.2)	(3,300.0)
Other	(4.9)	(56.1)	(107.4)	(170.2)
Plan Assistance	710.8	1,278.2	2,718.4	4,845.4
Grants	300.9	732.4	1,469.3	2,579.6
State Plan Schemes	(118.4)	(284.1)	(515.1)	(1,180.6)
Central Plan Schemes	(32.8)	(130.3)	(294.9)	(--)
Centrally Sponsored Schemes	(149.7)	(318.0)	(659.3)	(1,399.0)
Loans (gross)	409.9	545.8	1,249.1	2,265.8
State Plan Schemes	(330.4)	(513.6)	(1,192.0)	(2,022.7)
Central Plan Schemes	(11.7)	(18.9)	(43.5)	(--)
Centrally Sponsored Schemes	(67.8)	(13.3)	(13.6)	(243.1)
Ways and Means Advances	--	100.0	-	-
Total	2,055.8	2,762.1	7,774.6	11,929.9

[a]Budget Estimates.

Source: Reserve Bank of India Bulletin and budget documents.

Table 8.17

Rates of Sales Tax on Selected Commodities

(percentage of price)

Coal	4
Cotton yarn	6
Iron and steel and products	4
Crude petroleum oil	4
Agricultural machinery	6
Chemical fertilizers	4
Kerosene	3
Ready-made garments	3
Sweets and sweetmeats	10
Sheets, bars, rods, etc. of non-ferrous metals and alloys	6
Betel nuts	5
Sewing machines	4
Soap	8
Bicycles	6
Jewelery	10
Machinery used in the manufacture of goods	6
Domestic electrical appliances	15
Hydrogenated vegetable oils	8
Coffee and tea	10, 15
Paints and varnishes	15
Footwear (with price of above Rs. 40 per pair)	10
Non-alcoholic beverages	12
Furniture	6
Motor vehicles	10
Cameras	15
Refrigerators	12
Radios and gramophones	15
Duplicating machines and tape recorders	15
Television sets	3
Tractors	2
Cement	12

Source: Gujarat Finance Department; Janab (1985); and the Budget Speech for 1991-92.

Table 8.18

Rates of Electricity Duty

1. Residential premises	
(a) rural areas	20% of charges
(b) urban areas	25% to 40% of charges depending on consumption
2. Specified commercial undertakings	25% of charges
3. Cinema or theatre	45% of charges
4. Undertaking engaged in manufacturing food or drinks (for consumption on the premises of the undertaking)	10 paise per unit
5. Industrial undertaking, and an undertaking engaged in construction of factory buildings and installation of plant and machinery	
(a) high tension energy	20% of charges
(b) low tension energy	10% of charges depending on the load
6. Pumping of water for irrigation	5% of charges
7. Other	60% of charges

Source: Gujarat State Finance Department.

Table 8.19

Rates of Entertainment Tax

(percent of admission charge)

Admission charge	*Localities with population under 100,000*	*Localities with population over 100,000*
First Re 1 or any part thereof	35	40
Next Re 1 or any part thereof	45	50
Next Re 1 or any part thereof	55	60
Next Re 1 or any part thereof	55	60
Remainder	60	65

Source: Gujarat Finance Department.

Table 8.20

Receipts from User Charges in Relation to Current Expenditures, 1987-88[a]

(million rupees)

	Receipts from user charges	*Current expenditure*	*Receipts as per cent of current expenditure*
Education	97.1	5,032.0	1.9
Elementary	10.2		
Secondary	7.6		
University and other higher	40.0		
Technical	12.5		
Other	26.8		
Medical and Public Health	127.9	1,235.9	10.3
Hospital and dispensary charges	3.0		
Receipts from Employees' Insurance Scheme	103.3		
Tuition and fees for medical education	2.3		
Other	19.3		
Agriculture[b]	41.6	822.4	5.1
Crop Husbandry	7.5		
Animal Husbandry	8.2		
Fisheries	5.0		
Other	14.0		
Irrigation	90.4	2,179.9[c]	4.1
Major and medium irrigation	80.8		
Minor Irrigation	9.6		
TOTAL	57.0	9,270.2	3.9

[a]Based on Budget Estimates.
[b]Including receipts from sale of goods. Forestry has been excluded becaus the bulk of the receipts are from the sale of timber.
[c]Including interest payments of Rs. 2,089.1 million. Excluding thes payments, current expenditures on irrigation amount to Rs. 90.8 million.
Source: Gujarat State Budget documents.