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India's Fiscal Policy Space for Investing in Children

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Foreword

Children below the age of 18 years account for nearly 40 per cent of India's population. It goes without saying that enabling all children to realize their full creative potential is critical for sustaining India's economic growth and accelerating human development. Not all children have benefited equitably from the remarkable progress and transformation that the country has witnessed in recent years. Tens of millions still face basic challenges of survival and healthy development.

Children are first and foremost individuals, born with indivisible and inalienable human rights. They also belong to families and communities that need to have access to resources and services, as well as capacities to ensure realization of their rights. Policy approaches are needed that address both the income and non-income dimensions of children's deprivations. Continued neglect of material, human and psycho-social dimensions of child well-being can prevent children from living a full life and from making informed decisions later on in their life. India too would miss out on the dividends that can accrue from a full expansion of children's capabilities.

The Institute for Human Development (IHD) and UNICEF are partnering to offer a platform for examining different dimensions of child rights. Experts and commentators were invited to explore the impact of development policies on children and women and suggest alternative approaches to the elimination of children's deprivations. They have explored how best to ensure that all children benefit from equal and non-discriminatory access to basic social services. They have looked at ways of capitalizing on the demographic dividend, creating fiscal policy space for investing in children and strengthening the legislative and institutional framework for protecting children.

These contributions are being brought out as IHD - UNICEF Working Paper Series *Children of India: Rights and Opportunities*. We hope that the series will contribute to enriching public discourse and strengthening public action to promote the rights of children.

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India's Fiscal Policy Space for Investing in Children

Praveen Jha and Subrat Das*

Summary

This paper discusses several aspects of the fiscal policy space in India for public investments in children. With regard to the magnitude of the overall public spending in India, the paper highlights the pursuance of a 'conservative' fiscal policy by the Central Government over the last decade. In this context, it argues for increasing the overall magnitude of public expenditure in India for expanding the scope of development interventions by the government. The paper examines the priorities of different sectors within the prevailing quantum of public expenditure in the country and highlights the low priorities within the government budgets for expenditure on social sectors, in general, and for expenditure on child-specific services, in particular. In this regard, a case is made for significant re-prioritization of the total quantum of public expenditure in the country.

In order to influence development outcomes relating to children, the paper argues for significantly stepping up the quantum of public investments on important social services like education, health, water supply and sanitation, and nutrition. Moreover, both the Central Government and state governments also need to significantly enhance the quantum of public expenditure on

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interventions targeted towards children. As regards such public investments on child-focused interventions, the investments from the Central and State Budgets need to be increased, particularly for interventions in the hitherto neglected sectors of child health and protection of children in difficult circumstances.

The paper also deals with the issue of growing centralization of the overall fiscal policy space available in India for making public investments in children. In this context, it opines that the magnitude of untied funds transferred from the Centre to the states needs to be increased, which would provide the state governments additional fiscal space for public investments in accordance with their state-specific development priorities. With regard to the issue of ineffective implementation of the development programmes/schemes in several states in the country, the paper outlines a set of institutional and procedural bottlenecks in the planning and budgetary processes that need to be addressed for improving the effectiveness of programme implementation. Finally, the paper examines some of the pertinent issues in the domain of mobilization of public resources by the government; it highlights the issue of the low tax-GDP ratio in India and explores the scope for significantly stepping up the magnitude of tax revenue mobilized in the country.

India's Fiscal Policy Space for Investing in Children

A large proportion of India's children are highly vulnerable as they are exposed to a range of deprivations and difficult circumstances, some of the alarming manifestations of which are a relatively high rate of infant mortality, a very high proportion of children under the age of three years being underweight, a large number of children being out of school, the educational attainments of children enrolled in schools being very modest and the prevalence of child labour in almost all states in the country. The Central Government and state governments have made interventions through a number of development programmes/schemes focusing on children; however, the outcomes of many such government interventions are believed to have been far from satisfactory. On the one hand, acute shortage of financial resources has often been cited as a major lacuna with many such child-focused government interventions, while on the other, ineffective implementation of the programmes/schemes has been seen as a common problem in this domain. In this context, the present paper attempts to map the fiscal policy space available to the Government in India for making public investments in children.

This paper discusses several aspects of the fiscal policy space for public investments in children, each of which has significant implications for the development trajectory followed by the country. It begins with a brief assessment of the magnitude of the overall public spending in India, the magnitude of external assistance for public spending in the country, and the role of the Central Government in pursuing a 'conservative' fiscal policy in India over the last decade. This section puts forward an argument for increasing the overall magnitude of public expenditure in India for expanding the scope of development interventions by the government. In the second section, the paper examines the priorities of different sectors within the prevailing quantum of public expenditure in the country. It highlights the low priorities for expenditure on 'social sectors' and also comments on the meagre priorities observed for expenditure on 'child-specific' services within the government budgets. This section makes a case for significant re-prioritization of the total quantum of public expenditure in the country. The third section addresses the issue of growing centralization of the overall fiscal policy space available in India for making public investments in children and highlights some policy alternatives in this regard. The fourth section of the paper briefly comments on the issue of ineffective implementation of the development programmes/schemes in many states in India. It outlines a set of institutional and procedural bottlenecks in the planning and budgetary processes in the states, which need to be addressed for improving the effectiveness of programme implementation. The fifth section examines some of the pertinent issues in the domain of mobilization of public resources by the government. It highlights the issue of the low tax-Gross Domestic Product (GDP) ratio in India and explores the scope for significantly stepping up the magnitude of tax revenue mobilized in the country. In the concluding remarks, the paper sums up the key observations pertaining to the fiscal policy space available in India for making public investments in children.

I. Public expenditure in India

In India, there is no systematic database providing precise information on the magnitude of the total expenditure incurred by the entire government sector, since the available databases on government expenditure in India do not include: (i) expenditure incurred from Internal and Extra Budgetary Resources (IEBR) provided by the Public Sector Undertakings or PSUs (mainly in economic sectors like power, transport, communication, etc.), and (ii) expenditure incurred from the Own Revenue collected by local self-governments like *panchayats* and municipalities (however, the magnitude of such spending is believed to be very small in comparison to the magnitude of spending from the Central and state budgets). Hence, in this paper, the total expenditure from the budgets of the Centre and states is referred to as the Total Public Expenditure in India.

Table 1 depicts the magnitude of Total Public Expenditure in India, which, as a proportion of the country's Gross Domestic Product (GDP), had hovered at around 27 per cent over the decade 1998-99 to 2007-08. An international comparison of the total public expenditure in different countries for various years between 1997 and 2002, as presented in Figure 1, reveals that the magnitude of Total Public Expenditure in India has been significantly lower than that in several developed countries as well as in some of the developing countries. Thus, the overall fiscal policy space available in India for public investments towards the socio-economic development of the country appears to be limited in comparison to that of several other countries. Hence, in order to expand the fiscal policy space for public investments in children, the magnitude of Total Public Expenditure in India needs to be stepped up. However, there has been no trend increase in this magnitude over the decade from 1998-99

Table 1: Magnitude of Total Public Expenditure in India

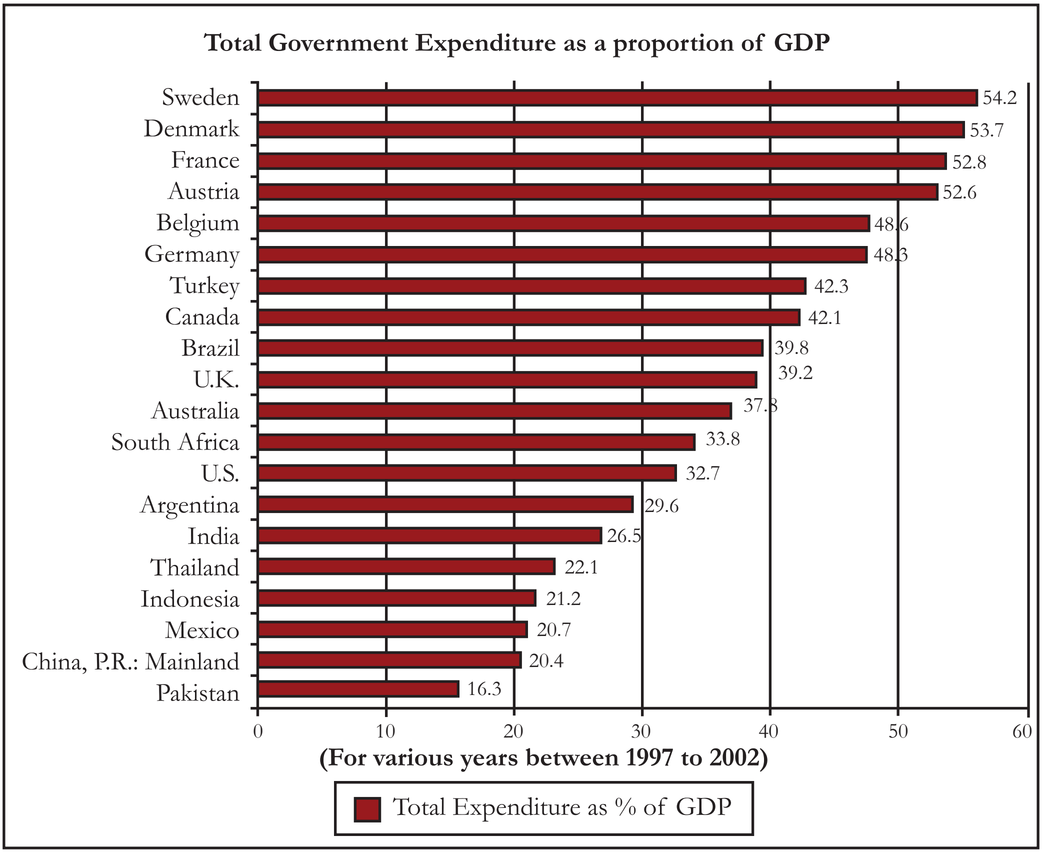
Year	GDP at Market Prices (at Current Prices) [in Rs. Crore]	Total Public Expenditure in India[1] (in Rs. Crore)	Total Public Expenditure as % of GDP	Central Government's Total Expenditure[2] (in Rs. Crore)	Central Government's Total Expenditure as % of GDP
1990-91	5,69,624	1,55,141.5	27.2	1,04,972.9	18.4
1998-99	17,51,199	4,45,980.3	25.5	2,63,755.0	15.1
1999-2000	19,52,035	5,17,056.1	26.5	3,07,509.1	15.8
2000-01	21,02,314	5,52,124.5	26.3	3,28,264.7	15.6
2001-02	22,78,952	6,13,591.0	26.9	3,60,616.3	15.8
2002-03	24,54,561	6,61,663.9	27.0	3,98,878.9	16.3
2003-04	27,54,621	7,62,764.7	27.7	4,26,131.6	15.5
2004-05	31,49,412	8,24,479.8	26.2	4,63,830.9	14.7
2005-06	35,80,344	9,33,641.8	26.1	5,01,083.3	14.0
2006-07 (RE)	41,45,810	1,12,3912.3	27.1	5,78,605.9	14.0
2007-08 (BE)	47,13,148	12,85,593.1	27.3	6,83,347.9	14.5

Notes:
1 This figure presents the Combined (Centre + states) Expenditure, incurred from the Union Budget and budgets of all the states and UTs (at current prices).
2 This figure presents the Total Expenditure incurred from the Union Budget (at current prices).
Sources:
(i) Government of India, 2008a.
(ii) Government of India, 2008b.

to 2007-08. (It may be noted here that the only source of data for total expenditure from the Union and state budgets, viz. the Indian Public Finance Statistics brought out by the Union Ministry of Finance, is presently available only up to 2007-08.)

On the contrary, we find a trend decline in the magnitude of Total Expenditure by the Central Government over the decade 1998-99 to 2007-08. The Total Expenditure from the Union Budget had declined from 15.8 per cent of the GDP in 1999-2000 to 14.5 per cent of the GDP in 2007-08 (BE). In fact, at 18.4 per cent of the GDP, this magnitude was much higher during the year 1990-91. This shrinking magnitude of Total Expenditure from the Union Budget indicates the nature of the fiscal policy adhered to by the successive governments at the Centre over the last one-and-a-half decades. The fiscal policy adopted by the successive governments at the Centre over the last one-and-a-half decades had been marked by 'fiscal conservatism', which advocated strongly for reducing the magnitude of

Figure 1: Magnitude of Total Public Expenditure across Different Countries



Source: Based on the data provided in Lorie, 2003.

deficits in the government's budget so that the size of public debt could be kept under check. The implications of government borrowing for the Indian economy, which, according to several economists, had been demand-constrained over the last decade, and the question of sustainability of public debt in India have been intensely debated among economists following different schools of thought. However, the policy-makers at the Centre had consistently adhered to fiscal conservatism until 2008-09 when the country started witnessing the adverse impact of the global economic recession.

Even if one doesn't question the economic rationale for the government's efforts to reduce the size of the public debt, the means through which it is achieved does raise serious concerns. As can be seen in the fifth section of this paper, India's performance in stepping up the magnitude of public revenue collected through taxes had been unsatisfactory until 2004-05.

In fact, the total tax-GDP ratio for the country had declined from the level of 16 per cent in 1989-90 to 13.8 per cent by 2001-02. Thus, in an era marked by declining magnitude of tax revenue (as a proportion of the GDP), the policy efforts towards curbing the magnitude of public debt implied a check on the magnitude of Total Public Expenditure. During the years 2004-05 to 2007-08, even when the collection of tax revenue under the Central Government tax system increased significantly (from 9.7 per cent of the GDP in 2004-05 to 11.6 per cent of the GDP in 2007-08 BE), there had been no expansion in the magnitude of Total Expenditure from the Union Budget (as compared to the GDP). The fiscal conservatism of the Centre was given legal teeth through the enactment of a Fiscal Responsibility and Budget Management (FRBM) Act, which was notified by the Centre in 2004. The FRBM Act made it legally binding for the Centre to eliminate the Revenue Deficit (in the Union Budget) and reduce the Fiscal Deficit (in the Union Budget) to less than 3 per cent of the GDP by 2009-10. As a result, even when the tax-GDP ratio for the Centre grew visibly over the last few fiscal years, the magnitude of Total Expenditure from the Union Budget (as compared to the GDP) was kept stagnant so that the deficits in the Union Budget could be reduced in accordance with the FRBM Act.

Besides reducing the magnitude of Total Expenditure from the Union Budget (as compared to the GDP), the Centre also advocated strongly for a check on the public spending by the states over the decade 1998-99 to 2007-08. It has been pointed out that starting with the Tenth Finance Commission (whose recommendations were applicable for five years from 1995-96 to 1999-2000), both the Terms of Reference for the successive Finance Commissions as well as their recommendations have indicated a bias towards promoting the conservative fiscal policy of the Centre and contributed towards the growing dominance of the Centre in the federal fiscal architecture in India. It must be noted here that a Debt Relief Package for States recommended by the Twelfth Finance Commission (in 2004 for the five years from 2005-06 to 2009-10) made it mandatory for the states to enact FRBM legislations from 2005-06 (in order to be eligible for the said package) and reduce deficits in their state Budgets progressively. With the exception of West Bengal, almost all the other states have enacted FRBM legislations by now, and thus made it legally binding for themselves to eliminate their Revenue Deficits and keep their Fiscal Deficits at less than 3 per cent of the Gross State Domestic Product (GSDP) by 2009. Even those economists who advocate strongly for the government's efforts to reduce the size of the public debt have questioned the arbitrariness in the targets set under the Central and state FRBM Acts. It may also be noted here that the Reserve Bank of India (RBI) had emphasized, in its annual publication State Finances: A Study of Budgets 2007-08, that "it is important to ensure that the process of fiscal correction (in the states) does not adversely impact capital outlay and expenditure on social sectors."

A crisis in the fiscal health of the states in the late 1990s and the early years of the present decade, which is discussed in the third section of this paper, had left most of the states with little scope to expand the magnitude of total expenditure from the state budgets until 2004-05. However, even after the recovery in their fiscal health from 2005-06 onwards, the states have found it difficult to expand the overall size of their state budgets, given the mandatory requirements for reduction of deficits as per their FRBM Acts.

Table 2: Total Magnitude of the Union Budget in 2008-09 and 2009-10

Year	GDP at Market Prices (at Current Prices) [in Rs. Crore]	Union Government's Total Expenditure* (in Rs. Crore)	Union Government's Total Expenditure as % of GDP
2008-09 (RE)	53,21,753	9,00,953	16.9
2009-10 (BE)	58,56,569	10,20,838	17.4

Note: * This figure presents the Total Expenditure incurred from the Union Budget (at current prices).
Sources: The GDP figure for 2008-09 is the revised projection released by CSO; the GDP figure for 2009-10 is taken from GoI, 2009a; the Total Expenditure figures are taken from GoI, 2009b.

Thus, it is observed that the magnitude of Total Public Expenditure in India was stagnant at around 27 per cent of the GDP over the decade 1998-99 to 2007-08. In order to expand the overall fiscal policy space available to the government for making public investments towards socio-economic development, the magnitude of Total Public Expenditure from the Central and state budgets would need to be stepped up, which may require policy-makers to adopt a liberal fiscal policy for both the Centre as well as the states.

In this context, it must be noted here that the total size of the Union Budget is projected to increase to 17.4 per cent of the GDP in 2009-10 (BE), which is a little higher than the level projected for 2008-09 (RE) and noticeably higher than the size of the Union Budget in 2007-08. This notable increase in the magnitude of the Union Budget reflects the willingness of the Central Government to adopt a liberal fiscal policy in the wake of the economic recession, as the fiscal deficit (of the Centre) is projected to go up to 6.8 per cent of the GDP and the revenue deficit (of the Centre) is estimated to be 4.8 per cent of the GDP in 2009-10 (BE). Thus, in the wake of the ongoing economic recession, the Central Government has decided to completely ignore the FRBM Act and resorted to a visible expansion in public spending from the Union Budget, financed by borrowing. However, this cannot be seen as any longterm decision made by the Government to adopt a liberal fiscal policy, since the Finance Minister made it clear in his Budget Speech (Union Budget 2009-10, presented in Parliament on 6 July 2009) that the Government is not at all giving up FRBM Act targets forever and that it would come back to the FRBM regime as soon as the country overcomes the adverse effects of the economic recession.

Table 3: Deficits in the Union Budget

Year	Revenue Deficit as % of GDP	Fiscal Deficit as % of GDP
2003-04	3.6	4.5
2004-05	2.5	4.0
2005-06	2.6	4.1
2006-07	1.9	3.4
2007-08	1.1	2.7
2008-09 RE	4.4	6.0
2009-10 BE	4.8	6.8

Source: GoI, Budget at a Glance, Union Budget, Various years.

It may be worthwhile here to also think of the significance of external assistance for public expenditure in India, since in the case of several developing countries, external assistance does play an important role in shaping the overall fiscal policy space for public investments. As shown in Table 4, the total external assistance for India (that is, the total magnitude of assistance for expenditure through government budgets in India in the form of loans, cash grants and commodity grants received from foreign countries and international organizations, all of which have been routed through the Union Budget) accounted for only 2.4 per cent of the Total Public Expenditure in the country in 2003-04 (RE), which had reduced further to the level of 1.5 per cent in 2007-08 (BE).

Thus, external assistance for expenditure through government budgets has hardly played any visible role in expanding the overall fiscal policy space for public investments in India. In this context, some of the policy analysts could make a case for a higher magnitude of external assistance (for development) for India. However, on the other hand, several policy analysts would not be in favour of such a recommendation. This is because it has been argued strongly that some of the international organizations providing external assistance to India have imposed conditionalities, which have constrained the policy space available to the Government and led to an increasing role for the private sector in the sphere of essential services.

Table 4: Magnitude of External Assistance for Public Expenditure in India

Year	Total Public Expenditure in India[1] (in Rs. Crore)	External Assistance[2] (in Rs. Crore)	External Assistance as % of Total Public Expenditure
2003-04 (RE)	8,01,264.82	19,257.06	2.4
2004-05 (RE)	8,69,835.9	19,257.06	2.2
2005-06 (RE)	9,74,431.0	17,559.29	1.8
2006-07 (RE)	11,23,912.3	18,281.91	1.6
2007-08 (BE)	12,85,593.1	19,586.69	1.5

Notes:
1 This figure presents the Combined (Centre + States) Expenditure, incurred from the Union Budget and Budgets of all the states and UTs (at current prices).
2 This figure presents the total magnitude of assistance (for expenditure through government budgets in India) in the form of loans, cash grants and commodity grants received from foreign countries and international organizations, all of which have been routed through the Union Budget.
Sources:
(i) GoI, Indian Public Finance Statistics, various issues.
(ii) GoI, Union Budget, various issues.

Thus, in the case of India, the overall fiscal policy space for making public investments towards socio-economic development depends, in the long run, on the magnitude of tax revenue collected by the Government, while, in the short run, it also depends on the policy adopted towards borrowing by the Government. Hence, it would be pertinent to discuss the scope for a significant stepping up of the magnitude of tax revenue mobilized in the country, which is taken up in the fifth section of this paper.

II. Priorities in public expenditure

While the overall fiscal policy space available to a government for public investments holds a lot of significance, even more significant are the policy priorities underlying the public investments by the government. The policy priorities of the government, or those of the successive governments, do get reflected in the trends and patterns in their public expenditure. It would be pertinent to examine the priorities for various kinds of expenditure within the Total Public Expenditure in India over the last decade.

Table 5 shows the shares of 'Developmental Expenditure' and 'Non-developmental Expenditure' in the Total Public Expenditure in India over the last decade. Given that the definition of

Developmental Expenditure in India has several unique elements, it may not be possible to compare its magnitude with those in other countries, as a result of which the assessment gets limited only to the trend in this expenditure over the years. It can be seen that the share of Developmental Expenditure had been gradually falling until 2002-03 (when it accounted for only 44 per cent of the total expenditure); however, it has been increasing since 2003-04 and reached 52.7 per cent of the total expenditure in 2007-08 (BE). The gradual increase in the share of Developmental Expenditure over the last few fiscal years is certainly a welcome trend. It may be noted here that a significant part of the Non-developmental Expenditure, such as that incurred on interest payments, pensions and other retirement benefits, among other things,

Table 5: Composition of Public Expenditure: Developmental Expenditure vs. Non-developmental Expenditure

Year	Total Public Expenditure[1] as % of GDP	Developmental Expenditure[2] as % of GDP	Non-developmental Expenditure[3] as % of GDP	Developmental Expenditure as % of Total Public Expenditure	Non-developmental Expenditure as % of Total Public Expenditure
1990-91	27.2	14.7	12.5	54.0	46.0
1998-99	25.5	11.8	13.7	46.3	53.7
1999-2000	26.5	12.2	14.3	46.0	54.0
2000-01	26.3	12.0	14.3	45.6	54.4
2001-02	26.9	12.1	14.8	45.0	55.0
2002-03	27.0	11.9	15.1	44.1	55.9
2003-04	27.7	13.1	14.6	47.3	52.7
2004-05	26.2	11.7	14.5	44.7	55.3
2005-06	26.1	12.3	13.8	47.1	52.9
2006-07 (RE)	27.1	13.8	13.3	50.9	49.1
2007-08 (BE)	27.3	14.4	12.9	52.7	47.3

Notes:
1 This figure presents the Combined (Centre + States) Expenditure, incurred from the Union Budget and Budgets of all states and UTs (at current prices).
2 Developmental Expenditure (including loans and advances) includes the following heads of expenditure from the Union Budget and Budgets of all the states and UTs: Social and Community Services (for example, education, medical and public health, family welfare, water supply and sanitation, labour and employment, etc.), Agriculture and Allied Services, Irrigation and Flood Control, Rural Development, Railways, Posts and Telecommunications, Foreign Trade and Export Promotion, Cooperation, Industry and Minerals, Power, Transport and Communication, Public Works, and Fertilizer Subsidy.
3 Non-developmental Expenditure (including loans and advances) includes the following heads of expenditure from the Union Budget and budgets of all the states and UTs: Defence Services, Interest Payments, Fiscal Services, Administrative Services, Organs of State, Pension and Other Retirement Benefits, Relief on Account of Natural Calamities (non-Plan), Compensation and Assignment to Local Bodies, and Food Subsidy.

Source: GoI, Indian Public Finance Statistics 2007-08, 2008a.

are committed expenditures, which the government cannot forego. Hence, it may not be easy for a government to curtail the magnitude of its Non-developmental Expenditure in the short run. However, if the government consistently prioritizes Developmental Expenditure in the additional magnitudes of public expenditure, the share of Developmental Expenditure can increase over time.

It would be worthwhile to examine the priorities accorded to some of the important sectors within Developmental Expenditure (such as Social and Community Services, and Agriculture and Allied Activities) and some of the major components within Non-developmental Expenditure (such as Interest Payments and Defence Services) in India over the last decade. Table 6 depicts the public expenditure on these major sectors as proportions of the country's GDP, while Table 7 shows these expenditures as proportions of the Total Public Expenditure in India over the last decade. Under the budgetary classification followed in India, all kinds of direct public investments in children are reported in the budget under Social and Community Services. Hence, the quantum of public investment for this sector constitutes the larger resource envelop within which targeted public investments in children are carried out. Likewise, the sector Agriculture and Allied Activities, as defined in Table 8, includes a large chunk of the direct government interventions meant for influencing the household incomes of people living in the rural areas.

In the Indian context, public investments in the Education sector directly influence the educational attainments of children; those in sectors like Medical and Public Health, Family Welfare and Water Supply and Sanitation, directly influence the survival and health outcomes for children; public investments in sectors like Nutrition and Social Security and Welfare directly influence the outcomes relating to early childhood care and development; and investments in sectors like Social Security and Welfare, and Welfare of Scheduled Castes (SCs), Scheduled Tribes (STs) and Other Backward Classes (OBCs) tend to influence outcomes relating to protection of children in difficult circumstances. As mentioned earlier, under the budgetary classification followed in India, public investments in all these sectors are reported in the budget under Social and Community Services. It can be seen that India's total public investment in Social and Community Services varied between 5 per cent and 6 per cent of the GDP during 1998-99 to 2007-08 (BE). In the late 1990s, the total public investment in Social and Community Services had registered a visible increase due to the hike in the pay scales for government staff following the implementation of the Fifth Pay Commission recommendations. During the subsequent years, however, public investment

Table 6: Some of the Major Sectors in Total Public Expenditure

Year	Total Public Expenditure[1] as % of GDP	Expenditure on Social and Community Services[2] as % of GDP	Expenditure on Agriculture and Allied Services[3] as % of GDP	Expenditure on Defence Services[4] as % of GDP	Expenditure on Interest Payments as % of GDP
1990-91	27.2	5.4	2.1	2.7	4.4
1998-99	25.5	5.5	1.9	2.3	5.5
1999-2000	26.5	5.7	1.9	2.4	5.6
2000-01	26.3	5.4	1.7	2.4	5.8
2001-02	26.9	5.2	1.7	2.4	6.2
2002-03	27.0	5.2	1.6	2.3	6.3
2003-04	27.7	5.1	1.7	2.2	6.4
2004-05	26.2	5.1	1.6	2.4	6.1
2005-06	26.1	5.3	1.8	2.2	5.8
2006-07 (RE)	27.1	5.9	2.0	2.1	5.6
2007-08 (BE)	27.3	6.0	2.8	2.0	5.4

Notes:
1 This figure presents the Combined (Centre + States) Expenditure, incurred from the Union Budget and budgets of all the states and UTs (at current prices).
2 Expenditure on Social and Community Services includes the expenditure from the Union Budget and Budgets of all the states and UTs under the following heads (excluding loans and advances): Education, Art and Culture; Scientific Services and Research; Medical and Public Health, and Water Supply and Sanitation; Family Welfare; Housing; Urban Development; Broadcasting; Labour and Employment; Relief on account of natural calamities (plan spending); Social Security and Welfare (Plan spending); and Others.
3 Expenditure on Agriculture and Allied Services includes the expenditure from the Union Budget and Budgets of all the states and UTs under the following heads (excluding loans and advances): Rural Development; Crop Husbandry; Soil and Water Conservation; Animal Husbandry; Dairy Development; Food Storage and Warehousing (excluding Food and Fertilizer Subsidy); and Others.
4 Expenditure on Defence Services does not include the expenditure incurred by the Union Government on Pensions for retired defence personnel.

Source: GoI, Indian Public Finance Statistics 2007-08, 2008a.

in this sector was checked, especially by the states as most of them suffered a crisis in their fiscal health until 2004-05. It can be seen that the magnitude of public investment in this sector fell from 5.7 per cent of the GDP in 1999-2000 to 5.1 per cent of the GDP in 2004-05; however, it recovered from 2005-06 onwards and reached 6 per cent of the GDP in 2007-08 (BE). But, even at the level of 6 per cent of the GDP, the quantum of public investment in this sector is low in comparison to the magnitudes of public investment in the social sectors in several other countries and in view of India's persisting development deficits in this sector. As regards the priority accorded to this sector in the Central and state budgets, it has been found that public investment in Social and Community Services

Table 7: Priorities for Major Sectors in Total Public Expenditure

Year	Expenditure on Social and Community Services as % of Total Public Expenditure	Expenditure on Agriculture and Allied Services as % of Total Public Expenditure	Expenditure on Defence Services as % of Total Public Expenditure	Expenditure on Interest Payments as % of Total Public Expenditure
1990-91	20.0	7.6	9.9	16.1
1998-99	21.4	7.4	8.9	21.4
1999-2000	21.4	7.0	9.1	21.3
2000-01	20.6	6.4	9.0	22.2
2001-02	19.1	6.4	8.8	23.0
2002-03	19.3	6.1	8.4	23.3
2003-04	18.6	6.0	7.9	23.1
2004-05	19.7	6.2	9.2	23.3
2005-06	20.3	7.0	8.6	22.1
2006-07 (RE)	21.9	7.5	7.7	20.6
2007-08 (BE)	22.2	10.2	7.5	19.7

Source: Computed from data given in Table 6.

accounted for 21.4 per cent of the Total Public Expenditure in India in 1998-99 and 1999-2000, which fell consistently over the next five years and reached 18.6 per cent of the Total Public Expenditure in 2003-04. The priority for this sector has gradually increased since 2004-05, and it accounted for 22.2 per cent of the Total Public Expenditure in India in 2007-08 (BE). Thus, from the perspective of stepping up direct public investments in children's needs, the priority for Social and Community Services in the Central and state budgets needs to be increased significantly. This would imply increasing the public investment in important social services such as, Education, Medical and Public Health, Family Welfare, Water Supply and Sanitation, Nutrition, Social Security and Welfare, and Welfare of Scheduled Castes (SCs), Scheduled Tribes (STs) and Other Backward Classes (OBCs), among others.

It is widely believed that an improvement in the income of a household tends to have a favourable impact on the well-being of children. As per the budgetary classification followed in India, the public investment reported under Agriculture and Allied Services (as defined in Table 6) captures a large chunk of the direct government interventions meant for influencing the household incomes of people living in the rural areas. During the period

1998-99 to 2007-08 (BE), India's total public investment in Agriculture and Allied Services shows a decline from 1.9 per cent of the GDP in 1998-99 to 1.6 per cent of the GDP in 2004-05. However, it recovered during the subsequent three years and reached 2.8 per cent of the GDP in 2007-08 (BE), which is a welcome trend. In terms of the priority accorded to this sector in the Central and state budgets, it has been found that public investment in Agriculture and Allied Services accounted for 7.4 per cent of the Total Public Expenditure in India in 1998-99, which then fell to the level of 6 per cent in 2003-04. However, the priority for this sector has been increased consistently since 2004-05 and it accounted for 10.2 per cent of the Total Public Expenditure in 2007-08 (BE). Given that almost 60 per cent of the country's population still depends on agriculture for livelihood and rural employment generation programmes (reported under Rural Development, which is included under Agriculture and Allied Services as per the definition being referred to here) constitute the most important intervention by the government for influencing the household incomes of people living in the rural areas, the priority for public investment in Agriculture and Allied Services in the Central and state budgets needs to be stepped up significantly.

Within the total quantum of Non-developmental Expenditure from the Central and State Budgets in India, expenditure on Defence Services constitutes a significant component. India's total expenditure on Defence Services had hovered around 2.3 per cent to 2.4 per cent of the GDP during the period 1998-99 to 2004-05. In 2004-05, India's capital outlay on Defence Services was almost doubled, as it rose sharply from Rs. 16,863 crore in 2003-04 to Rs. 31,994 crore in 2004-05. By then, India was already competing with China for the dubious distinction of being the 'largest buyer of conventional arms among developing nations'. With the substantial increase in the capital outlay on Defence Services in 2004-05, India did overtake China to become the 'largest buyer of conventional arms among developing nations' for the year 2004 (according to a story in BBC News, 2005). However, India's total public expenditure on Defence Services showed a gradual decline during the subsequent years and stood at 2 per cent of the GDP in 2007-08 (BE). Clearly, the Government could explore the possibility of further reducing the priority for expenditure on Defence Services and channelize the resources thus available towards sectors like Social and Community Services, and Agriculture and Allied Services. India's total public expenditure on Interest Payments (which stood at the level of 4.4 per cent of the GDP in 1990-91) increased from 5.5 per cent of the GDP in 1998-99 to 6.4 per cent of the GDP in 2003-04. It may be noted here that in the case of India, as in several other countries, the administered or policy-driven interest rates are seen as a benchmark for market interest rates. Hence, during the post-economic liberalization era in India in the 1990s and later, as the Central Government pursued liberalization of the financial services sector, there was a steep rise in the administered interest rates in the country. This rise in interest rates contributed significantly towards the rise in the magnitude of public expenditure on Interest Payments from the Central and state budgets. This led to a compression in the fiscal space available to the Central and state governments for raising public investments in sectors like Social and Community Services and Agriculture and Allied Services. However, the policy measures taken over the last few years for reducing the administered interest rates and helping the state governments swap their old debt, incurred at higher interest rates, with fresh debt, at lower interest rates, have led to a reduction in the magnitude of public expenditure on Interest Payments. The total public expenditure on Interest Payments fell from 6.4 per cent of the GDP in 2003-04 to 5.4 per cent of the GDP in 2007-08 (BE), which, as a proportion of the Total Public Expenditure in the country, reduced from 23.1 per cent in 2003-04 to 19.7 per cent in 2007-08 (BE). The Government should explore the possibility of further reducing the expenditure on Interest Payments, through appropriate monetary policies, and channelize the resources thus available towards sectors like Social and Community Services, and Agriculture and Allied Services. In general, the Government should reduce the share of Non-developmental Expenditure and prioritize Developmental Expenditure within the total public expenditure in the country.

As shown in Table 8, India’s total public expenditure on a set of critical social services, viz. Education, Medical and Public Health, Family Welfare, and Water Supply and Sanitation, has been less than 4.5 per cent of the GDP during most of the years over the last decade (this figure excludes the expenditure on education-related services incurred by other departments at the Centre and states, that is, departments other than that of Education, since such expenditures are reported under different heads in the budget documents). The combined public expenditure from the Central and state budgets on this set of critical social services had fallen from 4.5 per cent of the GDP in 1999-2000 to 3.9 per cent of the GDP in 2004-05, but it recovered during the subsequent three years and reached 4.3 per cent of the GDP in 2007-08 (BE).

Any international comparison of public spending on Education and Health clearly shows that India’s public spending on these important services continues to be very low. As shown

Table 8: Priorities for Critical Social Sectors in Total Public Expenditure

Year	Total Public Expenditure[1] as % of GDP	Public Expenditure on Social and Community Services[2] as % of GDP	Combined Public Expenditure on Education, Medical and Public Health, Family Welfare, and Water Supply and Sanitation as % of GDP
1990-91	27.2	5.4	4.4
1998-99	25.5	5.5	4.3
1999-2000	26.5	5.7	4.5
2000-01	26.3	5.4	4.3
2001-02	26.9	5.2	4.2
2002-03	27.0	5.2	4.1
2003-04	27.7	5.1	4.0
2004-05	26.2	5.1	3.9
2005-06	26.1	5.3	4.0
2006-07 (RE)	27.1	5.9	4.3
2007-08 (BE)	27.3	6.0	4.3

Notes:
1 This figure presents the combined (Centre+states) expenditure, incurred from the Union Budget and budgets of all states and UTs (at current prices).
2 Expenditure on Social and Community Services includes the expenditure from the Union Budget and Budgets of all States and UTs under following heads (excluding loans and advances): Education, Art and Culture; Scientific Services and Research; Medical and Public Health, and water supply and sanitation; Family Welfare; Housing; Urban Development; Broadcasting; Labour and Employment; Relief on Account of Natural Calamities (Plan spending); Social security and Welfare (Plan spending); and Others.

in Table 9, India's total public spending on Education (during the period 2002 to 2005) was less than 4 per cent of the GDP, while several of the developed and developing countries spent a higher magnitude (as a proportion of their GDP) on Education from their budgets. As is evident from Table 10, India's magnitude of public spending on Health is abysmally low; while it was less than 1 per cent of the GDP for India (in 2004), several developing and developed countries spent much higher levels of public resources (as a proportion of their GDP) on Health. From the point of view of influencing outcomes relating to child education and child health in India, the quantum of public investment on these critical social services needs to be stepped up significantly.

Over the last few years, some of the civil society organizations (like HAQ Centre for Child Rights and Centre for Budget and Governance Accountability, among others) have been

Table 9: Budgetary Expenditure on Education as % of GDP

Country	**2002-2005***
Cuba	9.8
Yemen	9.6
Denmark	8.5
Norway	7.7
Saudi Arabia	6.8
Malaysia	6.2
France	5.9
United States	5.9
United Kingdom	5.4
Iran (Islamic Republic of)	4.7
Korea (Republic of)	4.6
Brazil	4.4
India	**3.8**
Bangladesh	2.5
Pakistan	2.3
Tanzania (United Republic of)	2.2
China	1.9

Note: * Latest year from 2002 to 2005 for which data is available for a country.
Source: Human Development Report 2008, UNDP.

tracking the quantum of public investments from the Union Budget and budgets of different states, which are meant for child-specific schemes (that is, development programmes or schemes which are meant largely for the benefit of children). Table 11 shows the priority accorded to child-specific schemes in the Union Budgets of India (as well as the priorities for different child-related sectors) during the five years 2003-04 to 2007-08. It can be seen that the total public investment on child-specific schemes accounted for only 2.24 per cent of the total expenditure from the Union Budget in 2003-04 (RE), which increased to 5.08 per cent of the Union Budget in 2007-08 (BE). Even at 5 per cent of the total expenditure from the Union Budget, the priority accorded to child-specific schemes appears to be very low when we take into account the fact that children (that is, all persons up to the age of 18 years) now constitute more than 41 per cent of the country's population and that a large proportion of India's children are highly vulnerable as they are exposed to a range of deprivations and difficult circumstances. Likewise, a research study by the Centre for Budget

Table 10: Budgetary Expenditure on Health as % of GDP

Country	**2004**
France	8.2
Germany	8.2
United Kingdom	7.0
United States	6.9
Japan	6.3
Cuba	5.5
Turkey	5.2
Brazil	4.8
Argentina	4.3
Mexico	3.0
Korea (Republic of)	2.9
Saudi Arabia	2.5
Sri Lanka	2.0
India	**0.9**
Bangladesh	0.9
Pakistan	0.4
Myanmar	0.3

Source: Human Development Report 2008, UNDP.

and Governance Accountability, New Delhi (which was supported by UNICEF India) on the state budgets of Rajasthan, Uttar Pradesh and Madhya Pradesh has shown that in 2006-07 (BE), the total public investment on child-specific schemes accounted for 15.2 per cent of the state budget for Rajasthan, 14.8 per cent of the state budget for Uttar Pradesh and 14.4 per cent of the state budget for Madhya Pradesh. Thus, the Central Government and state governments in India need to significantly step up the quantum of public investments on interventions targeted towards children. Moreover, the investments from the Central and state budgets need to be stepped up particularly for interventions in the hitherto neglected sectors of child health and protection of children in difficult circumstances.

Table 11: Resources for Child-specific Schemes in the Union Budget

	2003-04 (RE)	2004-05 (RE)	2005-06 (RE)	2006-07 (RE)	2007-08 (BE)
Outlay for Child Development[1] as % of Total Outlay from Union Budget	0.46	0.45	0.78	0.84	0.88
Outlay for Child Health[2] as % of Total Outlay from Union Budget	0.27	0.31	0.55	0.46	0.52
Outlay for Child Education[3] as % of Total Outlay from Union Budget	1.45	1.75	2.81	3.31	3.63
Outlay for Child Protection[4] as % of Total Outlay from Union Budget	0.024	0.030	0.034	0.032	0.053
Total Outlay for Child-specific Schemes as % of Total Outlay from Union Budget	2.24	2.59	4.25	4.63	5.08

Notes:
- BE: Budget Estimates; RE: Revised Estimates.
- Expenditure Budget Volume II (Notes on Demands for Grants) in the Union Budget documents does not give Actuals, hence the Revised Estimates have been taken for the years from 2003-04 to 2006-07.
- Total Expenditure figures for 2002-03 to 2005-06 are also Revised Estimates, though Actuals are available. This has been followed for the sake of consistency in the analysis.
- 1 Outlay for Child Development includes the Union Budget outlays for all those programmes/schemes, meant largely for children, which are expected to influence the outcomes relating to child nutrition and early childhood care (for example, the Integrated Child Development Services scheme, Nutrition Programme for Adolescent Girls, Rajiv Gandhi National Crèche Scheme, etc.).
- 2 Outlay for Child Health includes the Union Budget outlays for all those programmes/schemes, meant largely for children, which are expected to influence the outcomes relating to child survival and child health (for example, the Reproductive and Child Health programme, Routine Immunization programme, Pulse Polio Immunization programme, etc.).
- 3 Outlay for Child Education includes the Union Budget outlays for all those programmes/schemes, meant largely for children, which are expected to influence the outcomes relating to child education (for example, Sarva Shiksha Abhiyan, Mid-day Meal scheme, outlays for Kendriya Vidyalayas, etc.).
- 4 Outlay for Child Protection includes the Union Budget outlays for all those programmes/schemes, meant largely for children, which are expected to influence the outcomes relating to protection of children in difficult circumstances (for example, Integrated Child Protection Scheme, National Child Labour Project, Scheme for Rescue of Victims of Trafficking, etc.).

Source: Centre for Budget and Governance Accountability (2007), "Budget 2007-08: Dream or Despair? – Response to Union Budget 2007-08", New Delhi (www.cbgaindia.org).

III. Issues in fiscal federalism

In the federal fiscal architecture in India, there is a 'vertical imbalance' between the powers of the states and the Centre to raise revenue through taxes and duties in comparison to their expenditure requirements. The powers of revenue mobilization vested with the states are insufficient to help them mobilize resources that would meet their total expenditure requirements. This kind of a vertical imbalance was built into the fiscal architecture of India keeping in mind the need for the Central Government's interventions to address the 'horizontal imbalance', that is, the limited ability of some of the states to mobilize adequate resources from within their state economies in comparison to others. In the fiscal architecture that has evolved in India, a significant amount of financial resources are transferred from the Central Government every year to every state government so as to enable the state governments to meet their expenditure requirements. In fact, for any state, a large part of the state government's total revenues is provided by the Central Government in the form of: a share in tax revenue collected under the Central Government tax system, grants and loans.

It has been argued by some observers that, over the last one-and-a-half decades, the space available to the states for shaping their fiscal policies has shrunk. The fifth section of this paper contains a discussion on the decline in the tax-GDP ratio for the country during the post-economic liberalization era of the 1990s. As shown in Table 14 (in the fifth section), the total tax revenue collected in India fell from 16 per cent of the GDP in 1989-90 to 13.8 per cent of the GDP in 2001-02, before it started recovering gradually from 2002-03. The magnitude of tax revenue collected under the Central Government tax system fell from 10.6 per cent of the GDP in 1989-90 to 8.2 per cent of the GDP in 2001-02. In the wake of the resource crunch faced by the Centre (which, as discussed later, was a consequence of some of the liberalization policies adopted by the Centre), the magnitude of financial resources transferred from the Centre to the states had been compressed. As shown in Table 12, the magnitude of gross devolution and transfers (GDT) from the Centre to the states (which include: the states' share in Central taxes, grants from the Centre, and gross loans from the Centre) fell from 7.2 per cent of the GDP in 1990-91 to 5.9 per cent of the GDP in 1998-99, and it hovered around 5 per cent of the GDP during the period 1999-2000 to 2005-06. (It may be noted here that following the creation of the National Small Savings Fund in 1999-2000, there was a change in the system of accounting. Prior to 1999-2000, the states used to be given their shares in small savings collection as loans from the Centre. However, since

Table 12: Gross Devolution and Transfers from Centre to States

Year	Gross Devolution and Transfers (GDTs) from Centre to States[1] (in Rs. Crore)	GDT as % of GDP	GDT as % of Aggregate Disbursements of States
1988-89	30,333	7.2	45.2
1989-90	32,862	6.8	42.8
1990-91	40,859	7.2	44.9
1991-92	45,143	6.9	41.8
1992-93	51,439	6.9	43.1
1993-94	57,848	6.7	43.2
1994-95	63,538	6.3	39.9
1995-96	68,725	5.8	39.4
1996-97	80,918	5.9	40.6
1997-98	94,009	6.2	42.0
1998-99	1,02,268	5.9	39.1
1999-2000	95,652	4.9	31.1
2000-01	1,06,730	5.1	31.4
2001-02	1,19,213	5.2	32.3
2002-03	1,28,657	5.2	31.4
2003-04	1,43,785	5.2	28.0
2004-05	1,60,750	5.1	29.0
2005-06	1,78,871	5.0	31.8
2006-07 (RE)	2,28,889	5.5	33.3
2007-08 (BE)	268,422	5.8	35.0

Notes: 1 Gross Devolution and Transfers (GDTs) include: (i) States' share in Central taxes, (ii) Grants from the Centre, and (iii) Gross loans from the Centre.
Source: Reserve Bank of India (2007).

1999-2000, the states are being given their shares in small savings collection as loans from the National Small Savings Fund, which is reported to be under internal debt in their budgets.) As a proportion of Total Expenditure from the budgets of all the states, the magnitude of gross devolution and transfers (GDT) from the Centre to the states fell sharply from 45 per cent in 1990-91 to 29 per cent in 2004-05.

Thus, the decline in transfer of resources from the Centre to the states, especially during the second half of the 1990s and the early years of the present decade, adversely affected the fiscal health of the states. Moreover, as mentioned earlier, a rise in the administered interest rates in the country under the policies for financial sector liberalization meant that the interest payment burden of the states rose sharply during the second half of the 1990s and early years of the present decade. In addition to that, a huge increase in the states' outlay on salaries for government staff during the late 1990s (following the implementation of the Fifth Pay Commission recommendations) meant a further blow to the worsening fiscal health of the states. As a result of all these factors, most states experienced a crisis in their fiscal health during the late 1990s and the early years of this decade.

The dominance of the Central Government in the overall fiscal policy space in the country increased during this period, when most of the states were facing a severe crisis in their fiscal health. The situation has started improving since 2006-07, as the magnitude of GDT from the Centre to the states has increased to the level of 5.8 per cent of the GDP and 35 per cent of the Total Expenditure from the state budgets in 2007-08 (BE). However, the overall fiscal policy space in India still continues to be dominated heavily by the Centre. As has already been mentioned, starting with the Tenth Finance Commission (whose recommendations were applicable for five years from 1995-96 to 1999-2000), both the Terms of Reference for the successive Finance Commissions as well as their recommendations indicate a bias towards promoting the conservative fiscal policy of the Centre and have contributed towards the growing dominance of the Centre in the federal fiscal architecture in India. It must be noted here that such a bias towards promoting the dominance of the Centre in the federal fiscal architecture in India has been pointed out even in the Terms of Reference given to the Thirteenth Finance Commission, which has recently submitted its recommendations for the five fiscal years from 2010-11 to 2014-15.

Another major issue pertaining to the growing centralization of the fiscal policy space in India is the changing composition of the grants given by the Centre to the states. Out of the different types of grants given by the Centre to the states, Non-Plan Grants (based on the recommendations of the Finance Commission) and Central Assistance for State Plan Schemes (based on the recommendations of the Planning Commission) constitute untied or block grants for states, which they can spend according to their own expenditure priorities. On the other hand, grants under Central Plan Schemes (Plan schemes of the Central Government in which the Centre contributes 100 per cent of the funds) and Centrally Sponsored Schemes (Plan schemes of the Central Government in which every state has to contribute a certain share of the funds) constitute the tied or conditional grants for the states. It is seen that in the total grants from the Centre to the states, the combined share of Non-Plan Grants and Central Assistance for State Plan Schemes fell from 77.7 per cent in 2000-01 to 73.6 per cent in 2007-08 (BE). This decline would most likely be sharper if the time period is extended further and the composition of grants in the 1990s is examined. On the other hand, the share of grants to the states under Central Plan Schemes and Centrally Sponsored Schemes (which are tied to the norms, conditionalities and unit costs of the Central schemes) in the total grants to the states has increased from 22 per cent to 25.7 per cent. Again, this increase would most likely be sharper if the composition of grants in the 1990s is examined. In this context, it may be noted that several of the states have been demanding an increase in the magnitude of untied grants from the Centre, which would give them the additional fiscal space to make public investments in accordance with their state-specific development priorities.

As regards public investments in children, a research study by the Centre for Budget and Governance Accountability, New Delhi on the State Budgets of Rajasthan, Uttar Pradesh and Madhya Pradesh has shown that all these states are heavily dependent on the Central Government's Plan schemes (such as the Sarva Shiksha Abhiyan, Mid-day Meal scheme, Reproductive and Child Health Programme, Universal Immunization Programme, Integrated Child Development Services, and National Child Labour Project) for targeted interventions focused on children and their State Plan Schemes for children have meagre financial resources. Until 2004-05, that is, before the recommendation period of the Twelfth Finance Commission started in 2005-06, the non-special category states in India (which includes all major states in the country) were required to take the Central Assistance for State Plan Schemes as 30 per cent grants and 70 per cent loans, which added to their indebtedness and hence some of the states were not keen to take a greater magnitude of grants from the Centre for State Plan Schemes. As a consequence, the importance of the Central Government's Plan schemes kept on increasing over the last one-and-a-half decades. However, the Twelfth Finance Commission scrapped the prevailing requirement and since 2005-06, the entire amount of Central Assistance for State Plan Schemes is being given as grants to the states.

Table 13: Composition of Grants (to States) from the Centre

Year	Grants from the Centre (in Rs. Crore	Grants for Various Components as % of Total Grants from the Centre				
		State Plan Schemes	Central Plan Schemes	Centrally Sponsored Schemes	NEC/ Special Plan Schemes	Non-Plan Grants
2000-01	37,783.8	42.9	3.0	19.0	0.3	34.8
2001-02	43,082.3	45.1	2.9	19.4	0.5	32.0
2002-03	45,682.5	43.4	3.8	19.0	0.5	33.4
2003-04	51,348	49.8	2.6	19.3	0.6	27.7
2004-05	56,857	52.6	2.3	18.4	0.5	26.2
2005-06	76,750	37.5	2.9	17.3	0.4	41.9
2006-07 (RE)	1,02,955	39.9	4.9	19.3	0.8	35.1
2007-08 (BE)	1,17,320	44.7	4.7	21.0	0.6	28.9

Source: Reserve Bank of India, Various issues.

IV. Factors constraining effective utilization of Budget outlays

The concern with regard to how well the budget outlays (that is, financial allocations made in the budgets) translate into physical outputs/services such as schools, hospitals, teachers, doctors, textbooks, medicines, etc. and ultimately lead to improvements in the development outcomes in the states such as improvement in children's school enrolment ratios, reduction in children's school drop-out rates, reduction in the Infant Mortality Rate (IMR), reduction in the proportion of under-weight children, etc. has been growing in India over the last few years. In this context, the Central and state Governments need to take a host of measures for addressing the institutional and procedural bottlenecks in the planning and budgetary processes, which have constrained the ability of some of the states to effectively utilize budget outlays.

Public expenditure in India is usually divided into two categories, viz. Plan expenditure, which refers to all kinds of public expenditure incurred on the programmes/schemes laid out in the ongoing Five Year Plan such as all kinds of expenditure incurred on Sarva Shiksha Abhiyan, Mid-day Meal scheme, and Integrated Child Development Services (ICDS), among others, and Non-Plan expenditure, which refers to all kinds of public expenditure that is outside the purview of the Five Year Plan such as expenditure on defence services, interest payments, organs of the state, and on the running of existing government institutions in different sectors, among others. In the case of Non-Plan expenditure, a very large part of this category of expenditure in the states is meant for the salaries of staff working for the government. Since such payments are in the nature of 'entitlements', it would be a lot easier for the government departments to disburse the funds meant for such payments when the concerned staff members are already in place. Hence, there is hardly any concern noticed with regard to the ability of the state governments to utilize their Non-Plan budget outlays. With regard to the Plan expenditure, however, several states have shown noticeable levels of under-utilization of Plan budget outlays, especially in the social sectors.

The findings of a study by the Centre for Budget and Governance Accountability, New Delhi (preliminary findings of the study are titled "District Level Analysis of Public Spending on Children", carried out with support from UNICEF India) throws light on a set of institutional and procedural constraints, which need to be removed in order to enable the states to effectively utilize greater magnitudes of Plan outlays in the social sectors. This study has analysed the implementation of major Plan schemes for children, like Sarva Shiksha Abhiyan, Mid-day Meal, Reproductive and Child Health Programme, Universal Immunization Programme, Integrated Child Development Services, National Child Labour Project, and Total Sanitation Campaign at the district level in selected states. With regard to the selected Plan programmes/schemes for children, the study finds that a number of problems have been observed across various states, particularly in the backward states, over the last few years, which are:

(i) Low capacity of some of the states to increase spending in the Plan schemes, which is evident from the noticeable levels of unspent budget outlays left with some of the states and low levels of actual spending as compared to approved budgets for the schemes in many states; and

(ii) Poor quality of spending/fund utilization in the Plan schemes, since the fund utilization levels are skewed across the four quarters in a fiscal year (typically, a large share of spending getting crowded in the last two quarters), fund utilization levels are skewed across different components in a scheme (spending on those components increases quickly where it is easier to disburse money as compared to some other components which require greater efforts from the implementing agencies), and fund utilization levels are skewed across different regions.

Some of the main reasons for such under-utilization of Plan outlays by the states in the child-focused schemes can be traced to the institutional and procedural bottlenecks in the process of implementation of Plan programmes/schemes and deficiencies in the planning process being followed at the district level.

The said study by CBGA identifies a number of factors that could be responsible for the above-mentioned problems in the levels and quality of fund utilization in Plan schemes for children, which can be broadly divided into the following categories:

(a) The first set of factors pertains to the deficiencies in decentralized planning being carried out in most of the schemes, which is caused by a shortage of staff to carry out planning activities, lack of emphasis on training and capacity building of staff and community leaders for decentralized planning, and inadequate emphasis on community participation in the planning process.

(b) The second set of factors pertains to bottlenecks in budgetary processes in the schemes, such as delay in the flow of funds, delay in sending sanction orders for spending, decision-making being centralized within the states, low delegation of financial powers to the district and sub-district level authorities, uniform norms of Centrally-sponsored schemes for all states, incomprehensibility of guidelines of some of the Centrally-sponsored schemes, very low unit costs that are unrealistic, and weak monitoring and supervision of programme implementation activities.

(c) The third set of factors relates to systemic weaknesses in the government apparatus in the states, particularly the backward States. A shortage of trained, regular staff for various important roles like, management, finance/accounts, and frontline service provision has weakened the capacity of the government apparatus to implement Plan schemes. Weak infrastructural facilities within the government apparatus too have had an adverse impact. Moreover, too many Plan schemes are being implemented in most of the states, without adequate convergence and integration across them.

As regards the last set of factors mentioned above, that is, the systemic weaknesses in the government apparatus in the states, it can be argued that Non-Plan expenditure by the state plays an important role in improving the overall capacity of the government apparatus.

Non-Plan expenditure shapes, to a significant extent, the strength of the state government apparatus in terms of the availability of regular qualified staff and adequacy of the government infrastructure, for implementing Plan programmes/schemes. However, over the last decade, Non-Plan expenditure in social services has been checked by many states due to the emphasis of the prevailing fiscal policy on the reduction of deficits through the curtailment of public expenditure. As a result, the overall capacity of the government apparatus to implement Plan programmes/schemes has been adversely affected. Thus, the country needs to have a fiscal policy that enables the state governments to increase Non-Plan spending in the development sectors. The institutional and procedural bottlenecks in planning, fund flow and fund utilization processes need to be removed through concerted efforts by both the Centre and the states. Moreover, there is also a need for imparting some flexibility to the states vis-à-vis the norms, guidelines and unit costs in the central schemes.

V. Resources for public expenditure

As discussed earlier in this paper, in the case of India, the overall fiscal policy space for making public investments depends, to a significant extent, on the magnitude of tax revenue collected by the government. Table 14 and Figure 2 present an international comparison of the total magnitude of the tax revenue collected in different countries for various years between 1998 and 2004. These two sets of data reveal that the total magnitude of tax revenue collected in India has been significantly lower than that in several developed countries as well as in some of the developing countries. Thus, the overall public resources available to the Government in India for making investments towards socio-economic development appear inadequate in comparison to several other countries.

Hence, in order to expand the fiscal policy space for public investments, the magnitude of tax revenue collected in India should have been stepped up significantly. However, as shown in Table 15, the magnitude of Total Tax Revenue in India fell sharply from 16 per cent of the GDP in 1989-90 to 13.8 per cent of the GDP in 2001-02, before it started recovering gradually from 2002-03. During this period, while the magnitude of the states' Own Tax Revenue increased marginally from 5.36 per cent of the GDP in 1989-90 to 5.59 per cent of the GDP in 2001-02, the magnitude of Central Taxes fell noticeably from 10.62 per cent of the GDP in 1989-90 to 8.21 per cent of the GDP in 2001-02.

Table 14: International Comparison of Tax–GDP ratio

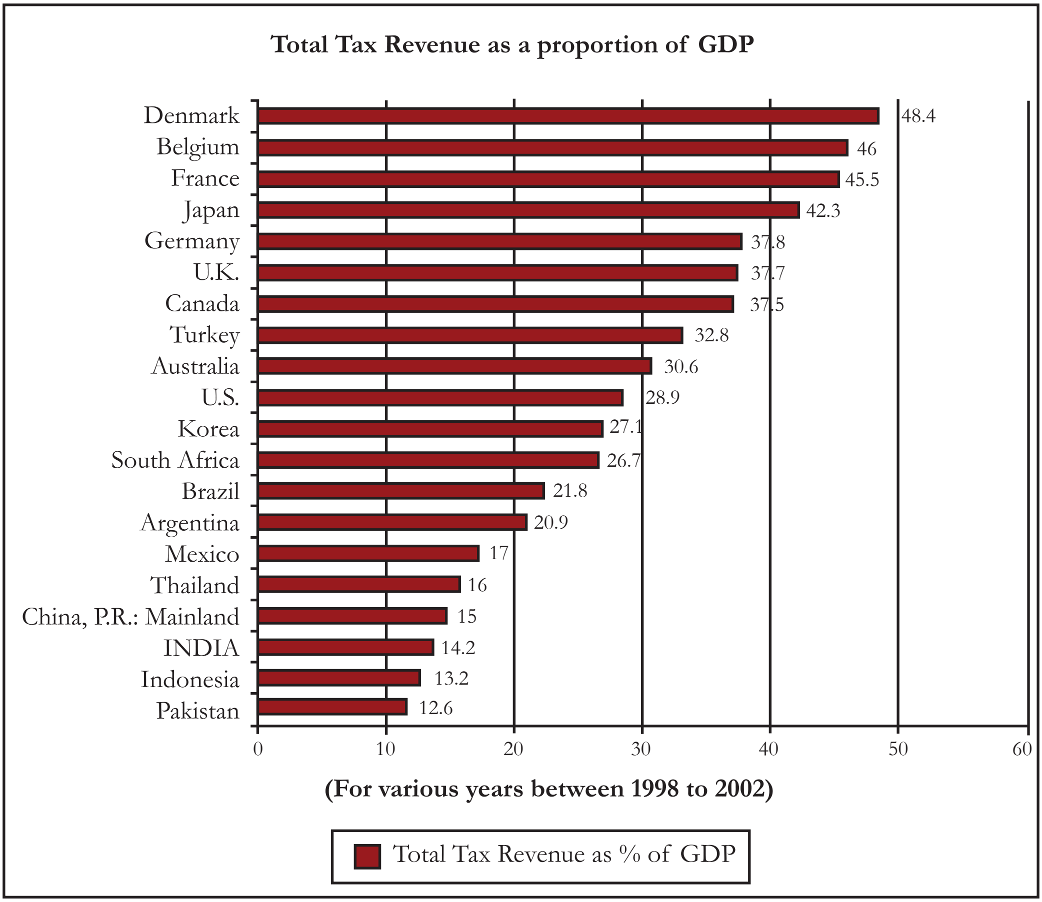
Total Tax Revenue as a proportion of GDP in 2004	
Countries	Gross Tax Revenue as % of GDP
Sweden	50.7
Denmark	49.6
Belgium	45.6
Netherlands	39.3
Spain	35.2
U.S.	25.4
S. Korea	24.6
Mexico	18.5
India *	16.0

Note: *2004-05 BE (Total tax revenue for the country)
Source: Srinivasan, 2005.

The decline in the magnitude of Central Taxes over the 1990s was rooted in some of the major policies taken by the Central Government during the era of economic liberalization. The reduction of customs duties under the policy of trade liberalization and the subsequent reduction of excise duties (to enable domestic producers in India to get the same advantage as those in other countries from which India imported commodities) led to a significant decline in the magnitude of indirect taxes, which fell from 13.7 per cent of the GDP in 1989-90 to 10.6 per cent of the GDP in 2001-02. The collections from direct taxes increased from 2.3 per cent of the GDP in 1989-90 to only 3.2 per cent of the GDP in 2001-02, which was mainly because of the inability of the Central Government to increase collections from direct taxes significantly in an era of rationalization (that is, reduction) of direct tax rates. As a result, the tax-GDP ratio for the country registered a sharp decline during the 1990s and in the early years of the present decade.

During the period 2002-03 to 2007-08, the collections from direct taxes improved noticeably from 3.56 per cent of the GDP to 5.7 per cent of the GDP, which was not only due to the improvement in tax administration in the country but also because of the skewed process of growth of the Indian economy that generated more surpluses for the private corporate sector. Likewise, the collections from indirect taxes went up from 11 per cent of the GDP in 2002-03 to 12.43 per cent of the GDP in 2007-08 (BE), and the increase in collections

Figure 2: Magnitude of Total Tax Revenue across Different Countries



Source: Based on the data provided in Lorie, 2003.

from Service Tax contributed significantly in this regard. As a result of these improvements, the magnitude of Total Tax Revenue in India increased from 14.5 per cent of the GDP in 2002-03 to 18.14 per cent of the GDP in 2007-08 (BE).

However, even at the present level, the magnitude of Total Tax Revenue in India falls far short of the levels of tax revenue collected in several other countries, and it is still inadequate from the point of view of the magnitude of public investment needed in the country. It has been pointed out in the context of the increase in the magnitude of direct tax revenue that, over the last decade, the share of the private corporate sector's surplus has increased very fast, and hence the government should have collected much greater magnitudes of

Table 15: Tax-GDP Ratios for India

Year	As % of GDP			As % of Total Tax Revenue (All India)	
	Central Taxes (Gross)	States' Own Taxes	Total Tax Revenue (All India)	Direct Taxes	Indirect Taxes
1988-89	10.55	5.33	15.88	2.31	13.56
1989-90	10.62	5.36	15.98	2.30	13.68
1990-91	10.12	5.30	15.43	2.16	13.27
1991-92	10.31	5.49	15.80	2.55	13.25
1992-93	9.97	5.28	15.26	2.59	12.66
1993-94	8.82	5.38	14.19	2.53	11.67
1994-95	9.11	5.49	14.60	2.85	11.75
1995-96	9.36	5.39	14.75	3.01	11.74
1996-97	9.48	5.21	14.69	3.00	11.69
1997-98	9.14	5.35	14.49	3.32	11.17
1998-99	8.26	5.12	13.38	2.82	10.56
1999-2000	8.80	5.27	14.07	3.12	10.95
2000-01	8.97	5.55	14.52	3.41	11.11
2001-02	8.21	5.59	13.80	3.21	10.59
2002-03	8.80	5.72	14.51	3.56	10.96
2003-04	9.23	5.80	15.03	3.98	11.06
2004-05	9.68	6.01	15.70	4.35	11.34
2005-06	10.23	6.19	16.41	4.68	11.73
2006-07 (RE)	11.28	6.46	17.74	5.57	12.17
2007-08 (BE)	11.63	6.51	18.14	5.70	12.43

Source: Government of India, Indian Public Finance Statistics 2007-08, 2008a.

tax revenue through corporate and personal income taxes. Likewise, the revenue collected through service tax too should have been much higher than what the government managed to collect. As regards the composition of the tax revenue in 2007-08 (BE), it is seen that direct taxes contributed only 5.7 per cent of the GDP, while indirect taxes contributed 12.43 per cent of the GDP, which was more than two-thirds of the Total Tax Revenue in India. This clearly implies that the tax system prevailing in the country is not very progressive yet. In this context, it has been argued that the Central Government needs to step up the collections from direct taxes through the imposition of Capital Gains Tax, higher rates of

Table 16: Tax Revenue Foregone in the Central Government Tax System due to Tax Exemptions/Incentives/Deductions

Items	Revenue Foregone in 2006-07 (in Rs. Crore)	Revenue Foregone as % of Aggregate Tax Collection in 2006-07	Revenue Foregone in 2007-08 (in Rs. Crore)	Revenue Foregone as % of Aggregate Tax Collection in 2007-08
Corporate Income Tax	45,034	9.56	58,665	10.09
Personal Income Tax	32,143	6.82	42,161	7.25
Excise Duty	75,475	16.02	87,992	15.14
Customs Duty	1,37,105	29.11	1,48,252	22.51
Total	2,89,757	61.51	3,37,060	58.00
Less (Related to Export Credit)	50,045	10.62	58,416	10.05
Grand Total	**2,39,712**	**50.89**	**2,78,644**	**47.94**

Notes:
•As per the Receipts Budget in the Union Budget, "the estimates and projections are intended to indicate the potential revenue gain that would be realized by removing exemptions, deductions, weighted deductions and affected by removal of such measures…(Also) the cost of each tax concession is determined separately, assuming that all other tax provisions remain unchanged".
•Aggregate Tax Collection refers to the aggregate of net direct and indirect tax collected by the Central Government.
•The figure of Aggregate Tax Collection for 2006-07 is based on Actuals, while that for 2007-08 is based on Revised Estimates.

Source: GoI, Receipts Budget 2008-09, 2008c.

Wealth Tax, and higher rates of taxes on speculative gains made in the stock markets. It must also be noted here that the numerous tax exemptions given under the Central Government tax system cost a substantial magnitude of tax revenue.

As shown in Table 16, the magnitude of tax revenue foregone due to tax exemptions/incentives/deductions under the Central Government tax system was estimated to be worth 51 per cent of the total tax collections in 2006-07 (that is, around 5.8 per cent of the GDP in 2006-07) and worth 48 per cent of the total tax collections in 2007-08 (that is, around 5.9 per cent of the GDP in 2007-08). Hence, the Central Government needs to take strong measures to curb the magnitude of tax revenue foregone due to exemptions and thus increase the volume of tax collections. While retaining only the progressive elements in such tax exemptions, the Government needs to do away with many of the exemptions given to the affluent sections of the population, such as the exemptions given to the private corporate sector and those in the indirect taxes on commodities that are consumed mainly by the richer sections of the population. The implementation of strong and progressive policy measures by the Government in the domain of taxation can be expected to play a significant role in expansion of the overall fiscal space available for public investments in the country.

VI. Concluding remarks

It can be noted that the overall public resources available in India for making investments towards socio-economic development appear insufficient in comparison to those in several other countries. In this context, it has been observed that the implementation of strong and progressive policy measures by the Government in the domain of taxation can play a significant role in expansion of the overall fiscal space available for public investments in the country. However, while in the long run, the overall fiscal policy space for making public investments depends mainly on the magnitude of the tax revenue collected by the Government, in the short run, it also depends on the policy adopted by the Government towards borrowing. Hence, there is clearly a need for moving away from conservative to progressive fiscal policy for the whole country. In terms of the expenditure priorities, the government should reduce the share of Non-developmental Expenditure and prioritize Developmental Expenditure within the total public expenditure in the country. From the point of view of influencing development outcomes relating to children, the quantum of public investment on important social services like education, health, water supply and sanitation, and nutrition needs to be stepped up significantly. Moreover, the Central Government and state governments also need to significantly enhance the quantum of public investments on interventions targeted towards children. As regards such public investments on child-focused interventions, the investments from the Central and State Budgets need to be increased, particularly for interventions in the hitherto neglected sectors of child health and protection of children in difficult circumstances. In the context of the growing centralization of the overall fiscal policy space in India over the last one-and-a-half decades, it has been opined in this paper that the magnitude of untied grants from the Centre to the states needs to be increased, which would provide the state governments additional fiscal space for public investments in accordance with their state-specific development priorities. Finally, with regard to the factors constraining the effective utilization of budget outlays, it was observed that the state governments should be enabled to increase Non-Plan spending in the development sectors;

the Centre and states should make concerted efforts to remove institutional and procedural bottlenecks in planning, fund flow and fund utilization processes; and the states should be given flexibility vis-à-vis the norms, guidelines and unit costs in the Central schemes.

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