MODULE – 3

PUBLIC EXPENDITURE AND PUBLIC DEBT

PUBLIC EXPENDITURE

Q.1 What is Public Expenditure? Examine the classification of Public Expenditure.

The term public expenditure refers to the expenses of public authorities like the Central, state and local governments. Public expenditure occupies a very important place in the study of public finance. It is the end of all financial activities of the government. Public expenditure is incurred basically to maximize social welfare.

Classification of public expenditure refers **to the systematic arrangement of different items on which the government incurs expenditure.**

1. Revenue and Capital Expenditure:

(A) **Revenue Expenditures** are **recurrent** or **consumption expenditures** incurred on public administration, defence forces, public health and education, maintenance of government machinery, subsidies and interest payments. These expenditures are **recurrent** in nature and they do not create any capital assets.
Revenue expenditure is classified into **development** and **non-development** expenditure

i) Development Expenditure:
The part of revenue expenditure that directly or indirectly contributes to the development of the country is known as **development revenue expenditure**. It includes expenditures on the **maintenance** and **functioning** of social and community services and physical infrastructure. For example, maintenance of education and public health infrastructure like schools, hospitals, irrigation facilities, electricity boards etc.

ii) Non-Development Expenditure:
The part of revenue expenditure that may not directly contribute to economic development is known as non-development revenue expenditure. They include expenditures on the maintenance of defence establishments, administrative expenditure, interest payments, payment of old age pension etc.

(B) **Capital Expenditures** are incurred on **building durable assets**, like highways, multipurpose dams, irrigation projects, buying machinery and equipment. They are a **non-recurring type** of expenditure in the form of **capital investments**. Such expenditures are expected to improve the productive capacity of the economy.

i) Not all capital expenditures are productive. Non-development capital expenditure on defence establishment which does not have any direct impact on economic development but is necessary for the security of the nation.

ii) Capital expenditures on **social infrastructure** like government schools, hospitals, primary health centers may not generate revenue and therefore cannot be termed productive in that sense, but they indirectly contribute to improving productivity.

2. Productive and Unproductive Expenditure

(a) Productive Expenditure:
Expenditure on infrastructure development, public enterprises or development of agriculture increase productive capacity in the economy and bring income to the government through tax and non-tax revenues. Thus they are classified as productive expenditure.

(b) Unproductive Expenditure:
Expenditures in the nature of consumption, such as defence, interest payments, expenditure on law and order, public administration do not create any productive asset which can bring income or returns to the government. Such expenses are classified as unproductive expenditures.

3. Non-Transfer and Transfer Expenditure:

(a) Non-transfer Expenditures:
Are incurred for buying or using goods and services. These include expenditure on defence, education, public health etc. Investment expenditures on capital assets are also non-transfer expenditures as the government gets capital goods and assets in return for them.

(b) Transfer Expenditures:
Refer to those expenditures against which there is no corresponding transfer of real resources i.e. goods or services. These include expenditures incurred on old age pension, unemployment allowance, sickness benefits, interest payments on public debt and subsidies.

4. Plan and Non-Plan Expenditure:

(a) Plan Expenditures:
Refer to the spending of the annual funds allocated by the Central government for development schemes outlined in the ongoing Five Year Plan. For example: Industrial Development, Agricultural Development, Infrastructure, Education & Health etc.

(b) Non-Plan Expenditures:
Include all those expenditures of the government that are not included in the ongoing Five-Year Plan. They include both development and non-development expenditure. Part of the expenditure is obligatory in nature e.g. interest payments, pensions etc. and a part is essential obligation e.g. defence and internal security.

5. Dalton's Classification:
Economist Hugh Dalton has provided the following comprehensive classification of public expenditure:

i) **Expenditures on political executives** i.e. maintenance of ceremonial heads of state, like the President.
ii) **Administrative expenditure** to maintain the general administration of the country, like government departments and offices.
iii) **Security expenditures** to maintain armed forces and the police forces.
iv) **Expenditures on administration of justice** include maintenance of courts, judges, public prosecutors.
v) **Developmental expenditures** to promote growth and development of the economy, like expenditure on infrastructure, irrigation etc.
vi) **Social expenditures** on public health, community welfare, social security etc.
vii) **Public debt charges** include payment of interest and repayment of principal amount.

Q.2 Examine the causes for Rapid growth of Public Expenditure in India. (OR) Explain the Wagner's Law of Public Expenditure.

The size of public expenditure has been rising in developed countries since early twentieth century and in developing countries since the middle of twentieth century. This is because governmental functions have increased. This increase has far reaching impact on economic growth and development through production, distribution, consumption, saving and investment.

Increase in public expenditure has been explained by **Wagner's Law** and **Wiseman-Peacock Hypothesis**. According to Wagner public expenditure in any economy increases because of an increase in the role of government. The government in every economy is performing the following fundamental duties.

1) The government is involved in the production of materialistic goods.
2) The government plays an important role in maintaining internal and external security.
3) The government also provides social justice through court i.e. maintaining law and order.

In the process of performing its duties the public expenditure increases.

In India there has been spectacular rise in public expenditure since 1950-51. The ratio of public expenditure to GDP rose steadily until 1990-91. From 9.1 percent of GDP in 1950-51, the ratio rose to 28.5 per cent of the GDP in 1990-91. From 1990-91 to 1995-96, there was a decline in this ratio. Since then, this trend has reversed and the public expenditure GDP ratio has been rising.

Total Public Expenditure (Revenue and Capital) since 1990-91

Year	Rs. Crores	% of GDP
1990-91	1,05,298	19.7
2007-08	7,12,671	14.4
2009-10	10,20,838	16.6

The following are the causes of growth of public expenditure in India:

1. **Defence:** One of the major contributors to rising public expenditure in India is the growing defence expenditure. Defence expenditure has increased from Rs.3,600 crore in 1980-81 to Rs.86,879 crore in 2009-10.
2. **Population:** In 1951, India's population was 36 crore. It rose to 102.9 crore in 2001. This massive growth in population has made it necessary for the government to spend ever increasing amounts on education, health, infrastructure, subsidies and development programmes.
3. **Rise in National Income:**Rise in public expenditure is directly related to rise in national income and per capita income. This is because, as income rises beyond subsistence level, and the basic necessities of people are satisfied, demand for public goods like education, communication, transportation, health care etc. tend to increase. Thus, governments are expected to spend more on such goods.
4. **Urbanisation:**With economic development and industrialization, urbanization has taken place. In 1951, the percentage of urban population was 17 percent, whereas in 2001 it was around 28 percent. With urbanization, public expenditure or urban infrastructure has increased.
5. **Subsidies:**The government gives subsidies to different sectors in order to make essential goods and services affordable to the poor. In India Central Government subsidies have increased from Rs.9,581 crore in 1990-91 to Rs.1,06,004crore in 2009-10.
6. **Development Programmes:**The government of India has always been committed to planned development. This requires heavy investments in various physical and social infrastructure projects. The Government's Plan expenditure was Rs.3,25,149crore in 2009-10.
7. **Poverty Alleviation and Employment Generation:**As part of the planned programme, the government has launched several programmes to directly attack the problems of poverty and unemployment. These require continuous ongoing expenditure for their implementation.

8. **Servicing of Public Debt:**Most plan capital expenditures in India have been financed through public debt from various sources. There has been a continuous growth in the total outstanding debt of the government. In India, interest payment is the single largest item of expenditure. It has increased from Rs.2,604 crore in 1980-81 to Rs.2,25,511crore in 2009-10.
9. **Administrative Machinery:**Indian government's administrative machinery is vast and has expanded many times over the years. Maintenance of various ministries, departments and offices, payment of salaries to a large staff has increased administrative expenditure over the years.
10. **Judiciary and Internal Security:** India has a strong and extensive judicial system that is designed to protect the rights of its citizens. Huge expenditure has to be incurred for the maintenance of courts and jails, salaries of the judges and other staff, as well as police forces involved in maintaining internal law and order.
11. **Democracy:**India is the world's largest democracy, Periodic elections and maintenance of the political representatives have increased public expenditure to a great extent over the years.

BUDGET

Q.1 What is budget? Examine the types of budget. OR Give a brief note about the classification of budget.

The public budget consists of a financial plan of a government. It contains the details of its programmes and policies, the estimated receipts and proposed expenditure under different heads for a specific period, usually a year. Preparing the budget is a very important activity of the government. Public budget is a very important fiscal document. It reflects the programmes and policies of a government.

1. **Departmental and Ministerial Budgets:**Every department of each ministry prepares its departmental budget. These departmental budgets are consolidated into the budget of the ministry. All such budgets of ministries are then consolidated into the main budget. This is presented to the parliament of the country every year. In some cases if a particular ministry is large, a separate budget is placed before the parliament by the concerned minister.
   Example: The railway budget in India. But its overall revenue and expenditure statement is included in the main budget.

2. **Multiple and Unified Budget:**The government budget is divided into parts in such a way that each part would enable to highlight the specialized functions of the government. A unified budget has the merit of enabling us to know the total effect on the economy, which is more important. Multiple budgets will require lots of exercises in order to know the true results of the fiscal operations of the government through a number of documents etc. A combination of both is ideal.

3. **Union and State Budgets:**Both the central government and the state governments require money for the fulfillment of their respective needs. The sources of revenue for them are different. The constitution contains the functions of the centre and the state. The types of taxes and the power to levy taxes and the distribution of taxes between the states and the centre are also laid down in the constitution.
   Thus every state government presents its state budget to its legislature and the central government presents the union budget. The grants-in-aid received by the state governments from the central government are mentioned in their respective budgets and also in the union budget.

4. **Administrative and Cash Budgets:**The administrative budget shows the revenue and expenditure on actual basic. It excludes those funds which are owned by the government. On the other hand, cash budget shows revenue and expenditure on actual payment basis. It includes funds which do not belong to the government.

5. **Plan and Non-Plan Budget:** The plan budget shows the budgetary provisions relating to the annual plan for the year. The plan budget includes the financial provisions of the government relating to the different sectors such as agriculture and allied sector, industry and mines, transport and communications, power, social services etc. The plan budgets also includes central assistance for state Plans. Non-plan budget relates to other than the plan expenditure.

6. **Executive and Legislative Budget:**The legislative budget is prepared by the legislature directly or with the help of committees. A legislature consists of elected representatives of the government.
   The executive budget is prepared by the executive wing of the government. The executive is responsible to the implementations of the budget proposals prepared by the legislation. The executive budget is likely to be better because the executive being actual player in the field can have more correct estimate of expected revenues and expenditures than the legislature.

7. **Revenue Budget and Capital Budget:** Revenue Budget refers to the financial statement of the government dealing with Revenue receipts and Revenue expenditure. Revenue receipts consists of both Tax Revenue and Non-tax revenue. Tax revenue includes both direct taxes and Indirect taxes. On the other sides Non-tax revenue includes fees, fines, penalties, surplus from public sector organizations, interest and dividends from investments etc. Revenue expenditure is the expenditure on the day to day activities or services of the government. Both revenue receipts and revenue expenditure are recurring in nature.
   Capital budge refers to the financial statement of the government dealing with capital receipts and capital expenditure. Capital receipts include funds received by the government in the form of borrowings, provident funds, loan recoveries, disinvestment funds and other incomes of government. Capital expenditure includes the expenditure on creation of capital assets like roads, buildings, irrigation projects, power generation projects, establishment of industries etc.

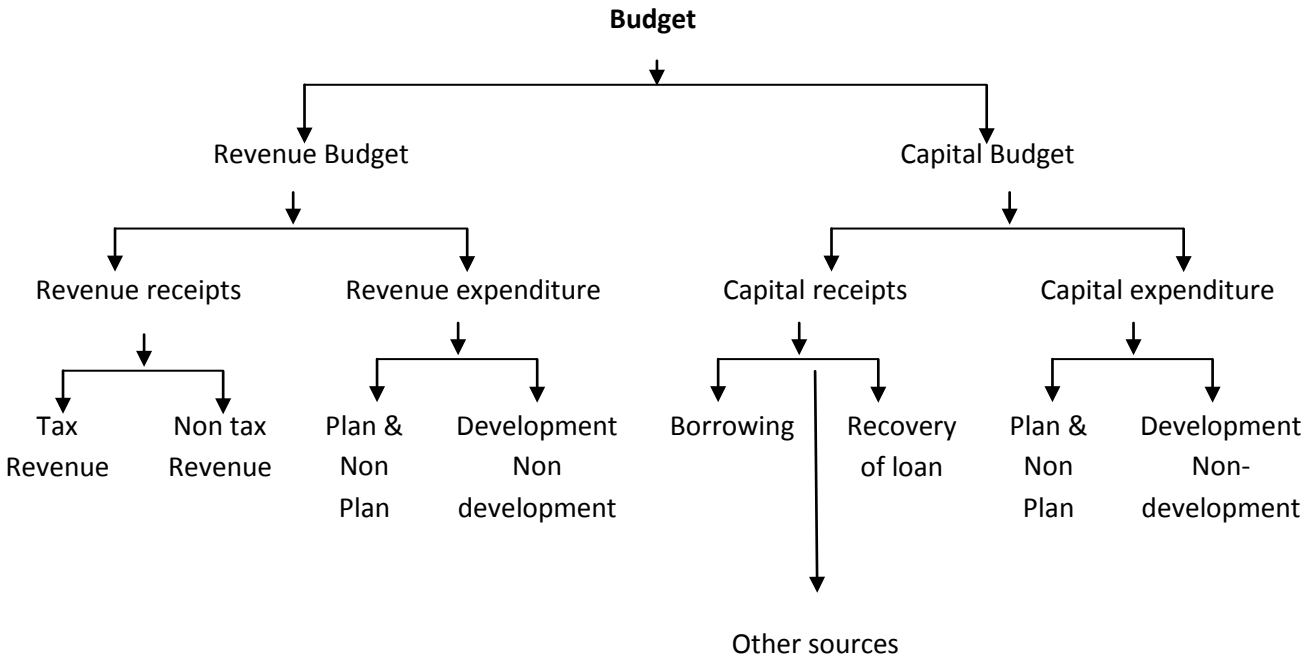
8. **Main budget and Supplementary budget:**Main budget refers to that budget which is presented for the entire fiscal year. It is an annual financial statement of estimated receipts and expenditures of the government.
   Sometimes a supplementary budget may also be presented to the parliament of the country. The supplementary budget is done to meet extra expenditure on emergencies like war, earthquake, floods etc.

9. **Deficit, Surplus and Balanced Budgets:** A budget is said to be balanced when public revenue equals public expenditure. If the public expenditure is more than public revenue it is called a deficit budget and if the public revenue exceeds the public expenditure it is known as surplus budget.

10. **Economic and Functional Classification:**The budget is a very important fiscal documents of the government. Hence it should be classified in such a way that it lays down major policy changes relating to the economy. It should also provide information on government receipts and expenditures both on revenue and capital accounts.

Q.2 Explain the components of budget / concepts of Budget.

A budget is an annual financial statement of the government showing estimated expenditure and estimated revenue for the coming year which runs from April 1 to March 31. It is presented at the end of February of the current year. It is a financial plan which gives estimates of how the government is going to distribute the resources of that year and how that expenditure is to be financed.



1. **Revenue Receipts:** Revenue receipts refer to those receipts which increase usable funds of the government without creating any debt liability. It includes receipts from taxation and other non-tax receipts like registration fees, court fees, fines and penalties surpluses from public enterprises and surpluses from public utilities. Revenue receipts is classified into following types.

a) **Tax revenue:** It includes proceeds of taxes and other duties imposed by the central government both direct as well as indirect taxes.
Income tax, interest tax, wealth tax, corporation tax are the direct taxes which people pay directly to the government. Such taxes are compulsory and cannot be avoided.
Customs duties, sale tax, service tax are indirect taxes.

b) **Non-Tax revenue:**It includes all other receipts. Receipts from registration fees, court fees, fines, penalties, escheat, surplus from public enterprises and public utilities, interest loans, dividends from investment and external grants fall under this category.

2. **Capital receipts:**Capital receipts refer to those receipts which increase the usable funds of the government by creating debt obligations or by causing a reduction in the assets of the government. It includes the following items:

a) Borrowing by the government from the public (market borrowings)
b) Borrowing from Reserve Bank of India and other parties through the sale of treasury bills.
c) External borrowing from foreign governments and international organization like world bank, Asian Development Bank etc.
d) Recoveries of loans from states and union territories.
e) Small savings and public provident fund (PPF)
f) Other receipts like proceeds from disinvestments is always included in capital receipts. Because it leads to a reduction in assets of the government.

3. **Revenue Expenditure:**Revenue expenditure refers to those items of current expenditure which reduce the usable funds of the government without reducing any debt liability. Such expenditure does not result in creation of assets. Revenue expenditure is incurred towards purposes like running of government departments, provision of various services, interest payments on government loans, subsidies etc.

4. **Capital expenditure:**Capital expenditure refers to expenditure incurred by the central government on acquisition of assets like land, building, machinery and equipment, investment on shares, loans granted to state and union territories, government companies, corporations etc.

5. **Development expenditure:**It refers to expenditure incurred by the government on programmes related to the growth and development activities of the government. It includes expenditure on education, health, industry, road, channels, rural developments, water works and power generation etc.

6. **Plan expenditure:**It refers to expenditure incurred by the government towards its planned development programmes. Both consumption and investment expenditure made by the government will be included under plan expenditure. Expenditure on power communication, industry, agriculture and health are the different types of expenditure falling under plan expenditure.

7. **Non development expenditure:**It refers to expenditure incurred on the non development activities of the government. It includes activities like maintenance of law and order, defence, tax collections, payment of interest and loan, payment of old age pension etc.

8. **Non plan expenditure:**It refers to expenditure made beyond the preview of the plan development activities of the government. It includes expenditure on subsidies, defence, law and order, payment of loan and interest etc.

Q.3 What is deficit budget? Explain the different concepts of deficit.

Budget is a financial statement of the government dealing with the public revenue and public expenditure and balancing both of them. In every economy budget plays a significant role in process of economic development. When the total revenue is more than the total expenditure it is called surplus budget. When total revenue is equal to the total expenditure it is called balanced budget. If the total expenditure exceeds the total revenue it is called a deficit budget.

In most of the developing countries and under developed countries there is always deficit budget and it has become a permanent feature. Deficit budget has been classified in to different types as explained below:

1. **Revenue Deficit:**Revenue deficit occurs when the revenue expenditure exceeds revenue receipts. Generally, a prudent public finance management aims at creating surplus which can be directed towards development expenditure. But, this is not so in India which has been facing persistent deficit in the revenue account.

   Revenue Deficit = ↓R.R. – R. Exp.↑

2. **Budgetary deficit:**Budgetary deficit denotes the difference between all receipts and expenditure of the government, both revenue and capital. It implies that government incurs more expenditure that its normal receipt from revenue and capital goods. Budget deficit is financed either by drawing down cash balances with the central bank or by borrowing from central bank against treasury bills. This is called deficit financing. As deficit financing results in creation of new money, it may lead to inflation.

Budgetary Deficit = Total Revenue – Total Exp.

[R.R. + C.R.] [R.E. + C.E]

3. **Fiscal deficit:** Fiscal deficit is treated to be a complete and comprehensive deficit. It is an internationally recognized concept. It is the excess of total expenditure (both revenue & capital accounts) over revenue receipts and non-borrowing types of capital receipts such as recoveries of loans and grants. In other words fiscal deficit is equal to budgetary deficit plus government's market borrowings and liabilities.

Fiscal Deficit = Total Revenue - Total Exp.

[R.R. + C.R.] [R.E. + C.E]

Excl. borrowings

4. **Primary deficit:** Primary deficit is equal to fiscal deficit minus interest payments. Primary deficit is considered to be an indicator of the actual position of the government finance it keeps away the interest payments.

Primary Deficit = Total Revenue — Total Exp.

[R.R. + C.R.] [R.E. + C.E]

Excl. borrowings Excl. Interest

5. **Monetised deficit:** It shows the net increase in holdings of treasury bills of the RBI and its contribution to the market borrowings of the government. In other words it refers to the increase in central bank's credit to the government.

Trends in Fiscal Deficit in India:

Fiscal imbalance can be analysed with reference to different indicators such as budgetary deficit, revenue deficit, gross fiscal deficit and primary deficit. All such indicators show is a steady increase over the years.

Out of all, the fiscal deficit is regarded as the internationally recognized measure of deficit. It is the most appropriate and reliable measure showing the clear picture of the fiscal mess.

The gross fiscal deficit of the central government has been constantly rising .

The efforts taken by the government failed to deliver the desired effect and fiscal deficit continued to remain high upto 1990-91 (6.6%). India faced the ugliest situation of debt crisis in the year 1990-91.

The immediate reforms brought the deficit somewhat under control and has been reduced to 4.7 percent in 1991-92 and further to 4.1 percent in 1996-97.

However, in recent years the fiscal deficit shows a rising trend and remained at 5.9 percent in 2002-03. However it declined to 4.1 percent in 2005-06. Keeping fiscal deficit at the level of 5 percent and above is absolutely unhealthy which can only invites disaster for the country

During the year 2010-11 the fiscal deficit was 4.8% of the G.D.P which increased to 5.1% in 2011-12 and 5.3% during the year 2012-13

PUBLIC DEBT

Q.1 Explain the meaning and types of Public Debt. (OR) Give a brief note of classification of public debt.

Public debt or public borrowing is considered to be an important source of income to the government. If revenue collected through taxes and other sources is not adequate to cover government expenditure, government may resort to borrowing.

Public debt may be raised internally or externally. Internal debt refers to public loans floated within the country, while external debt refers loans floated outside the country.

Loans taken by the government may be from individuals, banks, financial institutions like the International Monetary Fund, World Bank etc. The instruments of public debt take the form of government bonds or securities of various kinds.

Types of public Debt:

Government loans are of different kinds. They may differ in respect of time of repayment, the purpose, conditions of repayment, place of their floating and the method of covering the liability. Thus public debt may be classified into following types.

1. **Internal and External Debt:**The internal loans are raised within the country and subscribed mainly by its own citizens and/or institutions. It is repayable only in domestic currency. An internal debt may be either voluntary or compulsory. Internal debtimply a redistribution of income and wealth within the country and therefore it has no direct money burden.

   External loans are raised from foreign countries or international institutions. These loans are repayable in foreign currencies. External loans help to take up various development programme in developing and underdeveloped countries. These loans are usually voluntary. An external loan involves, initially a transfer of resources from foreign countries to the domestic country but when interest and principal amount are being repaid a transfer of resources takes place in the reverse direction.

2. **Voluntary and Compulsory debt:**Public debts may be incurred through voluntary or compulsory loans. Generally, public loans are voluntary in nature. In this case the government makes an announcement regarding the floating of loans. This announcement may be accompanied by some kind of publicity. The government floats a loan by issuing certificates, bond, etc. Individuals, banks and other financial institutions lend to the government willingly by purchasing these securities.

   On the other hand, compulsory loans are those which are raised by using coercive methods. A compulsory loan is a rare phenomenon in modern public finance unless there are some special circumstances like war or crisis. The rate of interest on such loans may be low. Considering the compulsion aspect, these loans resemble a tax, the only difference is that loans are repaid but tax is not. In India, Compulsory Deposit Scheme is an example of compulsory debt.

3. **Productive and unproductive debts:**Public debt is said to be productive when it is raised for productive purposes and is used to add to the productive capacity of the economy. If the borrowed money is invested in the construction of railways, irrigation projects, power generations, etc. It adds to the productive capacity of the economy and also provides a continuous flow of income to the government. The interest and principal amount is generally paid out of income earned by the government from these projects.

   Unproductive are those which do not add to the productive capacity of the economy. Such debts are not necessarily self-liquidating. The interest and the principal amount may have to be paid from other sources of revenue, generally from taxation, and therefore, such debts are a burden on the community. Public debt used for war, famine relief, social services,etc. is considered as unproductive debt.

4. **Short Term, Medium Term and Long-Term Debt:**Here the basis of classification is duration of loans. Short-term debt matures within a duration of 3 to 9 months. Generally, rate of interest is low. For instance, in India, Treasury Bills of 91 days and 182 days are examples of short term debts incurred to cover temporary shortages of funds. The treasury bills of government of India, which usually have a maturity period of 90 days, are the best examples of short-term loans. Interest rates are generally low on such loans.
   Long-term debt has a maturity period of ten years or more. Generally the rate of interest is high. Such loans are raised for development programmes and to meet other long0-term needs of public authorities.
   Medium-term debt has a maturity period in between short-term and long-term loans. The rate of interest is intermediate. They are generally raised for welfare programmes.

5. **Redeemable and Irredeemable Debt:**Redeemable debt is repaid at some specific future date and therefore, government has to make arrangement for repayment of interest and principle amount within a specific time period. These loans are terminable. The debts which the government promises to pay off at some future date are called redeemable debts.
   In case of irredeemable debt, no definite date for final repayment is promised for the rate of interest is paid regularly. Therefore, the government makes arrangements for interest payment only. Such debts are likely to become perpetual and therefore, they are considered as undesirable on the grounds of sound finance. The maturity period is not fixed. Such loans create a burden as taxes would be raised to pay the debt in the future.

6. **Funded and unfunded debts:**The basis of division is duration of the loan. It has a maturity period of at least twelve months at the time of issue. The period is generally longer than this and it may be even 30 years or more. Funded debt has an obligation to pay a fixed sum of interest, subject to an option to the government to repay the principal. The government may repay it even before the maturity if market conditions are favourable.
   Unfunded debt has an obligation to pay at due date with interest. In such debts duration is comparatively short say a year. Unfunded debts are incurred to meet temporary needs of the government. The rate of interest is low.

Q.2 Examine the trends and composition of Public Debt in India.

During recent years public debt in India has been growing at an alarming rate, with the budget deficit increasing significantly. Debt obligations of the Central government are divided into (i) **Internal Liabilities**, and (ii) **External Debts**. Besides, the **State governments debts and liabilities** are also growing.

(A) INTERNAL DEBT:

Internal Debt Liabilities of the Central Government

Year	Rs. Crore	Percentage of GDP
1990-91	1,54,004	28.8
2009-10	23,56,940	38.2

Internal debt comprises of the following:

1. **Market Borrowings:** These are interest bearing loans with maturity period of one year more. They are raised in the open market through sale of government securities. Such loans are used for development as well as non-development purposes. Market borrowings have increased significantly from Rs.70,520 crore in 1990-91 to Rs.17,66,900 crore in 2009-10.

2. **Treasury Bills:** T-Bills are a major source of short-term funds for the government, usually used to meet revenue shortfalls. On maturity the face value is paid to the holder. The government issues T-Bills of 91-day, 182-day and 364-day maturity period.

3. **Bonds:** Bonds are medium to long term credit instruments through which the government funds its development expenditures. The Government of India has issued gold Bonds, National Rural Development Bonds. Capital Investment Bonds, Special Bearer Bonds over the years.

4. **Special Floating and other Loans:** These include contribution of the Government of India towards the capital of IMF, International Bank for Reconstruction and Development and International Development Association. These are non-negotiable, non-interest bearing short term debt of the government and can be called back the International institutions.

5. **Special Securities Issued to the RBI:**The government issues non-negotiable, non-interest bearing special securities to borrow from RBI. Such borrowings are for not more than one year. In recent years, there has been a steep decline in this source of public debt.

6. **Ways and Means Advances:**These are temporary advances or overdrafts extended by RBI to the government. These advances bridge the gap between expenditure and receipts. They are not a source of finance but are meant to provide support, for temporary difficulties that arise because of mismatch or shortfall in revenue or other receipts. They have to be repaid usually within three months.

7. **Small Savings:**Small savings include Post Office Savings and Time Deposits, National Savings Scheme, KisanVikasPatra, National Savings Certificates, Small Savings play a significant role in mobilization of the financial resources required for planned development.

8. **Provident Funds:**These are of two types: (i) Employee's Provident Fund, and (ii) Public Provident Fund. These funds are liabilities of the government. The government uses these funds as a source of finance. People are encouraged to save in such funds as they offer attractive returns.

9. **Reserve Funds and Deposits:**They include Depreciation and Reserve Funds of Railways, Departments of Posts and Department of Telecommunications, deposits of Local Funds, departmental and judicial deposits and civil deposits. These funds and deposits are the liabilities of the Central government and they are divided into interest-bearing and non-interest bearing.

(B) EXTERNAL DEBT:

External Debt Outstanding of the Central Government

Year	Rs. Crore	Percentage of GDP
1990-91	31,525	5.9
2009-10	1,37,680	2.2

As a developing country. India has raised loans from many countries for developmental purposes. Major lenders include USA, former USSR, Japan, Germany and France. India has also borrowed from the IMF, IBRD and IDA. These debts are raised and repaid in foreign currency. External debts were initially in the form of concessional aids for development purposes but in recent years such aids have declined. The external debt- GDP ratio has declined since 1990-91.

(C) DEBT LIABILITIES OF THE STATE GOVERNMENTS:
The total debt of the State Governments comprises of the following:

i) Internal debt, which includes:

(a) Market loans and bonds
(b) Ways and means advances from the RBI
(c) Loans from banks and other institutions

ii) Loans and advances from the Union Government:

iii) Provident Funds

The total debt of the State governments has increased significantly from Rs.1,28,155 crore in 1990-91 to Rs.13,37,044 crore in 2008. A major part of this comprises of borrowings from the Central government.

Q.3 Explain the burden of Internal and External Debt.

Public debt is one of the sources of deficit financing. When the government expenditure exceeds its revenue it borrows either from people within the country or from external sources. Since it is a income with liability government has to repay in future course of time. Repayment of both internal and external debts impose burden on the community.

(A) BURDEN OF INTERNAL DEBT:

Internal public debts are raised and repaid within the country. Therefore, they have no direct money burden. The repayment of such debts results in transfer of purchasing power from one group of people to another. The government taxes some people to repay the interest and the principal to the creditors. Such debts give rise to real burden.

1. **Direct Real Burden:** Transfer of purchasing power will take place as the government imposes tax to repay the internal debts. When purchasing power is transferred from the tax payers to the public creditors, it will influence the distribution of income in the country. While, repaying debt, if tax burden falls more heavily on the poor then inequality of income distribution will increase. If the debt is repaid by imposing heavy taxes on the higher income groups, then the direct real burden will be less. In most cases, repayment of internal debt is more likely to transfer purchasing power from the poor to the rich. This is the direct real burden of such debts.

2. **Indirect Real Burden:**High rates of taxation generally have a negative effect on people's ability and willingness to work, save and invest. This in turn will affect productivity, production and investment in the economy.

3. **Burden on Future Generations:**It is usually the older generation who subscribe to government bonds and securities with their accumulated wealth. But the debts are repaid through taxes which are paid by the younger working population. Thus there is also transfer of purchasing power from the active to the passive population.

4. **Effect on Private Investments:**In order to borrow on a large scale, the government offers high rates of interest. Most people believe that government securities and small savings are a safe place to park their money in. Therefore, a large chunk of domestic savings are directed towards public debt. This reduces funds available for the private sector and adversely affects the growth of this sector.

5. **Effects on Capital Expenditure:**In most developing countries, including India, public debt is incurred to meet revenue deficit. Such use of public debt is considered unproductive. As government's debts become larger, the interest burden also increases. A very large portion of government revenue is then spent on paying interests. Thus the government is unable to make adequate capital expenditure on development of infrastructure.

6. **Inflation:**If indirect taxes are raised in order to repay internal debts, then inflation may take place. Inflation will reduce the real income or purchasing power of the poor.
   Therefore, though internal debts do not have direct money burden, they result in making some people better off than others through transfer of resources between them.

(B) BURDEN OF EXTERNAL DEBT:

External debt are raised from foreign countries. When such debts are raised they result in inflow of capital into the borrowing country. But when these debts need to be repaid it results in outflow of money in the form of interest and principal.

External debts create the following money and real burden:

1. **Direct Money Burden:**It is equal to the sum of money payments for principal and interest made to the creditor country.

2. **Direct Real Burden:** It is measured in terms of loss of welfare suffered by the people of the debtor country due to the repayment of debt. It will vary according to the proportion in which various members of the community contribute to the repayment in the form of higher taxes.

3. **Indirect Money Burden and Indirect Real Burden:**This may be measured in terms of effects on production and allocation of resources. To repay public debt, the government may increase taxes to reduce public expenditure. These will cause reduction in production and consumption in the economy. This is termed as indirect money and real burden of external debt.

4. **Burden of Unproductive Foreign Debt:**If foreign debts are taken for unproductive purposes then the burden of repayment will be very high on the community.

5. **Foreign Currency Burden:**Repayment of external debts has to be made in foreign currency. Foreign exchange reserves can be increased by increasing exports and controlling imports. Therefore the government may give a lot of incentives to the export sector. This will divert resources from other sectors and result in unbalanced development. Besides, if import of essential items is controlled to increase foreign exchange reserves, it may have an adverse effect on development of the nation.

6. **Domination by Creditor Country:**Heavy dependence on one or more powerful creditor country may result in the debtor country being economically and politically dominated by the creditor countries.

Q.4 Explain the meaning and frame work of public debt management.

Public debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other debt management goals of the government, such as developing and maintaining an efficient market for government securities.

The governments should try to ensure that the level and rate of growth of their public debt is sustainable, and can be serviced under a wide range of circumstances while meeting cost and risk objectives. Debt mangers of government debt should ensure that there is a strategy to reduce excessive levels of debt.

Importance of Public Debt Management:

1. A good public debt management can help reduce borrowing cost in many ways.
2. A carefully balanced composition of securities can contain financial risk, which are difficult to manage in countries having few alternative source of finance.
3. Good public debt management can also help to develop the domestic financial market. A well developed domestic financial market can facilitate economic development, and make the economy more resilient to external shocks, such as capital outflows.
4. The economies with well regulated and sound bond markets are less affected by shocks / crises or recovered faster.

FRAMEWORK FOR PUBLIC DEBT MANAGEMENT:

The IMF and World Bank have prepared the following framework for public debt management.

1. **Debt Management Objectives and Co-ordination:** The main objective of debt management is to ensure financing needs and payment obligations are met at the lowest possible cost.
   To achieve the objectives, debt managers, fiscal policy advisors, and central bankers should share an understanding of the objectives of debt management, fiscal, and monetary policies. Since their different policy instruments are inter-dependent, there should be better co-ordination between the above agencies.

2. **Transparency and Accountability:**The allocation of responsibilities among the Ministry of Finance, Central bank and debt agency should be disclosed. It is also important to provide information about the past, current and projected fiscal activity and consolidated financial position of the government.

3. **Institutional Framework:** There should be legal frameworks which clarify the authority to borrow, and issued new debt, invest, and undertake transactions on behalf of the government. Organizational framework should be specified and the roles are to be specified.

4. **Debt Strategy and Risk Management:** An effective debt strategy should be implemented. Risks in the portfolio should be mitigated by modifying the debt structure.

5. **Efficient Market for Government Securities:** An important instrument of public debt management is to ensure that the policies and operations are consistent with an efficient market for government securities. It is necessary to achieve a board investor base, with due regard to cost and risk, and need to treat investors equitably. The debt managers, central banks, ministry of finance should work closely with market participants and regulators for the development of efficient market.

6. **Broad Principles of Debt Management: Important principles of debt management are:**

(i) Low interest cost of servicing debt: Interest cost of servicing a debt should be kept as minimum as possible.

(ii) Satisfy the needs of investors: The public debt should be structured in such a way that meets the needs of varioustypes of investors.

(iii) Co-ordination between public debt, fiscal and monetary policies: Since the public debt, fiscal and monetary policies have common objective of stabilization of the level of economic activity, they should work in unison.

(iv) Funding of short-term debt into long-term debt: If possible, the government should try to convert short-term debt into long-term debt. The funding operations should be undertaken in such a manner that they do not lead to undue rise in the long-term interest rates.

Q.5 What are the Various Methods of Repayment of public Debt?

Public debt is a financial obligation of government which deals with borrowing and repayment activities. Public borrowing is a liability on the government. Hence government has to make a provision for the repayment of public debt. Government follows various methods in repayment of loans which have been explain below.

1. **Repudiation:**The simplest method of liquidation a debt is to repudiate it. However repudiation is highly undesirable from a number of angle. It is unethical on the part of the government to do so. Moreover it will certainly lower the credibility and will pose problems for floating, loans in future. The debt holders will face great losses since they had invested their life saving.
   If it is an external debt, repudiation may lead to serious difficulties for the country which repudiates the debt. The creditor country may resort to economic blockade or military action etc.

2. **Refunding:** In this, the maturing bonds are replaced by the issue of new bonds. The government offers new issue to the market and the holder of old debt are given an option to subscribe to the new debt by surrendering the old one. Usually the short term loans are cleared of by obtaining and by raising fresh funds through the sale of long term securities to the public. Thus short term loans are replaced by long term loans.
   However, refunding is a better alternative to retiring the debt when the government is not able to adopt other measures.

3. **Conversion:**This method involves converting the old debts into new ones. In this system, the loan is not repaid, but the form of debt is changed by altering a public debt from a higher rate of interest to a lower rate of interest. The government may be tempted to lower the rates since the rate of interest in the market might have fallen or it has become lesser than what it was at the time of floating of loan.

4. **Redemption:**The government can also repay the debt. The speed of redemption can be slow or quick. It will depend on the economic conditions of the borrowing country. The following are the methods adopted by a government to repay the debt under redemption.

(a) Sinking Fund: A certain amount of revenue is deposited every year towards the redemption of the outstanding debt. The fund is used for the purchase outstanding debt. i.e., securities and bonds. Sinking funds approach has been adopted by a number of governments. A certain amount of the budget is set apart by the government. The balance in the fund is also invested and the interest earned on that is also credited to the fund.

(b) Surplus Revenue: The government policy of surplus budget is an alternative to sinking fund. But during recent years surplus budget is a rare phenomenon.

(c) Terminal Annuities: The government of a country may also issue terminal securities, a portion of which matures every year according to the serial order or as decided by the lottery system. The advantage of this system is that the total volume of debt gets reduced every year and the cost of servicing the debt also stands reduced every year and by the time of maturity the debt will be fully paid off.

(d) Capital Levy: Capital levy is a sort of tax on property and wealth. Capital levy is a onetime tax imposed on the capital assets above certain value. This methods is advocated particularly to repay the debt raised during a war. This levy is imposed on the net property or wealth on a progressive scale. A capital levy can be justified on the following grounds.

1. A country may have to take war loans which are unproductive debts and which should be relinquished as early as possible by a capital levy instead of imposing additional taxes for years in order to repay the loans.
2. Capital levy is justified since it is paid by those who earn huge profits during the war.
3. Capital levy follows the principle of equity because the poor suffer most during the war. Thus the responsibility of the repayment of the debt should be borne by the rich.
4. It helps to fight inflationary trends since it removes the surplus purchasing power from the richer sections of the society.

5. In case of a depression after a war, the burden of public debt in real terms will increase and therefore the bond holders will gain. Thus it is necessary to impose capital levy on them for the repayment of debt. Thus the distribution of income is made equitable.
6. It provides phychological relief to the people because they know that there will be no more taxation in future for repaying the public debt

FISCAL RESPONSIBILITY OF GOVERNMENT

Q.1 Write short note on Fiscal Responsibility and Budget Management Act, 2003. (OR) Explain the features of the fiscal responsibility of the Central Government.

In order to bring fiscal discipline and to implement a prudent fiscal policy, the government introduced the Fiscal Responsibility and Budget Management Bill 2000 in the parliament in December, 2000. The Bill was referred to the parliamentary standing committee on Finance and a revised Bill was introduced and passed both in LokSabha and RajyaSabha. The president gave the accent and the bill became an Act in August, 2003.
The FRBM Act, 2003 become effective from July 5, 2004. Following are the rules under FRBM Act as notified by the government.

1. **Fiscal Policy Statement:**
The central government introduce the Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-economic Framework Statement along with the annual budget.

2. **Reduction in Revenue Deficit:**
a) Appropriate measures by the Central Government to eliminate revenue deficit and fiscal deficit and build up adequate revenue surplus;
b) Reduce revenue deficit by an amount equivalent to 0.5 percent of GDP or more at the end of each financial year beginning with 2004-2005.
c) Elimination of revenue deficit by 31st March, 2009.

3. **Reduction in Fiscal Deficit:**
Reduce fiscal deficit by an amount equivalent to 0.3 percent of GDP or more at the end of each financial year beginning with 2004-2005.

4. **No Direct Borrowing from RBI:**
Prohibition of direct borrowings by the Central Government from the Reserve Bank of India expect by way of advances to meet temporary cash needs in certain circumstances.

5. **Fiscal Transparency:**
a) Greater transparency in fiscal operations and to minimization of as far as practicable, secrecy in the preparation of the annual budget.
b) At time of presenting annual budget, the central government shall disclose following details latest by the Budget 2006-2007.
i) Significant changes in the accounting standards, policies and practices affecting or likely to affect the computation of prescribed fiscal indicators.
ii) The contingent liabilities created by way of guarantees and all claims and commitments made by the central government which have potential budgetary implications.

6. **Review of Trends in Receipts and Expenditure:**
Quarterly review of the trends in receipts and expenditures in relation to the budget by the Finance Minister and placing the outcome of such reviews before both Houses of Parliament.

7. **Cut in Expenditure:**
   The Central Government to cut expenditure in a proportionate manner, while protecting the 'charged' expenditure, whenever there is a shortfall of revenue or excess of expenditure over specified targets.

8. **Finance Minister Statement:**
   Finance Minister to make a statement in both Houses of Parliament explaining any deviation in meeting the obligations cast on the Central Government under this Act and the remedial measures the Central Government proposes to take.

Task Force on Implementation of FRBM Act.

Following the enactment of FRBM Act, Government constituted a Task Force headed by Dr. Vijay Kelkar for drawing up the medium term framework for fiscal policies to achieve the FRBM targets. The Task Force submitted its report in July 2004.

Report on the Task Force on implementation of the Fiscal Responsibility and Budget Management Act, 2003 (Tax reforms strategy):

i) An all India goods and services tax (GST), on the basis of a 'grand bargain' with states to foster a national common market.
ii) Income tax exemption limit to be increased to Rs.1,00,000.
iii) A two tier rate structure of 20 percent tax for income of Rs.1 lac to 4 lacs and 30 percent for income above Rs.4 lacs for individuals and elimination of standard deduction available to the salaried tax payers.
iv) A reduction in corporate income tax to 30 percent for domestic companies and a reduction in depreciation rates from 25 percent to 15 percent.
v) A 3-tier customs duty rates of 5, 8 and 10 percent to bring down tariffs to ASEAN levels.
vi) Empoweringpanchayats, local bodies through resource transfer

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Q.2 Critically Evaluate Fiscal Responsibility and Budget Management (Bill) Act, 2003

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The Fiscal Responsibility and Management Act is indeed a good attempt on the part of the government to get the country out of the fiscal mess. The act reveals the sincere commitment offered by the government to reduce fiscal deficit. The act, however, suffers from the following limitations.

1. **Reduction of Gross Fiscal Deficit to 2% an impossible task:**The Bill proposes to bring down GFD to 2 percent by March 31, 2006 and thereby restrict government borrowing not more than 2 percent of the GDP.
   It is believed that such a low level of government borrowing may not be sufficient to boost growth prospectus in a developing country like India. Even economists like Raja Chellah and Srinivasan are of the opinion that the ratio of GFD to GDP should be 4 to 5 percent.

2. **Unrealistic time frame:**The FRBM Act came into force from August 2003. As soon as it came into force, the central government announced that the annual target cannot be met for the current year and the date of elimination of revenue deficit must be extended beyond 2008. Such a poor exposure on the part of the central government will only send wrong signal to state governments which are likely to adopt such a legislation.
   More importantly, the time frame fixed by the government appears to be unrealistic considering the ground realities of our economy.
   A nation that consistently faces pressures from different quarters for increase in social sector expenditure on one hand and less scope for raising revenues on the other hand cannot touch zero revenue deficit by 2009.

3. **Declining capital expenditure – GDP ratio:**One of the major issues that threatens to affect economic growth is the declining ratio of Capital Expenditure – GDP ratio. The ratio which remained 5.6 percent in 1990-91 declined to 2.6 percent in 2001. The implementation of FRBM Act would further weaken the ratio. The proposals like reducing fiscal deficit, use of revenue surplus to pay off part of the public debt are likely to keep the situation still worse during the FRBM regime.

4. **The question of undesirable subsidies:**There seems to be no strong political will on the part of the government to reduce undesirable subsidies which are given out of revenue expenditure. Government is always under pressure to continue with such undesirable subsidies. In such a case, government will do balancing act by reducing expenditure in desirable areas which are not backed by interest group pressures. Such a step would definitely bring down investment on needy sectors like human resource development, infrastructure etc.

5. **Building up the sources of revenue:**One of the areas where FRBM act fails to address effectively is the issue of increasing revenues – both tax and non-tax. It is a matter of serious concern that the tax-GDP ratio is on decline during nineties. There is no target under FRBM Bill for the tax-GDP ratio.
   The act does not pay proper attention to the reforms in tax administration and collections.

6. **Non-coverage of State Governments:**The act targets the central government and imposes heavy restrictions on their expenditure to bring down deficit. But there is no such concern in case of state governments which are maintaining equally high deficits both in terms of GFD and RD. A real beginning in the fiscal reforms can take place only when we include state governments in such process.

7. **Neglect of expenditure reforms:**The act is silent on expenditure reforms and expenditure management. With the massive increase in population, India is certain to face the problem of expenditure growth. If the spending of the government is mismanaged, it can only add further problems. .

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   The recommendations of the expenditure Reforms Commissions should be taken up for serious implementation.

   Conclusion:
   To conclude, we can focus on two important view points

i) Fiscal improvement can be achieved only through effective performance and good governance by the central, state and local governments. Indian public finance must be viewed as a system combining three governments.
ii) We need to view fiscal management in terms of long term perspective. Though the FRBM Act talks about Medium Term Fiscal Policy statement, it is yet to be developed. A long term approach is a must.

FISCAL FEDERALISM

Q.1 What is fiscal federalism? Examine important issues/ key issues in fiscal federalism.

The Government can be classified into Unitary and federal depending upon the concentration and distribution of power and the relation between the central, state and local governments. In a federal system of government the power to govern is shared between national (central) and state or provincial governments.

It is the study of how expenditures and revenue side are allocated across central Government, State and local governments. It is concerned with understanding which functions and instruments are best centralized and which are best placed in the decentralized levels of government. Fiscal federalism is concerned with the division of economic responsibilities between the central (or federal) government and the state and local governments. Federalism covers issues that go beyond economics.

Key issues under Fiscal Federalism

1. **Division of Responsibilities and resources:**The main issues of fiscal federalism are concerned with the division of responsibilities and resources between the central government and the state and local governments. Just as there is a division of responsibility between the central government and the state and local governments.
   The central government must provide certain national public goods like defence that provide services to the entire population of the country. The State and local government should be concerned with the provision of goods and services whose consumption is limited to their own jurisdiction.

2. **Regulation:**The constitution restricts the laws that states can pass. Similarly, state and local governments may also be subject to the same pollution and environmental regulation that apply to private firms and individuals. Sometimes the central government has mandated that state and local governments provide certain services without providing the requisite funds. All these may give rise to problems in the federalism.
3. **Incentives for Resource Transfer:** The central government imposes its will through eligibility requirements for grants and loans, etc.The intention of central government aid to local government is to encourage local spending on particular public services.
   There are two primary types of transfer i.e. conditional and unconditional. A conditional transfer from a federal body to a state or local government involves a certain set of conditions, If the lower level of government is to receive this type of transfer, it must agree to the spending instruction of the federal government. An unconditional transfer is without any spending instructions.

4. **Tax Expenditure:**One of the important way that the central government affects state and local expenditures is through the sharing of central tax revenues with the states. This cal provide an incentive for grater expenditures at the state and local level.

5. **National and Local public Goods:** One of the important factor influencing fiscal federalism is difference between national public goods and local public goods. In the case of national public goods benefits accrue to the residents of a particular locality, e.g. traffic lights,fire protection, etc.

6. **Tax competition:**If the local governments use tax incentives to attract businesses and to increase employment opportunities, gain in the one locality or state are party at the expenses of losses in other localities or states. But the competition to attract businesses result in lower taxes for businesses. Thus, at the end businesses are the ultimate beneficiaries. From the perspective, it would be preferable for local governments to agree not to compete.

7. **Tax Subsidies:**Tax subsidies lead to increase expenditure on publicly provided goods and increased capital investment by state and local governments. At the same time, Tax subsidies are an inefficient way of subsidizing state and local governments due to following reason:

(i) Some of the benefits accrues to wealthy investors rather than to the communities.
(ii) Some of the benefits is passes on to the businesses and not to the residents of the communities.
(iii) Tax subsidies discriminate in favour of high-income individuals who haven a strong preferences for publicly provided goods.

8. **Financial Imbalance:**One of the main issue in the federal set-up is the financial imbalances. Financial imbalances means lack of harmony between functions and financial resources.
   The sources of revenue assigned to the centre and the states should be adequate to enable them to fulfill the functions allotted to them. It is very likely that the needs and resources of each government will not be balanced.

Q.2 Give an explanatory note about fiscal federalism in India. OR Discuss briefly the fiscal federalism in India.

The constitution of India has clearly laid down the division of responsibilities (Functions) involving expenditure and division of powers to raise resources between the centre and the states as also local bodies.

(1) Division of function:

The principle underlying the division of functions assigns countrywide tasks to the centre and state/ region. Similarly the tasks of local importance are assigned to municipalities in towns and panchayats in villages.

(A) Central government functions:

The several functions of the central Government are classified between developmental and non-developmental. Developmental functions are the ones which promote growth and welfare of the people, for e.g. provision of social and community services, economic services and grants in aid to states for developmental purposes.

Non-developmental functions include maintenance of law and order, maintenance of external relations**,** grants to states for non-developmental purposes.

(B) State Government functions:

The various responsibilities of the states are also grouped under two categories: developmental and non-developmental. Developmental functions include: social and community services; economics services etc.

Non-developmental functions include administrative services, Payment of pensions, interest payments on loans from the centre and from the market etc.

Justification for the division

The above mentioned division of function is justifies on the following grounds:

(i) Defence and communication services are to be provided uniformly throughout the country and thus should be the responsibility of the centre.

(ii) Critical areas such as foreign investment and foreign trade, which require a national agenda, are with the centre.

(iii) Further, services which differ from region to region like agriculture, are assigned to the states.

Problems:

The existing of functions has the following problems:

1. There is over lapping of functions in important areas like education and health
2. Many of the centrally sponsored schemes do not provide the required freedom and autonomy to the regions in respect to their designing and implementation and thus do not benefit the targeted groups.

(2) Division of resource raising powers: To meet the expenditures involved in the performance of functions, to the governments at different levels have been assigned powers to raise resources.

(A) Receipts of central Government:

There are various sources of receipts of the central government classified in to revenue receipts and capital receipts. Among the revenue receipts the most important is the tax revenue. The various types of taxes allotted to the centre or as follows:

1. Tax On income and expenditure, which include income tax, corporation tax and expenditure tax

2. Taxes on property and capital transactions which cover estate duty, wealth tax etc.

3. Taxes on commodities and services covering excise duties, customs duties, service tax etc.

As regards capital receipts the Government has the legal power to borrow from the domestic as well as the international markets, world institutions and foreign governments.

(B) Receipts of state Governments:

Receipts of states are also classified in to revenue and capital receipts. The revenue receipts come mainly from taxes on agriculture, Professional tax, property tax, stamp duty and registration, surcharge etc. Besides these direct taxes, states have the power to collect indirect taxes such as sales tax, entertainment tax, electricity duties etc.

Along with Tax revenue there are non -tax revenues such as interest receipts, Dividends from the state enterprises etc.

There are receipts on capital account, which are loans taken from the market in the form of Bonds and securities, and loans from the central government.

(3) Financial Imbalance: Even though there is a clear division of the powers and the financial resources between the centre and states, there is an imbalance in the division of resources. This imbalance is in favour of the centre. It has been observed that the responsibilities of the states or increased but their revenue resources are not increased substantially.

(4) Transfer of Resources from centre to states: The constitution has recognised the financial problems of states and therefore a special provision is made for the transfer of resources from the centre to states in following manner:

* Transfer of a part of tax revenue form centre to states through the agency of finance commission
* Transfer in the form of grants a loans from centre to states which is also done through the finance commission
* Transfer in the form of assistance for a plan projects through the planning commission.