

TAX BURDEN ON FARM AND NON-FARM SECTORS IN INDIA

(An Inter-Sectoral and Inter-Class Analysis)

By

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Mr. President,

At the outset, I wish to convey my sincere thanks to Dr. Charan Singh, and through him, to the E Grow Foundation for providing me with this opportunity to present before such an august audience the substance of what I did 50 years ago as a Ph.D. dissertation, now published verbatim without any revision. I also wish to confess what inspired me to get this published now. It was what Dr. Govinda Rao, an outstanding public finance expert and former Director of NIPFP, who has also written a Forward Note for this book, revealed to me at an informal chat I had with him some time ago. Dr. Rao said that when he as a young scholar approached Dr. D. T. Lakdawala, then Director of the Department of Economics, University of Bombay, for guidance in undertaking research, Prof. Lakdawala took out a copy of this thesis kept in his bookshelf and told Dr. Rao that “a Ph.D. thesis should be like this”. That made me realize the folly of not getting the thesis published earlier, even though the Indian Council of Social Science Research (ICSSR) had approved a grant of Rs.3,000 for getting it published at that stage. That apart

INTRODUCTION

I do feel somewhat uncomfortable talking today about a book that had the economic and public policy background of five decades old. There has been considerable transformation in the economic system. Agriculture's share in national income was about 48% to 50%. And the population dependent on it was equally large, much above 50%. Today, the share of the sector in national income has dwindled to 18% to 19%, though the labour force dependency has remained around 46% to 47%. Nevertheless, many scholars have said that apart from the methodology employed for research in the book, what is contained in the book has some relevance even today.

The study starts with the basic hypothesis that the agricultural sector in India is under taxed. The entire edifice of 344 pages of the book is built and hovered around this simple hypothesis. The most onerous task has been one of building statistical series on myriad concepts involved in the construction of the edifice. These statistical series relate to the period covered in the study: 18 years from 1950-51 to 1968-69, the first three five-year plan periods and the subsequent three years of Annual Plans.

In the Introductory chapter, the study plunges into addressing the then widely-held view that the most important limiting factor in the initial stages of development of an economy is the “agricultural surplus” and taxation is the only device to siphon off those surpluses into promoting overall economic development. In this respect, I quote the series of secondary sources of extensive research done to unravel the historical experiences of two major nations – Japan and Russia, where rapid industrialization was financed by surpluses compulsorily extracted from their agricultural sectors. Though divergent in political approaches and ideologies,, both the countries adopted exploitative method of extracting agricultural surpluses . The study concludes that overall, the socio-economic and political conditions in democratic India are quite different and those historical experiences are almost impossible of being adopted here.

But the study argues that the crucial role of agriculture in the industrialization process cannot be denied. Thus, in the context of India and developing countries in general, adequate collection of tax revenues from the agricultural sector is also linked to the basic theory of mobilizing agricultural surpluses for industrialization. It was said that as the agricultural sector formed the largest segment of the economy, it must bear a substantial part of the cost of development. But, in essence, the evolution of the taxation system is such that in democratic societies like India’s, the mass-based unorganized farm sector gets neglected in the process of mobilization of resources. In reforming this process, the basic issue boils down to achieving some inter-sector equity in tax burden. As opined earlier, the foundational theme addressed in the book relates to this inter-sector equity in taxation. And it involves seeking answers to a number of questions with the help of empirical data and that in turn involves the quantitative estimation of a number of basic concepts.

Basic Concepts

To be brief, there are four relevant concepts which require detailed empirical analysis for the 18-year period covered in the book. After this introduction, the next four chapters of the book extensively deal with these four concepts. They are:

(i) **Taxable capacity**, for it is the prevailing capacity to pay taxes that will determine the scale of taxes; each sector’s capacity is much lower than income;.

(ii) **Incidence of taxation or tax burden**, separately estimated for farm and non-farm sectors, leading to a close examination of the sectors' burden-capacity ratios;

(iii) **Benefits of public expenditure**, both developmental and non-developmental, distributed amongst the two sectors, weighing the burden-benefit ratios, that is, examining whether the relative tax burden for a sector is more than the relative public expenditure benefit; relative meaning throughout non-farm measure divided by farm sector's measure;

(iv) **Inter-class incidence of taxation** involving the estimation of (a) the patterns income distribution within sectors; (b) distribution of tax burdens amongst different income groups; and (c) juxtaposing the above two, analyzing the inter-class equity in tax burdens.

Chapter 1: Taxable Capacity

The concept of taxable capacity is a tricky subject and many eminent economists have addressed the issue in diverse ways: Hugh Dalton, Sir Josiah Stamp, Findlay Shirras, Nicholas Kaldor, Paul Baran, and Simon Kuznets. A common thread that runs through all of them is that the concept of taxable capacity can be measured by the surplus principle, that is, the excess of income over the minimum subsistence needs of the concerned population.

The above literature provides further guidance on placing the concept in a dynamic setting in a time series form; this involves making allowance for two elements: (i) a permitted rate of increase in the minimum consumption requirements, for any organized society aims at certain improvements even in its minimum standard of living; and (ii) a minimum investment required for (a) for protecting the existing production apparatus, and (b) for facilitating the permitted increase in minimum consumption requirements.

When an attempt is made to measure the concept of minimum subsistence needs through the nutritional needs of the population based on the results of the NSS data, complex issues arise in the form of adjustments required to be made due to the known over-reporting of foodgrains consumption in the NSS data. With this complicated process, estimates of per capita minimum consumption requirements, separately for rural and urban sectors, are arrived at for a unique year 1959-60. The cut-off points are spotted within the expenditure bracket of Rs.15-18 for rural areas and Rs. 24-28 for urban areas. . These are assumed to be valid for farm and non-

farm sectors, respectively, in per capita terms. But, while estimating the absolute sectoral estimates, the population estimates of farm and non-farm sectors are applied. Incidentally, It is estimated that about 20 per cent of rural households belong to non-farm category and they are added to the urban population estimate, to derive the non-farm population estimate.

Using the price factor relevant for farm and non-farm households, the time series of minimum consumption requirements in per capita terms are estimated for farm and non-farm sectors; the results are presented in Table 2. We have also made allowance for a nominal increase at one per cent per annum in the minimum consumption requirements for both the sectors, since household expenditure data for the economy as a whole do not reveal any significant increase in the per capita consumption expenditure in real terms during this period under study (Table Numbers as per the Book)

Table 2. Estimates of Minimum Consumption Requirements and Potential Surpluses for Farm and Non-farm Sectors

Table 2 Estimates of Minimum Consumption Requirements and Potential Surplus for Farm and Non-Farm Sectors										
Year	Farm Sector						Non Farm Sector			
	Percentage variations in the price factor(a)	Medium consumption requirements derived from variation in the price factor	Minimum consumption requirements after allowing for an increase of one percent per annum	Per capita income	Per capita potential surplus (5-4)	Consumer Price Index number Working class (Base 1949=100) (b)	Minimum consumption requirements based on Consumer Price Index Numbers	Minimum consumption requirements after allowing for an increase of one percent per annum (Rupees)	Per capita income	Per capita potential surplus (10-9)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1951-52	+7.05	198	200	206	6	105	266	269	433	164
1952-53	(-)-2.82	192	194	195	1	104	264	267	429	162
1953-54	(-)-1.87	188	190	210	20	106	269	272	435	163
1954-55	(-)-16.63	157	159	171	12	99	251	254	434	180
1955-56	(-)-3.04	152	154	174	20	96	244	247	443	196
Average for First Plan	(-)-3.46	177	179	191	12	102	259	262	455	175
1956-57	+23.47	182	184	207	23	107	271	273	457	184
1957-58	+4.59	190	192	195	3	112	284	287	474	187
1958-59	+7.41	204	206	224	18	118	299	302	483	181
1959-60	(-)-1.80	200	202	220	18	123	312(c)	315	499	184
1960-61	+1.89	204	206	237	31	124	315	318	529	211
Average for Second Plan	+7.11	196	198	217	19	117	296	299	488	189
1961-62	(-)-0.79	202	204	234	30	127	322	325	561	236
1962-63	+5.21	213	215	231	16	131	332	335	589	254
1963-64	+8.36	231	233	262	29	137	348	351	620	269
1964-65	+20.19	278	280	324	44	157	398	401	663	262
1965-66	+5.83	294	297	308	11	160	429	455	710	277
Average for Third Plan	+7.76	244	246	272	26	144	366	369	629	250
1966-67	+18.52	343	346	354	8	191	484	488	740	252
1967-68	+20.34	413	416	458	42	213	540	545	736	191
1968-69	(-)-6.21	387	391	449	58	214(d)	543	548	771	223
Average for Annual Plan	(+)-10.22	381	384	420	36	206	522	527	749	222

(a) See the text

(b) The Consumer Index Numbers -Working class (base : 1949=100) are regularly published in Reserve Bank of India publications see *Reserve Bank of India Bulletin (Monthly) and Report on Currency and Finance (Annual)*

(c) *The estimates of minimum consumption requirements for 1959-60 are derived from National sample survey data on consumer expenditure. For details see the text.*

(d) *The consumer Price Index for 1968-69 is an average for ten months (April 1963 to January 1969)*

WE have not yet reached the stage of getting the numbers of taxable capacity. We have derived the Potential Surplus defined as equivalent to the per capita minimum consumption requirements subtracted from the per capita income of the respective sectors; this we treat as the sector's potential surplus per capita (Equivalent to potential savings and not actual savings)

Allowance for Investment for Sustaining the Production Process

To get at the estimate of taxable capacity, we have to make some allowance for the minimum investment necessary to sustain the production process.

Based on another Reserve Bank of India study (Estimates of Tangible Wealth in India) it is assumed that the minimum investment outlay necessary for the non-farm sector for any year is three times the amount necessary for the farm sector.

Thus we derive the estimates of per capita taxable capacities for farm and non-farm sectors. Further on the basis of these per capita estimates and the corresponding estimated population, estimates of aggregate potential surpluses and taxable capacities based on per capita and aggregate estimates with which the study is most concerned.

Corrected Estimates of Potential Surplus

So far, average minimum consumption requirements per person have been uniformly applied to the entire population, implying thereby as if minimum consumption requirements actually accrue to the entire population in each sector.

But, in reality, as explained later there is a considerable number of households in each sector whose actual consumption is less than the minimum consumption requirement (See a paragraph below).

The various processes involved in the corrected estimates of taxable capacity are presented in Table 5.

Comparison of Corrected and Uncorrected Estimates

At this stage, it is useful to compare the uncorrected estimates presented so far with the corrected estimates. Such a comparison is attempted in Table 7, wherein it may be observed that the corrected estimates are significantly different from uncorrected estimates, particularly for the farm sector.

Table 7. Comparison of Corrected and Uncorrected Estimates of Taxable Capacity- Farm and Non-Farm Sectors

	Uncorrected Estimate		Corrected Estimates	
	Per capita	Aggregate	Per capita	Aggregate
	(Rs.)	(Rs.Crores)	(Rs.)	(Rs.Crores)
Farm Sector				
First Plan	9	237	44	1170
Second Plan	16	464	53	1526
Third Plan	23	746	77	2505
Annual Plan period	31	1138	194	6952
Non Farm Sector				
First Plan	165	1879	226	2570
Second Plan	180	2278	241	3047
Third Plan	249	3516	341	4780
Annual Plan period	207	3238	407	6372

Absolute Taxable Capacity in Relation to Sectoral Incomes

Data summarized in Table 8 provide an interesting result. That is, measures of taxable capacity constitute much smaller compared with sectoral incomes. According to the corrected estimates, the taxable capacity ranged between 23 per cent and 28 per cent of the farm sector's income. Such differences are observed even in respect of the non-farm sector.

Table 8. Absolute Taxable Capacity as Percentage of Sectoral Incomes

	<i>Uncorrected Estimates</i>		<i>Corrected Estimates</i>	
	Farm	Non-Farm	Farm	Non-Farm
First Plan	4.7	38.0	23.3	51.9
Second Plan	7.4	36.8	24.3	49.2
Third Plan	8.4	39.4	28.3	53.6
Annual Plan period	7.6	27.6	46.2	54.4

Another observation regarding the farm sector is that during the Annual Plans Period, there was a significant improvement in farm incomes, and it is likely that more of these increased incomes have accrued to the high-income farm groups.

This is, in fact, reflected in the corrected estimates of taxable capacity, which as percentage of the sector's income, increased from 28.3 per cent during the Third Plan period to 46.2 per cent during the Annual Plans Period. Since the required type of NSS data are not available for a more recent period, the results have not been extended beyond 1968-69, but there are sufficient indications to show that the above trend has got reinforced during the next three years 1969-70 to 1970-71 when the farm incomes at both constant and current prices have experienced relatively high growth rates.

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The gain from new Agriculture strategy too have flowed more largely to this group... If the structure of income distribution was skewed in countryside, it seems to have been rendered more so by the developments in recent years.

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The farm sector share in aggregate national income at current prices was around one-half during the first Three Plan periods. Even according to the corrected estimates, the share worked out to approximately one-third during the first three Plans periods. The obvious reason is that the farm sector's income increased at a slow pace during the first fifteen years of Planning and its income was shared by larger population. During the last Annual Plans period, there was a sharp increase in the farm incomes at current prices partly due to rise in real incomes and partly due to increase in farm prices, particularly at a time when the growth in non-farm incomes was almost negligible. Therefore, the share of the farm sector (inclusive of the share of income originating in house property) in aggregate national income at current prices went upto 56.2 per cent during this period, while that of the non-farm sector declined to 43.8 per cent.

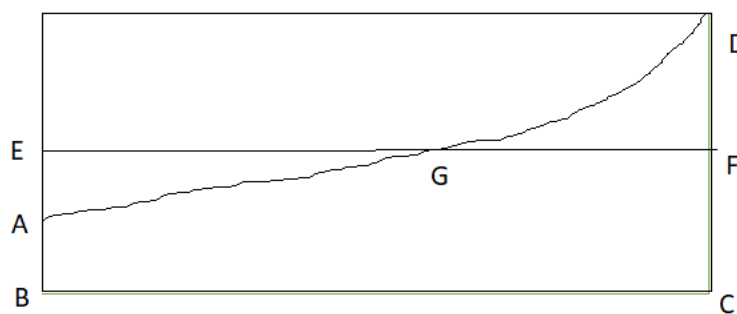
The Results

To briefly set out the results, based on the nutritional norms and the National Sample Survey data on consumption of food grains in terms of quantity

(suitably adjusted for the possible errors in reporting), estimates of minimum consumption requirements in per capita terms for 'farm' and 'non-farm' sectors have been attempted.

So far, average minimum consumption requirements per person have been uniformly applied to the entire population. But, in reality there is a considerable number of households in each sector whose actual consumption is less than the minimum consumption requirements. Because of inequality in the distribution of income, there is deficit in the actual consumption (from the norms of minimum consumption requirements) in respect of these households, and the potential surplus of an entire sector is concentrated in the hands of those households falling above the dividing line in the sector. In order to more explicit, we may present this in a diagrammatic form:

Diagram for Corrected Surplus



Aggregate income of the sector is represented by the area ABCD, the curve AD showing a given typical pattern of income distribution. Area of the rectangle BCFE represents that part of income which is equal to the total minimum consumption requirements of the entire population at a uniform rate. Area EAG is equivalent to the deficit in consumption in respect of the households below the dividing line, and area GDF represents the potential surplus concentrated in households who fall above the dividing line. Given this position, the potential surplus for the sector ought to be GDF and not the difference between GDF and EAG. The reason is that, in reality, the deficit EAG is not compensated by the surplus GDF.

As shown in Table 5, the surplus of sectoral income over the minimum consumer expenditure is considered as the potential surplus (that is, potential savings as against actual savings). When this estimate is adjusted for the minimum investment required to sustained production process, we get the estimate of taxable capacity.

Table5**Summary Picture of Aggregate and Per Capita Taxable Capacity in Farm and Non-farm Sector During**

	Plan				Periods				(Corrected				Estimates)			
	Farm Sector		Non -Farm Sector		Farm Sector		Non -Farm Sector		Farm Sector		Non -Farm Sector		Farm Sector		Non -Farm Sector	
	First plan	Second Plan	Third Plan	Annual Plan	First plan	Second Plan	Third Plan	Annual Plan	First plan	Second Plan	Third Plan	Annual Plan	First plan	Second Plan	Third Plan	Annual Plan
Estimates of Absolute Taxable Capacity																
(1) National income originating in sector at current price																
(Rupees, Crores)	5021	6288	8853	15045	4951	6190	8926	11718								
(2) Aggregate expenditure																
(Rupees, Crores)	3772	4675	6251	7914	2290	3029	4005	5111								
(3) Potential Surplus or Surplus Households																
[(1)-(2)]																
(Rupees, Crores)	1249	1613	2602	7131	2661	5161	4921	6607								
(4) Investment allowance																
(Rupees, Crores)	79	87	97	179	91	114	141	235								
(5) Aggregate taxable capacity (3)-(4)																
(Rupees, Crores)	1170	1526	2505	6952	2570	8047	4780	6372								
(6) Population estimates																
(in thousands)	26,32,52	28,97,36	32,42,44	35,81,57	11,39,00	12,65,52	14,06,024	15,64,37								
(7) Per capita taxable capacity																
(Rupees)	44	53	77	194	226	241	340	407								
Estimates of Relative Taxable Capacity																
(8) Relative taxable capacity :					First plan	Second Plan	Third Plan	Annual Plan								
(A) based on aggregate estimates					2.2	2.00	1.91	0.92								
in item 5 above :																
$T = T_b/T_a$																
(B) based on per capita estimates																
in item 7 above:					5.13	4.55	4.42	2.10								

Table 8. Absolute Taxable Capacity as Percentage of Sectoral Incomes

	<i>Uncorrected Estimates</i>		<i>Corrected Estimates</i>	
	Farm	Non-Farm	Farm	Non-Farm
First Plan	4.7	38.0	23.3	51.9
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An interesting revelation in these data is that the measure of taxable capacity constitute much smaller than the sectoral incomes. According to the corrected estimates, the taxable capacity ranged between 23 per cent and 46 per cent of the sector's income. Such differences are observed even in respect of the non-farm sector.

Another significant revelation is that there was a sizeable improvement in the level of absolute taxable capacity of the farm sector during the Annual Plans period 1966-67 to 1968-69 because its share in National Income at current prices had improved and also there was a more than proportionate increase in its share in aggregate taxable capacity, particularly as per the Corrected Estimates.

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Chapter 2: Estimates of Relative Tax Burden

Taxation involves consideration of two distinct concepts, namely, 'formal' incidence and 'effective' incidence, or 'incidence' and 'effects' of taxation. The "effects" are said to be infinite and indeterminate and hence there are no empirical results known.

We, therefore, confine ourselves to the measurement of 'formal' incidence, that is, the distribution of 'money burden' of taxation between farm and non-farm sectors.

The Existing Tax Structure in India

DIRECT TAXES

Central Direct Taxes

Income Tax

Among these, 'individuals' form the most dominant group, paying generally about 40 per cent of the total or 80 per cent of the income-tax due from the non-corporate assesses.

The Corporation Tax (Not found to be shifted to labourers consumers or to shareholders; borne by companies themselves)

Other Central Direct Taxes

Three taxes – expenditure tax, wealth tax and gift tax – which are imposed only on the non-farm households are straightaway assigned to the same sector.

STATE DIRECT TAXES

1.Land Revenue

2.Agricultural Income Tax

3.Estate Duty

Central Government Budgets have been providing the break-up of the Estate Duty Collections into (i) 2q+ agricultural land, and (ii) property other than agricultural land, since the 1957-58 budget in their Revised Estimate versions.

4.Urban Immoveable Property Tax

5.Profession Tax

6.Stamp and Registration Duties

INDIRECT TAXES

As for indirect taxes, the Taxation Enquiry Commission (1953-54) had attempted a systematic study on the incidence of Central and State indirect taxes on rural and urban households by different expenditure groups for 1953-54. Subsequently, follow up studies have been carried out by the Tax Research Unit of the Union Finance Ministry (Department of Economic Affairs) for two reference periods, 1958-59 and 1963-64.

Electricity Duties

Residual Head of Revenue

The Results

With the foregoing elaborate exercise, we have been able to attempt a quantitative estimate of the incidence of Central and State taxes on two sectors of the Indian economy during the first eighteen years of planning from 1951-52 to 1968-69. .

At the outset, it was pointed out that the important hypothesis to be examined here is: the relative taxable capacity of the farm sector may be low, but the relative burden of taxation on the farm sector may be equally low, or lower than the relative taxable capacity. Before we go into this burden capacity comparison, it is necessary to make a few observations on the absolute levels of tax burdens estimated for two sectors of the economy. Table 9 provides a summary picture of sectoral tax burdens (direct, indirect and total) both in aggregate as well as in per capita terms.

Rate of Increases in Tax Burdens During Plan Periods

Table 9. Summary Picture of Estimates of Tax Burden on Farm and Non-Farm Sectors (Refer Table 13 below)

Table 10. Annual Increases in Tax Burdens During Plan Periods

Period	Per Capita Estimates		Aggregate Estimates	
	Amount (Rupees)	Annual Percentage Increase @ (Compound)	Amount (Rupees)	Annual Percentage Increase @ (Compound)
		Farm Sector		
First Plan	9.71	4.2	255.52	5.7
Second Plan	14.47	9.3	419.14	11.6
Third Plan	24.87	12.9	806.33	15.7
Annual Plans	33.11	4.2	1186.12	6.9
		Non Farm Sector		
First Plan	35.78	(-)	407.6	1.2
Second Plan	53.53	11.3	677.5	13.8
Third Plan	101.79	14.8	1431.4	17.7
Annual Plans	137.54	4.8	2151.6	7.1

Note: Aggregate estimates are in Rupees, crores.

Tax Burden in Relation to Sectoral Incomes

Table 13. gives the estimates of tax burdens for farm and non-farm sectors as percentage of sectoral incomes. The farm sector, which was contributing about 5.1 percent of its income during the First plan period to the central and states tax pool, had its contribution raised to 6.7 percent during the Second Plan period, and to 9.1 percent during the Third; the corresponding percentage contributions by the non-farm sector were 8.2, 10.9 and 16.0 respectively.

However, during the Annual Plans period (1966-67 to 1968-69) while the farm sector's percentage thus reversing the continuously rising trend, that of the non-farm sector continued to rise (from 16.0 percent to 18.4 percent).

Again, the fact that a large proportion of the contribution, both in farm and non-farm sectors, was from indirect taxes is revealed also by the data presented in Table 13.

Table 13: Sectoral Tax Burden as Percentage of Sectoral Income (Average)

Year/ Period	Farm							Non-Farm							(Rupees, Crores)		
	Income Originating in Farm Sector	Total Tax Burden	Direct Tax Burden	Indirect Tax Burden	Total Tax Burden as Percentage of Income	Direct Tax Burden as Percent of Income	Indirect Tax Burden as Percentage of Income	Income Originating in Non-Farm Sector	Total Tax Burden	Direct Tax Burden	Indirect Tax Burden	Total Tax Burden as Percentage of Income	Direct Tax Burden as Percentage of Income	Indirect Tax Burden as Percentage of Income			
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15			
Average for First Plan	5020	255.52	77.12	178.40	5.1	1.5	3.6	4951	407.59	198.46	209.13	8.20	4.0	4.2			
Average for Second Plan	6288	419.14	108.27	310.87	6.7	1.7	5.0	6190	677.46	282.26	395.2	10.9	4.6	6.4			
Average for Third Plan	8853	806.33	137.56	668.77	9.1	1.6	7.6	8926	1431.43	556.85	874.58	16.0	6.2	9.8			
Average for Annual Plan	15045	1186.12	129.38	1056.74	7.9	0.9	7.0	12718.0	2151.61	742.93	1408.68	18.4	6.3	12.0			

Part of Table 13:

As Percentage of Sectoral Incomes

Average for	Farm Sector			Non-Farm Sector		
	Total Tax Burden	Direct Tax Burden	Indirect Tax Burden	Total Tax Burden	Direct Tax Burden	Indirect Tax Burden
First Plan	5.1	1.5	3.6	8.2	4.0	4.2
Second Plan	6.7	1.7	5.0	10.9	4.6	6.4
Third Plan	9.1	1.6	7.6	16.0	6.2	9.8
Annual Plans	7.9	0.9	7.0	18.4	6.3	12.0

Summary of Foregoing Observations

All these observation on the estimates of absolute tax burdens put together show that there are wide variations in inter-sectoral tax burdens. While the per capita tax burden on the farm sector ranged between Rs.9 and Rs.35 during the eighteen-year period, that on the non-farm sector ranged between Rs.38 and Rs.143. AS shares of incomes, while the contribution of farm sector ranged between 5 and 10 percent, that of non-farm sector varied between 9 percent and 19 percent, during the period under study.

But, could it be considered as sufficient evidence to vindicate the hypothesis that the farm sector has been under-taxed? Further analysis that follows will show that to draw such a conclusion at this stage on the basis of this evidence alone will be premature.

Taxable Capacity and its Distribution

Two phenomenon which come into sharp focus in this context - one described in the previous Chapter and another in a subsequent Chapter - are that: (i) per capita taxable capacity has always been higher in the non-farm sector than in the farm sector; and (ii) taxable capacity (or income) is more inequitably distributed in the non-farm sector than in the farm sector.

Tax burden as percentage of taxable capacity has always been higher in the farm sector than in the non-farm sector except during the Annual Plans period when the taxable capacity of the farm sector showed a sharp rise accompanied by no commensurate rise in the tax burden.

Relative Sectoral Incomes vs. Relative Tax Burdens

If Sectoral incomes are considered as the yardstick, the ratios of relative tax burdens always outstrip those of relative Sectoral incomes, indicating under-taxation of the farm sector in the entire period under study.

Ratio of Relative Sectoral Income and Relative Tax Burden

Period	Based on per Capita Estimates		Based on Aggregate Estimates	
	Relative Sectoral Income	Relative Tax Burden	Relative Sectoral Income	Relative Tax Burden
First Plan	2.28	3.68	0.99	1.6
Second Plan	2.25	3.7	0.98	1.62
Third Plan	2.31	4.09	1.01	1.78
Annual Plan	1.78	4.15	0.78	1.81

As stated earlier, it is unrealistic to consider income as the determinant of taxable capacity without making allowance for minimum consumption needs of the population. Besides, taxable capacity is more appropriately determined by the degree of inequality in income. The average of Sectoral income worked out per person hides, to some extent, the potential surpluses which the sector concerned is capable of generating. The corrected estimates of taxable capacity attempted here take into account both the basic consumption needs as well as the differential degrees of inequality in the distribution of income (or surpluses).

Table 15. Average Burden -Capacity Ratio

(Rupees in Crore)

	Farm Sector			Non - Farm Sector		
	Corrected Taxable Capacity	Tax Burden	Burden Capacity Ratio	Corrected Taxable Capacity	Tax Burden	Burden Capacity Ratio
	(Rupees)	(Rupees)	(Percentage)	(Rupees)	(Rupees)	(Percentage)
First Plan	1170	255.52	21.8	2570	407.59	15.9
Second Plan	1526	419.14	27.5	3047	677.46	22.2
Third Plan	2505	806.33	32.1	4780	1431.43	29.9
Annual Plans	6952	1186.12	17.1	6372	2151.61	33.8

The significant conclusion is that, during the first three Plan periods, the tax burden on the farm sector was in no way less than that on the non-farm sector, if taxable capacity is considered as the yardstick to compare with. But, during the Annual Plans period, burden-capacity ratio in respect of the farm sector declined to 17.1 per cent, while in respect of the non-farm sector it rose to 33.8 per cent. There was a significant improvement in the farm sector incomes during the last period.

Therefore, it is clear that though a major portion of national income originated in the farm sector, due to excessive dependence of population, the farm sector had a relatively lower taxable capacity than the non-farm sector, with the result in aggregative terms, the tax burden as a proportion of taxable capacity during the first three Plan periods was certainly not less on the farm sector than on the non-farm sector.

The Thesis of Under Taxation

Yet another way of examining the thesis of under-taxation of the farm sector is to juxtapose the relative capacity ratio (\bar{t} or T) against the relative burden ratio (\bar{b} or B). If the relative capacity ratio is higher than the relative burden ratio, it is a situation in which the non-farm sector is under taxed, or the farm sector is overtaxed. If the relative capacity ratio is less than the relative burden ratio, it is a situation of over taxation of the non-farm sector, or under-taxation of the farm sector. If both are equal, that is, if $\bar{t} = \bar{b}$ or T=B, there is complete inter-sectoral equity in incidence of taxation insofar as such tax incidence is compared with the taxable capacity.

Table 17. Relative Taxable Capacity and Relative Tax Burden Ratios Based on Aggregate and Per Capita Estimates

Period	Based on per Capita Estimates		Based on Aggregate Estimates	
	Relative Capacity	Relative Burden	Relative Capacity	Relative Burden
First Plan	5.13	3.68	2.2	1.6
Second Plan	4.55	3.7	2	1.62
Third Plan	4.42	4.09	1.91	1.78
Annual Plan	2.1	4.14	0.92	1.81

As stated earlier, it is unrealistic to consider income as the determinant of taxable capacity without making allowance for minimum consumption needs of the population. Besides, taxable capacity is more appropriately determined by the degree of inequality in income. The average of sectoral income worked out per person hides, to some extent, the potential surpluses which the sector concerned is capable of generating. The corrected estimates of taxable capacity attempted here take into account both the basic consumption needs as well as the differential degrees of inequality in the distribution of income (or surpluses).

Summary

Formal incidence of overall taxation for farm and non-farm sectors have been estimated for all the eighteen years from 1951-52 to 1968-69. The substantive part of analysis is centered around juxtaposition of the ratios of relative tax burdens (B or \bar{b}) with the ratios of relative taxable capacity (T or \bar{t}). The broad conclusions are summarized here.

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The most significant conclusion that emerges from the substantive analysis is that during the first three Plan periods, the relative tax burden ratio has always been less than the relative capacity ratio, that is, \bar{b} less than \bar{t} and B less than T. This implies that if the relative taxable capacity is considered as the yardstick to compare the relative incidence of taxation, the burden borne by the farm sector does not appear to be inadequate as compared with its relative taxable capacity. The only exception to this is the Annual Plans period for which the thesis of under-taxation of the farm sector is found to be valid.

Chapter 3: The Incidence of Public Expenditure

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The purpose of this chapter is to probe into the relative incidence of public expenditure on the farm and non-farm sectors and build up an integrated picture of tax burdens in relation to expenditure benefits.

While the incidence of taxation could be fairly satisfactory estimated, the matter of gauging the benefits of public expenditure is a hard task.

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While such difficulty in distinguishing money benefits from real benefits is present in almost all of the broad developmental heads like transport, agriculture, industry, development expenditures. Apart from developmental functions, the traditional functions of the State, namely, the maintenance of law and order and defence of the country from external aggression, entail vast public expenditures. Such non-

development expenditures, unlike development outlays, are not designed to provide any direct "productive" benefit to any sector. Such outlays are intended to provide non-monetary real benefit to the community to protect itself from external conflict and internal disorder and administer a form of civilized life. The real benefits are incalculable and they accrue to the inhabitants of farm and non-farm sectors alike.

However, there is no gainsaying the fact that these unproductive outlays spent on defence, police and civil administration are to large extent in the form of salaries and wages for the staff and personnel manning these services; these are obviously treated as non-farm incomes and charged to the Indian Income-Tax.

Therefore, if the analysis is restricted to "direct money benefits", it is conceivable that such benefits of non-development outlays accrue only to the non-farm sector.

The vary fact of the existence of such protection from internal disorder and external aggression creates an atmosphere conducive to the maintenance of the material well-being of the community. Therefore, it would be improper to apportion the entire benefit to the non-farm sector.

The Principle of "Primary Benefit"

The principle adopted by us in working out the incidence of public expenditure may be called the principle of "primary benefit". From the above observations, it is clear that it is not possible to adopt either the "real benefit"; for, if we adopt the former, we are likely to underestimate benefits accruable to one sector or the other; if we adopt the latter, the multiplier effects of such benefits are difficult to spot since they are a continuous process. The principle of "primary benefit" is a via media between the two.

Corresponding to the principle of "formal incidence" of taxation, we adopt the principle of "primary benefits" for public outlays.

Every expenditure sub-head, whether developmental or non-developmental, State or Central, or Revenue Account or Capital Account, has been analysed in respect of the first eighteen years of planning in India and allotted to either of the sectors in full, or to both in certain given proportions. This has involved a minute analysis of the data with so many intricate details. The highlights of the empirical evidence employed and the proportions for distribution arrived at, are presented in an explanatory note appended to this chapter.

However, the basic ingredients of the principle of "primary benefits" run common, as they should, to all items of expenditure enumerated above. We proceed to explain these ingredients.

- (1) Where "direct money benefits" and "real benefits" coincide in, and accrue to, a single sector, the incidence of such public outlay has been fully allocated to the same sector. To illustrate, the example of outlays on "Industries" under the Revenue Accounts of the Central and the State Governments or Capital outlays on "Industrial Development" under their Capital Accounts may be cited.

Prima facie, their benefits fully accrue to the non-farm sector. It may be questioned that public outlays incurred on such industrial products as fertilizers, pesticides, and tractors and other agricultural implements only benefit the non-farm sector; for these products are produced for the farm sector. But, such benefits as may accrue to the farm sector are only derived or secondary benefits; they are not primary benefits. When a fertilizer unit is established and put into production with the help of public outlays, additions made to the national product accrue to the non-farm sector and not to the farm sector. When its products are sold to the farm sector, it does pay for it. Parallel to this example, we have the cash crops produced by the farm sector and supplied to industries as raw materials. If government incurs some direct expenditure on, say, raw cotton production, it cannot be said that a part of the benefit is derived by the non-farm sector, though almost the entire part of raw cotton output is generally for cotton mills consumption. It is clear that in these types of expenditures, the primary benefit accrues to the sector in which monetary benefits and real benefits converge.

- (2) Where a given outlay is primarily intended to benefit one sector, but its direct money benefits are shared by the other sector, a part of such outlay is assigned to the latter sector in proportion to the direct money benefits derived by that sector. The principle behind this allocation is that the outlay should benefit the sector to which it is intended except to the extent of direct money benefits derived by the other sector. Here, we may once again cite the example of outlays on "Agriculture" reveals that more than 20 per cent of these outlays is on "administrative staff and supervision". Obviously, this type of expenditure spent on salaries adds to the process of "urbanization (and to increasing urban incomes) by their very first order effect; these salaries are, in fact, considered as non-agricultural incomes and charged to the Indian Income-tax *ceteris paribus*. Therefore, it is incongruous to consider that the entire expenditure on "Agriculture" benefits only the farm sector. We have allotted rest to the farm sector. It may be noted here that the 20 per cent benefit obtained by the non-farm sector is not a "derived benefit" or "secondary benefit" in the sense of consequential benefits flowing in from the primary or direct benefit, but it in itself forms a part of the primary or direct monetary benefit accruable from the total public outlays under this head. In other words, the primary benefit is shared between the farm and the non-farm sectors in the ratio of 80:20.
- (3) Where a given outlay is intended to benefit the general community as a whole, as on education or health, its incidence is by and large divided between the two sectors in proportion to the possible real benefits accruable to them. However, even in respect of such expenditure heads, wherever the administrative expenditure is high, allowance is made for such expenditure by allotting a proportionately higher share to the non-farm sector. The reason is obvious. On account of the heavy administrative cost involved in carrying out such development programmes, non-farm incomes stand to gain as compared to farm incomes. Therefore, in allotting the incidence of expenditure, some allowance has to be made for such additional gains obtained by the non-farm sector, besides the normal "real benefits". There are many sub-heads of expenditure which belong to this category: education, medical (including public health), public works, (or civil works) and electricity.
- (4) The principles enunciated above are also applicable to non-development expenditures. Nevertheless, there are certain practical difficulties in allocating

the incidence of such expenditures. As opined earlier, the benefits in real terms derived from expenditures on defense, police or civil administration, are incalculable. It is, therefore, obvious that their benefits should be divided in proportion to the real benefits received by two sectors of the economy. Now, the question arises as to how the proportions of real benefits themselves are to be arrived at. How much of the benefit out of expenditure on defense is derived by the farm sector and how much is derived by the non-farm sector? Obviously, this question will provoke as many answers as there are men and women in studying the issue.

However, certain ad hoc criteria do strike as a logical possibility. These are: sectoral population or sectoral income. We consider that the proportion of national income contributed by each sector should be a better criterion than the population dependent upon each. First, the problem may be viewed from the angle of protection such expenditures provide to maintain the material life of the community and hence, the material production contributed to the national wealth becomes the apt criterion to adopt. Secondly the capacity of a sector to obtain the benefit of "protection" is essential in proportion to what it produces. Considering these issues, we have decided that the farm and the non-farm sectors should receive benefits from the non-development outlays in proportion to their contribution to national income.

However, there are two observations which we should emphasise before concluding the ingredients of "primary benefits" principle; both of these observations pertain to the analysis of non-development expenditures. First, while the incidence of every sub head of outlay under developmental head is worked out on the basis of full empirical evidence, the incidence of expenditures under the non-developmental head is derived on the basis of certain a priori principle. Though the principle is valid, some other principle may be logically found to be equally justified. Therefore the incidence of non-development expenditures is not made a part of the substantive analysis. We have, by and large, relied on development expenditures for judging the relative benefits of public outlays. True, in a study of "burden-benefit" analysis of fiscal policy of the Government, it is difficult to ignore the incidences of non-development expenditures which are financed out of taxation. Therefore, we have not ignored them, but they have been relegated to the background for obvious reasons.

Secondly, looking at it from another angle, it is clear from the nature of non-development expenditures incurred by the central and state governments, that their incidence on the non-farm sector should be more, if any other reasonable criterion is adopted. The reason is that the bulk of non-developmental outlays is disbursed as salaries of civil, defence and police personnel, which are non-farm incomes. The proportion 50:50 employed here takes into account the possible real benefit that may accrue to the farm sector. This shows that the benefits received by the non-farm sector ought to be more than the estimates arrived at here in this study, if we rigidly confine ourselves to the principle of primary benefit. In the circumstances, whatever conclusions we arrive at should be qualified by the statement that overall benefits of public outlays derived by the non-farm sector ought to be more than what is worked

out here. In other words, insofar as farm sector is concerned, the picture of incidence of public expenditure worked out here depicts the outer limit of overall benefits.

The Results

Thus, corresponding to the "formal incidence" of taxation, we have worked out, with an elaborate exercise, the estimates of "primary benefits" of public expenditure accruing to the farm and non-farm sectors of the economy during the first eighteen years of planning. The details of this exercise and their results are contained in the Explanatory Note on this Chapter and Statistical appendices appended thereto. Tables 1 and 2 contain a summary of these results from farm and non-farm sectors, respectively. In table 3, these aggregate estimates are converted into per capita estimates for (i) development expenditure and (ii) total public expenditure. Estimates of individual years show fluctuations from year to year and hence, for purposes of comparison, simple annual averages for the different Plan periods are also worked out and shown in these Tables. By and large, we have relied on these annual averages for analysis.

The Absolute Levels of Primary Benefits

First, the benefits of development expenditure at the absolute level were far higher for the non-farm sector than for the farm sector, Such benefits for the farm sector stood at an annual average of Rs.213 crore during the First plan and at Rs. 958 crore during the Annual plans period (1966-67 to 1968-69), whereas the corresponding benefits for the non-farm sector stood at Rs.297 crore and Rs.1534 crore. Since the farm sector supports a larger population, the differences get further widened in per capita terms. The per capita benefits of development expenditure for the farm sector averaged Rs.8.08 during the first plan, Rs.14.01 during the second plan, Rs.21.75 during the Third and RS.26.76 during the Annual Plans period; the corresponding benefits on the non-farm sector stood at Rs.26.05, Rs.57.36, Rs.84.69 and Rs.98.08 respectively (see table 3). The benefits of total public expenditure, including the non-development expenditure, show obviously similar differences.

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Expenditure Benefits Compared with Tax Burdens

The third notable result is that when we compare the absolute levels of expenditure benefits with absolute levels of tax burdens, the trends in the burden-benefits relationship bring out a pattern which holds true of the strategy employed for resource mobilization and public investment over different plan periods. Such a comparison is presented in Table 5, wherein estimates of development and total public expenditure benefits are given as percentages of estimates of tax burdens for farm and non-farm sectors, respectively. It may be observed therefrom that during the First plan period, the average annual benefit of development expenditure for the farm sector formed about 83 per cent of its average tax burden and for the same period, the corresponding proportion for the non-farm sector was 73 per cent. During the second plan period, the position for reversed; the average annual development expenditure benefit formed as high as 107 per cent for the farm sector. The first five-year plan was basically an

agricultural reconstruction plan. During the second plan period, there was a significant shift of investment in favour of industrial and allied growth sectors. On the other hand, there was no commensurate increase in tax revenue from that sector.

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The Relative Incidence Benefits of Development Expenditure

It may be recalled that we worked out the relative tax burdens on the two sectors with the formulae $b = b_b / b_a$ and $B = b_b/b_a$, that is, the ratios of sectoral tax burdens based per capita and aggregate estimates. Similarly, in the analysis of the Incidence of public expenditure, we have derived figures of relative benefits obtained by the two sectors from public expenditure under heads of accounts. These may be termed as relative benefit ratios. The relevant ratios are defined thus.

$e = \frac{\text{Per capita benefit derived by non- farm sector}}{\text{Per capita benefit derived by farm sector}}$

Per capita benefit derived by farm sector

$E =$ Aggregate benefit ratios are separately worked out for development of expenditure and total public expenditure. These ratios, which are shown in Table 6, form the kingpin of burden-benefit analysis.

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Table 6: Relative Benefit Ratio Compared with Relative Burden Ratio

	<i>Relative Benefit Ratio</i>				<i>Relative Burden Ratio</i>	
	Aggregate	Estimate	Per Capita	Estimates	Aggregate	Per Capita
	Development Expenditure	Total Public Expenditure	Development Expenditure	Total Public Expenditure		
1951-52	1.53	1.30	3.54	3.00	1.76	4.06
1952-53	1.38	1.27	3.19	2.93	1.74	4.02
1953-54	1.32	1.24	3.06	2.88	1.55	2.59
1954-55	1.40	1.26	3.24	2.91	1.50	3.47
1955-56	1.38	1.25	3.18	2.88	1.48	3.42
Average First plan	1.39	1.26	3.22	2.92	1.60	3.68
1956-57	1.69	1.38	3.90	3.19	1.61	3.73
1957-58	1.96	1.53	4.54	3.53	1.60	3.69
1958-59	2.08	1.57	4.75	3.62	1.60	3.67
1959-60	1.60	1.33	3.66	3.05	1.63	3.74
1960-61	1.66	1.36	3.81	3.12	1.63	3.73
Average Second Plan	1.79	1.43	4.09	3.28	1.62	3.70
1961-62	1.67	1.40	3.82	3.20	1.71	3.92
1962-63	1.70	1.45	4.10	3.32	1.73	3.95
1963-64	1.79	1.40	4.10	3.20	1.81	4.15
1964-65	1.72	1.39	3.94	3.20	1.82	4.18
1965-66	1.53	1.30	3.50	2.97	1.77	4.05
Average Third Plan	1.68	1.37	3.87	3.17	1.78	4.09
1966-67	1.57	1.26	3.59	2.88	1.84	4.02
1967-68	1.57	1.26	3.59	2.89	1.81	4.15
1968-69	1.66	1.34	3.81	3.06	1.79	4.09
Average	1.60	1.29	3.67	2.94	1.81	4.15

Note : For the definition of these ratios , see the text

The emphasis in the strategy of investment was shifted in favour of the non-farm programmes during the Second Plan. This imbalance in the strategy was, however, slightly corrected in the Third Plan. During the Annual Plans period, while the overall investment itself remained stagnant greater emphasis was given to a new agricultural strategy and hence, even out of reduced total outlays, a larger proportion was devoted to farm and farm-oriented programmes.

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As may be observed from Table 8, for the first plan period, $e < b$ or $E < B$ implying that the relative expenditure benefit for the non-farm sector was lower than its relative tax burden. During second plan period, the position was reversed and quite significantly; e was seen to be much greater than b (and E greater than B), indicating that the relative benefits for the non-farm sector outstripped its relative burden. Again, for the Third Plan period, the benefits-burden relationship went against the non-farm sector, e tending to be lower than b (and E lower than B), though the degree of differences in the ratios was only marginal. However, during the Annual Plans period, the benefit-burden relationship again went significantly against the non-farm sector, thus almost restoring the position obtaining during the First plan period.

Table 8. Ratios of Relative Tax Burden and Relative Expenditure Benefit – Plan Averages

	<i>Relative Benefits Ratios of Development Expenditure</i>		<i>Relative Burden Ratios</i>	
	$(E = Eb / Ea)$	$(E = eb / ea)$	$(B = Bb / Ba)$	$(B = bb / ba)$
First Plan	1.39	3.22	1.60	3.68
Second Plan	1.79	4.09	1.62	3.70
Third Plan	1.68	3.87	1.78	4.09
Annual Plans	1.60	3.67	1.81	4.15
All Plans	1.64	3.76	1.75	4.00
First Three Plans	1.67	3.82	1.70	3.90

(iv) During the Annual Plans period, a sharp reduction in overall development outlays was accompanied by top priority for agriculture and the introduction of new agricultural development strategy.

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Table 10 . Index of Burden – Benefit Relationship

	<i>Aggregate Estimates</i>			<i>Per Capita Estimates</i>		
	Relative Benefit Ratio	Relative Burden Ratio	(1)As per cent tage of (2)	Relative Benefit Ratio	Relative Burden Ratio	(4)As percentage of (5)
	1	2	3	4	5	6
First Plan	1.39	1.60	87	3.22	3.68	88
Second Plan	1.79	1.62	110	4.09	3.70	111
Third Plan	1.68	1.78	94	3.87	4.09	95
Annual Plans	1.60	1.81	88	3.67	4.15	88
First Three Plans	1.67	1.70	98	3.82	3.90	98
All Plans	1.64	1.75	94	3.76	4.0	94

*As stated 1n the text, these index numbers should, in fact, be identical or rounding off differences.

The index treats the relative benefit ratio as percentage of relative burden ratio. The index thus built up should be identical for aggregate and per capita estimates but for the rounding off differences, because per capita burdens and per capita benefits are derived with the help of a common denominator, namely, sectoral population. The base level of 100 represents sectoral equality in the burden benefit relationship.

Such index worked out to 88 for. the First Plan, increased to 111 during the Second Plan, but again declined to 95 during the Third Plan period, and further declined to 88 during the Annual Plans period. This brings out the nature of fluctuating sectoral allocations of public sector outlays made during the various Plan periods. When we take all the Plan periods together, we find that the index of burden-benefit relationship works out to 94 only, indicating that the relative burden on the non-farm sector was only marginally higher, than its relative benefits of development expenditure.

Even this is due to the inclusion of Annual Plans period during which there was a definite shift relatively in favor of agricultural and agriculture-oriented programmes. When we consider only the first three plan periods, the index is reduced to 98, which shows that the relative burdens and benefits were almost equitably distributed between the farm and the non-farm sectors.

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We have made a close scrutiny of all the expenditure heads and come to two definite conclusions; First, the overall development expenditure , as also the total expenditure , has benefited the non farm sector relatively more than the farm sector, and secondly, the relative benefits between farm and non farm sectors have fluctuated during different periods in accordance with fluctuating strategy adopted for investment allocations during the various Plan periods.

When these relative benefits are juxtaposed against the relative tax burdens, it is observed that during the first three plan periods, the tax burdens and expenditure benefits seem to have been fairly evenly distributed between farm and non-farm sectors; no inter sectoral inequality appears to be discernible from the empirical evidence cited here.

Conclusions:

The principle of "formal incidence", which is used for estimating the burdens of taxation for farm and non-farm sectors, cannot be strictly adhered to while estimating the benefits of public expenditure. For., if it is done, 'direct money benefits' of sane expenditures (like expenditures on rural roads and agricultural research departments), which are intended to confer real benefits on the farm sector, are likely to be entirely derived by the non-farm sector. Similarly, there are some expenditure heads like education and medical health, real benefits of which accrue to both the sectors but the 'direct money benefits' are likely to be entirely appropriated by the non-farm sector. Such real benefits, which are also direct and immediate, cannot be ignored in working out the burden-benefit balance sheet for farm and non-farm sectors. Accordingly, an objective criterion of 'primary benefit' is adopted for allocating public expenditures between farm and non-farm sectors. For the substantive part of the analysis, only the benefits of development expenditures are considered since the benefits of non-development expenditures are immeasurable. It is also noted that while the non-developmental expenditure benefits could be apportioned on the crude criterion of the proportion of national income at current prices originating in the two sectors {generally 50:50}, the 'direct money benefits' derived by the non-farm sector should be substantially more.

A significant observation made in our estimates was that the fluctuation in these ratios seem to be in accordance with the fluctuating strategy adopted for investment allocations during the various Plan periods.

Finally, when the relative benefit- burden relationship is examined it is found that the index of this relationship worked out to 94 (the base =100 representing sectoral equality) for the entire eighteen -year period under study indicating that the relative burden on the non-farm sector was only marginally higher than its relative benefits . When the Annual Plans period excluded, the index worked out to 98 which shows that during the first three plans period, the relative burdens were almost equitably distributed between the farm and the non-farm sectors.

Chapter 4: Inter-Class Incidence of Taxation

Given a progressive system of taxation, the greater the inequality in distribution of income, the larger is the tax revenue earned by the State. It may be argued that the existing differential in the tax burdens of farm and non-farm sectors may be explained by the difference in their inequality pattern.

But, any equitable system of taxation with devised for the farm and non-farm sectors under their existing patterns of income distribution, entails that the proportion of income paid as tax be equal in the comparable income groups of the two sectors.

This is not to suggest that the two sectors should have identical systems of taxation with identical rates schedules. But, any equitable system of taxation, devised for the farm and non-farm sectors under their existing patterns of income distribution, entails that the proportion of income paid as tax be equal in the comparable income groups of the two sectors.

Basically, the measurement of the inter-class burden of taxation entails the juxtaposition of two sets of data: the data on income distribution and the data on tax burdens at different income levels. In Section I, we examine the patterns of income distribution in the two sectors; we devote Section II to examining the distribution of tax burdens among the different income groups in the two sectors; in Section III, the results of the first two Sections are juxtaposed for analysing the inter-class 'equity' of tax burdens.

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Section 1 : The Pattern of Income distribution in Farm and Non-farm Household Sectors

The only studies which bear a close resemblance to our requirements are those of Ojha and Bhatt :in the Reserve Bank of India Bulletin and NCAER. However, the N.C.A.E.R. studies are not available for any year before 1960 and hence the extent of changes in income distribution, in recent years over the earlier.

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OJHA-BHATT MODEL

We have depended on the Ojha-Bhatt (RBI) model for working out the income distribution data. But we noticed a major flaw in the Ojha-Bhatt stud. The most serious one pointed out by Ranadive pertains to the inadmissibility of deriving the size-distribution of personal household income from a given size-distribution of per capita. Consumer Expenditure. This needs to be amplified.

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This apparent inconsistency is evident from the results of different rounds of NSS which presents data on the size of households by expenditure classes (Table 1 & Table 2)

On the other hand, all Round result of the NSS consumer expenditure, which are given in terms of per capita expenditure classes show that average size of households is the lowest in the last two highest expenditure classes, both rural and urban areas.

In fact, among the 13 expenditure classes, the size increases with expenditure classes initially, but thereafter it tapers off reaching the lowest size in the last two highest expenditure classes. Table 1 reproduces the results of a few Rounds to show how consistently these observations hold good in result of both rural and urban sectors and in all the Rounds of the N.S.S. This shows that in the N.S.S classification, those households with large household size (much above the average) fall under lower classes of per capita expenditure. Alternatively, those households which report small total household

expenditures, but which have equally small household size fall under higher expenditure groups.

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In the Ojha-Bhatt method, the total expenditure of the high-income households is derived by multiplying the per capita expenditure of the high expenditure classes (I 2) by their respective household size. These are the households for which low household size is revealed in the N.S.S. results. The total expenditure of these households with such low household size are taken as the expenditures of the high-income groups. It is precisely this that is objectionable.

The total expenditures of these households may be high, but certainly not as high as the total expenditures of those households with large household size.

Table1. Average Size of Household by Monthly Per capita Expenditure classes

(In numbers)

Monthly Per Capita (Rupees)	Fourth Round (April – September 1952)		Twelfth Round (March -August 1957)		Eighteenth Round (Feb 1963-Jan 1964)	
	Rural Areas	Urban Areas	Rural Areas	Urban Areas	Rural Areas	Urban Areas
0-8	5.48	5.53	5.61	6.65	5.98	6.96
8-11	5.03	6.00	5.34	5.60	5.73	6.52
11-13	4.76	5.44	5.06	5.06	5.68	6.40
13-15	5.06	4.63	5.30	5.39	5.52	5.32
15-18	5.18	5.46	5.04	5.37	5.45	5.74
18-21	5.69	5.19	4.66	4.92	5.26	5.36
21-24	4.76	5.23	4.54	4.64	5.21	5.53
24-28	4.62	4.74	4.86	4.77	4.86	5.21
28-34	5.17	4.69	3.89	4.02	4.78	4.70
34-43	4.91	4.58	3.85	3.38	4.41	3.87
43-55	4.36	3.84	4.04	3.42	4.25	3.31
55- & above	4.14	3.17	3.86	2.76	3.62	3.27
					3.69*	2.82*
All classes	5.02	4.73	4.97	4.50	5.15	4.59

Table2. Average Size of Household by Household Expenditure classes

(In numbers)

Monthly Household (Rupees)	4 th Round (April–Sept 1952)		12 th Round (Sept 1957-May 1958)		17 th Round (Sept 1961 –July 1962)	
	Rural Areas	Urban Areas	Rural Areas	Urban Areas	Rural Areas	Urban Areas
0-25	3.18	2.36	3.23	2.30	1.85	1.38
26-50	-	-	-	-	3.08	2.13
51-100	4.63	3.95	4.99	4.08	4.63	3.57
101-150	5.66	4.98	6.21	5.37	5.82	4.93
151-300	7.21	6.26	7.76	6.77	7.25	6.33
301-500	9.21	7.60	9.62	8.28	10.10	7.98
501-1000	12.24	9.00	-	-	-	-
1001 & Above	-	10.76	-	-	-	-
All Classes	5.01	4.62	5.08	4.58	5.12	4.65

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In this regard, in some of the NSS Rounds themselves, where the data are presented in household expenditure classes, there is evidence that large household expenditure groups have a bigger size of households. For instance, the data, reproduced in Table 2 from a few Rounds of the N.S.S., reveal how consistently size of households increases with the increase in the monthly household expenditure classes, both in rural and urban areas. It is also revealed that, against all expenditure classes, the household size is higher in rural areas than in urban areas; and this difference is particularly significant in the highest expenditure class, viz., Rs.300 and above.

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Incidentally, this assumes that there are no savings by the low income households.

Now, proportions of both estimated households and persons above this limit are observed to be higher in the data with household expenditure classes than in the data with per capita expenditure classes.

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It has been made possible because the National Sample Survey have themselves provided the consumer expenditure data in terms of households in three Rounds, namely, Fourth Round (April-September 1952), Thirteenth Round (September 1957- May 1958), and Seventeenth Round (September 1961-July 1962).

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The NSS data are used basically for two purposes. First, for apportioning between rural and urban sectors the total household expenditure derived with the help of CSO's estimates of private income and other related data; and secondly, for distributing the sectoral expenditures between low and high income groups

Thus, the picture of income distribution is presented in respect of three periods, each being an average of two years, namely 1952-53/1953-54, 1957-58/1958-59 and 1961-62/1962-63. The households are initially divided into two groups (i) The low income group, that is , households with annual income up to Rs.3,000 and (ii) the high-income households, that is , those with incomes

above Rs.3,000 per annum. The high-income households are further divided into (1) middle income bracket (Rs.3,001-Rs.25,000) and (b) Top-income bracket (Rs.25,000 and above)

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Step I: Derivation of Personal Disposable Income of Low and High Income Groups in Rural and Urban Sectors

At the outset, independent estimates of total household expenditure are derived with the help of CSO's private income estimate and other relevant data (see Table 5). The total household expenditure is apportioned between the farm and non-farm sectors. This is done by relating the per capita consumer expenditures in 'rural' and 'urban' sectors to the estimated population of 'farm' and 'non-farm' sectors, respectively.

Within each sector, household expenditure is divided between two groups, namely (i) low income groups (annual income upto Rs.3,000) and (ii) the high-income group (income above Rs.3,000 per annum), on the basis expenditure data. The three NSS Rounds, referred to the above, provide size-wise expenditure per capita for the following monthly households expenditure classes: Rs.0-50, Rs.51-100; Rs.101-150; Rs.151-300 and Rs.301 and above.

Assuming that the low income households earning less than Rs.3,000 per annum do not make any savings in both 'rural' and urban sectors , the monthly expenditure of Rs.151-300 becomes the dividing line between the low and high income brackets.

Since the low income households make no savings, the estimated household saving of the two sectors are added to the household expenditures of the high-income households in the respective sectors to their disposable incomes. Thus, the distribution of disposable income between the low and high-income groups becomes available separately for farm and non-farm sectors.

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Therefore, 1.51 percent should be fairly representative of the country as a whole.

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Considering these factors, it would be reasonable to assume that the top-income group in the farm sector has appropriated about 2.0 percent of the total farm income during the entire period under study. To eliminate the element of arbitrariness in this, it is observed that even if this proportion is varied within a range of 1.5 percent to 3.0 percent for any of the periods under consideration, it does not affect, to any noticeable extent , any of the conclusions arrived at based on proportion of 2.0 percent.

		Assam	Madras	Kerala	Total
(1)	Net-Value of agricultural output (Rupees)	217.51	491.85	249.94	959.3
(2)	Total Income assessed to Agricultural Income Tax (Rupees)	7.9	7.04	16.39	31.33
(3)	Income Assessed in Respect of Top Income Group (Rs.25,000 and above) (Rupees)	7.76	2.52	4.16	14.44
(4)	(3) As percentage of (1)	3.57	0.51	1.66	1.51

Step IV : Estimation of Personal Disposable Incomes of Low and High Incomes Groups in the Non-Farm Sector

Deducting the personal disposable incomes, of the 'farm' households from those of the rural households, the personal disposable incomes of the 'non-farm rural' households get derived and adding it to the personal disposable income of the 'urban ' household gives the personal disposable income of all 'non-farm' households.

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The Results

There are a few differences between the results of the Ojha-Bhatt study and those of the present study. The first major difference relates to the proportion of farm income appropriated by high-income households. According to the Ojha-Bhatt study, the high-income farm households(with income above .3,000 per annum) appropriated about 12.5 per cent of the total farm income during the first period (1953-54/1954-55) and about 11.1 percent during the second period (1955-56/1956-57) (see table 8). On the other hand, our results show that these households appropriated about 30.4 percent during 1952-53/1953-54, about 25.7 percent during 1961-62 /1962-63. The most important explanation for the difference is to be found in the method employed by the Ojha-Bhatt study in deriving size-distribution of household income from the size distribution of per capita consumer expenditure. As explained earlier, this has introduced a definite downward bias in the estimation of income of high income groups both in the farm and non-farm sectors, but the degree of underestimation is more in farm sector than in non-farm sector.

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Table 7. State of Income distribution in the farm and Non- Farm Sectors

Grades of Income (Rupees)	1952-53/1953-54				1957-58/1958-59				1961-62/1962-63			
	Households		Income		Households		Income		Households		Income	
	Number in thousand	Percentage in Total	Amount (In Rs, Crores)	Percentage to Total	Number in thousand	Percentage in Total	Amount (In Rs, Crores)	Percentage to Total	Number in thousand	Percentage in Total	Amount (In Rs, Crores)	Percentage to Total
Farm Households												
Low: Below 3000	47,104	90.54	3,676	69.6	52,373	92.74	4,464	74.3	5,54,68	90.94	5,328	73.4
High: Above 3000	4,922	9.46	1,602	30.4	4,100	7.26	1,544	25.7	55,26	9.06	1,930	26.6
(i) Middle Rs.3001-Rs.25000	4880	9.38	1,496	28.4	4,055	7.18	1,424	23.7	6477	8.98	1,785	24.6
(ii) Top: Above 25,000	42	0.08	106	2.0	45	0.08	120	2.0	49	0.08	145	2.0
Total	52,026	100.00	5,278	100.00	56,473	100.00	6,008	100.00	60,994	100.00	7,258	100.00
Non-Farm Households												
Low: Below 3000	19,939	87.05	2,890	59.5	22,758	90.09	3,785	63	23,597	86.66	4,476	58.7
High: Above 3000	2,966	12.96	1,967	40.5	2,503	9.91	2,220	37	3,633	13.34	3,150	41.3
(i) Middle Rs.3001-Rs.25000	2,743	12	1,461	30.1	2,336	9.25	1,753	29.2*	3,395	12.47	2,311	30.3
(ii) Top: Above 25,000	223	0.95	506	10.4	2	0.66	467	7.8*	238	0.87	839	11
Total	22,905	100.00	4,857	100.00	25,261	100.00	6,005	100.00	27,230	100.00	7,626	100.00
Grand Total	74,931	-	10,135	-	81,734	-	12,013	-	88,224	-	14,824	-

*Certain adverse factors had brought down the share of high income urban households during these years.

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It is observed that the share of farm income appropriated by top- income bracket (earning more than Rs.25,000 per annum) works out to about 2 percent whereas the share of corresponding group in the non-farm sector generally stands at slightly more than 10 percent throughout the period under study.

Comparing the Ojha-Bhat estimates with their own, the NCAER write thus :” As a result, the RBI data understate the concentration of income among upper income groups both at the rural and urban levels and give an appearance of relative equality of incomes in India compared with developed economies which is not warranted.”

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Before we conclude, it must be stated that we do not claim to have provided conclusive answers to all the problems connected with the estimates of income distribution for farm and non-farm sectors in India. We are primarily concerned with the problem of tax burden and the inter-class variations therein. However, we could not have proceeded further without succeeding in presenting fairly accurate estimates of income distribution for farm and non-farm sectors.

Table 12. Share of High - Income Groups (Income Above as Rs.3000 in Non farm and Urban incomes (in percentage)

Share of High Income House holds in Total of	Ojha-Bhatt Study		NCAER Studies	Our Estimates		
	1953-54/ 1954-55	1955-56/ 1956-57	1960	1952-53/ 1953-54	1957-58/ 1958-59	1961-62/ 1962-63
Urban incomes	34.9	41.9	50.2	-	-	-
Non-farm incomes	24.5	28.1	40.3*	40.5	37.0	41.3

- This is derived by combining the NCAER’s estimates of income distribution for urban households and for non farm households in rural sectors

@The Income -Tax Revenue statistics do contain these figures in respect of some exceptional assesseees.

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In other words, the direct tax burden devolved upon the middle-income groups (earning between Rs.3000 and Rs.25000 per annum) in the non-farm sector forms less than 25 percent of the total direct tax burden. The significance of this phenomenon lies in the fact that, in contrast, the brunt of direct taxation in the farm sector is borne by low and middle-income households (earning less than Rs.25000 per annum), as may be observed from the following paragraphs. Incidentally, as is widely known, the low-income group in the non-farm sector does not bear any direct tax burden.

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Khusro has worked out corrected acreage with land revenue per acre as an index of fertility. He thus found that both gross output and farm business income per corrected acre are constant with increase in farm size, Therefore, the obvious inference is that land revenue is proportional to farm purpose.

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On these lines, quantitative estimates of direct tax burden on different income groups, in the farm sector are made. A summary picture of these is presented in Table 17. As may be observed from this table, during the entire period under study about two thirds of the direct tax burden on the farm sector is borne by the low-income households, and the balance of about one third is shared between the middle and the top income brackets.

Now, when the above distribution of tax burden in farm sector is compared with that in the non-farm sector, the following conclusion emerges;

- (i) While the low income group earning less than Rs.3000 per annum pays no direct taxes in the non-farm sector, its counterpart in the farm sector bears about two-thirds of the direct tax burden on the farm sector; and
- (ii) The top income group, which bears more than 75 percent of the direct tax burden in the non-farm sector is not a significant tax paying group in the farm sector

However, while these results are useful as part of the preliminary reasoning, their interpretative significance is limited unless the absolute amounts of tax burdens are brought into relation with the quantitative estimates of household incomes in respect of different income groups in farm and non-farm sectors ; this is attempted in the next section.

Table 17. Distribution of Direct Tax Burden by Grades of Incomes in Respect of Farm Households
(Amount in Rupees , Crores)

	1952-53/1953-54		1957-58/1958-59		1961-62/1962-63	
Grade of Income (Rupees)	Amount	Percentage to Total	Amount	Percentage to Total	Amount	Percentage to Total
Low : Below Rs.3000	49.08	66.1	72.4	68.6	87.42	67.9
High : Above Rs.3000	25.16	33.9	33.34	31.4	41.26	32.1
(i)Middle Rs.3001-25000	20.49	27.9	24.42	23	30.74	23.9
(ii)Top : Above 25000	4.67	6.3	8.92	8.4	10.52	8.2
Total	74.4	100.00	106.08	100.00	128.68	100.00

Section III

Incidence of Taxation by Grades of Income

Direct Taxation

In respect of different income groups in farm and non-farm sectors, percentages of direct tax burdens to respective income levels are worked out and presented in Table 18. As may be observed therein, of the two income groups on which the incidence of direct taxation falls, namely, the middle and top- income groups, the middle income group(Rs.3,001-Rs.25,000) in the non-farm sector paid about 1.9 to 2.0 percent of its income as direct tax during all the three periods under study. The corresponding income groups in the farm sector has paid only a slightly less proportion of its income and direct tax, except during the first period when the incidence was at 1.4 percent in the farm sector as against 1.9 per cent in the non-farm sector. During the subsequent two periods, the incidence on the farm group remained static at 1.7 percent as against 1.9 percent and 2.0 percent on the non-farm group during the second and third periods, respectively.

On the other hand, the top income bracket (i.e income above Rs.25000 per annum) in the non-farm sector paid a considerably heavier burden of direct taxation than its counterpart group was at 18.7 percent and 18.2 percent during the first and the last periods as against 4.4 percent and 7.4 percent on the farm group during the same periods. It is precisely on account of this reason that the incidence of the direct taxation on the high income group (Above Rs.3000 per annum) as a whole in the non-farm sector worked out to levels higher than those on the farm sector high income group, that is 6.2 percent,7.1 percent and 6.3 percent on the non-farm sector group during the three periods, respectively as against 1.6 percent and 2.1 percent for the farm sector group.

Thus the disparity in direct tax burden on the households of the two sectors is observed in respect of two income groups. First, the low income group (earning less than Rs.3000 per annum) pays no direct tax in the non-farm sector, while in the farm sector the corresponding group does bear some direct tax burden. Secondly, the top income group (earning above Rs.25000 per annum) in the non-farm sector pays substantially larger proportion of its income as tax than what the corresponding groups in the farm sector does. However, the significance of this disparity in the tax burden on top income brackets of the two sectors gets diluted when it is noticed that the share of top income farm house holds in the total farm income is, both in relative and absolute terms, virtually insignificant as compared with share appropriated by the top income group in the non-farm sector. As emphasized earlier, the estimated share of incomes earned by top income brackets formed about 7 to 8 percent

of the incomes earned by the high income group (Rs.3000 and above) in the farm sector during the entire period under study. On the other hand, for the non-farm households, the corresponding share of the top bracket worked out to be 26 to 27 percent. In other words, the revenue potentiality of the incomes earned by the top income farm households is limited, as subject to which the next chapter is devoted.

Table 18 .Incidence of Direct Taxed by Grade of Income- Farm and Non-Farm Sectors

Grades of Income (Rupees)	1952-53/1953-54			1957-58/1958-59			1961-62/1962-63			
	Income (Rupees, Crore)	Tax Burden(Rupees,Crore)	Tax Burden as percentage of Income	Income (Rupees, Crore)	Tax Burden(Rupees,Crore)	Tax Burden as percentage of Income	Income (Rupees, Crore)	Tax Burden(Rupees,Crore)	Tax Burden as percentage of Income	
	1	2	3	4	5	6	7	8	9	10
Farm Sector										
Low: Below 3000	3,676	49.08	1.3	4,464	72.74	1.6	5328	87.42	1.6	
High:Above 3000	1,602	25.16	1.6	1,544	33.34	2.2	1930	41.26	2.1	
(i) Middle Rs.3001-Rs.25000	1496	20.49	1.4	1,424	24.42	1.2	1785	30.74	1.7	
(ii)Top: Above25,000	106	4.67	4.4	120	8.92	7.4	145	10.52	7.3	
Total	5,278	74.24	1.4	6,008	106.08	1.7	7,258	128.68	1.8	
Non-FarmSector										
Low: Below 3000	2,890	-	-	3,785	-	-	4,476	-	-	
High:Above 3000	1,967	121.9	6.2	2,220	156.66	7.1	3,150	199.13	6.3	
(i) Middle Rs.3001-Rs.25000	1,461	27.52	1.9	1,753	66.65	1.9	2,311	46.4	2.0	
(ii)Top: Above25,000	506	94.38	1.9	467	123.01	26.3	839	142.73	18.2	
Total	4,857	121.90	2.5	6005	156.66	2.6	7,626	199.13	2.6	

To summarise the significant conclusions: the bulk of the direct tax burden in the farm sector is born by low and middle income groups the incidence on which is very well comparable with the incidence on the corresponding groups in the non-farm sector. On the other hand, the bulk of direct taxation in the non-farm sector impinges on the top-income bracket whose tax burden is much higher than the burden on the corresponding group in the farm sector, but the top income brackets does not form an important income -earning group in the farm sector, though the unequal tax burden borne by these comparable income groups in the two sectors do involve inequality .The non-farm household sector taken as whole does bear a higher direct burden than the burden borne by the farm household sector only because of the existence of top income brackets to a much larger extent. Viewed strictly from the angle of 'equity' these top income brackets have to be eliminated from the overall picture, and when done so, empirical evidence does not seem to show significant inter sectoral 'inequity' in the incidence of direct taxation.

All the income brackets studies (low, middle and top) have paid as indirect tax higher proportion of their respective incomes in the non-farm sector than in the farm sector, but the extent of these differences in their incidence pattern does not appear to be significant except in respect of the top-income group. Here, to gauge the extent of these differences, the relative position of these incidence of indirect tax on each group of the non-farm sector is shown as a ratio of the incidence on the corresponding group in the farm sector. When the ratio equal to unity, inter sectoral equity is achieved in the concerned income group. If the ratio is more than unity, the farm sector is relatively under taxed and the farther away is the ratio from unity. Higher is the degree of under taxation.

It may be observed from this table that for the top income bracket (above Rs.25000 per annum), the ratio of incidence in the non-farm sector to that in the farm sector stood at 5.25,4.73 and 3.94 during the three periods under study respectively. For the middle income group (Rs.3,001- Rs.25,000), the ratio was at 1.36 for the first period; it dwindled to 1.09 in the second period, but again picked up to 1.26 in the last period. In respect of all classes together, the ratio of relative incidence works out to 1.26 1.27 and 1.24 during the three periods, respectively.

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Table 20 : Relative Incidence of Indirect Taxation by Grades of Incomes (Ratio of incidence of Non-farm sector groups to incidence of farm sector groups)

Grades of Income (Rupees)	1952-53/1953- 54	1957-58/1958- 59	1961-62/1962- 63
Low: Below 3000	1.11	1.25	1.1
High: Above 3000	1.33	1.15	1.19
(i) Middle Rs.3001- Rs.25000	1.36	1.09	1.26
(ii)Top: Above25,000	5.25	4.73	3.94
All Grades	1.26	1.27	1.24

Note : Estimates of indirect tax incidence are given in Table 19.

These studies have also shown that within the urban and rural sectors, there is increase in incidence with the increase in expenditure sizes. The present work is also based on the results revealed by these studies, but there is an important difference in the criterion adopted for working out the incidence patterns. While these studies have put out figures of indirect tax incidence in per capita terms and only in relation to consumer expenditure, the present study is concerned with incidence per unit of income earned by various income groups.

In this regard, as the above studies have themselves indicated, the most appropriate measure of incidence of a tax on households is the ratio of its burden to household income rather than households expenditure. The drawback in employing household consumption rather than income as the base for working out incidence is that "incidence measured in relation to the consumer expenditure tends to overstate the progression or understate regression of the tax system since consumer expenditure as proportion of income tends to fall as one moves up the income scale" . This drawbacks is not only applicable to the inter- class differences in tax incidence within a sector but also to inter-sectoral differences. For, it is widely known that the saving – income ratio is lower in the rural sector than in the urban sector. Besides, the inter sectoral differences in saving-income ratio may not be uniform at all comparable income groups in the two sectors. Available evidence suggests that the differential is higher in the large income brackets. Therefore, the differences in the incidence of indirect taxes between rural and urban sectors should be less when the incidence us based on household income than when it is based household expenditure; this should be particularly true in respect of the relatively large income brackets.

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Table 21. Total Tax Burden by Grades of Income- Farm and Non- Farm Sectors

Table 21. Total Tax Burden by Grades of Income- Farm and Non- Farm Sectors										
Grades of Income (Rupees)	1952-53/1953-54			1957-58/1958-59			1961-62/1962-63			
	Income (Rupees, Crore)	Tax Burden (Rupees, Crore)	Tax Burden as percentage of Income	Income (Rupees, Crore)	Tax Burden (Rupees, Crore)	Tax Burden as percentage of Income	Income (Rupees, Crore)	Tax Burden (Rupees, Crore)	Tax Burden as percentage of Income	
	1	2	3	4	5	6	7	8	9	10
Farm Sector										
Low: Below 3000	3,676	151.49	4.1	4,464	267.76	6.0	5328	399	7.5	
High: Above 3000	1,602	86.87	5.4	1,544	133.44	8.6	1930	219.98	11.4	
(i) Middle Rs.3001-Rs.25000	1496	81.36	5.5	1,424	122.72	8.6	1785	206.81	11.6	
(ii) Top: Above 25,000	106	5.51	5.2	120	10.72	8.9	145	13.17	9.1	
Low and Middle : Below Rs.25000	5172	222.5	4.5	5,888	390.48	6.6	7113	606.8	8.5	
All Grades	5,278	238.36	4.5	6,008	401.20	6.7	7,258	619.80	8.5	
Non-Farm Sector										
Low: Below 3000	2,890	89.05	3.1	3,785	209.2	5.5	4,476	290.03	6.5	
High: Above 3000	1,967	224.56	11.4	2,220	322.2	14.5	3,150	548.91	17.4	
(i) Middle Rs.3001-Rs.25000	1,461	109.02	7.5	1,753	165.86	9.5	2,211	336.4	14.6	
(ii) Top: Above 25,000	506	115.54	22.8	467	156.34	33.5	839	212.51	25.0	
Low and Middle : Below Rs.25000	4,351	198.07	4.6	5,538	375.01	6.8	6,787	626.43	9.2	
All Grades	4,857	313.61	6.5	6005	531.34	6.8	7626	838.94	11.0	

Inter-Class incidence of Direct and Indirect Taxes Together

The aggregate picture of direct and indirect tax burdens together on various income groups of farm and non-farm sector shown in table 21. In order to examine , the extent of inter sectoral disparity in incidence patterns, the ratio of tax burdens on non-farm income groups to tax burdens on corresponding farm income groups is depicted in Table 22.

The important conclusions are summarized below.

First, the low- income group in the farm sector paid generally more tax as percentage of its income than the low income group in the non-farm sector. Thus , while the tax incidence on the farm sector low income group ranged between 4.1 percent and 7.5 percent during the entire period under study, that on the corresponding non-farm sector group ranged between 3.1 and 6.5 percent . In terms of the ratios presented in table 22, the ratio of incidence on non-farm low income group to that on the comparable farm group worked out to 0.76 , 0.92 and 0.87 during the three periods respectively. The important reason for this inter-sectoral disparity among the low income groups is that the non-farm low income group paid no direct tax , and that the incidence of indirect taxation, though generally higher on this group than on the comparable farm group , did not fully compensate for the lower level of direct tax burden borne by the farm group.

Table 22 . Relative Incidence of Direct and Indirect Taxes Together (By Grade of Income)

Grades of Income (Rupees)	1952-53/1953-54	1957-58/1958-59	1961-62/1962-63
Low: Below 3000	0.76	0.92	0.87
High: Above 3000	2.11	1.69	1.53
(i) Middle Rs.3001-Rs.25000	1.36	1.10	1.26
(ii)Top: Above25,000	4.38	3.76	2.78
Low and middle (Below Rs.25000)	1.02	1.03	1.08
All Grades	1.44	1.31	1.29

Secondly, the difference between the incidence level of the middle income group (Rs.3001-Rs.25000) in the two sectors do not appear to be significant except during the first period when the non-farm middle group paid about 7.5 percent of its income as tax while the corresponding farm group paid only 5.5 percent of its income, the ratio working out to 1.36. Thereafter, the total tax burden has increased on these groups in both the sectors, the proportion of tax burden to income rising from 7.5 percent in the first period to 14.6 percent in the last period in the non-farm sector, and from 5.5 percent to 11.6 percent during the same period in the farm sector. But, due to faster growth in the incomes of this group in the non-farm sector, the relative tax burdens between the groups of two sectors have dwindled to as low levels 1.10 during the second period and 1.26 during the last period. This phenomenon of the burden differential among the middle groups being marginal is true of both direct and indirect taxes and hence, true of the aggregate picture of incidence.

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Conclusion

The inter-class incidence of direct and indirect taxation together leads to the following conclusions:

(i) Among the three income groups, low- and middle-income groups in the non-farm sector do not appear to have significantly higher incidence of taxation than the incidence on the corresponding groups in the farm sector; it is about 9 per cent of income each.

(ii) Also, in a period low and middle income growth in the farm sector pays Rs. 607 crore out of the total tax burden in the sector 620 crore (98 per cent); in other words the top-income group in the farm sector pays only Rs 13 crore in earlier (2 per cent).

(iii) The top-income bracket in the non-farm sector, on the other hand, bears a far higher incidence of taxation other than top-income group in the farm sector; almost 75 per cent of the tax assets for income tax

payers in the non-corporate non-farm sector are paid by top income brackets

- (iv) If the top income groups are excluded from the overall picture on the ground that the income earned by them in the farm sector is almost insignificant, empirical evidence does not seem to show any inter-sectoral disparity in tax incidence between farm and non-farm sectors.

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Chapter 5: Estimates of Potential Tax Revenue from Farm Sector Based on Inter-Sectoral Equity in Tax Burden

Though appears hypothetical, is not without import. That is , if the farm sector were also subjected to the same level incidence of taxation as the non-farm sector, what is the quantum of additional (potential) tax revenue obtainable from that sector?

To bring this issue to its logical conclusion , it is proposed to work out the amount of additional tax revenues which the farm sector would have given to the state exchequer if the level of incidence as borne by the non-farm households was applied to the farm households.

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Untapped Tax Potential in Non-Farm Sector

There are two independent sets of data presented in the previous chapter. The first one pertains to the income-tax Revenue Statistics which data on tax assessment and income assessed (see Table 14 in Chapter 4) . The second set of data pertain to the distribution of sectoral non-farm household income and the proportions of income paid as direct tax at different income levels. There is a vast divergence between the two sets of data. Between the two, the income-Tax Revenue Statistics do not give a complete picture of the income earned by assessable households in the non-farm sector. The income-tax law contains a series of exemptions and personal allowances, which lighten the burden of income-tax on the non-farm households. There are family allowances, higher exemptions limits for Hindu Undivided Families, exemptions of certain types of savings like Provident Fund Contributions and Insurance Premia, depreciation allowances for individual business incomes- all these make a long list of exemptions.

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Table 2 : Non Farm Household Income and Income Assessed to Income Tax

Year	Non-Farm Household Income (Rupees, Crores)	Non-farm Household Income Appropriate by High Income Groups	Income Assessed to Income Tax (Rupees Crores)	Income Tax Assessed (Rupees Crores)	Income Assessed to tax as percentage of Non-Farm Household Income Groups	Income Assessed to Tax as Percentage of Income of High Income Households	Tax Assessed as Percentage of Income Assessed	Tax Assessed as Percentage of Total Non-Farm Household Income Groups	Tax Assessed as Percentage of Household Income of High Income Households
1	2	3	4	5	6	7	8	9	10
1950-51	4390	1778	429	85	9.8	24.1	18.8	1.9	4.8
1951-52	4631	1876	583	104	12.6	31.1	17.8	2.2	5.5
1952-53	4788	1939	511	98	10.7	26.4	19.2	2.2	5.1
1953-54	4927	1995	561	94	11.4	28.1	16.8	1.9	4.7
1954-55	4979	2016	562	91	11.3	27.9	16.2	1.8	4.5
1955 -56	5235	2120	597	99	11.4	28.2	16.6	1.9	4.7
1956 -57	5514	2040	700	107	12.7	34.3	15.3	1.9	5.2
1957 -58	5896	2182	717	109	12.2	32.9	15.2	1.8	5.0
1958 -59	6111	2261	818	114	13.4	36.2	13.9	1.9	5.0
1959 -60	6487	2400	867	117	13.4	36.1	13.6	1.8	4.9
1960 -61	6972	2580	900	117	12.9	34.9	13.0	1.7	4.5
1961 -62	7336	3030	1022	137	13.9	33.7	13.4	1.9	4.5
1962 -63	7917	3270	1054	140	13.3	32.2	13.3	1.8	4.3
1963 -64	8499	3510	1084	136	12.8	30.9	12.5	1.6	3.9
1964 -65	9452	3904	1229	152	13.0	31.5	12.4	1.6	3.9

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As may be observed from table 2 , during all the years from 1951-52 to 1964-65, the non-farm household income assessed to income-tax rarely exceeded on third-of the actual assessable income (i.e., the actual income accruing to the high-income households). In other words, about two-thirds of the non-farm assessable income gets concealed from the taxation authorities. Kaldor who examined the problem came to the conclusion that “the total of assessable incomes in all sectors outside agricultural comes out to be almost exactly twice assessed income “ Tax laws provide a number of deductions, exemptions and exclusions and therefore, assessable incomes themselves are lower than the earned incomes of the assessable households. Gandhi places the earned income of this group at “about 2.5 times the actually assessed income of the individual and Hindu Joint Families paying income tax”.

It follows, therefore, that the actual incidence of direct taxation on the non-farm high income households group is much smaller than what the income-tax data reveal. While the income -tax assessment as percentage of income assessed varied between 12 to 20 percent, the same as percentage of actual assessable income worked out to only about 4 to 5 percent during the fifteen -

year period. Incidentally, it is also revealing that the income tax assessment as percentage of income assessed has shown a consistently declining trend during this period even though there has been a significant step up in the marginal tax rates, particularly during the Second and Third plan periods. In fact, the actual incidence of income tax on the non-farm households as revealed by the percentage of tax assessment to actual assessable income has remained static at around 4 to 5 percent.

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The significance of this divergence for the present analysis lies in the fact that it is improper to consider only the assessed income as the base for deriving the incidence of taxation. The non-farm sector had larger taxable incomes than what are revealed by the Income-Tax Revenue Statistics and consequently, their actual direct tax incidence is substantially lower than what is revealed by these statistics. As presented in Table 4, **if the pattern of incidence revealed by tax data are applied to actual incomes attributable to the middle and top-income groups, the tax potential of the non-farm household sector works out to about three times the actual tax revenue accrued to the State exchequer at present.** Thus, for 1961-62/1962-63, the tax potential of the non-farm household sector works out to Rs.545 crore against the actual direct tax revenue of Rs. 199 crore accrued to the exchequer. From among the middle-income group, the tax revenue would have been Rs.139 crore as against the actual revenue of Rs.46 crore. Similarly, for the top-income group, the tax payment of Rs.153 crore should actually have been Rs.345 crore if the actual income accrued to them were considered.

Thus, within the prevalent administrative and legal constraints, a given pattern of income distribution in the non-farm sector gives rise to a given quantum of direct tax revenue that is considerably lower than what it ought to be.

Super-imposing the same constraints and the emerging direct tax incidence on the non-farm sector to the pattern of income distribution obtaining in the farm sector, we estimate the potential tax revenues from the farm sector. This has been made possible by the estimates of size-wise distribution of income and tax burdens in respect of both farm and non-farm sectors worked out in the previous chapter.

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The significance of the estimates of untapped direct tax potential for the farm sector as a whole is indicated in Table 6. In absolute terms, the untapped direct tax potential ranged from Rs.21 crore to Rs.27 crore during the first three Plan periods, but for the latest Annual Plans period the untapped potential worked out to Rs.44 crore, which is equivalent to about 34 per cent of the total direct tax burden on the farm sector or 40 per cent of the burden from land revenue and agricultural income-tax together, or 44 per cent of the present land revenue collections. It should be emphasized that more than these proportions, it is the spurt in the absolute levels of untapped tax potential during the latest Annual Plans period that appears significant. This shows that the recent spurts in agricultural incomes have somewhat reduced the incidence of direct taxation on the farm sector. **In this context, it may be recalled that all the earlier stages of the present study had revealed that while the farm sector was not significantly undertaxed during the first three Plan periods, the recent spurts in agricultural incomes have somewhat reduced the incidence of direct taxation on the farm sector relative to the incidence levels in the non-farm sector.**

Table 6: Significance of Untapped Direct Tax Potential - Farm Sector

-+*

Annual Average for	Untapped Direct Tax Revenue Potential (Rupees, Crore)	Estimates of Actual Burden on Farm Sector (Rupees, Crore)					Farm Sector's Untapped Direct Tax Potential in Percentage of		
		Total Direct Tax Burden	Burden of Land Revenue and Agricultural Income Tax	Burden of Land Revenue	Tax Burden of Direct and Indirect Taxes Together	Total Direct Tax Burden	Burden of Land Revenue and Agricultural Income Tax	Burden of Land Revenue	Total Burden of Direct and Indirect Taxes Together
First Plan	21	77	71	66	256	27	30	32	8
Second Plan	27	108	100	92	419	25	27	29	6
Third Plan	26	138	124	114	806	19	21	23	3
Annual Plan	44	129	110	99	1186	34	40	44	4

Note: For untapped direct tax revenue potential, see Table 5 here

Total Untapped Tax Potential of Farm Sector

So far, we have considered only the direct tax incidence. In Table 7, a similar attempt is made for untapped tax revenues from both direct and indirect taxes together. It may be observed therefrom that, in absolute terms, the untapped total tax potential works out to as high an amount as Rs.160 crore for the Annual Plans period of which Rs.44 crore are from the direct taxes and Rs.116 crore from the indirect taxes. This untapped potential, again, in absolute terms, was low during the first two Plan periods (Rs.47 crore and Rs.44 crore), but during the Third Plan period, it rose to Rs.94 crore of which Rs.26 crore was from the direct taxes and Rs.68 crore from the indirect taxes. As proportions of actual tax burden, as may be observed from Table 8, estimates of untapped total tax revenue worked out to 12 to 14 per cent of the total tax burden on the farm sector during the Third Plan and Annual Plans periods. In other words, to bring about equity in incidence of taxation between the farm and the non-farm sectors, the present incidence on the farm sector would have to be raised by about 14 per cent.

Table 8 Significance of Untapped Total Direct Tax Potential - Farm Sector

Annual Average for	Untapped Indirect Tax Revenue Potential (Rupees, Crore)	Estimates of Actual Indirect Tax Burden on Farm Sector (Rupees, Crore)	(2) vs Percentage of (3)	Untapped Total Tax Revenue Potential (Rupees Crore)	Estimates of Actual Total Tax Burden on Farm Sector (Rupees, Crore)	(5) vs Percentage of (6)	(2) vs Percentage of (6)	Direct Tax Potential (Rupees, Crore) Col. (5) - (2)	(9) vs Percentage of (6)
1	2	3	4	5	6	7	8	9	10
First Plan	26	178	16	47	256	19	10	21	8
Second Plan	17	311	5	44	419	11	4	27	6
Third Plan	68	669	10	94	806	12	8	26	3
Annual Plan	116	1057	11	160	1186	14	10	44	4

Note: For untapped direct tax revenue potential, see Table 5 here

Table 7 : Estimates of Potential Total Tax Revenues from the Farm Sector on Equity consideration with Tax Burdens and Non Farm Sector

Year / Period	Personal Fram Income (a) (Rupees, Crore)	Proportion of Farm Income Appropriated by Middle Income Group (Rupees)	Estimates of Farm Income Appropriated by Middle Income Group (Rupees, Crores)	Estimates of Potential Tax Revenue Untapped Middle Income Group as % Group Income Amount (Rs, Cr)		Proportion of Farm Income Appropriated by Top Income Group (b) (In Percentage)	Estimates of Farm Income Appropriated by Top Income Group (Rupees, Crore)	Estimates of Potential Tax Revenue Untapped Top Income Group as % Group Income Amount (Rs, Cr)		Estimates of Total Tax Revenue Untapped (Rupees, Crores)	Or Total Tax Potential Untapped Potential Direct Tax Indirect Tax	
1	2	3	4	5	6	7	8	9	10	11	12	13
1951-52	5225	28.4	1484	2.0	30	2.0	105	17.6	18	48	22	26
1952-53	5025	28.4	1427	2.0	29	2.0	101	17.6	18	47	21	26
1953-54	5530	28.4	1571	2.0	31	2.0	111	17.6	20	51	24	27
1954-55	4575	28.4	1299	2.0	26	2.0	92	17.6	16	42	19	23
1955-56	4750	28.4	1349	2.0	27	2.0	92	17.6	17	44	21	23
Average for First Plan	5020	28.4	1426	2.0	29	2.0	100	17.6	18	47	21	26
1956-57	5760	23.7	1365	0.9	12	2.0	115	24.6	28	40	25	15
1957-58	5525	23.7	1309	0.9	12	2.0	111	24.6	27	39	24	15
1958-59	6490	23.7	1538	0.9	14	2.0	130	24.6	32	46	28	18
1959-60	6510	23.7	1543	0.9	14	2.0	130	24.6	32	46	28	18
1960-61	7155	23.7	1696	0.9	15	2.0	143	24.6	35	50	30	20
Average for Second Plan	6288	23.7	1490	0.9	13	2.0	126	24.6	31	44	27	17
1961-62	7235	24.6	1780	3.0	53	2.0	145	16.2	23	76	21	55
1962-63	7280	24.6	1791	3.0	54	2.0	146	16.2	24	78	21	57
1963-64	8460	24.6	2081	3.0	62	2.0	169	16.2	27	89	24	65
1964-65	10793	24.6	2655	3.0	80	2.0	216	16.2	35	115	32	83
1965-66	10499	24.6	2583	3.0	77	2.0	210	16.2	34	111	31	80
Average for Third Plan	8853	24.6	2178	3.0	65	2.0	177	16.2	29	94	26	68
1966-67	12364	24.6	3042	3.0	91	2.0	247	16.2	40	131	36	95
1967-68	16386	24.6	4031	3.0	121	2.0	328	16.2	53	174	48	126
1968-69	16386	24.6	4031	3.0	121	2.0	328	16.2	53	174	48	126
Average for Annual Plan	15045	24.6	3701	3.0	111	2.0	301	16.2	49	160	44	116

(a) See table 5 in chapter 1

(b) See Table 1 in chapter 4

(c) See table 12 in chapter 4

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It may be observed from the above data that as between the two taxes, the untapped potential has always been higher in respect of indirect taxes than direct taxes. In absolute terms, even the indirect taxes untapped potential was relatively low during the first two Plan periods, but during the Third Plan and Annual Plans, it rose considerably. While untapped direct tax revenue potential worked out to hardly 3 to 4 per cent of the total tax burden on the farm sector during the Third and Annual Plans periods (Table 6), untapped potential of indirect taxes worked out to about 8 to 10 per cent during the same periods (Table 8).

Limited Scope for Steeply Progressive Direct Taxation in the Farm Sector

One of the important objections against the existence system of direct taxation in the farm sector is that the sector has been enjoying a highly differential tax advantage compared to the non-farm sector. **We have estimated the extent of this differential and found that while the thesis of the differential tax advantage is valid, the extent of the differential appears to be exaggerated.**

The results presented above provide an answer to the question raised at the outset, namely, if the farm sector were also subjected to the same incidence levels as those on the non-farm sector, what is the quantum of potential tax revenue obtainable from that sector? To put it precisely, albeit crudely, the answer was that about Rs. 44 crore could be obtained from the farm sector as additional direct tax revenue, if a highly progressive system of direct taxation as the one prevailing in the non-farm sector were applied to the farm sector. This was based on the assumption that the existing

administrative and legal constraints which considerably dilute the tax base in the non-farm sector, would operate in a similar way in the farm sector. If a better and more efficient system of administrative and legal framework is assumed, the revenue potentiality could still be higher. However, that possibility is ruled out here.

Here, it must be emphasized that, besides the administrative and legal framework of taxation assumed as given, there are other characteristic features of the present farm economy which are likely to dilute further the tax base if a steeply progressive direct taxation as the farm sector. The factors are: (1) land reforms and changes in land distribution; (2) larger size of households (with more than one number of workers in majority of households); and (3) scope for under-reporting of income inherent in the farm practices.

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Size of Household and Number of Workers Per Household: Scope for Legal Evasion

We have already mentioned the size of households being considerably larger in the farm households than in the non-farm households. Directly relevant to the issue of a progressive tax on the farm sector is that both the size and number of workers in farm households increase with the size of land. This is a known phenomenon; nevertheless the data in Table 10 from the Sixteenth Round of the National Sample Survey on Land Holdings are revealing. **The average size of households is as high as 8.35 in the highest size group of operational holdings of 50.0 acres and above and in this group, the average number of working members is 4.16. This shows the extent to which the legal division of land holdings is possible.** This division may be entirely different from the division resorted to for circumventing the ceilings and tenancy laws. It is conceivable that even under existing level of productivity there is scope for levying a progressive agricultural income-tax even after the imposition of ceilings but the effectiveness, revenue-wise, of such progressive taxation can be considerably diluted, for the existence of such large sizes of households and working members obviously provides considerable leeway for the households to partition their holdings and show more than one assessee.

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Groves, who made a pioneering study in this field, has made the following observations: "It is commonly agreed that of all groups which the income-tax seeks to reach, farmers are the most difficult." For recent years, however, these results have been questioned.

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Reporting is based on tax morality and there is no reason to believe that, in this regard, the farm population are less dependable than the non-farm population. To the extent tax morality is a function of factors like literacy and the capacity to keep farm financial accounts, it is conceivable that the farm population in India today are less efficient in tax reporting than their counterparts in the other sector. Here, there are two factors which appeal to reasoning. First, ironically, it is greater literacy and knowledge of tax laws that is mainly responsible for the under-reporting of incomes among the non-farm population, particularly those small-scale businessmen, traders and merchants in whose case there is considerable tax dodging. Secondly, a phenomenon likely to be true of illiterate peasantry is that "there is some cause for suspecting that poor records instead of leading to under-statement of income, often result in over-reporting." It is thus conceivable that poor farm households in their accounts omit more expenses than they do of their gross income.

Another difficulty cited for taxing farm incomes is that for a farm household there is no clear-cut distinction between business and personal accounts. Again, this need not be a problem peculiar to farming; all small business and professional firms, especially un-incorporated ones, would be so. If the extent of it is more in farming, it is not restricted to the family expenditure side alone. As shown in the preceding paragraphs, every large land-operating household has three to four family workers who contribute to income.

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The Implications of these for a tax policy for the farm sector is that given the existing structure of indirect taxes, larger revenue yields are possible only if there is greater monetization and relatively larger purchases of manufactured goods by the farm sector. The monetization and diversification of the consumption pattern of the farm households are a slow and gradual process, for by and large they are the result of the process of economic development itself.

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It is sometimes suggested that agricultural income-tax may be imposed on a household (family) income rather than on the legal owner of land. While such a precaution is necessary in the law, it is to be conceded that there is still considerable scope for partitioning the landed property, for the legal definition of a family cannot be stretched too far. Two married brothers claiming to be separate households cannot be compelled to submit one income-tax return. It should be obvious that such possibilities are many among farm households.

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CHAPTER 6: A Policy Framework for Reforms in Agricultural Taxation

The significant result of the present study is that the thesis of under-taxation of the farm sector vis-à-vis the non-farm sector, strictly viewed from the principle of equity, is found to be exaggerated at least insofar as the first fifteen years of planning are concerned.

Besides, there is a vast divergence between the legal incidence as shown in the tax rate schedules and its actual incidence in practice. Over the years, this divergence has also got further widened rather than reduced. This in turn is explained by two factors. First, the provision for a number of personal allowances and tax exemptions either dilute the tax base or lighten the tax burden. The second and the most important factor is the scope for tax evasions and avoidances which seem to take place on a wide scale.

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A large proportion of national income originates in the farm sector (about 48 to 50 per cent), but the taxable high-income households (with income above Rs.3000 per annum) within the sector pay hardly 2 per cent of their income as direct tax, as compared to more than 6 per cent paid by the corresponding non-farm households.

Dynamic Situation

The contention of this chapter is that, in such a situation, the present direct tax structure in the farm sector, in its totality, is sure to prove inflexible as it cannot keep pace with the increases in money incomes. There is also lack of progressiveness in the system which has obviously created vertical inequality within the farm sector and some inequity between high-income groups of the farm sector

and their corresponding classes in the non-farm sector. These defects have got to be eliminated in any system of taxation contemplated for the future.

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Thus, land revenue receipts increased from Rs.49.6 crore in 1950-51 to Rs.83.7 crore in 1956-57 and the bulk of the increase during this period could be attributed to the abolition of intermediaries. But, by 1963-64, the land revenue receipts had gone up to Rs.123.7 crore, showing an increase of Rs.40 crore, only a small portion of which could be attributed to abolition of intermediaries.

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The farm economy consists of “numerous small holdings, a large proportion of them being uneconomic, a small number of middle peasants, and a sprinkling of substantial owners”.

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Two guiding principles regarding future farm taxation policy emerge from this situation. One of the ingredients of the tax policy should be to provide for “a means of mass taxation which would raise large amounts from a broad segment of the agricultural population without imposing excessive burdens on particular groups”. Secondly, while direct fiscal tools are necessary from the viewpoint of equity and plugging of loopholes, substantial resource mobilization is possible only by combining many fiscal and para-fiscal methods and by putting them into effective operation at different points of time and in different areas depending upon the widening of the tax base.

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Continuation of Land Revenue As a Mass Taxation

Such inter-regional disparities in tax burden could be surely corrected by other measures such as betterment levy, for increases in land productivity in certain regions could be largely attributed to public programmes like irrigation facilities and therefore, a part of the betterment, revenue, could as well be taxed through rationalized land revenue, could as well as taxed through betterment levy. Thus, the total incidence may be made more equitable between different regions of a State and to some extent, even between different income groups.

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After concluded that “as long as land revenue remains a tax in rem instead of a tax in person, equity as we understand in the modern theory of taxation cannot be infused into the land revenue system.

An attempt may be made by all the States to introduce some progressively graded surcharges on land revenue assessments so as to make land revenue appear as progressive as possible. In order to make it effective, the surcharges may be imposed on family holdings rather than on individual holdings.

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Substantive Measures

(1) An agricultural income-tax on the same lines as the Central income-tax on non-farm personal incomes should be introduced by all the States, though its application may be done in stages depending upon the regions and crops; (2) all other direct taxes applicable to non-farm households, namely, wealth tax, with lower levels of exemptions; (3) a progressive betterment levy should be

imposed in all areas where important public projects have helped increase land value and output , and higher levels of water rates and electricity charges should also be imposed; and (4) since it is imperative that indirect taxes form a significant proportion of total revenues of government in a developing economy, some additional imposts on farm-oriented commodities-inputs as well as consumption goods may be made.

Agricultural Income-Tax:

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In India, while the legislation for the betterment levy has been enacted in almost all the states, "almost everywhere, enforcement of legislation has lagged behind". Therefore, the revenue receipts are meagre; for instance, during the Second Plan period, the actual realizations were only about Rs.3 crore against the estimate of Rs.47 crore. There is thus considerable scope for increasing realization from this source.

Incidentally, though it is not strictly a tax measure, an obvious issue linked with the realization of larger revenues from irrigation projects is the low levels of water rates. It is observed that "state governments are at present incurring commercial irrigation works including multi-purpose river projects." These irrigation facilities, thus made available only to the people in the areas commanded by the system, impose a heavy burden on the rest of the community. It is imperative that only those people who benefit from the system should bear the burden. The Committee to Suggest Ways and Means of Improving Financial Returns From Irrigation Projects made a number of suggestions, such as (1) fixation of irrigation rates at 25 to 40 per cent of the additional net benefits to farmers gross income from irrigated crops, (2) a levy of compulsory surcharge sufficient to cover at least the maintenance and operation charges, (3) imposition of betterment or capital levy. These measures call for urgent attention from State Governments in the interest of vertical equity and resource mobilization.

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Raising Incidence of Indirect Taxation

As brought out in the previous chapter, as between direct and indirect taxes, the latter show, in quantitative terms, a significantly higher untapped potential than the former. While the differences in the indirect tax incidence as between the farm and the non-farm sectors are largely explained by the existing patterns of consumption and methods of production, it should be possible to devise indirect tax measures which would relate to the existing pattern of consumption in the farm sector. Thus, those items which at present enter into the consumption of households and those which form a significant part of inputs may have to be taxed heavily. As for taxing inputs, the additional imposts may be adopted in stages as the farm incomes grow and as the adoption of new farm practices and technology gets stabilized.

In this regard, the Government has already imposed a Central excise duty on fertilizers and power-driven pumps. These may be gradually extended to other important inputs like pesticides, tractors, and other types of agricultural machinery. Even the rates of duty may be raised gradually.

Among consumer goods, the most important omission at present is salt. The Indian polity is gradually sliding away from the days of sentiments.

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The consumption pattern, as revealed by the National Sample Survey, shows that per capital expenditure on salt is more in the farm sector than in the non-farm sector.

Because of the considerably low levels of prices, salt tax had a psychological advantage unlike taxes on other commodities whose prices are already high. The incidence will go almost unnoticed. There is thus considerable scope for raising its price by two to three times, albeit gradually; finally it will fetch an additional revenue of approximately Rs.150 crore per annum when the current salt price level is raised by about 300 per cent through the salt tax. In terms of additional household expenditure, the impact will be almost insignificant and that too will be more equitably distributed. Our estimates show that when the salt price is raised by 300 per cent through salt tax, a household belonging to the lowest expenditure bracket (Rs.1-50) in the 'rural' sector will have to pay less than Rs.6 per annum, while the highest expenditure bracket (Rs.301 and above) will have to pay about Rs.25 per annum.

The results of the National Sample Survey on Consumption Expenditure reveal that on certain consumer goods like domestic utensils, cash expenditure incurred by high expenditure farm households is more than the cash expenditure incurred by the corresponding non-farm households. Similarly, there are certain other commodities like sugar, tobacco and oils on which these high expenditure brackets almost spend equal amounts in farm and non-farm sectors. There is thus scope for raising the indirect tax levels on these commodities with a view to making the high-income farm households bear a higher burden of indirect taxes.

Before we conclude, two more observations must be made. First, the three important characteristics of the farm economy revealed by us are; (1) a limited number of 'large' incomes; (2) wide dispersal of income and wealth, and (3) limited monetization. Therefore, the basic objective of tax reform, namely, the achievement of equity and progressivity, productivity, and income-elasticity cannot be achieved with the help of any single tax measure. As Wald put it, "a prudent fiscal policy requires selecting the best possible combination of revenue measures rather than relying on any one measure alone." The policy framework presented here and the broad but integrated system of agricultural taxation built up thereon have kept that objective in view.

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Practically every scholar or authority who has examined the problem of agricultural taxation in the context of Indian reality has come to the conclusion that land revenue should not be given up. The Taxation Enquiry Commission had said thus.

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The main defects of the system are: (1) in some of the States or regions land is still un surveyed and unsettled and assessments fixed in the past followed no scientific principles; (2) even where lands have been undertaken though they were due almost three to four decades ago; (3) there are also disparities in settlement periods in individual States; (4) land revenue as at present fixed in unresponsive to prices and production; and (5) it lacks progression.

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The Centre, which is confronted with a heavy demand from states for development funds, without commensurate efforts at resource mobilization, has two alternatives: (1) The Centre may persuade the states to get a constitutional amendment to this effect passed so that agricultural income can also be taxed as an integral part of total income. The Centre can also wave the olive-branch of entire revenue being assigned and distributed to the states. Here, the unsavoury part of the imposition

goes to the Centre while the states get the necessary revenue. This is what the Centre should attempt to achieve in the long run. (2) The immediate alternative is to persuade all the states to impose agricultural income-tax by incorporating as many features of the central personal tax as possible, and for this purpose, the Centre may adopt carrot and stick method by withholding or increasing the development grants to the states depending upon their performance in the field of agricultural taxation.

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It should be noted that any one measure may appear insufficient from the viewpoint of resource mobilization on an equities basis. Instead, a combination of these measures is called for.

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According to the Thirteenth Round of the NSS, cash expenditure on domestic utensils per capita for a period of 30 days in respect of the highest expenditure class of Rs.301 and above was Re.0.58 in rural areas and Re.0.14 in urban areas. See the NSS Thirteenth Round, op. cit., pp.43 and 103.

Key Substantial Measures

Direct Taxes

- (i) Continuation of Land Revenue as a marked taxation**
- (i) Some progressively graded surcharges on Land Revenue assessments**
- (ii) Strengthening of agriculture income tax**
- (iii) Strengthening of the current betterment levying systems which are considerably lagging behind**
- (iv) Improving the corrections of irrigation charges**

Indirect Taxes (Using NSSO data on Consumer Expenditure)

- (v) Introduction of Salt Tax**
- (vi) Sales Tax on expensive domestic utensils**
- (vii) Sales Tax on some agricultural inputs**
