*e*conomics Division Working Papers

Development Issues

Fiscal policy and tax regimes: a cross-national analysis of comprehensive reform in Australia, New Zealand, India, Pakistan and Philippines

Muhammad Aslam Khan

95/5

School of Pacific and Asian Studies ANU

Enquiries
The Editor, Working Papers
Economics Division
Research School of Pacific and Asian Studies
The Australian National University
Canberra 0200
Australia

Tel (61-6) 249 4700
Fax (61-6) 257 2886

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Key to symbols used in tables

n.a.	Not applicable
..	Not available
-	Zero
.	Insignificant

Muhammad Aslam Khan has recently completed his PhD in Development Administration in the National Centre for Development Studies in the Research School of Pacific and Asian Studies at the Australian National University. He has returned to Pakistan, where he is Deputy Director of the Department of Planning.

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abstract

This paper overviews public finance in Australia, New Zealand, India, Pakistan and Philippines and describes how policies relating to public expenditure, revenue mobilisation efforts and intergovernmental relations influence central and state government relations. It describes the structure of government, the assignment of expenditure and taxing powers to each government level, and the fiscal conditions at the various levels of government. Centralisation issues and policies for decentralisation are discussed and their impact on expenditure functions and taxing powers at different levels of government are investigated. The paper also discusses the implications of vertical fiscal imbalance. The equity of the revenue-sharing system is evaluated in relation to revenue capacity and expenditure needs at different levels of governments. Analysis in this paper has benefited from visits to New Zealand, Philippines and Thailand, as well as a field survey of eight districts within the four provinces of Pakistan between November 1993 and April 1994.

fiscal policy and tax regimes: a cross-national analysis of comprehensive reform in Australia, New Zealand, India, Pakistan and Philippines

The tax reform movement is almost universal. During the 1980s (now considered the decade of tax reform) a majority of countries introduced comprehensive reform of medium and long-term fiscal policies, with consideration given to structural issues, growth, inflation, the provision of public goods and income distribution. In the process, tax bases were broadened through the rationalisation of tax incentives and tax rates. Many governments reduced the tax burden on incomes by shifting to broad-based consumption taxes. Efforts were made to harmonise the tax structure through the adoption of a uniform taxation system (Khalilzadeh-Shirazi and Shah 1991:xvi).

The objective of this paper is to review fiscal policies and practices in selected countries. Of the five countries analysed, two have a unitary form of government and three are federations. New Zealand and Philippines moved swiftly to adopt comprehensive tax reform. Australia, India and Pakistan have been cautious, moving slowly to broaden their tax base. All have considered the adoption of broad-based consumption taxes. The countries with a unitary form of government (New Zealand and Philippines) have adopted a consumption-based value-added tax, whereas in countries with a federal form of government (Australia, India and Pakistan) the tax has either been rejected by popular vote or is being considered for adoption.

Australia

The federation of Australia has three levels of government: a Commonwealth government, six sovereign states and two mainland federal territories, and over 900 local government authorities. The Australian Constitution confers exclusive power on the Commonwealth to levy customs and excise duties, coin money and initiate referenda for constitutional change. The Commonwealth, however, exercises a large number of concurrent powers with the states, in which its laws prevail in the event of conflict. Over time, the Commonwealth has established substantial legislative and administrative authority around each of these powers. In this arrangement, the states have retained residual legislative responsibility for the bulk of provision of services such as maintenance of law and order, education and health.

All the major taxes—income tax, customs and excise duties and taxes on production and distribution—are collected by the Commonwealth (Table 1). The taxes available to states, though numerous (with the exception of payroll taxation) are narrowly based, and collection is inefficient (Rye and Searle 1994:12). The Commonwealth has had a monopoly over major taxes since 1942 (Mathews 1985:9). The Commonwealth assumed control over income taxation as a wartime measure, and this continued after World War II on the justification of maintaining macroeconomic stability, income distribution and simplicity of taxation administration (Walsh 1991:9). In the late 1940s a High Court decision barred the states from imposing any form of consumption tax on the grounds that they are excise duties (Mathews and Jay 1972:131–2).

The composition of total public sector outlays is such that the Commonwealth share is slightly above state and local government expenditure assignments (51 per cent of total outlays; 54 per cent of current outlays, primarily in social security, health benefits and defence; and 24 per cent of capital outlays). The states' share of current expenditure

Table 1 **Structure of the Australian public sector, 1990–91** (per cent)

	Commonwealth	State	Local	Total public sector
Outlays				
Current	54	42	4	100
Capital	24	62	14	100
Total	51	44	5	100
Own-source revenue				
Taxation	78	18	4	100
Total	72	24	4	100
Net debt[a]	30	66	4	100
Capital stock[b]	17	88[c]	-	100
Employment[d]	23	67	10	100

[a] As at 30 June 1990.
[b] Share of total net capital stock (excluding public financial enterprises).
[c] For 1989–90, including local governments.
[d] Share of total employment.
Sources: Walsh, C. and Thomson, N., 1994. *Federal Fiscal Arrangements in Australia: their potential impact on urban settlement*, Federalism Research Centre, The Australian National University, Canberra; Commonwealth of Australia, 1993. *Commonwealth Finance Relations with Other Levels of Government 1993–94*, Budget Paper 3, Commonwealth Government Printer, Canberra.

(42 per cent) is predominantly in education, hospitals, transport, housing, road construction, maintenance of public order and safety, and community amenities. The states' share of capital outlays, however, is 62 per cent (Walsh and Thomson 1994:2). The Commonwealth also exerts a disproportionate influence on general expenditure decisions in policy areas through specific purpose payments in areas where it has no explicit constitutional authority (Fletcher 1992:2).

The Australian taxation structure has developed many weaknesses including high taxes on personal incomes (Freebairn 1990:16, 1992:29; Chessell 1993:6), an inefficient indirect tax system and a centralisation of intergovernmental relations (Walsh and Fletcher 1994:6). Taxes on personal incomes as compared to other countries in the region are high (Table 2). The major indirect tax—the wholesale tax—is administratively complex, inequitable and inefficient (Tait 1988:34). The system is riddled with exemptions and arbitrary rate differentiations, and in its present shape is highly discriminatory and distorting in its effect (Head 1985:123). Among many committees and reviews on Australian tax reform, the Asprey Taxation Review Committee (1975) and the Fightback tax package (Chessell 1993) have recognised the need for comprehensive tax reform. The recommendations of these committees/packages/ reviews, however, have not been implemented in full.

The system of sharing fiscal responsibilities in the federation of Australia has changed over time as the country's political, social and economic situation has changed. The *Surplus Revenue Act 1910* introduced the per capita principle of distribution of revenues. The introduction of financial assistance grants in 1959 paved the way for *ad hoc* assistance to the weaker states outside the Grants Commission arrangements. Between 1972 and 1975 the Whitlam (Labor) government introduced significant expansion of specific purpose grants augmenting the Commonwealth's role in areas such as transport, health, education, housing, urban and regional programs. The Fraser (Liberal) government's efforts to limit the role of tied grants in Commonwealth financial assistance to the states in favour of general revenue-sharing arrangements from 1976–77 provided the states with greater certainty and flexibility within a context of restrained growth in total grant transfers from the Commonwealth (Fletcher and Walsh 1991:6). These are some examples of the switching of policies on issues relating to intergovernmental relations. But over time, there has been a strengthening of federal government involvement in a range of state policy areas outside its formal constitutional jurisdiction (Sharman 1988:18).

The current system of fiscal equalisation was introduced in 1978 with the justification of improving the horizontal fiscal imbalances (inequality in the expenditure and revenue needs and revenue capacity of governments at the same level), and providing comparable services to the citizens in all states, and is seen as the best form of horizontal equalisation for all federations (Mathews 1994:1). The equalisation process concentrates on methods for distributing financial benefits to the states as a way of allowing the

Table 2 **Variations in individual income tax structure, selected countries, 1985–93**

	Number of slices[a] (including zero-rated first bracket)		Tax rates % 1985		Tax rates % 1993	
	1985	1993	Lowest slice charged	Highest slice charged	Lowest slice charged	Highest slice charged
Australia[b]	6	5	30	60	20	47
New Zealand	5	2	20	66	24	33
Indonesia	19	3	5	50	15	35
Korea	16	5	6	55	5	50
Malaysia[c]	9	9	4	35	2	34
Philippines						
Fixed income	37	10	3	70	-	35
Self-employed	37	5	3	70	3	30
Pakistan	8	4	15	60	10	35
Singapore[d]	14	14	3	33	2	30
Thailand	11	5	7	55	5	37
Japan[e]	15	5	10	70	10	50

[a] Countries with zero-rated first bracket: number of slices includes zero-rated first bracket but the lowest tax rates are the first positive rates.
[b] 1993 rates as of 1 November 1993.
[c] Took effect in 1993 covering income of 1992.
[d] Assessment took effect in 1994.
[e] Applicable from 1988.
Sources: Organization for Economic Cooperation and Development, 1987. *Taxation in Developed Countries*, OECD, Paris.

states to develop their fiscal capacity to provide equal services to all Australians (Fletcher 1992:4). In this arrangement, inter-regional differences in economic performance on a per capita basis generate substantial implicit inter-regional transfers from the Commonwealth, in which high incomes are associated with relatively high federal tax liability, and low incomes with relatively high receipts of Commonwealth transfer payments (Walsh 1991:32).

The equalisation arrangements have provided a powerful mechanism to the federation of Australia, in which states are held together by providing comparable standards of living to all regions. The equalisation process allows states to have an opportunity through the maintenance of their fiscal capacity to provide a fair standard of services to their citizens. Fairness is a central part of regional development in Australia, and is a central part of policies ranging from social justice through to regional economic reform (Fletcher 1992:9). The equalisation mechanism, despite its many advantages, is open to criticism. Being a federal activity, the equalisation process allows the central government to assume the mantle of uniformity by assessing the needs of regional people rather than of regional governments. The rapid shift in the balance of Commonwealth grants towards tied (specific purpose) grants in recent years illustrates the growing attempts to centralise power (Walsh 1991:7). In the equalisation process, it is possible that a state may be discouraged from levying a particular form of taxation because of a fear that the additional revenue gained from the tax will be offset by a reduction in the amount of the grants. The Commonwealth Grants Commission procedures are, however, designed to minimise this possibility (Mathews 1985:2).

Furthermore, the vertical imbalance (mismatch between expenditure requirements and revenue sources of government at different levels) in the distribution of financial resources between the Commonwealth and the states may threaten the stability of the horizontal fiscal equalisation system (Mathews 1993:ix). With growing Commonwealth involvement in state fiscal jurisdiction through special purpose grants, the Australian fiscal arena is becoming more centralised compared with other federations (Barwise and Castles 1991:6; Galligan, Hughes and Walsh 1991:5). As a result, the fiscal arrangements in the federation of Australia are more like those of unitary countries among the developed nations (Walsh and Thomson 1994:5). If the growing Commonwealth monopoly in financial matters is not properly addressed, vertical imbalances are likely to weaken the equalisation process in the country.

New Zealand

New Zealand's constitutional traditions are derived principally from British experience. Unlike Great Britain, however, New Zealand's parliament is a unicameral House of Representatives. In the absence of a written constitution the parliament enjoys remarkable support and institutional continuity (Jackson 1987:ix). In this unitary form of government, the central government enjoys substantial power while the local authorities play a subordinate role. The central government deals with matters affecting the state as a whole, while the local authorities and territorial and *ad hoc* agencies deal with matters that are local in their application. The local authorities are creations of parliament, so they act only within the limits of their authorised statutes, and have no powers other than those explicitly granted to them.

New Zealand has in recent years implemented the most radical economic adjustment program of all the Organization for Economic Cooperation and Development (OECD) countries. The principal reform measures have been the policy of corporatisation *(State-owned Enterprises Act 1986)*, which transformed government trading entities into companies, and the *State Sector Act 1988* which substantially altered employment arrangements in the public service. Through the *Public Finance Act 1989*, the New Zealand government sought to reduce the size of government by both trying to impose controls on public expenditure through placing cash limits and by increasing tax revenue. The *Local Government Act 1988* rationalised the structure of local governments: the number of regions were reduced from 22 to 14; territorial authorities were reduced from more than 200 to 74; and the number of *ad hoc* or special purpose authorities dropped from over 400 to six. The *Local Government Amendment Act 1992* redefined the functions, duties and powers of regional councils. New Zealand is experiencing positive economic results from these reforms: fiscal deficits have been controlled to a moderate level; domestic production, especially exportable production, has increased; and inflation at around 1 per cent is at a record low level (Table 3).

Fiscal management in New Zealand is highly centralised, with only restricted fiscal powers given to local government units. The central government uses local bodies to carry out specific functions, rather than recognise them as having independent and autonomous status. Powers of local authorities are only those which have been conferred by the parliament and their involvement in fiscal management is small. The regional councils, territorial authorities, community boards and special authorities together collect approximately 5 per cent of total consolidated revenues and spend less than 5 per cent of total expenditure. Local authority rates are the only form of tax revenue beyond the direct control of the central government. Prior to 1988 there were in place various central government revenue assistance schemes to local governments, mainly in the form of subsidies, levies and grants. These have now been largely phased out to the point where regional, territorial and community boards are now funded

Table 3 **New Zealand: demand, output and prices, 1990–94** (per cent)

	1990	1992	1994
Private consumption	-0.8	1.9	2.2
Government consumption	1.0	-0.4	-0.4
Gross fixed capital formation	1.9	2.8	6.4
Final domestic demand	0.2	1.7	2.8
Change in stocks	-0.2	2.2	0.2
Total domestic demand	-	3.8	2.9
Export of goods and services	7.1	-0.1	6.1
Imports of goods and services	4.3	7.9	4.3
Change in foreign balance	0.4	-3.5	0.3
GDP (expenditure at market prices)	0.5	0.6	3.5
Consumer prices	6.4	1.0	1.5
Unemployment rate	7.9	10.3	9.7

Source: Organization for Economic Cooperation and Development, 1993. *Economic Outlook 53*, OECD, Paris.

from property rating, raising loans and charging for services. In the case of special purpose authorities, those that remain receive either central government funding via a contractual arrangement, or charge for their services in an entrepreneurial manner.

In the early 1980s, most New Zealand government revenue came from direct taxes—taxes on income, profits and wealth. Of the 75 per cent in direct taxes, the major share was derived from taxes on income; of the 25 per cent of the total taxes gathered by indirect taxes, 6 per cent came from customs and excise duties and 19 per cent from all other indirect taxes. The wholesale tax rate varied from 10–60 per cent with a large number of exempt goods and services, and thus had highly distorted effects. As recognised in the 1987 Budget, the tax system was unable to provide adequate revenue because of its heavy reliance on income-based taxes. The tax system was also widely believed to be unfair in its erosion of the income base by concessions and by the exploitation of loopholes. High marginal rates of income tax encouraged the growth of non-taxable forms of income.

Since the mid-1970s, the New Zealand government administrations of both the Labour (1984–90) and National (1990–95) parties have adopted radical policies to improve the social and economic management of the country. Fiscal policies have been implemented to reduce budgetary deficits, increase social expenditure and reduce unemployment (Bollard 1992:3). The major objective of the tax reform program has been to correct the anomalies in the tax structure, so as to be compatible with the needs of a growing economy and more responsive to international market forces. To this end, a variety of base-broadening measures have been introduced along with the removal of many selective tax incentives and non-uniform tax rates. A family assistance package was designed to protect low-income families and social security beneficiaries from any regressive impact of the efficiency-oriented tax reform package. The 1986 tax reform focused heavily on reducing income tax rates and substituting a wholesale tax with a goods and service tax (GST), so as to be as neutral as possible in terms of its impact on spending and investment decisions (Bollard 1992:4).

The average marginal income tax rate has been reduced from 66 per cent to 33 per cent, with only two statutory rates of income tax for households, and only one for companies. Almost all tax exemptions have been abolished (OECD 1989). Where there was a narrow base of wholesale taxes, the GST now covers approximately 300,000 effective registered taxpayers. The GST has become an efficient source of government revenue that has helped the government reduce the fiscal deficit from 10.9 per cent of GDP in 1983 to 4.2 per cent in 1992 (International Monetary Fund 1993). These reforms have had a positive impact on macroeconomic management, but the level of unemployment (approximately 10 per cent) is still very high (Table 3).

On the distribution side, however, improvement in New Zealand government revenues has not been shared equally. With large cuts in personal income tax occurring only at the top end of the income distribution, and without any exemptions for necessities, a greater burden has been imposed on low-income groups. Many of the expenditure policies introduced have had an adverse impact on low-income groups. Shipley (1990:1–4) has shown that the poor have been the greatest losers from the reforms, both in absolute dollar terms and in terms of percentage of income. This position was aggravated in April 1991 by a series of cuts in social security benefits to reduce government expenditure (Franklin 1991:156). The government policy objective adopted since 1988 to allocate government expenditure for social sector development to provide a 'modest safety net' is yet to be realised.

In the reform package, many social and community service functions have been transferred from central government to local governments, but without matching funding. The burden of this action is likely to fall heavily on communities with relatively limited resources, especially on district and regional councils facing high unemployment and limited economic resources such as Northland, the East Cape of the North Island, and the West Coast of the South Island.

The reforms have had a healthy impact on the economic situation of the country, especially on growth and fiscal management. Over-centralisation, and devolution of various functions by the central government to local governments without providing adequate funding, is likely to put pressure on the local governments' inadequate resource base. This is likely to result in tension within communities and between local and central governments.

Philippines

The Constitution of the Philippines provides for a presidential form of government, composed of an executive branch, a judiciary and a bicameral congress. Administratively, the country is divided into regions, provinces, cities, municipalities and *barangays*. In this multi-tier system of policymaking and implementation, the formulation of economic policy is a responsibility shared by both the executive and legislative branches of government. Most economic legislation is initiated by Congress with the explicit endorsement of the executive branch. In addition, the President can issue executive orders which have the force of law in certain economic areas—but only when Congress is not in session. The existing institutional infrastructure in which the central government has absolute power leaves little opportunity for representation of local government units.

In the 1960s and 1970s, prolonged domestic political turmoil limited the Philippine government's capacity to implement structural adjustment policies. Financial, managerial and technical weaknesses in several key public institutions, along with bureaucratic resistance to policy changes, adversely influenced the government's policy programs and outcomes. President Marcos' administration (1966–86) also adversely influenced public institutions through excessive interference, particularly directed to the interests of his cronies. During this period most government policies designed to expand the economy were largely unsuccessful. Fiscal sector performance was especially dismal. Tax policies initiated during the Marcos period, such as a temporary import levy, gross receipts tax on financial intermediations and various stamp taxes and fees, reduced allocations for public infrastructure and maintenance, and reduced the wages of public employees. These measures temporarily improved public finances in the mid-1980s, but led to social tensions which forced the government to abandon them (World Bank 1993:ix).

Many reforms aimed at removing the distortions in the Philippine economy and achieving long-term economic growth were undertaken during the Aquino administration (1986–93). These reforms included the implementation of a comprehensive agrarian reform program, the liberalisation of trade and industry policies aimed at promoting competition and efficiency, a debt management policy, and the streamlining and decentralisation of the government bureaucracy. The fiscal policy of the Aquino administration focused on measures designed to raise revenues and optimise the use of scarce budgetary resources (Dickno 1986). The 29 measures of fiscal sector reform included a renewed emphasis on increasing government revenue, rationalising the income tax structure, rationalising the system of taxing goods and services, simplifying tax administration and more equitable sharing of the tax burden (Yoingco, Montego and Palugod 1988:87; National Taxation Reform Commission 1986:1). The most notable of the fiscal reforms was the introduction of a broad-based, consumption-type value-added tax.

Over the last 10 years the continued emphasis on fiscal reforms has had a healthy impact on Philippine government finances. Tax buoyancy and elasticity have improved. A reduction in the outstanding debt level has been achieved and greater control has been established over public expenditures. The full benefits of these reforms have not been realised, however. Growth in government revenues has been limited by institutional weaknesses (particularly in tax administration), lack of availability of skilled personnel, presence of complicated rules and regulations, centralised bureaucratic controls and limited computerisation of tax administration. Poor revenue collection (especially of value-added tax) and increased public sector expenditure have resulted in increased public sector borrowing, which has increased both domestic and external debt (Table 4). Because of the growth in GDP, however, total external and domestic public debt as a percentage of GDP declined since 1988 to an average of about 80 per cent of GDP in 1991 (Table 4).

Another problem hampering improvement of the fiscal system is the central Philippine government's relationship with local government units. Further clashes of interests at each level of the local government units' administration has undermined their collective and coordinated efforts for the development of their area and for

Table 4 **Phillipines: outstanding domestic and external debt of the national government, 1985–91 (billion pesos)**

	1985	1988	1991
Total outstanding debt	392.1	789.1	999.3
Domestic	79.9	266.4	330.4
External	312.1	522.7	668.9
Long-term external debt (US$)	16.4	24.5	25.1
Interest on debt	2.4	45.9	74.9
Domestic	1.4	32.2	56.3
External	1.0	13.7	18.6
Population (million)	54.7	58.7	62.9
GDP (market prices)	571.7	803.0	1,244.7
Memo items			
Per capita debt burden (pesos)			
Total debt	7,171.4	13,438.4	15,894.7
Domestic	1,462.2	4,536.8	5,255.3
As per cent of GDP			
Total debt	68.6	98.3	80.3
Domestic	14.0	33.2	26.5
External	54.6	65.1	53.7

Sources: Central Bank of the Philippines, *Annual Report*, Manila (various issues); International Monetary Fund, 1991. *Public Finance Statistics Yearbook, 1991*, IMF, Washington, DC.

national development as a whole. The national government holds all executive, legislative and judicial power. Within this framework, the 15 regions are the focal points for the decentralisation of certain administrative and planning functions of the national government, and a source of strength for central government supremacy at the local level. The local government units are the basic political units, consisting of 73 provinces, 60 cities, 1,532 municipalities and 40,904 *barangays*, none of which have any inherent fiscal power. The local government units' powers and functions are conferred on them by the national government through laws enacted by Congress. Congress may create, abolish, divide or merge local governments. The President's general supervision over local government units through national agencies provides opportunities for them to operate freely according to their preferences in local development and administration, however.

The 1973 and 1987 Philippine Constitutions and the *Local Government Code 1991* ensured the autonomy of local governments, but in practice these units are highly dependent on the national government. According to the *Local Government Code 1991*, the local government units are entitled to a 40 per cent share in the proceeds of taxes collected by the national government, in the proportion of 23 per cent to provinces, 23 per cent to cities, 34 per cent to municipalities and 20 per cent to *barangays*. The share of each province, city and municipality is determined on a 50 per cent population basis, 25 per cent land area basis and 25 per cent equity basis (Sections 284 and 285 of *Local Government Code* [Nollendo 1993:121–2]).

The local governments are given authority to levy taxes and fees to finance their activities (Section 18 of *Local Government Code* [Nollendo 1993:14]), provided these taxes and fees are not in conflict with national government sources. In addition to their internal revenue allotment, the local government units are also entitled to a 40 per cent share of mining taxes, royalties, forestry and fishery charges. These additional revenues are distributed as follows: 20 per cent to provinces; 45 per cent to cities/municipalities; and 35 per cent to *barangays* (Section 29 *Local Government Code* [Nollendo 1993:124]). These provisions, however, are not self-executory and Congress has to enact the laws to implement them. The constitutional provisions and *Local Government Code* have not improved the local government units' financial position. Local government share in total revenues during 1994 was approximately 12 per cent, whereas 88 per cent of revenue was claimed by the national government (Table 5). Moreover, the national government has the discretion to spend 90 per cent of its expenditures according to its own priorities, whereas local government units have primary control over only 10 per cent of their expenditure responsibilities.

India

India ranks seventh in the world in terms of geographical area and second only to China in terms of population; it is a multi-racial, multi-religious and multi-lingual country. Its Constitution provides for a federal form of government. The socioeconomic structure of the country has been influenced by the caste system, the existence of sharp inequalities in terms of income and wealth distribution, as well as employment opportunities (Agrawal, Varma and Gupta 1989:1). The gains of development remained confined to a small section and did not reach the majority of the population (Dandekar 1988:111). Financial provisions of the Indian Constitution favour centralisation in fiscal management (Chakrabarty 1990:xviii).

Policy measures undertaken during the 1980s and early 1990s had a view to strengthening economic management, particularly for reducing fiscal and balance of payments imbalances. The impacts of most of the reform measures have fallen short of expectations, however (Rao 1994:2). Policies designed to reduce inequalities and improve income distribution have lacked coverage. Intergovernmental relations during the 1980s were dominated by the centre. As a result the vertical imbalance between

Table 5 **Philippines: consolidated budget, 1992–94** (billion pesos)

	1992	1993	1994
Total revenues	330.3	349.2	416.7
Total national government	308.3	312.1	366.2
National government	223.3	213.7	259.5
Government corporations	85.0	98.4	106.7
Local government units	22.0	37.1	50.5
Total expenditure revenues	376.7	458.1	547.1
Total national government	354.7	421.0	496.6
Local government units	22.0	37.1	50.5
Total revenue less total expenditure revenue	-46.4	-108.9	-130.4
Non-development	292.0	335.9	409.8
Total national government	275.4	306.2	371.7
National government	214.9	230.1	284.1
Government corporations	60.5	76.1	87.6
Local government units	16.6	29.7	38.1
Capital outlays	84.7	122.2	137.3
Total national government	79.3	114.8	124.9
National government	54.2	57.6	60.7
Government corporations	25.1	57.2	64.2
Local government units	5.4	7.4	12.4
Share in total revenues	100	100	100
National government	93	89	88
Local government units	7	11	12
Share in expenditure	100	100	100
National government	94	92	91
Local government units	6	9	9
Non-development	100	100	100
National government	94	91	91
Local government units	6	9	9
Capital outlays	100	100	100
National government	94	94	91
Local government units	6	6	9

Source: Republic of Philippines, 1994. *Budget and Expenditures and Sources of Financing: fiscal year 1994*, Manila.

the centre and states enlarged. The system of transfers from centre to states has not improved the fiscal position of poor states. The reform process has concentrated on stabilisation issues, while matters relating to state-level reforms have received little focus (Rao 1994:3).

The fiscal situation in India, under strain throughout the 1980s, reached a critical point in 1990–91. The consolidated fiscal deficit as a proportion of GDP reached more than 12 per cent in 1990–91 (Government of India 1994:23). The most deleterious impact of this growing deficit has been on capital formation which during the 1980s declined as a share of total capital formation. Declines in public savings since the mid-1980s have led to sharp increases in the public sector's borrowing requirements and the accumulation of outstanding debt from 45.5 per cent of GDP in 1980–81 to 65.2 per cent in 1990–91 (Government of India 1994:19). The servicing of this debt alone accounted for 11.3 per cent of total expenditure in 1990–91, up from 6.1 per cent in 1980–81 (Government of India 1994:16, 23).

The deterioration of government finances in India is a manifestation of the need for comprehensive tax reform. In the past 20 years, the government has taken several measures to enhance the efficiency and administration of the taxation system: rationalisation of the tax rate structure; increasing the non-tax base of government revenue; improving public sector enterprise performance; improving the management of non-development expenditures and greater resource to user charges (Government of India 1985:302; Dhar 1988:15). These policy initiatives have improved the fiscal position to some extent, but because of their piecemeal nature have fallen short of expectations and have been unsuccessful in reducing the growing budgetary deficits. The second factor which has substantially undermined domestic resource mobilisation efforts in the past has been the growing imbalance in intergovernmental relations between the constituent units of the Indian federation.

The Constitution of India provides three lists: the Union List; the State List; and the Concurrent List. In this constitutional setting all matters relating to currency, banking and finance, defence, foreign affairs, interstate relations and matters affecting the country as a whole are the exclusive responsibility of the central government. The State List assigns the responsibility of providing key social and economic services to the Indian people, including maintenance of law and order, land and agriculture. In this framework the states' financial needs for carrying out constitutionally assigned activities far exceed their normal revenue-raising capacities. This has resulted in uneven provision of social and economic infrastructure across states resulting in widening inequalities (Rao 1994:28).

The system of financial transfers to the states provided in the Constitution of India follows the *Government of India Act 1935* (Chanda 1965:178). The distinguishing feature of fiscal arrangements is that there is no concurrent power of taxation. The states and the centre have been given exclusive powers to impose these in their respective fields

(Grewal 1975:9; Chakravarti 1980:181). The Seventh Schedule of the Indian Constitution (Article 246) has clarified the taxing power at the central and the state government levels. The State List contains 19 items—land revenue taxes on agricultural income, excise duty on liquor and opium, taxes on sales consumption and sale of electricity, taxes on sale of goods other than newspapers and so on (Entry 45–63 of Article 246 of the Indian Constitution). The Union List contains 13 items—taxes on personal income and corporate profits other than agricultural income, custom and excise duties, stamp duty and so on (Entry 81–91A of Article 246 of the Indian Constitution). In this scheme all the important and productive taxes are collected by the central government.

The constitutional scheme of sharing of fiscal resources between the central and state governments makes the state governments inevitably dependent on central transfers (Grewal 1975:12). The states in India have very few elastic revenue sources. Constitutionally all the major taxes (barring the sales tax) are collected by the central government (Table 6). As a result, the central government's share in total revenues collected has increased substantially over time from 68.7 per cent in 1960–61 to 89.5 per cent in 1988–89 (Table 6), whereas the states' financial position has substantially deteriorated. Their share in total budgetary resources has been reduced to 10.5 per cent in 1988–89, from 31.3 per cent in 1960–61.

Presently the states generate approximately 60 per cent of their revenue from their own sources. Sales tax, the only tax over which the states have control, is their major revenue source. Through the transfer of divisible revenues and grants-in-aid, the federal government meets the remaining 30–40 per cent of financing requirements (Table 7).

The Constitution of India requires the President to establish a Finance Commission within two years of the commencement of the Constitution and subsequently at least once every five years to make recommendations on the distribution of net proceeds of taxes between the central government and states. Finance Commission awards are based on population size, per capita income and states' relative poverty. Population size in this arrangement gets a high weighting (60 per cent). The Finance Commission's jurisdiction is limited, however, with a substantial portion of financial transfers outside the purview of the Finance Commission (Grewal 1975:13). Specific grants from the centre to state governments (whether for Plan or non-Plan purposes) do not come under Commission jurisdiction. Plan purpose grants are made under Planning Commission recommendations while non-Plan purpose grants are determined by the Union Ministries independently. Involvement of various agencies in intergovernmental transfers has increased the complexity of the system. In this environment it is difficult for the government to adopt uniform criteria for the distribution of resources such as on the basis of population size, land area or a state's domestic production to satisfy every interest group in the society. There are inherent difficulties in establishing a workable criterion in the allocation of the Seventh Five Year Plan's (1985–90) expenditure to the various states (Table 8).

Table 6 **India: consolidated budgetary transactions, 1960–91** (billion Indian rupees)

	1960–66	1980–81	1990–91
Total revenues	20.1	307.5[a]	1106.1[a]
Central government	13.8	229.9	864.1
States	6.3	77.6	242.0
Tax revenue	12.3	198.4	877.2
Central government	8.7	136.6	673.0
Income and corporation tax	2.7	28.2	146.2
Customs	1.7	34.1	229.0
Union excise duties	4.2	65.0	279.4
Others	0.1	9.3	18.4
States	3.6	61.9	204.2
Non-tax receipts	4.1	47.2	228.9
Central government	1.5	31.4	191.1
States	2.7	15.8	37.8
Total revenues (per cent share)	100.0	100.0	100.0
Central government	68.7	74.8	78.1
States	31.3	25.2	21.9

[a] Including grants.

Sources: Government of India, 1994. *Economic Survey of India 1994–95*, Economic Division, Ministry of Finance, New Delhi; Government of India, 1992. *Economic Survey of India 1991–92*, Economic Division, Ministry of Finance, New Delhi; Agrawal, A.N., Varma, H. O. and Gupta, R.C., 1989. *India Economic Information Yearbook 1989–90*, National Publishing House, New Delhi; International Monetary Fund, 1993. *International Financial Statistics Yearbook 1993*, IMF, Washington, DC.

India needs to address the cascading element in its taxation system. It is possible to achieve efficiency and equity in fiscal management if various cascading-effect taxes, especially the complications of the sales tax structure, are reduced substantially (Rao 1994:20). The sales tax regime in India creates distortions adversely affecting taxpayer compliance and tax administration. Central government efforts to improve the fiscal base are not likely to be successful unless the states mobilise sufficient resources. Under the present revenue-sharing arrangements states find little initiative to improve their revenue base (Gupta 1994:4). This policy is clearly not sustainable in the medium term. A mechanism is needed to encourage states to mobilise sufficient resources to balance their budgets.

The experience of countries with value-added tax suggests that the tax would help the government to reduce fiscal deficits and substantially reduce the cascading impact

Table 7 **India: states' budgetary transactions, 1960–89 (billion Indian rupees)**

	1960–61	1980–81	1980–89
Own sources	6.3	77.6	249.0
Tax revenues	3.6	61.9	206.0
Land revenue	1.0	1.6	5.2
Agricultural income tax	0.1	0.5	1.0
Stamps and registration fee	0.4	4.3	12.5
General sales tax	1.2	40.2	136.7
State excise duties	0.5	8.4	28.5
Motor vehicles tax	0.3	4.2	13.4
Taxes on passenger and goods	0.1	2.8	8.7
Non-tax revenue	2.7	15.8	43.0
Net contribution of public undertakings	0.5	-1.6	-10.9
Administrative receipts	1.4	9.1	32.4
Others	0.8	8.3	21.4
Shared taxes	1.7	37.9	104.8
Share of income tax	0.9	10.0	27.7
Share of state duty	0.0	0.1	0.0
Share of union excise duty	0.8	27.7	77.0
Grants-in-aid	1.2	30.1	62.3
Total transactions	9.2	145.6	416.0
Percentage share in total revenues	68.4	53.3	59.8
Dependence on central government	31.6	46.7	40.2
Share in divisible resources	18.4	26.0	25.2
Grants-in-aid	13.2	20.7	15.0

Sources: Government of India, 1992. *Economic Survey 1991–92*, Economic Division, Ministry of Finance, New Delhi; Agrawal A.N., Varma, H.O. and Gupta, R.C., 1989. *India Economic Information Yearbook 1989–90*, National Publishing House, New Delhi.

on inputs and capital. A broad-based central value-added tax on consumption will also improve interstate and international trade transactions. Such a scheme would clearly be resisted by the states. A central value-added tax would not only reduce the states' major revenue resources but would increase central government domain in fiscal management. If the states are allowed to retain their sales tax structures and the central government imposes a value-added tax independently as a new revenue source, a situation similar to Canada would arise, creating confusion and distortion in the taxation system.

Pakistan

Pakistan's fiscal system is not compatible with the needs of a developing society. Past state efforts to mobilise domestic resources in amounts adequate to satisfy the needs of a growing economy have been weakened because of the inherent inflexibility of a

Table 8 **India: Seventh Five Year Plan allocations to states and union territories** (percentage share)

	Total population (1981)	Land area ('000sq. km)[a] (1988–89)	Net state domestic product	Plan allocations (1985–90)
Uttar Pradesh	16.2	8.9	13.1	12.4
Bihar	10.2	5.3	6.4	6.0
Maharashtra	9.2	9.4	14.3	12.4
Tamal Nadu	7.1	3.9	7.4	6.8
West Bengle	8.0	2.7	8.4	4.9
Madhya Pradesh	7.6	13.5	6.2	8.3
Karnatka	5.4	5.8	6.0	9.1
Gujarat	5.0	6.0	7.1	7.1
Rajistan	5.0	10.4	4.5	3.6
Orissa	3.8	4.7	3.1	3.2
Kerala	3.7	1.3	3.3	2.5
Punjab	2.4	1.5	4.5	3.9
Haryana	1.9	1.3	3.2	3.4
Delhi (Federal area)	0.9	..	..	2.4
All others	13.7	25.3	12.5[b]	14.0
Total India	100.0	100.0	100.0[b]	100.0

[a] As of 31 March 1982. Figures are provisional.
[b] Only states. Mizoram domestic production has been assumed at 1987–88 level.
Sources: Agrawal, A.N., Varma, H.O. and Gupta, R.C., 1989. *India Economic Information Yearbook 1989–90*, National Publishing House, New Delhi; Government of India, 1992. *Economic Survey of India 1991–92*, Economic Division, Ministry of Finance, New Delhi; Government of India, 1985. *Statistical Yearbook*, Central Statistics Office, New Delhi.

system which is the result of years of ill-conceived and contradictory policies. The system has been influenced by international, regional and domestic imperatives which have exacerbated the deterioration in budgetary resources. Deterioration in government revenues, rapidly growing government expenditures and heavy losses by public sector enterprises have contributed to chronic deficiencies in the fiscal system. Many additions, modifications and amendments made to improve the system have only adversely affected the fiscal base. Several factors have contributed to this weakness. The Pakistan government, like those in many other developing economies, made lavish legal and administrative provisions for incentives and tax exemptions to attract foreign and domestic private investment (Shah and Toye 1990). This strategy created problems and abuses in the fiscal system such as massive tax evasion, corruption and the development of a large informal sector without any corresponding increase in investment (Heller 1972:5; Gersovitz 1987:615).

Since the 1980s various studies and reviews have argued the need for a comprehensive reform of the Pakistan fiscal system including restraints on public spending to reduce the budget deficit as a percentage of GDP (National Taxation Reform Commission 1986:6; Ahmad and Stern 1987:2; Peat Marwick 1988:I.5; United Nations Development Programme 1991:206). No comprehensive tax reform has been initiated by the government. Instead, *ad hoc* management of fiscal affairs has further aggravated the fiscal position. The fiscal deficit is comparatively high at approximately 9 per cent of GDP. Measures to reduce it by cutting development expenditures have created problems in the maintenance of physical infrastructure.

The federal government in Pakistan comprises three independent bodies: the executive, legislative and judicial branches. According to the Constitution of Pakistan 1973, the executive authority of the federation is vested in the President and is exercised either directly or through subordinate officers in accordance with constitutional provisions (Article 19[1]). The Cabinet of Ministers is appointed by the President to aid and advise in the exercise of presidential functions (Article 91[1], [2], [2A]). The role of the Cabinet of Ministers is to aid and advise the Governor (Articles 129 and 130[1], [2]). At the provincial level the executive authority of the province is vested in the Governor, a nominee of the President. In practice the central government's legislative, executive and judicial powers appear to have no legal boundaries.

The current division of fiscal powers in the Federation of Pakistan is one of the major causes of weakness in domestic resource mobilisation efforts, particularly at the provincial level. The revenue-sharing arrangements are derived from the revenue-sharing provisions of the *Government of India Act 1935* which laid down the formula for distribution of revenue from divisible sources (Government of Pakistan 1975:2, and 1985:74; National Finance Commission 1991:1). These provisions were incorporated after independence in 1947 into successive constitutions, delineating the respective revenue-raising powers of the federal and provincial governments (Khan 1992:1123).

These arrangements have been reviewed and updated many times, for example in 1951 under the Raisman Award and subsequently by National Finance Commissions. Due to periodic political disturbances, no such review was undertaken between 1974 and 1991. In this period the revenue-sharing arrangements were made through the Distribution of Revenues and Grants-in-Aid Order 1975, Presidential Order of Distribution of Revenues 1983 and through administrative arrangements between the federal and provincial governments (National Finance Commission 1991:13).

According to the 1991 National Finance Commission award, revenue sharing under the divisible pool between the federal and the provincial governments takes the form of a partial or full transfer of proceeds in proportion to their population (Punjab 57.9 per cent; Sindh 23.3 per cent; North West Frontier Province 13.5 per cent and Baluchistan 5.3 per cent) from five taxes: taxes on income; sales tax; export duty on cotton; excise duty on sugar, tobacco and tobacco manufactures; proceeds of development surcharges on natural gas on a well production basis and the gift tax levied and collected by the federal government (National Finance Commission 1991:28–9). The award also includes the distribution of bulk generation of hydro-power to provinces in which hydro-electricity stations are located (National Finance Commission 1991:29).

The application of the federal system in Pakistan suggests that financial arrangements between the federal government and the provincial governments clearly violate requirements to protect citizens against excessive coercion. The powerful centrifugal forces inherent in the policy exert their influence on developing an appropriate constitutional and political system. The effectiveness of the system is influenced by a lack of national sentiment among the constituent units of the Federation. Unlike the federal systems of the United States, Australia, Canada and India, there is a sense of distinct nationality in Pakistan; Punjabs, Sindhis, Pathans, Baluchis and Mohajirs have a strong sense of ethnicity. The sense of a common nationality is weak (Chowdhury 1988:186). Further, the component units of the Federation are very conscious of their regional rights. They feel more comfortable calling themselves Punjabis, Sindhis, Pathans, Baluchis or Mohajirs than Pakistanis (Kardar 1991:5). This regional affiliation has made the federal system more conspicuous and at times more vulnerable.

The constitutional division of legislative, administrative and financial powers between the constituent units of the Federation has not produced a congenial environment for policymaking on improvement in relations between the federal and provincial governments. Instead an environment of mistrust and conflict has developed. Political motives on the part of different actors and weak links between society and government have led to a weak Federation confronted with many political, social and economic problems. At both levels of government, policymaking and policy implementation have been influenced by groups wielding ultimate political power (Whitehead 1990). While the dominant group possesses a large measure of autonomy, it has been noted that this autonomy is constrained to an extent by the existence of different groups based on class or regional loyalties (Berry 1990).

The present expenditure functions and revenue sources result in a marked degree of vertical imbalance between the two major levels of governments (Table 9). Under the 1973 Constitution, a clear distinction was made between the central and the provincial governments' taxing powers and sharing of revenues—local bodies, which can generate substantial resources at the grassroots level and help reduce growing budget deficits by sharing social and infrastructure responsibilities, have been kept outside the fiscal arrangements. In the constitutional arrangements all major sources of income have been assigned to the federal government, leaving the provinces with minor taxes. The federal government collects approximately 95 per cent of consolidated taxes (federal and provincial). Against this, the federal government accounts for 75 per cent of current expenditures and 77 per cent of capital outlays. Deterioration in the provincial financial position has been remarkable. In 1972–73, the dependence of provinces on the federal government was approximately 20 per cent; in subsequent years this has increased to nearly 60 per cent.

Table 9 **Pakistan: vertical imbalance, 1972–91** (billion Pakistan rupees)

			Transfer from federal government			Provincial government	
	Provincial government: share of public sector outlays[a]	Provincial government: own resources[b]	Shared taxes	Grants[c]	Total	Own resources as % of provincial outlays[d]	Dependence on federal government[e]
1972–73	4.07	1.43	0.75	0.05	0.80	35	20
1977–78	10.78	2.83	3.51	2.12	5.63	26	52
1982–83	19.86	6.16	9.35	3.21	12.56	31	63
1987–88	44.50[f]	9.30	16.23	18.95	35.18	21	79
1990–91	54.54	10.87	33.79	9.86	43.65	20	80

[a] Current and capital expenditures, including interest paid to the federal government.
[b] Tax and non-tax, excluding shared taxes.
[c] Grants-in-aid and foreign grants for current and capital expenditure.
[d] Column 3 as per cent of column 2.
[e] Column 6 as per cent of column 2.
[f] Includes expenditure on special development programs.
Sources: Government of Pakistan, 1989. *Public Finance Statistics 1987–88*, Ministry of Finance, Islamabad; Government of Pakistan, 1993. *Economic Survey of Pakistan, 1992–93*, Economic Adviser's Wing, Ministry of Finance, Islamabad; Provincial Government Budget documents (various issues).

Table 10 **Pakistan: horizontal imbalance, 1987–88** (per capita Pakistan rupees)

	Punjab	Sindh	NWFP[a]	Baluchistan
Provincial government expenditure[b]	544	556	740	938
Provincial government revenues from own sources[c]	94	94	66	47
Population (million)[d]	61.474	24.752	14.200	5.6200

[a] North West Frontier Province.
[b] Current and capital outlays.
[c] Excluding shared taxes.
[d] Provincial population figures calculated by applying the 1987–88 revenue distribution formula based on population ratios emerging from the 1981 population census.
Sources: Government of Pakistan, 1991. *Explanatory Memorandum of Budget 1990–91*, Ministry of Finance, Islamabad; Government of Pakistan, 1989. *Public Finance Statistics 1987–88*, Ministry of Finance, Islamabad; Government of Pakistan, 1993. *Economic Survey of Pakistan 1992–93 (Statistical Supplement)*, Economic Adviser's Wing, Ministry of Finance, Islamabad.

The situation in Pakistan regarding horizontal equity is not promising. Constituents of the component governments receive unequal fiscal treatment from government services. Citizens of fiscally strong provinces receive proportionally fewer benefits from public services in terms of the burden they bear from paying taxes and charges compared to the low fiscal capacity provinces. Per capita expenditure and per capita revenue from provincial governments' own sources vary substantially between provinces (Table 10). For example, per capita expenditure is highest in Baluchistan followed by North West Frontier Province, Sindh and Punjab, whereas per capita revenue generation is low in Baluchistan, followed by North West Frontier Province, Punjab and Sindh. This situation has remained largely static since the late 1970s.

Conclusion

The 1980s saw a shift in policy priorities. Policies were designed primarily to strengthen economic management, particularly the budget and balance of payments. Fiscal policies generally embarked on medium-term strategies to reduce fiscal deficits by broadening tax bases, rationalising public expenditure and improving institutional framework.

The tax reform process in the early 1980s involved reducing income tax rates and a shift of revenue emphasis from direct to indirect taxes—a shift from income-based taxes to consumption-based taxes. In the second half of the 1980s, the tax reform emphasis was on lowering top corporate and individual income tax rates, reducing income tax brackets and rationalising public sector expenditure. The underlying argument of such policies was that a reduced tax burden on incomes would move more money into industrial investment, which would have a favourable effect on the long-term performance of the economy.

The five countries surveyed have responded positively to wide-ranging fiscal reform measures initiated in the 1980s. The majority of these countries have achieved macroeconomic stability—expanding domestic production, easing import growth and regaining export volumes strength. Employment creation continued along with productivity gains and inflation remained low. Some of the countries, however, faced serious bottlenecks from the implementation of various policies.

The full benefits of fiscal reforms have not been realised in the majority of the countries surveyed. Government expenditure as a proportion of GDP has continued to rise, while government revenues failed to grow in line with expenditure. The increased burden of public sector borrowing requirements has put added pressure on interest rates and adversely affected the availability of resources for productive investment. In the highly centralised fiscal system, whether federal or unitary, the vertical imbalance between central government and other levels of governments has become more pronounced. In addition the states/provincial/local governments have become more dependent on central government transfers. Increasing recourse to specific purpose payments by the central governments has increased the influence in the state/provincial/local domain. The reform process has mainly concentrated on stabilisation issues while matters relating to state-level reform have received little focus. Policies designed to reduce inequalities and improve income distribution have in most cases lacked coverage. In public expenditure general public services, education and health have received little priority (Table 11). The slow rate of capital formation has influenced the supply of infrastructure, especially power supply. Consequently, in countries like India and Pakistan, long hours of power load-shedding have constrained domestic production.

Widening fiscal deficits in the early part of the 1980s led to a quicker build-up in public debt. Associated debt interest payments rose even more quickly during the period, putting greater pressure on deficits. In Australia and New Zealand, the impact of rising debt and higher interest rates on debt interest payments was reversed as the decade progressed; smaller deficits reduced debt accumulation, real interest rates fell from their peaks and the growth of debt interest payments slowed sharply. In India, Pakistan and Philippines, however, fiscal policies provided little relief to governments. Public sector borrowing requirements continued to rise, and as a result, interest payments pressure on budgets intensified.

Table 11 **Structure of general government outlays by function, 1980–92** (per cent of GNP/GDP)

	Australia		New Zealand		India		Pakistan		Philippines	
	1980	1992	1980	1992	1980	1992	1980	1992	1980	1992
Total expenditure[a]	36.6	41.3	41.0	41.1	25.9	33.0[b]	22.3	25.5	16.5[b]	19.9
Traditional domain										
Public goods										
Defence	2.5	2.3	2.2	1.8	3.1	3.1	5.7	6.3	1.8	2.1
General public services	3.3	4.3	3.2	2.0	3.2	4.0	1.8	1.8	2.5	1.7
Other functions	1.0	0.8	0.3	0.4	0.1	0.0	0.6	0.6	0.0	0.1
The welfare state										
Merit goods										
Education	6.9	6.3	5.1	5.5	3.5	4.4	1.3	1.8	2.4	3.1
Health	4.5	6.3	5.4	4.9	1.1	1.2	0.4	0.6	0.7	0.8
Housing and other	0.8	1.3	0.3	0.5	1.4	2.3	0.4	0.4	0.4	0.2
Income transfers										
Income maintenance	7.4	8.9	12.1	14.8	0.7	1.0	0.9	0.9	0.2	0.5
Administration	1.4	1.5	0.6	1.5	0.0	0.0	0.3	0.3	0.0	0.4
The mixed economy										
Economic services	5.3	5.4	6.3	3.3	8.7	9.0	7.2	6.7	7.4	4.8
Public debt interest	1.8	1.6	4.8	6.4	2.2	4.8	2.4	4.8	1.1	6.0
Other expenditure	1.9	2.5	0.6	0.0	1.7	3.3	1.5	1.5	0.0	0.2

[a] Excludes intergovernmental transfers.
[b] Includes expenditure on public order and safety.
[c] Includes expenditure on recreation and culture.
[d] Mainly expenditure on social security and welfare.

Sources: Government of India, 1994. *Economic Survey of India,1994–95*, Economic Division, Ministry of Finance, New Delhi; Government of Pakistan, 1994. *Economic Survey 1994–95*, Economic Adviser's Wing, Ministry of Finance, New Delhi; International Monetary Fund, 1986. *International Financial Statistics Yearbook 1986*, IMF, Washington, DC; International Monetary Fund, 1993. *International Financial Statistics Yearbook 1993*, IMF, Washington, DC; Organization for Economic Cooperation and Development, 1986. *Revenue Statistics of OECD Member Countries 1965–1985*, OECD, Paris; Organization for Economic Cooperation and Development, 1994. *Revenue Statistics of OECD Member Countries 1964–1993*, OECD, Paris.

Countries under the federal form of government (Australia, India and Pakistan) were able to reduce central government budgetary deficit, mainly by reducing central government expenditures. The state/provincial governments' fiscal deficits continued to increase, however. The state/provincial governments were under no obligation to reduce their deficits through rationalising their expenditure and broadening their revenue bases. The over-centralised fiscal arrangements leave little incentive to other levels of governments to improve their fiscal position. Generally, fiscal policies initiated in the 1980s failed to address issues affecting central and other government levels' fiscal relations.

New Zealand and Philippines, both with unitary forms of government, have introduced value-added tax. The tax has helped these governments to improve their financial position and rationalise their indirect tax structure, which was a continuous source of inefficiency. The highly centralised form of government helped these countries to overcome political and social resistance at the time of value-added tax implementation. Australia, India and Pakistan, with their federal forms of government, so far have no comprehensive value-added tax system. In these countries, taxation of domestic goods and services are highly discriminatory and have distorting effects: wholesale tax at the Commonwealth level in Australia; sales tax at the federal government level in Pakistan; and sales tax at provincial government level in India. The deficiencies of the tax structure in these countries have not only limited governments' capacity to generate additional revenues, but are a continuous source of distortion in the allocation of resources and distribution of the tax burden. Major adjustments in the countries' tax structures are needed to ensure financial viability in the medium to long term. The long-term goal of a sound fiscal policy in these countries should be to finance a greater portion of government expenditure from domestic non-borrowed resources. Australia, Pakistan and India can benefit from the experience of New Zealand and other OECD countries with value-added tax. Use of a broad-based consumption-type value-added tax in Australia, Pakistan and India would provide considerable economic and administrative advantages. The value-added system would help simplify the indirect tax system and eliminate most anomalies.

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