Discussion Paper
Finances of the Central Government

The central government collects about 60% of the total government revenue generated in the country and has a share of about 40% in expenditure (remaining attributable to states). The central government collects receipts from: (i) taxes such as income tax, GST, and custom duty, (ii) non-tax sources such as dividends from public sector utilities (PSUs) and interest receipts, and (iii) capital receipts such as disinvestment proceeds from selling the government shareholding in PSUs. In 2022-23, tax revenue is estimated to constitute about 86% of the total receipts of the central government. 11% of the receipts are expected to come from non-tax revenue and another 2% from disinvestment. The central government spends towards key national imperatives such as defence and internal security, promotion of industry, trade and commerce, poverty alleviation and social security, and infrastructure needs including national highways and railways. Central government’s receipts have consistently fallen short of expenditure plans and the gaps have been funded through borrowings (fiscal deficit). This has led to increasing debt levels and higher interest expenditure, and reduced space for capital expenditure. In this context, we discuss the state of finances of the central government.

Tax collection level remains below potential

In about thirty years since 1990-91, the total tax collection of central and state governments has not seen any significant change (Figure 1). Total tax collection had increased from 15.2% of GDP in 1990-91 to 17.9% of GDP in 2007-08. Since then, it has ranged between 15.5%-17.5% of GDP. The 15th Finance Commission had observed that India’s tax collection remains below the estimated tax capacity. In comparison, in other developing economies, tax revenue as a percentage of GDP has been rising. The Economic Survey (2015-16) had estimated that after accounting for both level of economic development and type of political system, India’s overall tax-to-GDP ratio (centre and states together) is lower by about 5.5% of GDP than that of comparable countries. Government expenditure was estimated to be lower by about 6% of GDP. Gross tax revenue collected by the central government is estimated to be 11.1% of GDP in 2023-24. Net tax revenue is estimated at 7.7% of GDP in 2023-24. It is the amount left with the centre after the devolution of funds to states as per the Finance Commission recommendations.

Revenue from corporation tax has seen a decline in recent years, income tax collection increases

Tax revenue of the central government is classified as direct taxes (on income, profits, and assets) and indirect taxes (on transaction of goods and services). Major direct taxes are corporation tax and income tax. The central government’s policy for direct taxes is to broaden and deepen the tax base while gradually phasing out exemptions. In recent years, there has been a decline in the contribution of corporate tax to gross tax revenue, as the tax rates were rationalised to attract investment and support economic growth. Revenue from income tax has seen an increase during this period. While there has been an increase in the number of tax returns filed, the tax base itself is very narrow. For the assessment year 2018-19, 5.87 crore returns were filed (4.4% of total population). Among these, 40% of the returns were in the nil tax bracket while 53% of the returns were in the tax bracket below Rs 1.5 lakh.

Figure 1: Tax collection in India as % of GDP

Figure 2: Major direct taxes as % of GDP

Sources: RBI, MoSPI, Union Budget Documents; PRS.
Tax collection under GST is lower than the previous tax regime

About 45% of the gross tax revenue accrues from indirect taxes. With the introduction of GST, several indirect taxes were subsumed under the new regime. In 2016-17, the revenue from taxes subsumed under GST was about 6.7% of GDP. Revenue collected under GST has been lower than this level so far.

Reasons for lower GST revenue level include: (i) a decline in the effective tax rate (from 14.4% in 2017 to 11.6% in 2019), as compared to the revenue-neutral rate for GST which was recommended to be 15%-15.5%, (ii) economic slowdown between 2018-19 and 2020-21, and (iii) inverted duty structure (higher tax on inputs than finished products), leading to large refunds through input tax credit and less than expected net tax collections for the government.3,5

The 15th Finance Commission has estimated the potential for a GST-to-GDP ratio of 7% over the medium term (net of revenue from compensation cess).3 The revenue buoyancy in indirect taxes other than GST was driven by an increase in excise duties and cesses and surcharges on petroleum products.3 While the levy of cesses and surcharges has helped maintain the revenue level for the central government, it has led to a lower devolution to state governments.

Uncertainties with disinvestment receipts

Disinvestment is the dominant source of capital receipts for the central government. It involves mobilising revenue through the sale of government’s shareholding in public sector enterprises. As per budget estimates of 2023-24, 61% of capital receipts is expected to be earned through disinvestment. The central government has consistently fallen short of achieving the target for disinvestment. Since 2011-12, the disinvestment target was achieved only in two years – in 2017-18 and 2018-19. In February 2021, the central government released the new public sector enterprises policy.6 The policy envisages maintaining a bare minimum presence of public sector enterprises in strategic areas with complete privatisation and closure of enterprises in non-strategic areas.6 This may adversely impact the non-tax revenue, about 30-40% of which comes from dividends and profits of public sector enterprises.

High level of committed expenditure

Expenditure can be categorised into capital (spending on creation of assets or reduction of liabilities) and revenue (other than capital). A high percentage of revenue expenditure of the central government is committed in nature, i.e., it is difficult to rationalise them in short term. In 2023-24, about 69% of the revenue receipts is estimated to be spent towards three items – interest, salaries, and pension (together termed as committed expenditure). Between 2012-13 and 2023-24, the committed expenditure has ranged between 65%-70% of revenue receipts, except in 2020-21 (COVID year).

Defence and Railways are two of the largest employers under the central government. In 2023-24, 72% of the total revenue expenditure under the Ministry of Defence is estimated to be towards salaries and pensions. The corresponding number for Railways is estimated at 53%. As of March 2013, the central government employed about 33.1 lakh persons (excluding defence forces).7 This number is expected to increase to 35.5 lakh persons as of March 2024, against sanctioned posts of around 40 lakh.8,9 As of February 2021, the number of persons employed in defence forces was about 13.6 lakh.10

As of March 2021, the total number of pensioners is around 68.6 lakh: (i) defence – 34.1 lakh, (ii) railways – 15.5 lakh, (iii) civil – 11.1 lakh, (iv) telecom – 4.7 lakh, and (v) post – 3.2 lakh.11 Measures such as the shift to
contributory pension system around 2003 and introduction of Agnipath scheme for recruitment in defence are expected to rationalise government’s pension expenditure in the longer run.

Figure 5: Committed Expenditure as % of Revenue Receipts

Note: Figures for 2022-23 and 2023-24 as per revised and budget estimates, respectively.
Sources: RBI, Union Budget Documents; PRS.

Continued reliance on borrowings for financing recurring expenditure

The central government has continued to incur a substantial revenue deficit over the last few years. Revenue deficit implies that borrowings are needed to finance expenditure which do not lead to the creation of assets or reduction of liabilities. Since 2008-09, revenue deficit has been above 2% of GDP. Revenue deficit had decreased to 2.1% of GDP in 2016-17. In 2023-24, it is expected to be significantly higher, at 2.9% of GDP. A higher revenue deficit in 2023-24 as compared to 2016-17 can be attributed to: (i) a lower revenue receipts (by about 0.2% of GDP), (ii) an increase in interest payment obligations (by about 0.5% of GDP), and (iii) increase in expenditure under central sector and centrally sponsored and schemes such as PM-KISAN and Jal Jeevan Mission (by about 0.5% of GDP). Subsidies in 2023-24 are estimated to be 1.3% of GDP, lower than 2016-17 (1.5% of GDP). A consistently high revenue deficit has constrained capital expenditure by the central government.

Capital expenditure had ranged between 1.5%-2% of GDP between 2008-09 and 2019-20. Capital expenditure could increase to 2.2% of GDP in 2020-21 and further to 3.3% of GDP in 2023-24, on back of a significantly higher fiscal deficit.

Rise in debt level, more than 40% of revenue receipts to go towards interest payments

The Fiscal Responsibility and Budget Management Act, 2003 was passed by Parliament to place certain limits on debt and deficit. In 2018, this Act was amended to set the debt ceiling for India at 60% of GDP (to be achieved by 2024-25). Of this, the limit for the central government was set at 40% of GDP. The dependence on borrowings to fund government expenditure has increased in recent years. This was due to the economic slowdown followed by the onset of the COVID-19 pandemic. There has been a steep rise in general government debt (centre and states) from about 70% of GDP at the end of 2018-19 to about 85% of GDP at the end of 2022-23. The debt of the central government is estimated to rise from 49% of GDP at the end of 2017-18 to 58% of GDP at the end of 2022-23. High debt levels over the years have required the central government to set aside a significant portion of its revenue receipts towards interest payments.
In 2023-24, interest payment is budgeted at 41% of revenue receipts. While the fiscal deficit is estimated at 5.9% of GDP in 2023-24, interest payment alone is estimated to be 3.6% of GDP. The borrowings levels in the next 3-4 years are expected to remain high, with the fiscal deficit targeted to be brought back from 6.4% of GDP in 2022-23 to 4.5% of GDP in 2025-26.  

![Figure 7: Outstanding Liabilities as % of GDP](image)

Note: External liabilities are taken at the current exchange rate. Figures for 2021-22 and 2022-23 as per revised and budget estimates, respectively. 2022-23 GDP as per first advanced estimate. Sources: RBI, MoSPI, Union Budget Documents; PRS.

![Figure 8: Interest Payment as % of Revenue Receipts](image)

Note: Figures for 2022-23 and 2023-24 as per revised and budget estimates, respectively. Sources: RBI, MoSPI, Union Budget Documents; PRS.

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**Implementation of the FRBM Act**

The FRBM Act, passed in 2003, sought to set the following targets: (i) elimination of revenue deficit, (ii) maintaining fiscal deficit level at 3%, and (iii) gradual reduction in liabilities. Since its inception, the Act has been amended several times. In 2012, the Act was amended to remove the target of eliminating revenue deficit and instead require the elimination of effective revenue deficit (revenue deficit after adjusting for grants for the creation of capital assets). In 2018, the Act was amended to remove the targeting of effective revenue deficit and require the central government to ‘endeavour’ to keep its debt below 40% of GDP. Amendments from time to time have also postponed the deadlines for achieving various targets. The implementation of the Act has been put on hold altogether at times. The first instance was in the backdrop of the Global Financial Crisis in 2008-09. The second instance was following the COVID-19 pandemic in 2020-21. The 15th Finance Commission observed that the Act needs a major restructuring, given the challenges both in relation to debt and fiscal deficit. It recommended forming a high-powered inter-governmental group to: (i) review the Act, and (ii) recommend a new FRBM framework for the centre as well as states, and oversee its implementation.

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