

### Role of the Government

In most modern societies, the government is responsible for a number of crucial functions. These include the more traditional functions like defending the country and maintaining internal law and order.

In addition, the government has to take responsibility of setting up and running schools, colleges, libraries, health centers, hospitals, post offices and a variety of other public institutions. The public transport system and the infrastructure of roads and railways are constructed and maintained by the government. In providing water, sanitation, electricity facilities the government has to play an active role. Facilities like healthcare and sanitation, electricity, public transport, schools and colleges are known as public facilities.

The important characteristic of a public facility is that once it is provided, its benefits can be shared by many people. You have read about this in Class VIII. For instance, a school in a village will enable many children to get educated. Similarly, the supply of electricity to an area can be useful for many people: farmers can run pump sets to irrigate their fields. Factories, offices, shops and markets require a reliable source of power to run. Students will find it easier to study and most of the people whether in a village or a town will be benefited in some way or the other. These public facilities have to be available to all and at an affordable rate. Governments have the responsibility for this. It may take up the work on its own or get it organised.

Besides the provision of public facilities, the government has the responsibility towards protection of livelihoods. You have read about the Right to Work and the MGNREGA in rural areas. The Act mandates that it is the responsibility of the government to provide manual work on demand and the wages to the workers and the capital needed are to be paid by the government. The distribution of food grains at fair prices in the PDS shops is organised and the costs borne by the government. As we have seen, these are critical for the food security of the poor.

The Indian government in the past has also played a major role in setting up heavy industries such as heavy engineering, power generation, production of steel, extraction and refining of petroleum etc. without which industrialisation would have been very difficult. You read more about these basic industries in Chapter 7 in this book.

- In your city/ town/ village, what are the roles that you have seen the government playing? Discuss.
- Collect and list out some details of government expenditure from reading the newspapers of your region.
- Can you guess from where the government gets money for public facilities and other activities?

### Subsidies

Money paid by government to reduce the cost of certain important goods such as fertilizers, foodgrains, diesel and other important goods so that their prices can be kept low and affordable to all.

In rural areas, investments on irrigation projects and agricultural extension works by the government are crucial for farming. The government also helps farmers by selling fertiliser at a lower price than what would have been otherwise by the factories. The government compensates factories to some extent so that the final price of fertilizers is affordable by farmers. This money paid by the government to the factories is the subsidy for fertilisers. If this was not there the price charged by the factories would have been much more. Similarly the government provides subsidies for many products, by compensating the producer, so that the price is kept affordable, especially for those who need it most. In this way it subsidises the price of kerosene, food grain from ration shops, LPG gas cylinders etc. These days there's a lot of debate on how effective these subsidies have been. Are they benefitting people? Are there better ways of organising them? You'll read about some of these issues in this chapter.



*Fig. 11.1: Some government activities*

To fulfil the various roles, the government must have adequate money. The money required for the different functions of the government is collected from the people in the form of taxes. There are a variety of taxes that the government collects, about which we shall study in the next sections. The taxes collected constitute the

revenues of the government. Revenues are necessary to finance the expenditures of the government. The Annual Budget presented before the Parliament by the Finance Minister gives the expected expenditure by the government on its various programmes for the coming year. It also states that how these expenditures are going to be met through various revenue collections. Similarly in each state assembly the state government presents the budget for that state.

## Expenditures by the Government

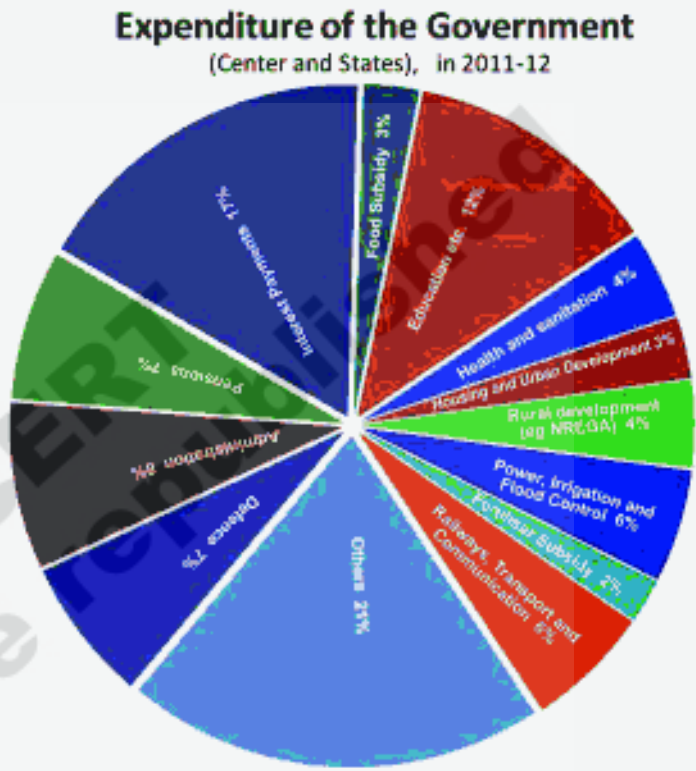
Let us look at the actual expenditure of the Indian government to get a sense of how and how much money the government spend on us. In 2011-12, the government spent around Rs. 23,00,000 crores (23 lakh crores). This seems to be a lot of money and indeed it is. Nearly one-fourth of the total spending in the Indian economy is by the government. Rest of the three-fourth of the spending is by the private sector – households that spend on food, education, travel, cloth, housing, health, entertainment etc; and businesses whether it is a manufacturing or a service that have to spend on raw materials, machines, other products, wages and salaries to employees, sales and marketing and other expenses for running the business.

The pie-chart gives the proportion in which this money was spent across various expenditure heads by the government in India in the year 2011-12, i.e. the 1st April 2011-31st March 2012. Here the Government refers to both Central government and all the State governments. In the year 2011-12, 12% of the total expenditure was on education, art and culture. This includes both salaries of employees, running costs of schools and colleges, etc. as well as new investments like construction of new school buildings, purchase of new computers, books etc.

Similarly, 4 % of total spending was on health and sanitation; 4% was on rural development, and so on.

When you look at the pie-chart, you will notice that besides spending on development activities, there are certain other expenditures, like administration, pension, interest and defence. These do not contribute to development directly, but they are necessary. To run its various departments, programmes and the organs of the state (legislature, executive and judiciary), there are expenditures on administration. The government also pays pensions to workers who are retired from the government. Then, there are expenditures on interest payments. Since every year the Indian government has to borrow some money to meet its expenditure, it has to pay interest on its past borrowings.

How much the government spends on health versus defence depends on the policy priorities of the government and people's voice. Every year, around the time



of the budget and once the budget is presented you would have seen there is a lot of media attention on these issues. Though the decisions on budgetary spending is mostly taken by the government, consultations happen between the government and industry groups, farmer groups, civil society activists etc. Groups representing certain sections of the people voice their views, demands and at times their disagreements before the government. It is through pressures of this kind that the people have demanded greater spending on social sectors, such as education, health, food subsidy etc.

The check on the government on matters of budget is ensured through legislative control. The Parliament has to debate the various issues of the budget that has been placed before it and approve the expenditure proposals of the government. The Parliament has to allow the government to withdraw money for its expenditures. Similarly, no tax can be levied except by the authority of the law passed by Parliament. Thus, as per the Constitutional requirement, the elected representatives of the people have an important say in the budgetary decision-making.

- Using the information in the above section calculate the expenditure of the government on food subsidy? Discuss on what all was this money spent and the purpose for this?
- With the help of your teacher, try to relate some of the expenditures in the pie-chart to the roles played by the government as discussed in Section 1.
- In the year 1947-48, the budget for independent India was only Rs.197 crores. What would be the various reasons for such a large increase in budget since then?
- Why do you think the Parliament has been given power over the government's budget?
- There have been continuous attempts by the government to reduce fertiliser subsidy. This means that the government would no longer control the price of fertiliser. Farmers would have to buy fertilisers at the higher market price. At present, the government has to pay (compensate) the fertiliser producing companies for the losses that they make. Once fertiliser subsidy is removed it is said this would make space for other important expenditures in the government budget. Also some argue that subsidised fertiliser does not benefit the small farmer but only encourages the large farmers to overuse it.

Imagine you are a farmer using fertilisers in farming, and you genuinely believe that the farmers need subsidized fertiliser. How would you argue your case? Write a letter to the Finance Minister.

## Taxes

Taxes are the main source of revenue for the government. There are a variety of taxes collected by the government. You might have heard about some of these like VAT (Value Added Tax), service tax, excise duty, income tax, property tax, customs duty etc. The taxes can broadly be classified into two categories: indirect taxes and direct taxes.

## Indirect Taxes

Indirect taxes are charged on goods and services. You would have seen alongside the printed Maximum Retail Price (MRP) of goods is written “inclusive of taxes”. It means that the price includes taxes. Similarly, for most services like telephone and mobile phone services the price that consumers pay includes taxes.

Let us see how the taxes work by taking the example of a few important taxes.

Excise duty is charged on goods that are produced or made in factories. Before the goods manufactured in a factory can leave the factory gate, excise duty on the goods produced has to be paid. The owner or the manager of the factory pays the money (tax) to the government according to the amount of production.

Excise duty is charged from the factory itself, but in reality the tax is passed to those who buy the goods. The factory owners sell their goods after adding to the price what they pay in tax. The cost of manufacturing a TV is, say, Rs. 10,000. The company paid an excise duty of Rs. 1200 to the government. This will get included in the price at which the TV is finally sold and the consumer bears the tax.

While all taxes on goods add to the price, taxing certain goods raises the overall prices more. For example, to manufacture bicycles, steel pipes are needed. In order to make steel, the steel factory needs iron and coal. If excise duty (tax) on iron is increased, it will have an effect on cycles as well. The prices of all goods made of iron will go up. And since iron is used to make steel, the prices of all things made of steel will also go up. In this way, a tax increase on iron has far reaching effects.

Thus taxing heavily on basic raw materials and goods used by many other factories - intermediate goods-sets up a

chain reaction and all things which are connected to this good, in one way or the other are affected.

After production the goods passes through a chain of sellers (wholesaler/distributor/ retailer). While excise duty is levied on manufacture of goods, sales tax is charged when goods are sold. Next time you receive a proper bill for your



- Petrol, diesel, etc. are used to run vehicles, motor pumps, generators sets etc. What will happen if the tax on diesel and petrol goes up?

purchases of goods, you will see that the price includes a VAT (Value Added Tax). VAT on your bill refers to the sales tax, which the retailer has to pay to the government. Like the excise duty, the retailer passes on the sales tax to the consumer and the consumer pays a higher price.

Let us look at the example of the TV mentioned earlier to see how the taxes add up to the price. All figures are in Rupees.

Cost of manufacturing including profit of the manufacturer	Rs. 10,000
Excise Tax	1,200
Cost of Transport, Storage and Retail	1,000
Profit to the traders	1,000
Sales tax	1,650
Price for the consumer	14,850

The proportion earned as profits and the taxes paid would vary from one good to another good and also from one state to another state. The important thing to remember is that most goods carry an element of tax as part of its price. Similarly, most services are taxed, so that their final price includes a tax element. The tax on services is called service tax.

Some common examples of service tax include: speed post, telephone/mobile communication, restaurants, AC class/first class train travel.

Another major tax on goods, called customs duty, is charged on goods when we import it from other countries. For example, a person is returning from a foreign trip and has bought a new camera from abroad. At the airport in our country, she will have to pay a customs duty. Many factories need machines or raw material to be bought from foreign countries. On these things too, customs duty has to be paid.

- In the example of TV, what proportion of the cost of the TV did the consumer pay as tax?
- Collect some bills which mention taxes. Collectively make a collage of the taxes on goods. Make a separate collage of taxes on services with the help of your teacher. See if there are other kinds of taxes that you come across.
- If there are two people manufacturing the same goods and one of them evades paying taxes, what advantages could he/ she get over the other?
- If the tax on iron is increased, which other things will this affect? Give some examples.

### Indirect Taxes as Value Added Tax (VAT)

- Tara bought two hard drives for her school computers from Sai Ram Computers. The bill gave the total sale value before VAT at Rs.5,000. To this VAT was added at the rate of 5%. After adding the VAT amount of Rs.250, the total sale price including VAT was Rs.5250.

- Sajida has bought an inverter battery for her house. The shopkeeper gave Sajida a bill, which says:
- When Preeti paid for the LPG cylinder she noticed that the bill mentioned VAT as zero.

Particulars	Amount (in Rs.)
Battery	9,165
Add VAT at 12.5%	1,146
Total	10,311

There is no VAT charged on LPG in some cities in India such as Delhi.

Over the last decade, the tax on goods has gradually been shifted towards a Value Added Tax system, hence the name VAT. This is done for both excise and sales tax. Let us read the following example to understand what it means.

Suppose there is a biscuit manufacturer. She regularly purchases raw materials for production from a reliable person. The supplier from whom she purchases gives her a bill that says:

	Cost of materials	Tax	Total bill Paid
Raw Materials like wheat, flour, sugar etc.	Rs. 90	10	Rs. 100

Now, suppose she produces biscuits at a cost of Rs 450. This includes all the costs that she has incurred- cost of materials, wages for staff and labour, rent for office and factory etc. She adds Rs 50 as her own profit. So Rs.500 is the value of the output now. She sells the biscuits to a distributor. Remember the manufacturer will have to pay taxes on selling his biscuits. Let the tax rate be 10%. How much tax does she have to pay?

Under the old system, the biscuit manufacturer would have to pay Rs.50 (i.e., 10% of Rs.500) to the government. In total then, the government has collected Rs. 10 + 50 as tax. Rs10 was paid by the supplier and included in the bill that she paid.

Under the system of Value Added Tax (VAT), the producer only pays tax on the value added. Rs.500 is the worth of the output. And Rs.100 is the worth of the input for production (raw materials). The value added is simply the difference between the value of output and input, which is Rs.400 in this case. At the rate of 10%, he has to pay Rs.40 as tax. The inputs used in production that have already been taxed once are not taxed again. In this system the government will collect Rs 10+ 40 =50 as tax, on the whole.

You can see that the tax paid by the manufacturer under Value Added Tax system is smaller since she does not have to pay tax on inputs. Production of industrial goods go through long chains and depend on many goods produced in different factories. In the value added system inputs are not taxed again. Hence in this system the total tax on goods is less and therefore it should cost less.

There is another advantage of Value Added Taxes. All producers and traders will have to keep genuine record of their sale and purchase. Everyone has to keep proper records and ask for bills for purchase. It is only on this basis they can show the tax already paid on cost of inputs. The tax department (tax inspectors) will be able to match records of the seller and purchaser for verification. Non-payment of tax, which is very common, is expected to be more difficult.

- What is your opinion about the value added taxes? Discuss.
- Fill in:  
The purchases by Tara, Sajida and Preeti show \_\_\_\_\_ tax rates across goods. (same/ different)  
Can you guess why this should be so?

## Direct Taxes

We pay taxes on goods and services that we buy/consume. We have seen how the producer or the trader adds the taxes to the final prices, which consumers have to pay. As the goods pass through a number of stages of production and sale, at each step the taxes are paid to the government. However, the total tax is finally passed to the consumer. Thus, taxes on goods and services are also called indirect taxes. Consumers pay it, but indirectly.

In addition, there are taxes, which are directly charged to individuals directly on their income or directly on the profits earned by companies and business. These taxes have to be paid directly by the individuals or businesses to the government and hence are called Direct Taxes.

There are two important direct taxes – Income Tax and Corporate Tax.

Companies that run factories or businesses have to pay taxes. Companies or businesses, receive money from the sale of their products or services. After subtracting all expenses (on raw materials, salaries etc.) from their earnings, the portion that remains is known as the profit of that company or factory. On this profit, corporate tax has to be paid according to the rules.

Income tax is charged on personal income of individuals. There can be a variety of sources of individual incomes like wages, salaries and pensions. An individual can also earn interest income on money that is kept in banks. A person might also get rent on properties that he owns, like house rent. All these are considered as incomes on which taxes have to be paid. Income tax is charged only for those who earn above a certain amount. This is charged as a percentage of the income earned. Those who earn a higher income have to pay a greater proportion of their income as tax.



## What is the fair way of collecting tax from income?

1. You might think it would be fair for everyone to pay the same amount of tax. Consider the following three people:

Person	Work	Earning per month (in Rupees)	Tax as fixed amount per month (in Rupees)
Jyoti	Daily wage labourer	1500	50
Asif	School teacher	8000	50
Nithesh	Business person	30,000	50

Would it really be fair if each of the three people has to pay the same amount? If Jyoti cannot even afford to feed her children properly, is it fair for her to pay 50 rupees as tax?

2. You might think it would be more fair to ask each person to pay a certain percentage of what they earn as tax. Supposing everyone paid 10% in taxes, calculate how much each person would pay.

Person	Earning per month (in Rupees)	Tax as fixed amount per month (in Rupees)
Jyoti	1500	
Asif	8000	
Nithesh	30,000	

Would this be fair? Still Jyoti may not have enough to live. Asif may not have enough for repairing of his house. But Nithesh would have plenty of money for all basic necessities even if he had to pay 20% of his income as taxes.

3. To make taxes more fair you might then say only people earning more than a certain amount say Rs. 7000 per month have to pay taxes. You might also say that the richest people should pay greater proportion of their earnings as taxes. For example

If you earn	You will pay as tax
Less than 7000	0%
7001 to 15000	10%
15,001 to 25,000	20%
More than 25,000	30%

Calculate how much each person will pay.

Person	Earning per month (in Rupees)	Tax as fixed amount per month (in Rupees)
Jyoti	1000	
Asif	6000	
Nithesh	20,000	

Would this be fair?

## Fairness in Taxation

What kind of taxation we follow depends on the values that the society as a whole holds. Most societies feel that it is not fair that a few people have lakhs of rupees, while others don't have enough to eat. The government should collect more taxes from the rich, and the poor should not be taxed or taxed minimally. If the society as a whole aspires, the taxes so collected can be spent, to raise the income of the poor by providing better opportunities and living conditions. Notice that as the incomes of the poor improve more taxes can be collected!

As in the example of Jyoti, Asif and Nithesh, in most countries across the world, the government taxes those with a higher income at a higher rate. According to rules of income tax, those with higher incomes have to pay greater part in tax. Those who are less well-off pay not only lower taxes, but a smaller proportion of their income as taxes. Hence direct taxes are preferred but in India, as you read in the previous section, the major source of tax is indirect i.e. on goods and services. Whether rich or poor, everyone has to pay the same amount of tax when buying something. The poor "feel the pinch" as they say.

While levying taxes on goods and services it becomes difficult to distinguish between the poor and the rich. There is however a way by which the distinction between some goods can be made. For example, grains, pulses, vegetables, cloth, kerosene, cooking oil, cooking gas etc. are goods that are essential. Rich or poor, everyone buys them but the poor spend almost all of their income on these goods. Then there are goods and services which only the rich can purchase: cars, laptops, air-conditioner, dining in restaurants, etc. It is difficult for the poor to afford these luxuries. Hence one way to distinguish between the rich and the poor is not to tax the essential things but to tax luxury items. (Remember what may be considered as luxury may become necessities in the future as living conditions improve etc.)

The problem is that since not many people can afford to buy these luxury items, taxing only such things cannot bring much income to the government.

There is another consideration that the government has to keep in mind in taxing goods and services. There are a number of goods and services that are not directly used by people, such as diesel, steel, aluminium, machines, trucks, truck tyres etc. Such things are used in making or transporting other things. You can imagine the large number of places - industries, factories and businesses where these might be used. People do not buy them directly for consumption.

We saw that when tax is increased on things such as steel, diesel etc, this increase gets added to the cost of goods which are made out of them or transported with their help. With this, even the poor who buy grain or cloth have to pay some part of the tax on diesel or steel. When such things are taxed, the price of many other things goes up. Thus we often hear people saying:

*“The increase in the price of petrol and diesel has led to an all round increase in prices. Fruits, vegetables, pulses and other food items, for example, have become more expensive.”*

For this reason the question that troubles everyone each year is: which taxes should be increased more? Taxes can be collected more easily on goods, but except for luxury items, taxing essential goods affects the poor greatly. Taxes charged and collected have a strong impact on people’s lives. The tax on income falls more heavily on the rich and therefore can be considered more fair. But the taxes from income might not be enough to cover the large government expenditure. Any budget has to take into account all these considerations. That is why the time of the budget is of great importance for everyone.

### Collection and Evasion of Taxes

The government gets money from many kinds of taxes. It has to decide how much money to collect through each kind of tax. For this it has to consider: how many people would have to pay; whether this tax can be collected easily; how would it affect rich and the poor. A related question is whether people pay their taxes or evade it.

You know that a large number people in our country depend on agriculture. Most of them are small and medium farmers. There are also some large farmers with high incomes. However all agriculture income is exempted from tax. Similarly a large section of people in the country earn very low income whether from trade

- We read about some of the major taxes collected by the government. Fill in the table from the information given. Income Tax: 12%; Corporation Tax: 24%; Customs Duty: 10%; Excise Duties: 16%; Service Taxes: 5%; Sales Tax: 23%; Other Indirect Taxes: 10%.

#### Taxes Collected by the Government

Taxes	Percentage of Total Tax
Direct Taxes	36%
Indirect Taxes	
Total Taxes	100%

1. Which kind of taxes generates more revenues for the government?
2. Kanti has an income of Rs. 1,75,000 per year and has to pay an income tax of Rs. 3000. Kamlesh's annual income is Rs.3,00,000 and he has to pay an income tax of Rs.5,500.
  - Who pays more income tax?
  - Who has to pay a larger part of the income as tax?
  - In such a situation the person with higher income is paying a \_\_\_\_\_ (smaller/ greater/ equal) part of the income in tax.

or running small shops or providing labour. The income of these people would be below the limit for income tax. Thus the percentage of total number of people who could be paying income tax is small.

Even this small percentage of people of a large population implies that tax has to be collected from a sizable number of people. For example in 1997 the incomes of 114 lakh individuals were assessed for income tax. They would be living in different places in the country. Collecting income tax is not easy. There are many hurdles. Many people do not disclose their entire income or show it to be less than what it actually is. This income, which is kept hidden, is known as black money.

Many factory owners, rich moneylenders, traders, those doing private business can easily show a low income. It is easy to calculate the income of those who are paid monthly salaries. Tax on their income is directly deducted at the source from where they get their salaries. But many salaried persons also have other sources of income which they keep hidden. Such people, whether they are workers, officers, ministers or clerks, often do not disclose their income correctly. Because there is no tax on income from agriculture many wrongly show their income as income from land and therefore evade tax.

Thus there are many 'tax evaders' and the black money, that is the money on which tax should have been paid but wasn't, goes on accumulating. To get hold of this hoard of black money, the income tax department raids many people's places. It has also tried to make the procedures more convenient for people to pay their own tax. Despite these efforts a large number of people do not pay income tax, or pay less than they should.

On the other hand taxes on goods can be collected more easily since there are fewer places from where it has to be collected. Excise duty is collected from factories, customs duty from international airports and seaports and sales tax from traders and shopkeepers. As compared with income tax to be paid by individuals, the government finds it easier to keep a track of these factory records or shops.

Even here there are those who try to escape taxes by showing lower production than has actually taken place. Sales tax is evaded on a wide scale. Some traders, by not issuing proper bills or recording it in their official registers show much lower sales than what actually occurred. VAT as we saw in this chapter is intended to reduce the evasion of taxes on goods and services.

### Key words

- |                  |                |                    |
|------------------|----------------|--------------------|
| 1. Annual budget | 2. Black money | 3. Value Added Tax |
| 4. Corporate tax | 5. Direct tax  | 6. Indirect tax    |
| 7. Income tax    |                |                    |

## Improve your learning

1. Why does the government need a budget? Why does the budget talk of taxes?
2. What is the difference between income tax and excise duty?
3. Match the following:
  - i. Excise duty                      a) levied on the yearly income of individuals.
  - ii. Sales tax                        b) levied on the yearly profit of companies and business establishments.
  - iii. Customs duty                c) levied on the production or manufacture of goods
  - iv. Income tax                      d) levied when goods are sold.
  - v. Corporate tax                  e) levied on goods brought from abroad
4. You are expected to tax on steel, matches, clocks, cloth, iron; a tax increase on which of these would affect the prices of other commodities the most, and why?
5. Ordinary food items, such as grain, pulses, oil are used by all. Then why is it said that imposing tax on them will have a greater effect on the poor?
6. A group of four friends decided to stay together by contributing money towards the rent of a house. The rent was Rs.2000 per month.
  - How could this be shared among them?
  - We also know that two of them earned Rs.3000 per month and the other two Rs.7000 per month. Is there some other way of sharing the cost so that each one of them feels the same pinch?
  - Which way of sharing would you prefer and why?
7. Tax on income or tax on commodities. Which of the two affects the rich more and which affects the poor more? Explain with reasons.
8. How would VAT reduce the evasion of taxes on goods?
9. What is the difference between the Excise duty and Customs duty?
10. Is there any hike in the bus fares recently? If so, try to know the reasons for it.
11. Read the paragraph under the heading 'Direct Taxes' (Income Tax is charged only for ...) and answer the following:

Why do high income earners pay more tax?

## Project

Bring a few wrappers of soaps, toothpastes, tablet strips or any other things which contain MRP. Discuss the rate mentioned and the rate to which they are sold. Talk about the profit that the retailer gets.