



TAX REVENUE PERFORMANCE IN TAMILNADU: A STUDY

A.Udhayakumar* and R. Sivakumaresan

Department of Economics, Annamalai University, Tamilnadu, India

Received 18th August, 2010; Received in revised form; 25th August, 2010; Accepted 27th September, 2010; Published online 15th December, 2010

ABSTRACT

This paper seeks to analyse tax performance across the states taxes. Percentage contribution of state own tax receipts to state domestic product (SDP) at current prices of government of Tamil Nadu during 1990-91 to 2005-06. The tax effort indices obtained show that generally the upper middle-income and high-income between the study period tax bases to increase revenue, as seen from the high percentage number of state taxes with a tax effort index above unity for the two groups as compared to the others and taxes.

Key words: Own Tax Revenue, Tamil Nadu, Tax Performance

INTRODUCTION

Taxation policy has always been an important instrument for augmenting revenue, especially in developing countries, where it is the major source of domestic revenue. It is also an important instrument for attaining a proper pattern of resource allocation, income distribution, and economic stability, in order that the benefits of economic development are evenly distributed. Increased revenues are desired for many other purposes including expanding socially desired government current expenditures, or even on pragmatic grounds, as to impress foreign aid donors with evidence of the nation's 'effort' to develop on the basis of domestic resources. The state still face difficulty in raising tax revenue to the level required for promotion of economic growth. A poor tax performance, in terms of raising revenue can mean either deficiencies in tax structure policy or an inadequate effort to collect, on the part of the government, both of which are influenced by various factors. Underlying the conceptual argument that the yield of the tax system is a function of the tax bases available, the rates applied to these bases, and the probability of collecting any specific levy, are a number of other factors. In other words, as Eshag (1983) states, the actual amount of tax revenue collected depends only partly on, the taxation potential of the individual state taxation, the taxation targets set by the authorities, and the ability of governments in practice to collect taxes. Given these, the success of the authorities in exploiting the tax potential and in attaining the taxation target will depend on a number of other factors, which include, the economic structure, the general level of

development (reflected in SDP income and levels of literacy, urbanization, communication, etc.), the administrative and political constraints on the fiscal system, social-political values, indigenous institutional arrangements, popular desires for government spending, plus other factors which condition overall willingness to pay taxes. It is likely that these factors interact in a different way, at different times, and in different state, as a result of which, the magnitude of their effects varies among the states, bringing about the disparity in tax revenues between taxes.

2. The Determinants of Tax Performance

The literature suggests that economic development is assumed to bring about both an increased demand for public expenditure (Tanzi, 1987) and a larger supply of taxing capacity to meet such demands (Musgrave, 1969). Musgrave argues that the lack of availability of 'tax handles' might limit revenue collection at low levels of income and these limitations should become less severe as the economy develops. In addition urbanisation, which tends to be linked with development, brings about a greater demand for public services while at the same time facilitating tax collection (Tanzi, 1987). There is a broad consensus in the literature on the use of per capita income as a proxy for the overall level of development. It has a "normative" significance from the taxation point of view (Bahl, 1971 and Ansari, 1982). Per capita income is an index of the surplus income available for taxation as a result of economic development (Radhakrishnan, 1991). A higher per capita income reflecting a higher level of development is held to indicate a higher capacity to pay taxes as well as a greater capacity to levy and collect them (Chelliah, 1971).

*Corresponding author: economics1776@gmail.com

Trade taxes have historically been a major source of government revenue during the early stages of economic development because they are easier to collect than domestic income taxes or consumption taxes when tax administration is rudimentary and tax handles are limited, (Tanzi 1987). The administrative ease with which trade taxes can be collected makes them an attractive source of government revenue when administrative capabilities are scarce (Linn and Weitzel, 1990). Consequently the importance of trade taxes as a source of tax revenue is arguably inversely related to the economic development. Common observation as well as the results of the earlier studies in general indicates the degree of openness to be an important factor affecting the tax ratio in developing countries. Certain features of overseas trade make it more amenable to taxation than domestic activities, and in developing countries, the overseas trade sector is typically the most monetized sector of the economy. Entrance and exit to the country takes place in specified locations. The growth of public spending has generated large fiscal deficits in many states, leading to increases in the share of public debt relative to GDP. The existence of a large public debt has important implication for the taxation potential of any country. With such a large debt, the government needs to raise the revenues necessary to service it. When the interest on the debt exceeds net borrowing plus the possible reduction in non-interest expenditure, the level of taxation must go up unless the rate of growth of the economy is high enough to neutralize the increase. Aid and grants have been the principal source of development finance for the majority of developing countries over the past few decades. Empirical literature has tended to evaluate the impact of aid by including it as a variable in a regression for the determinants of some economic performance indicator, emanating from the general concern that it might have a negative impact on some of such indicators. For instance, there is a general concern that aid may decrease taxation revenue in recipient countries. Demographic characteristics should be carefully examined, so as to enable identification of the various conditions and the circumstances, which influence the process and pattern of development, thereby affecting the tax ratio. Population density is assumed relevant according to the literature, due to its effect on some significant economies of scale. It is difficult however to point out the direction of the effect, without a systematic study.

3. Empirical Model

International comparison of fiscal efforts of developing countries is researched several times. The famous studies in this area are Harley (1965); Lotz and Morss (1967); Raja (1971); Roy (1979); Dehnashwar Ghura (1998); Abhijit Sen Gupta (2007). Most of these studies used ordinary least square method (OLS) technique to find the determinants of total tax to GDP ratio and most common exogenous variables used by these studies were share of agriculture sector, share of industrial sector, share of foreign trade and per capital income. There are number of empirical studies (ordinary least square method in India)

based on time series data. Some of important studies include Sahota (1961) Sury (1978) Purohit (1978) Rao,(1979) Khadye (1981) Amaresh Bagchi (1994) Dwivedi (1996) GovindRao (2000) Upender (2002) Indira Raja Raman, *et.al.*, (2006) and Upender,(2008) in this study will be an addition to the existing literature on tax performance in the Tamil Nadu. Determinants of tax performance during post tax reform period and degree of differential tax performance.

The response coefficient from time series data is estimated by using the following revenue exponential function.

$$T = a Y^b$$

or taking logarithms on both the sides,

$$\text{Log } T = \log a + b \log Y$$

In a least square fit of this logarithmically linear equation on time series data, the regression coefficient a is the constant and the regression coefficient b signifies percent change in (T) that accompanies 1 percent change in (Y).

4. Discussion and Results

As far as the individual tax is concerned, the buoyancy of direct tax is less than unity (0.18). This indicates that direct taxes is inelastic and has a small degree of progressively in it. The buoyancy of land revenue shows that these are the least buoyancy ones. The negative indicates inverse relationship between tax revenue and SDP. For many years the state was changed by some economic factors. The partly in power has to follow this course to get votes from agricultural sector, which has 70 per cent of the population in Tamil Nadu. The negative buoyancy also explains that the tax has not been properly maintained but poorly administered and collected during first phase of globalization period. The buoyancy coefficient of stamp and registration duty is greater than unity. The inference is that the increase in SDP fulfill by 99 per cent increase in revenue. Motor Vehicle Tax (MVT) is basically meant for regulating and controlling motor traffic, and it is levied on all motorised vehicles and at high rates. Its buoyancy is a fraction of the number of vehicle, road and transport infrastructure of the government. The buoyancy estimation is 0.76; it may increase in the sales of vehicles. The entertainment tax in the state is elastic as it is 'b' coefficient of 0.25 percent. The entertainment tax is a levy on admission of the place of amusement or entertainment. This includes exhibition, cinemas, circus etc, The state excise duty is the whole tax system. The revenues on account of this depend mainly on the states prohibition policy and revision of tax rates. High revenue in such a short span of time twice indicates that consumption expenditure on liquor in the state has decreased (0.31).

Sales tax is the main source of income to the state government. It includes Central and State Sales Tax. The 'b' coefficient of sales taxes which provides 2/3rd of state tax receipts has a positive impact on State Domestic Product at Current Prices. Hence the sales tax is elastic.

5. Conclusion

The researcher concluded that long-run estimation results for state tax revenue to be inelastic with respect to the quarterly Change in GDP. However, discretionary changes undertaken over the period of the study did enhance revenue collection and that the existing tax performance, if left alone, has limited potential for revenue generation. It is therefore a challenge to the government to proceed with tax reforms in the excise tax system if economic growth is to have any meaning in government revenue generation. The reforms should cover tax administration, revision of tax rates and broadening of the tax base. The empirical results of the present exercise, based on the stationary time series annual data for the period from 1990-91 to 2005-06, elucidate that the gross tax buoyancy estimate is just above the unity during study period evincing the fact that the ratio of Gross Tax Revenue to Gross Domestic Product was increasing with the increase in Gross Domestic Product during the study period.

REFERENCES

- Abhijit Sen Gupta (2007), Determinants of Tax Revenue Efforts in developing Countries, *IMF Staff Paper*, 245-295.
- Andreoni, J., Erard, B., and Feinstein, J. 1998. "Tax Compliance", *Journal of Economic Literature*, 36: 818-860.
- Ansari M. 1982. Determinants of Tax Ratio: A Cross-Country Analysis", *Economic and Political weekly*, 1035-1042.
- Amrita Jairaj and Barbara Harriss-White 2006. Social Structure, Tax Culture and the State: The Case of Tamil Nadu" *Economic Political Weekly*, 41(51): 5247-5256
- Annual Issues of "Tamil Nadu: An Economic Appraisal", 1990-91 to 2005-06
- Baltagi, B.H. 2001. *Econometric Analysis of Panel Data*, 2nd edition. John Wiley and Sons, Singapore.
- Bird, R.M. 1978. Assessing Tax Performance in Developing Countries: A Critical Review of the Literature", in *Taxation and Economic Development* Ed. By Toye, J.F.J., Frank Cass and Company Ltd. London, 33-57.
- Cao Duc Thac and Lim D. 1984. Papua New Guinea's Tax Performance, 1965-77" *World Development*, 12(4) 451-459.
- Chelliah R.J. 1971. Trends in Taxation in Developing Countries", *IMF Staff Papers*, 18(2): 254-325.
- Cheasty A. 1990. Fiscal Implications of Trade Liberalization", in *Fiscal Policy in Open Developing Economies*, ed. By Vito Tanzi, IMF.
- Dehnashwar Ghura, 1998. Tax Revenues in Sub-Saharan Countries. *IMF Staff Paper* 98/135.
- Ehstishan A. and Stern N. 1989. Taxation for developing Countries" in *Handbook of development Economics*, 2 ed. by Chenery H. and Srinivasan T.N., Netherlands.
- Elena Ianchovichina, Lili Liu, and Mohan Nagarajan 2006. Sub national Fiscal Sustainability Analysis: What Can We Learn from Tamil Nadu" *World Bank Policy Research Working Paper*_3947
- Govinda Rao. M, 2005. Tax system reform in India: Achievements and challenges ahead", *Journal of Asian Economics* 16: 993-1011
- Indira Raja Raman and Others, 2006. Tax Buoyancy Estimates for Indian States", *Economic and Political Weekly* April 22, 41(16): 1570- 73
- Khadye, J.K., 1981. "The Responsiveness of Tax Revenues to National Income in India (1960-61to1978-79)" *RBI occasional papers*, 2(1) 23-70.
- Musgrave R.A. 1969. *Fiscal Systems*, Yale University Press, London, UK.
- Purohit, M.C.,1978. Buoyancy and Income Elasticity of State Taxes in India" *Artha Vijana*, 20(3):244-287
- Sham Bhat, K and G. Kannabiran, 1992. Measuring Elasticity and Buoyancy of Tax Revenue in Tamil Nadu: A Divisia Index Approach", *Prajnan*, 21:2,
- Subramanian. M.S. 1991. Determinants of own tax revenues and Expenditures of Tamil Nadu State Government" *Prajnan*, 20(3):522-269
- Sury, M.M, 1985. Buoyancy and Elasticity of Union Excise Revenue in India: 1950-51to1980-81" *Margin*, 40-67
- Tanzi V. 1987. Quantitative Characteristics of the Tax Systems of Developing Countries", in *The Theory of Taxation for developing Countries*, ed. by Newbery and Stern, Oxford University Press, New York, 205-241.
- Tanzi V. and Zee Howell H. 2000. Tax Policy for Emerging markets: Developing Countries", *National Tax Journal*, 53(2): 299-322.
- Upender, M. 1999. An Income Tax Laffer curve: The Indian Experience", *Artha Vijana*, 41:2
- Upender, M. 2008. Degree of Tax Buoyancy in India: An Empirical Study" *International Journal of Applied Econometrics and Quantitative Studies* 5(2):5 9-70
