

Who Pays for Welfare Programmes?

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The government finances its various welfare programmes for the poor largely from the revenue collected through various taxes. If we analyse the tax burden — who actually pays taxes — it seems that the government is taking money from one group of poor to give it to another group of poor. Contrary to the popular perception that middle and upper classes — the better-off in short — of our society are taxed to provide welfare and support to the poor, it is actually the poor who are paying for the welfare programmes run for their benefit!

Taxes are broadly of two types: direct and indirect. Direct taxes consist primarily of corporation tax and income tax. Others like estate duty, interest tax, wealth tax, gift tax, land revenue, hotel and agricultural tax are very minor contributors. Indirect taxes, levied on goods and services, consist primarily of excise and customs duties, and sales tax. Taxes on entertainment, vehicles and electricity are other crucial components of indirect taxation in our country.

Indirect taxes are, by and large, regressive. That is, the poor who consume almost all of their incomes pay more indirect taxes in proportion to their income compared to the upper classes. How? Consider a poor man Ramu earning Rs 3,000 a month. He spends all of his income to meet his basic existential requirements. On every paise he spends, in buying salt, matchbox, slippers, or alcohol, he pays either sales tax, or excise, or customs duty (if the alcohol or cigarettes happen to be imported). Assume for a moment that the average of these indirect taxes comes to 10%. Ramu then pays Rs 300 in indirect taxes (10% of Rs 3,000). Rony, on the other hand, earns Rs 30,000 per month. He spends Rs 20,000 on his consumption needs and the rest is saved. He also pays some form of indirect tax on every paise of his Rs 20,000 that he spends on Cuban cigars, Cognac, or Honda City. At the rate of 10%, the taxes would amount to Rs 2,000 for our richie-rich Rony.

While dealing with these two hypothetical cases, you have surely not missed a couple of important implications: one, in proportion to their incomes, Ramu pays 10% of his income in indirect taxes (Rs 300 [tax]/Rs 3,000 [income]), Rony, however, pays only 6.66% (Rs 2,000 [tax]/Rs 30,000 [income])! Second, Rony does not pay any indirect tax on Rs 10,000 that he saves. Indirect taxes are regressive — tax burden is heavier on the poor than on the rich.

Table 1: Tax Revenues of the Union Government

Year	Tax Revenue	Direct as a prop of total tax	Income Tax as a prop of direct tax	Corp Tax as a prop of Direct Tax	Indirect as a prop of tax	Excise as a prop of Indirect Tax	Customs as a prop of indirect
1994	67454	0.28	0.19	0.75	0.72	0.43	0.55
1996	93701	0.27	0.18	0.73	0.73	0.34	0.63
1998	104652	0.31	0.18	0.76	0.69	0.39	0.56
2000	136658	0.36	0.47	0.51	0.64	0.56	0.54
2002	164177	0.37	0.46	0.53	0.63	0.65	0.44
2004(RE)	254923	0.41		0.61	0.59	0.62	0.33

Source: <http://www.rbi.org.in/sec7/37043.doc>

Table 2: Effective Rates of Major Indirect Taxes by Expenditure, 1988-89

Monthly per capita expenditure class (Rs.)	Urban Areas	Rural Areas
1 90-110	10.31	9.78
2 135-160	10.84	9.86
3 185-215	11.34	10.24
4 215-255	11.40	10.43
5 385-520	12.74	11.57
6 Above 700	14.31	13.75
All Classes	12.15	11.21

Source: "Who pays for Taxes?", Aggarwal, Pawan. K, Gayatri Publication, 1998, taken from SARVEKSHNA, VOL xiv, NO. 3, issue No. 46, January- March, 1991, pp S-7 & S-8

Table 1 gives the break-up of the net tax revenue of the Union government in terms of the direct and indirect taxes it levies, as well as their share in total tax revenue for a few years. Till 1994, the share of indirect tax was well above 70%, which began to fall, once the economic reform began kicking in, to about 59% in 2004.

When we consider the combined tax revenues of the Centre and states, the share of indirect taxes is even higher. In the 1980s, it was in the 80% range, highest being 85% in 1987-88. This began to decline in the 1990s. It was 73% in 2001 and 72% in 2002. Thus, the Centre and state governments rely heavily on regressive indirect taxes to finance their programmes, including those for poverty alleviation, employment generation, and welfare for the poor.

The government seems to be taking money from the poor and then trying to return it in the form of various employment and welfare schemes. These programmes transfer money, not from the rich to the poor as is commonly assumed, but from one group of poor to the another group of the impoverished of our country.

Table 2 gives the effective rates of major indirect taxes by expenditure class. Note that there is not much difference in the effective tax rates across income slabs or across rural and urban areas — it ranges from about 10% to 14%. The indirect tax on actual expenditures is surprisingly similar, irrespective of the amount of money spent, or where it is spent. The regressiveness then comes from the part of the income that is not spent.

The L K Jha Committee on taxation reforms had reported in early 1980s that 85% of the taxes were collected from the poorer section of society. Many of the tax reforms since have tried to shift the burden of raising government revenues from indirect to direct taxes.

Add to the fact that the poor are largely paying for the welfare programmes, the now well-established comment from Rajiv Gandhi that of every rupee spent on the poor, only 15 paise actually reaches them. The Planning Commission's evaluation of the poverty programmes puts this number at 10 paise! The government takes Rs 100 from the poor in taxes and gives back Rs 10 in anti-poverty schemes! The welfare programmes indeed are a cruel joke on the poor. Is it any wonder that these programmes, despite more than 50 years of existence, haven't improved the lives of the poor in India?

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