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A PROPOSAL FOR STATE-LEVEL BUDGETARY REFORMS

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A PROPOSAL FOR STATE-LEVEL BUDGETARY REFORMS

Correcting the fiscal imbalances today is the single most important task of macro-economic management in India in the face of rising inflation, burgeoning public debt and deepening balance of payments crisis. A series of measures towards this end have already been initiated and some more are contemplated by the Central government after recommendations of the two expert committees, one on tax reform and the other looking into the reform in the financial sector, are received and considered.

While there has been a lot of discussion on the problem of fiscal imbalances and the need to undertake corrective measures by the Central government, the issue at the State level has not received the attention it deserves. Fiscal reforms at the State level are important, for, the States raise about 35 per cent of the total Central and State revenues and account for about 58 per cent of total revenue expenditures. Of the estimated total revenue deficits, which were close to 4 per cent of GDP in 1989-90, the revenue deficit on account of the States' budgetary operations was over one per cent of GDP. The fiscal deficit attributable to the States was also substantial, at about 3.5 per cent of GDP in 1990-91. Therefore, for any successful attempt at undertaking fiscal reforms to bring down revenue as well as fiscal deficits, it is necessary to review and reform the budgetary policies of the State governments as well.

This paper seeks to examine the present state of public finance at the State level with a view to tracing the emerging trends in the medium as well as in the long term. The objective of this exercise is to identify the major problem areas and to indicate the policy changes needed to tackle them. Section I brings out the seriousness of the fiscal problems at the State level. The major trends and problems on the expenditure and

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revenue sides are discussed, respectively, in Sections II and III. Section IV deals with the policy changes needed to tackle the identified problems.

I. Emerging Trends in State Finances

One of the most distressing features of the State finances is the emergence of substantial and growing revenue deficits in recent years. The continuous outpacing of the growth of revenue expenditures by that of revenues, (Table 1), both in the seventies and the eighties, has led to serious deterioration in the States' budgetary positions, from a surplus of 1.2 per cent of GDP in the mid-seventies to a deficit of about 1 per cent of GDP in 1989-90 (Table 2). In absolute terms, the net revenue deficit in 1989-90 was close to Rs 4600 crore.

Since 1987-88, dissaving of a significant magnitude has appeared and it has been showing large increases year after year mainly due to very high growth of revenue expenditures. The increase in expenditures has been particularly alarming in the 1980's when it grew at an average rate of 17.6 per cent per annum. What is more, with the interest liability itself growing at 22.7 per cent per year, expenditure growth has become self-propelling. Equally causing grave concern is the high growth of wages and salaries and subsidies. Unless bold and decisive measures are taken immediately, expenditure growth will become explosive.

It is important to note that the problem of growing fiscal imbalance has emerged in spite of revenues increasing at a reasonably high rate. The States' own total revenues registered an average annual growth of 15 per cent in the last decade and a half, and their tax revenues increased at a marginally higher rate of 15.6 per cent. In fact, in the eighties, the rate of growth of States' tax revenues was higher at 16 per cent per year.

Table 1

Growth of State Revenue and Expenditures

(Per cent per annum)

	1974-75 to 1979-80	1980-81 to 1989-90	1974-75 to 1989-90
(1)	(2)	(3)	(4)
I. Revenue Receipts			
a. Own Tax Revenue	14.4	16.1	15.6
b. Own Non-Tax Revenue	11.9	12.5	12.3
c. Own Total Revenue	13.9	15.4	15.0
d. Central Transfers to States	18.4	15.8	16.5
Total-Revenue Receipts	**15.9**	**15.5**	**15.6**
II. Total Revenue Expenditure	16.1	17.6	17.2
III. Total Capital Outlay	20.1	11.1	13.5
IV. Total Expenditure	17.5	15.8	16.2

Note : Sub period growth rates have been computed by using kinked exponential model.

Source : Computed on the basis of data taken from Indian Economic Statistics - Public Finance, Ministry of Finance, Government of India

However, the non-tax revenues increased only at the rate of 12 per cent per annum and if cess and royalty on mines and minerals are excluded the growth rate was just about 8 per cent. The reluctance to levy proper user charges on social and economic services and the poor and declining returns from departmental and non-department commercial enterprises are the principal reasons for the low and declining proportion of non-tax revenues.

It is also notable that, during the last decade, the growth of Central transfers to the States on revenue account at 15.8 per cent was higher than that of both Central revenues (14.5 per cent) and States' own revenues (15 per cent). The transfers within the revenue account presently form about 38 per cent of Central revenues and, given the Centre's own difficult fiscal

Table 2

Budgetary Position of State Governments

(Rs Crore)

Year	Revenue receipts	Revenue expenditure	Revenue surplus (+)/ deficits (-)	Revenue surplus/ deficits as per cent of GDP
(1)	(2)	(3)	(4)	(5)
1975-76	7475	6522	953	1.21
1980-81	15036	14136	900	0.66
1981-82	17504	16193	1310	0.82
1982-83	20243	19354	889	0.50
1983-84	22908	22691	218	0.10
1984-85	26210	27118	-898	-0.39
1985-86	31906	31362	544	0.21
1987-87	35981	35960	21	N
1987-88	42167	43205	-1038	-0.31
1988-89	47767	49592	-1825	-0.46
1989-90 (RE)	53873	58449	-4576	-1.03

Note: N = Negligible

Source:
1. Indian Economic Statistics, Public Finance, Ministry of Finance.
2. Economic survey 1990-91, Government of India.

position, it may not be feasible to increase the transfers as a ratio of Central revenues any further, at least in the medium term context.

The higher growth of revenue expenditure in relation to the growth of revenue receipts has created an explosive cycle of expenditure growth. The use of borrowed funds for meeting revenue expenditure, while increasing interest liability, does not create corresponding sources of revenue. In addition to this, as even the borrowed funds used for capital spending are not efficiently utilised, interest liabilities feed back into the growth of expenditures requiring even larger diversion of borrowed funds. Due to this, the States' gross interest payments during the decade of the 1980's grew at the rate of 22.7 per cent, while the growth of net interest payments (after adjusting for interest receipts) during the period was 31.2 per cent. Clearly, such a high growth of interest payment expenditure is unsustainable.

The emphasis on having large plans even when commensurate resources were not available resulted in taking recourse to heavy borrowing year after year. As the borrowed resources were not effectively used to generate either direct revenue yielding assets or infrastructural facilities, the debt repayment obligation had to be met by borrowing more funds. Thus, the States' total borrowings as well as borrowing from the Central government increased at the rate of 16 per cent per year during the last decade.

This has created a very serious problem of non-plan capital gaps in every State. The Finance Commissions prior to the Ninth, reduced the non-plan capital gaps by rescheduling and writing off of the Central loans, which merely transferred the burden to the Centre. Given the underlying trends this practice by the Finance Commissions only provided a temporary relief as, at the end of every five years, the new Finance Commission was faced with the same problem with greater intensity. The Ninth Finance Commission, unlike its predecessors, did not reschedule the Central loans, but stressed the need for better fiscal management on the part of the States and reasonable lending terms by the Centre. As the Commission did not provide any significant debt relief to the States they would have sizable non-plan capital gaps and hence, would be left with very little resources to finance their plan requirements after meeting debt repayment obligations. During the period 1990-95, the estimated non-plan capital gaps of the States works out to about Rs 9750 crore.

The outstanding debt of the State governments which was only Rs 21600 crore by the end of March, 1980 increased by four and a half times in a decade. By March, 1990, the States' indebtedness amounted to Rs 91000 crore. As a proportion of GDP, the States' indebtedness increased from 17.6 per cent in 1980 to 23 per cent in 1990. It must be noted that this order of increase has come about in spite of the Central government providing substantial debt relief on the recommendations of Finance Commissions. Along with increase in indebtedness, the outgo by way of loan repayments has also increased substantially. In 1989-90, for example, loan repayments of the States amounted to about Rs 4200 crore at 30 per cent of their gross borrowings. In fact, repayments have increased at the rate of about 14 per cent per year in the last decade. Consequently, funds available for capital investment have been greatly reduced.

A major consequence of the difficult resource position in the States has been to decelerate capital outlays significantly. The resource constraint which became binding after the introduction of the overdraft regulation scheme in the mid-eighties resulted in a significant slow-down in the growth of capital expenditures from 20 per cent per year in the seventies to just about 11 per cent in the eighties. Consequently, capital expenditure as a proportion of GDP declined from 3.9 per cent in 1980-81 to 2.6 per cent in 1989-90.

Thus, the States face an explosive cycle of revenue expenditure growth and are virtually in the throes of a debt trap. Given that the growth rate of revenues, particularly that of tax revenues is already reasonably high, it may not be possible to accelerate their growth further without seriously affecting the incentives. The remedial action, therefore, should primarily concentrate on decelerating the growth of expenditures and phasing out the hidden subsidies through the levy of proper user charges.

Assuming that the observed trend in revenues will continue into the future in the medium term, in order to phase out the revenue deficit in the next three years, i.e., by 1994-95 the expenditure growth would have to be decelerated to 12.9 per cent per annum, by almost 4.7 percentage points. If a longer period of five years is taken for adjustment, revenue deficit will be phased out if expenditure growth is brought down to 13.8 per cent per year. Considering that interest payments have been growing at the average annual rate of 22.7 per cent, the growth of remaining items of expenditure would have to be brought down substantially to 11 per cent or 12 per cent, respectively for making the adjustment in three years or five years. This indeed is a tall order and therefore, immediate remedial measures to compress expenditures must be undertaken. This calls for a more detailed analysis of expenditures. This is undertaken in the next section.

II. Analysis of Public Expenditure Growth in States

The economic implications of expenditure growth are brought out more clearly when the expenditure trends are analysed in terms of economic and functional classification. For this purpose, we have obtained unpublished data from the Central Statistical Organisation (CSO) and each of the components of expenditure has been adjusted for price increases by using appropriate deflators. Unfortunately, since the data are available only upto 1987-88, the analysis could not be brought upto date.

The analysis presented in Table 3 clearly brings out that the current expenditure **in real terms** increased at a rapid pace, in the 1980s almost at 8 per cent per year, which was much higher than the growth of GDP which was approximately 5 per cent during the period. Expenditure on capital formation, on the contrary, grew at 4.7 per cent; the growth of capital expenditure was as low as four per cent in real terms in the low income States and even in the high income States it was higher only by one percentage point (Annexure Table 1). Capital formation expenditure formed less than four per cent of GDP and only 25 per cent of total expenditure in 1987-88. Let us now discuss the trends in various components of current expenditure in greater detail.

a. **Subsidies**: Of the various items of current expenditure, the highest growth in real terms was observed in the case of subsidies and interest payments - both grew at 12.6 per cent, followed by other transfers which grew at (8.4 per cent). Subsidies formed almost seven per cent of total expenditures and the share of interest payments was about 10 per cent. It is also seen that the growth of subsidies was higher in low income States

(13.7 per cent) than in both middle income (12.7 per cent) and high income States (9.9 per cent) (Annexure Table 1). It may be clarified that subsidy figures given here do not include various hidden budgetary subsidies arising from non-recovery of costs on account of social and economic services. In magnitude and composition of these "subsidies" will be discussed in the next section which deals with the non-tax revenues.

Table 3

Growth and Composition of State Expenditures

Item of expenditure	Expenditure as a per cent of GDP 1987-88	Expenditure as a per cent of total expenditure : 1987-88	Growth of expenditure (1980-81 to 1987-88) per cent, at constant prices.
(1)	(2)	(3)	(4)
I. Economic Categories			
1. Wages and salaries	4.03	27.41	7.83
2. Goods and services	1.10	8.02	4.76
3. Interest payment	1.47	10.02	12.66
4. Subsidy	1.01	8.89	12.61
5. Other current transfers	3.30	22.43	6.44
6. Total current expenditure	10.98	74.78	8.19
7. Total capital expenditure	3.71	25.24	4.73
II. Functional Categories			
1. General services	2.14	14.59	6.93
2. Social services	6.11	41.50	8.24
3. Economic services	4.62	32.01	3.93
4. Total expenditure	14.69	100.00	7.97

Source: Estimated from the unpublished data provided by Central Statistical Organisation, Ministry of Planning, Government of India.

Note: The functional categories do not include interest payment.

In addition to these subsidies, there exist a large number of schemes of direct transfer payments intended to benefit various vulnerable sections of the community in each of the States. The important schemes include unemployment benefit, pensions for the old, widows, agricultural workers and the disabled, various nutrition schemes for the children and subsidisation of foodgrains and other items of mass consumption. Over the years, the coverage and the financial outlay on these schemes have grown in importance. Even excluding the transfer payments made for various poverty alleviation programmes (about Rs 2100 crore) the spending on these social security and welfare schemes in the major States in 1986-87 was about Rs 1100 crore (Table 4) forming about 5 per cent of their revenue expenditures. The coverage and benefits of each of the schemes vary across the States widely and many a time, these are ill-targeted and even duplicating.

b. **Wages and Salaries**: The increase in wages and salaries at a very high rate is a matter of serious concern. Expenditure on wages and salaries increased at an annual average rate of about 8 per cent in real terms during the period, 1980-81 to 1987-88. In fact, in the period subsequent to 1987-88, expenditure on this item must have grown at even faster rate due to the pay revision in the States subsequent to the recommendation of the Fourth Central Pay Commission and the consequent decision of the Central government to revise the pay scales for its employees. On an average, the pay revision in the States is estimated to have enhanced the salary bill by almost 18 per cent[1].

A major reason for the spectacular growth of government expenditures on wages and salaries at the State level is the phenomenal increases in employment in State governments as well as in government schools, aided institutions and local bodies. In the 14 major State governments alone, the net employment increased from 4.9 million in 1981 to 6.6 million in 1987, or at the rate of 3.6 per cent per year (Table 5). As generally about 3 per cent of the employees superannuate every year, the gross employment seems to have registered a growth of about 6.6 per cent, which surely is staggering by any standard.

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1. The salary bill in the States in 1988-89 was estimated at Rs 24,331 crore of which, the effect of pay revision (excluding arrears) was estimated at Rs 4358 crore or 18 per cent.

With the growth of organised sector employment decelerating from 2.5 per cent during 1973-77 to 1.4 per cent during 1983-87[2], in the absence of a proper social security or unemployment insurance system, the State governments appear to have intervened in a major way to ease the pressure of huge and increasing backlog of unemployment. But this method of tackling unemployment problem is surely self-defeating for, increase in direct employment by the State government is at the cost of expenditure on the maintenance of capital assets or incurring capital expenditures on infrastructural sectors itself and the bottlenecks created thereby in the infrastructural sectors clearly result in lower employment in the non-governmental activities. A prudent policy is certainly not to spend more on wages and salaries, but to make funds available for better provision of social and economic infrastructure.

There are also other important reasons for the rapid growth of State government employment. A number of new programmes under the plan are taken up year after year even when the existing projects and programmes cannot be adequately funded due to shortage of resources. The employment of a large number of functionaries by various line agencies implementing each of the Centrally Sponsored Schemes at village, block and district levels instead of having a smaller number of multipurpose workers with adequate work assignments, is another reason for the high growth of State government employment. Also, in recent times, the difficult law and order situation in many parts of the country has necessitated the high growth of employment connected with the maintenance of law and order.

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2. See, "Employment, Past Trends and Prospects for 1990s", Planning Commission, New Delhi, May, 1990.

Table 4

Financial Implications of Various Transfer Payments

(Rs. Lakh)

States	Pensions and Financial Assistance to Old and Disabled		Unemployment Benefits and Employment Schemes		Nutrition Schemes For Children		Direct Subsidies on Commodities and Services		Total of All Schemes	
	1982-83	1986-87	1982-83	1986-87	1982-83	1986-87	1982-83	1986-87	1982-83	1986-87
Andhra Pradesh	1059.5	2760.5	-	-	269.7	1324.9	9575.0	19283.0	10904.2	23368.4
Assam	0.2	258.3	38.6	94.8	369.8	780.6	-	-	408.6	1133.7
Bihar	5944.9	5321.8	873.8	901.4	781.7	1038.1	4.9	5.0	7605.3	7267.0
Gujarat	178.7	303.5	-	-	706.8	5149.5	-	-	885.5	5453.0
Haryana	315.2	654.1	3.5	4.6	107.3	502.5	-	-	425.9	1101.2
Karnataka	2617.0	6114.8	-	-	722.5	5152.1	149.0	745.4	3490.2	12012.1
Kerala	1828.0	3319.5	80.0	1004.0	1409.0	1190.3	29.1	59.1	3346.8	5572.8
Madhya Pradesh	750.0	950.0	-	-	325.0	568.3	-	-	1075.0	1518.3
Maharashtra	NA	2053.0	-	23443.0	1131.2	1808.2	-	-	-	27304.2
Orissa	96.9	637.0	-	-	726.8	0.0	-	-	823.6	637.9
Punjab	441.3	707.0	43.0	68.8	78.2	288.3	-	-	562.4	1064.4
Rajasthan	366.0	467.2	1.1	0.4	255.0	947.8	-	-	623.8	1415.4
Tamil Nadu	798.0	1432.0	-	-	10872.2	14152.5	136.0	142.0	11806.2	15726.5
Uttar Pradesh	342.6	2309.7	-	-	469.4	368.5	0.7	0.3	812.7	2678.5
West Bengal	281.5	446.3	1165.0	578.0	1332.3	1821.1	-	-	2778.6	2843.3
All Major States	15022.9	27735.0	2205.2	26092.9	19558.4	35093.2	9895.5	20235.4	45549.0	109156.4

c. Goods and Services: Expenditure on wages and salaries has a strong complimentarity with spending on goods and services. The larger the number of employees, the higher is the amount of government spending on goods and services, particularly on items like office space, transport and communication, and stationery and printing. When the funds are pre-empted for items with a strong complimentarity, the resources available for spending on maintenance of capital assets and other important items of goods and services necessary for the effective provision of services become woefully inadequate. Often, when adequate provision for maintenance and stores and spares is not made, salary expenditure is incurred without any commensurate service being rendered, as the employees, particularly in departments like public works, have little work to do.

Table 5

Total State Government Employees ##
(As on 31St. March)

(in thousands)

	1981-82	1987-88	Compound Growth Rates
Andhra Pradesh	391.22	502.30	4.25
Gujarat	223.93	266.68	2.95
Haryana	200.38	243.24	3.28
Karnataka	383.97	478.76	3.75
Kerala	285.12	344.19	3.19
Madhya Pradesh	565.40	706.17	3.77
Maharashtra	500.39	605.83	3.24
Orissa	227.81	281.41	3.58
Punjab	265.57	291.68	1.58
Rajasthan	364.92	430.32	2.79
Tamil Nadu	451.80	612.30	5.20
Uttar Pradesh	685.52	832.53	3.29
West Bengal	353.80	470.72	4.87
Total of 13 States	4899.82	6066.12	3.62

Note: ## Excluding aided institutions and local bodies.

Source : Memoranda submitted to the Ninth Finance Commission by the States.

Table 6 brings out the relationship between expenditure on wages and salaries and goods and services more clearly[3]. In the aggregate, in 1971-72 every rupee of expenditure on wages and salaries resulted in current spending on goods and services to the extent of Rs 0.44. As the need for maintenance of capital assets necessitates larger expenditure on goods and services in the case of economic services, the relationship between salary expenditure and spending on goods and services is clearly stronger than in the case of administrative or social services. At the same time, over the years, given the shortage of resources after meeting salary expenditures, spending on goods and services per rupee of salary

3. The relationship has been estimated by regressing expenditure on goods and services on wages and salary expenditures in a linear regression equation, using cross-section data.

expenditure has continuously declined and by 1987-88, a rupee of salary expenditure resulted in spending on goods and services only to the extent of about Rs 0.21. While this trend is seen in the case of every functional expenditure category, the substantial weakening of the relationship seen in the case of economic services underlines the decline in the provision for maintenance of assets over the years.

Table 6

Relationship Between Expenditures on Goods and Service and Wages and Salaries : All Major States

Type of Service/ Year	Administrative Services	Social Services	Economic Services	Total Expenditure
1971-72	0.2416	0.2170	0.6637	0.4389
1976-77	0.3065	0.0505#	0.3752	0.3149
1980-81	0.2503	0.0454#	0.3933	0.2603
1985-86	0.2383	0.0408#	0.3592	0.2379
1986-87	0.2149	0.0731#	0.2278	0.2327
1987-88	0.1619	0.0823#	0.2496#	0.2053

Note: 1. All Coefficients except those marked # are significant at 5 per cent level of significance.
2. Estimated on the basis of the Equation

$$G = a + bE$$

Where, G = Expenditure on Goods and Services and
E = Expenditure on Wages and Salaries

In 1971-72, for example, a rupee of salary expenditure was associated with goods and services expenditure of Rs 0.66 whereas, in 1987-88, it was associated with just about Rs 0.25.

The relationship between wages and salaries and goods and service expenditures in individual States over the period 1971-72 to 1987-88 brings out another dimension of this problem. On the average, goods and service expenditure for every rupee of salary expenditures at Rs 0.29 in more developed States was approximately twice the value obtaining in middle and low income

Table 7

Relationship Between Goods and Services and Wages and Salaries : Time Series
Time Period :1971-72 to 1987-88

	Administrative Services	Social Services	Economic Services	Total Expenditure
I. High Income States				
1. Gujarat	0.116	0.583	1.428	0.506
2. Haryana	0.104	0.116	0.534	0.179
3. Maharashtra	0.086	0.467	0.341	0.240
4. Punjab	0.188	0.106	0.459	0.194
Aggregate	0.118	0.276	0.638	0.285
II. Middle Income States				
1. Andhra Pradesh	0.142	0.229	0.403	0.230
2. Karnataka	-0.080	0.117	0.224	0.083
3. Kerala	0.109	0.072	0.507	0.159
4. Tamil Nadu	0.080	0.113#	0.354	0.146
5. West Bengal	-0.010#	0.161	0.186#	0.019#
Aggregate	0.049	0.155	0.317	0.135
III. Low Income States				
1. Bihar	0.113	0.074	0.506	0.139
2. Madhya Pradesh	0.074	0.113	0.339	0.119
3. Orissa	-0.102	0.081#	0.121#	0.010#
4. Rajasthan	0.109	0.090	0.320	0.142
5. Uttar Pradesh	0.181	0.359	0.306	0.301
Aggregate	0.111	0.134	0.394	0.166
All Major States	0.091	0.167	0.429	0.179
All States	0.107	0.170	0.438	0.189

Note:1. All Coefficients except those marked # are significant at 5 per cent level of significance.

2. Estimated on the basis of the Equation

$$G = a + bE$$

Where, G = Expenditure on Goods and Services and
E = Expenditure on Wages and Salaries

States (Table 7). The pattern was broadly similar in the case of administrative, social and economic services. This indicates that the relative shares of wages and salaries in poorer States were larger and, given the more acute resource problem, their allocation for the maintenance and upkeep of assets, smaller.

d. **Expenditure Growth by Functional Categories**: The analysis of the growth of State government expenditures classified into functional categories shows that spending on economic services grew at less than 4 per cent per year in real terms which was lower than the rate of growth of GDP by one percentage point. In the case of middle and low income States the growth rates were even lower. In fact, it is in these States that the levels of economic infrastructure has to be augmented more, but these States' priority appears to be to enhance spending on administrative services to reach parity with the more advanced States. Even within the economic services, as increasing proportions are spent on wages and salaries, subsidies, and other transfers, the increase in spending for the maintenance of capital assets and creation of new assets is insignificant.

The increases in expenditures result in enhanced service levels only when these expenditures are productively spent. Political considerations dictate taking up a large number of projects, but resources available after meeting the fast growing current expenditures are meagre. Consequently, even when large scale borrowing is resorted to, resources get thinly spread over a large number of projects, and this causes enormous cost and time overruns and drastically reduces productivity of public expenditures.

III. Additional Revenues: Problems and Prospects

a. **Tax Revenue**: As mentioned earlier, tax revenues in the States have registered a fairly rapid growth and the prospects for their acceleration without adversely affecting economic incentives appear to be limited. There are, however, features of tax policy in the States which are positive hindrances to faster economio growth. Therefore, simplification and rationalisation of the States' tax systems must receive immediate attention to make them both growth oriented and growth responsive.

The most important item calling for immediate attention is the simplification and rationalisation of the States' sales tax systems. Over the years, the tax has become highly complicated and distorting. First, increasing resort to taxation of inputs and capital goods has introduced a very high degree of cascading element. This has been accentuated by the preference for the first point levy on administrative considerations.

The large inter-State differences in effective tax rates due to variations in nominal rates, schemes of industrial incentives and administrative efficiency, have resulted in the resource allocation being influenced in unintended and inefficient ways. It is difficult to estimate the extent of trade diversion and resource misallocation caused on account of inter-State tax competition in the form of both indulgence in rate war and according generous sales tax incentives for industrialisation; but surely, this must be considerable. Besides, such a competition works only to the disadvantage of the poorer States. Although it is neither desirable nor feasible to have identical tax structures in all the States, it is important to avoid inequity and distortions arising purely on account of inter-State tax competition, and hence some action to minimise these is definitely called for.

Extreme complications in the sales tax structures prevailing in the States is another serious issue. If equity considerations dictated rate differentiation among different commodities, the 'rate war' among the States have multiplied them further. The constant struggle between the taxpayer to evade and avoid the tax and the tax-collector to enforce the tax by plugging the loopholes through various amendments to the Acts has only added to the complications. As a result of all these, the sales taxes levied in the States present a wide array of systems with varied mixtures of single point at the first (manufacturing) or the last (semi-wholesale) stages, double-point and multi-point levies. The rate differentiation varies from six in Orissa to as many as 17 in Bihar and Gujarat. In addition, there are additional sales taxes or turnover taxes or surcharges on sales taxes. The complications resulting from this medley and mixture defeat the very purpose for which they are introduced in the first place and increase both administrative and compliance costs. It is possible to achieve the objectives of equity, efficiency and revenue, by substantially reducing the complications in the structure of sales taxes. There is a strong case for evolving a model sales tax law which can be followed by all the States with adequate flexibility to modify them suiting their own particular situations. Simplification of sales tax structure, standardisation of its administration and enforcement will be great step forward in tax harmonization among different States. There can be a broad agreement relating to the taxation of inputs, incentives for industrialisation, maximum rates of tax to be levied on items of mass consumption and minimum rates in respect of others. The model tax law thus evolved should keep in view the fact that redistribution is mainly the function of Central government and, therefore, should make minimum rate differentiation.[4]

Another serious problem arising from the prevailing sales tax systems is the inter-State tax exportation. The taxation of inter-State sale at the rate of 4 per cent has virtually segregated the States' economies into different tariff zones and substantially reduced the gains accruing from an integrated common market. The taxation of inputs and capital goods under the States' Sales Tax Acts has accentuated this phenomenon. Even where the tax system allows a set off for the tax paid on inputs, in some States the relief is limited to the

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4. The efficacy of redistributive policy at the State level is limited by the mobility of population.

goods sold within the State and inter-State sales carry the burden of input taxes also. The perverse transfer of resources arising from the taxation of residents in the consuming States by the producing States has introduced inequity in the resource flows. Trade and industry has tried to avoid the inter-State sales tax through consignment transfers, but if the proposed consignment tax to plug this loophole is implemented, the regional segregation and inequity will be much more pronounced. While there cannot be any apology for tax avoidance, a time has come to evaluate the merit of having an inter-State sales tax itself, keeping in view the long term interest of the economy. Better economic integration of the country and rational resource allocation is possibly only when all barriers on inter-State trade are removed. Such a removal through appropriate measures will help in reaping greater gains form the customs union in the long run.

b. **Non-tax Revenue**: As mentioned earlier, the proportion of non-tax revenue in total revenue receipts of the States has been low and declining over the years. The only item of non-tax revenue which has registered high growth rate in the eighties is the cess and royalty on mines and minerals. The receipts by way of user charges as well as returns from investments in departmental and non-departmental State enterprises have been actually declining in real terms.

The studies conducted at the NIPFP have shown that implicit and explicit subsidy involved in the provision of social and economic services in the 14 major States in 1987-88 amounted to Rs 27463 crore or 8.3 per cent of GDP. What is more, over the period, 1977-78 to 1987-88, the subsidy increased at the rate of 18 per cent per year in nominal terms and the cost recovery through user charges as a proportion of the cost of providing the services declined from 22 per cent to 14 per cent (Annexure Table 3). Almost 53 per cent of the subsidies accrued in the course of providing social services, and economic services claimed the remaining 47 per cent. Education, agriculture, irrigation and power were the sectors where the volumes of subsidies were significant. On higher education alone, the subsidy amounted to about Rs 2000 crore, and recovery rate was as low as 1.7 per cent. Even in the commercial sectors like irrigation and power, the recovery rates were less than 30 per cent. The NIPFP study also shows that in respect of every sector the recovery rates declined significantly during the decade 1977-87.[5]

Cost recovery through proper user charges is an important area whereby more revenues can be raised in the short or medium term. Proper pricing of services like higher education, irrigation or electricity, would not only help in raising larger revenues but also would result in the more economic use of resources. The vulnerable sections or the intended groups can be helped through selective subsidies or transfer payments.

An important source of implicit subsidy is the public enterprise losses. The financial performance of the most important State level public enterprises - the Electricity Boards (SEBs) and the Road Transport Corporations (SRTCs) - has continued to be a matter for serious concern. In the case of SEBs in 1990-91, the commercial loss was estimated at over Rs 4300 crore forming about 14.4 per cent of the capital base (Annexure Table 4). In as many as twelve States, the net losses were more than 15 per cent of the capital base. What is important, the working of SEB's has shown a steady deterioration over time, the commercial losses as a ratio of capital base increasing from 11 per cent in 1985-86 to 14.4 per cent in 1990-91. It may be recalled that the latest amendment to the Electricity (Supply) Act, 1948 stipulates that the SEBs should generate a surpluses of not less than 3 per cent of the capital base after meeting their depreciation and interest liabilities.

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5. For details, see, M. Govinda Rao and Sudipto Mundle, "An Analysis of Changes in Government Subsidy at the State Level: 1977-78 to 1987-88". Paper presented at the seminar on State Finances, World Bank and NIPFP, April 19-20, 1991.

Table 8

Subsidies in Major States

	1987-88 Subsidies (Rs crore)	Per cent of total	Recovery rate (Per cent)
I. Social Services	8,309	30.3	1.4
1. Education of which, Higher education	1,994	7.3	1.7
2. Medical and public health	2,591	9.4	2.7
3. Water supply, sanitation, etc.	2,111	7.7	5.9
4. Other social services	1,528	5.6	5.6
Total Social Services	14,539	52.9	2.8
II. Economic Services			
1. Agriculture and allied activities	4,065	14.8	28.6
2. Irrigation	4,705	17.1	20.6
3. Power and Energy	1,633	6.0	26.5
4. Industry and Minerals	705	2.6	28.4
5. Transport and Communication	1,745	6.4	12.7
6. Other Economic Services	71	0.2	-
Total - Economic Services	12,924	47.2	24.6
Total Subsidy	27,463	100.0	14.4

Source: See, Rao, M.G. and Mundle, Sudipto, "An Analysis of changes in Government Subsidy at the State Level: 1977-78 to 1987-88", Paper presented at the Seminar on State Finances, World Bank and NIPFP, April 19-20, 1991.

The poor performance of power utilities is on account of a wide variety of reasons, the important among which are: poor operating efficiency, lopsided tariff structure - particularly the charging of very low rates for agricultural consumption which forms a large proportion in some States - disproportionately high transmission and distribution losses, huge arrears in revenue collection and inordinate delays in the construction and commissioning of power projects.

Road Transport Corporation is the second most important public enterprise run by the States. Although section 22 of the Road Transport Corporation Act stipulates that the SRTCs should carry on their activities on business principles, the net losses in 1987-88 amounted to Rs 300 crore, forming about 12 per cent of the capital invested (Annexure Table 5). The net loss was as high as 83 per cent of the capital invested in Orissa and only in the States of Andhra Pradesh, Punjab and Rajasthan, no net losses were reported. In fact, in most of the States the receipts did not cover even the operating expenses, leave alone paying interest on the borrowed funds. The more important factors accounting for poor financial results are unrealistic fare structure and inability of the RTCs to revise the fares in keeping with cost increases, low operational efficiency due to high staff-bus ratio, poor fleet maintenance and utilisation, low load factor and revenue earning kilometer per vehicle per day, growing burden of interest payments and multiplication of socially oriented concessions.

In 1989-90, there were about 829 State level enterprises of which 274 were promotional in nature. The remaining 549 financial and commercial enterprises with the investment of Rs 3843 crore, yielded dividend amounting to merely Rs. 48 crore, as against the normative return of Rs 175 crore estimated by the Ninth Finance Commission. In fact, many of these enterprises were incurring cash losses and have had to be accommodated through budgetary support.

A significant increase in non-tax revenues cannot be brought about unless user charges at proper rates are levied for the social and economic services provided by the States and the working of State-level enterprises, both departmental and non-departmental, is substantially improved. While these issues as well as specific solutions to resolve them have been widely discussed in both official and academic literature, improvement in budgetary positions of the States will come about only when the necessary political decisions are taken and implemented.

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IV. The Suggested Policy Changes

The precarious fiscal position in the States calls for bold and decisive policy measures. These measures should be directed to effect substantial savings and should improve the productivity of resource use and at the same time, they must be immediately feasible. Given that, by and large, tax revenues of the States have shown reasonable rates of growth, the adjustment has to come about mainly by compressing their revenue expenditures and by targeting subsidies. The policy measures also should attempt at enhancing efficiency in resource use and the productivity of capital assets. The measures relating to tax revenues should be directed primarily towards rationalisation and simplification of the tax structures.

In undertaking fiscal reform at the State level, the short and medium as well as the long term perspective should be kept in view. In the short and medium term, the attempt at containing the growth of expenditures should be carefully designed so that the levels of services with a high degree of externality, particularly those involved in the provision of social and economic services are not adversely affected. The usual measures like across-the-board cuts in expenditures or the policy of cutting down 'non-plan' expenditures, may, in fact result in cutting down the most productive forms of expenditures. In the longer term perspective, the attempt should be to compress expenditures, improve productivity and impart greater degree of accountability to make the expenditure programmes cost effective. Let us now turn to some specific suggestions for States' budgetary reforms.

a. Containment of Emoluments:

i) Reduction in employment: The longer term solution to the problem of burgeoning salary outlay lies in observing the principle that government is basically meant to provide administrative, social and economic infrastructure and not employment _per se_. Governmental operations are meant to provide a conducive environment and the necessary economic externalities for making productive investments, which in fact, should generate employment.

It is possible to reduce the total number of employees without undertaking harsh measures like retrenchment by simply putting a freeze on fresh recruitment in the State governments and aided institutions for the next three years. As about 3 per cent of the employees superannuate every year, this measure in the course of the next five years can result in the saving of about 10 to 15 per cent of the expenditures. In 1992-93 itself, there can be a reduction of about 3.9 lakh employees in State governments, schools and other aided institutions. This can reduce the expenditure on salaries and allowances by almost Rs 875 crore, and if the other complementary expenditures are taken into account, the saving could be over Rs 1000 crore.

The across-the-board freeze on government employment may affect some programmes and schemes more severely than others. Besides, the extent of overemployment is not uniform across all departments and programmes. Therefore, there must be a detailed review of every programme to ensure its viability and careful scrutiny of each department to identify the surplus manpower. The programmes and projects which are not viable and do not have the potential for being viable should be discontinued and those which are potentially useful should be revived and consolidated with appropriate policy packages. The employees in the projects and programmes which are to be discontinued should be redeployed, if necessary, after some retraining, to vacancies arising from retirement and to those programmes with real developmental content which really require larger manpower (for example, educational programmes). Similarly, the surplus manpower identified in various departments should form the reservoir for redeployment to those activities where they would be needed and where their marginal productivity will be higher.

Whenever a freeze on fresh employment is imposed, exemptions are sought by various departments under one pretext or another, although in some cases, there may be a genuine need for additional posts. To avoid such pressures, in every State, it is necessary to have a high powered independent institution set up to monitor and implement the freeze in fresh employment. This institution should also assess the genuine manpower requirements of the programmes, and where needed, and undertake redeployment after retraining the identified surplus manpower.

A frequent method employed to overcome the employment freeze is to employ people on a casual or daily wage basis and `regularise´ them after a period of time. If they are not regularised by the government itself, the courts have ruled that casual employees serving continuously for more than 180 days automatically become permanent employees. Once made permanent, they are no longer motivated and to carry on the work and new batches of casual workers have to be employed. This is particularly true in the case of departments like public works. There must be a strict ban on taking personnel on casual or daily wage basis.

Another important cause of employment growth is the proliferation of Centrally Sponsored Schemes and the conditions attached to those schemes. Creation of a large number of posts, particularly the field posts, by various line agencies administering and implementing different Centrally Sponsored Schemes has resulted in substantial unproductive employment in recent years. Many of the programmes are of dubious value and serve no useful purpose. There must be a careful review of all Centrally Sponsored Schemes and only the schemes in extremely important activities such as primary health and family planning, education, drinking water supply and anti-poverty programmes where, without such a shared cost programme, the States would not provide the services at optimum levels, should be continued. Even in these cases, the States should have adequate flexibility for effective utilisation of the existing manpower.

In the past, imposition of restraint on employment generation was often overcome by taking the projects and programmes in the name of development under the plan. It is, therefore, important that in the short term no new projects should be taken up for implementation. This would release more funds for the maintenance of capital assets and to complete the projects already in the pipeline and thus help in improving the productivity of investments. Further, even future planning should be confined only to the core areas.

ii) Wages and salaries: One of the important reasons for the high growth of outlay on wages and salaries has been the revision of salaries and pensions and giving various other perquisites in the form of leave encashment, leave travel concession and bonus. It is imperative that in any serious attempt at containing the growth of expenditure on wages and salaries, the structure of pay scales must be reviewed carefully. After the revision of pay scales by the Centre in 1986, many of the States too have revised their scales to bring parity. What the States have failed to take account of, however, is that while the Central scales were revised after 13 years, many of the States have already had three or four revisions during this period. With every revision, the benefit of 'fixation' of scales has resulted in the employees with a few years of service in the States already getting higher emoluments than similar employees at the Centre even prior to the Central pay revision. Revising of scales to bring about parity has further widened the difference in the case of such employees. What is more, in States like Karnataka, even the scales of certain categories of employees are higher than the Central pay scales. While it may be difficult to reverse the decisions already taken, the least the States can do is to desist from undertaking pay revisions in the next five years even in the case of those who have not adopted the Central pay scales.

One of the major changes brought about by the revision of pay scales consequent on the recommendation of the fourth pay commission is the greater degree of indexation of salaries to price increases. The pay scales evolved by the third pay commission in 1973 provided for full neutralisation for price increases upto the basic salary of Rs 740 (at the consumer price index of 200; 1960 = 100). At current prices in 1986, when the Fourth Pay Commission gave its recommendations, at the consumer price index of 608, this works out to Rs 2,250. However, the pay structure evolved by the Fourth Pay Commission neutralises employees fully for price increases upto the basic salary of Rs 3500. There are about 7 lakh employees in the State governments with basic salaries between Rs 2250 and Rs 3500 and the additional expenditure on account of full neutralisation is substantial.

The two important perquisites given to government employees in most of the States are, the Leave Travel Concession (LTC) and Leave encashment. Given the difficult fiscal position in the States, there is a strong case for postponing the LTC facilities for the next two years. Altogether, there are about 1.3 crore employees in State governments, aided institutions and local bodies. Even at the rate of Rs 750 per employee, this measure alone can result in the saving of almost Rs 1000 crore in the next two years. In fact, in some private enterprises, instead of reimbursing the actual fares, the practice of giving lump sum allowances is in vogue, which actually works out cheaper. In the long run, the State governments may also think of such an option, after carefully evaluating the alternatives.

In the case of leave encashment, the prevailing practice varies widely across States, but generally every year, employees are allowed to encash their earned leave by 15 days to a month. There is no reason why when there is a widespread perception that substantial overemployment exists in the government, additional benefits in the form of leave encashment should be given. There is a strong case for withdrawing this facility. Even if on the average, leave encashment benefit is assumed at 15 days' salary per year, withdrawal of this facility can result in the saving of about Rs 1200 crore every year. If this is also extended to the public enterprises, the saving would be much larger.

Another important item of emoluments is the bonus given to government employees. With the Central government giving bonus to its staff, the States too have had to follow suit. The concept of `productivity linked bonus´ is certainly not appropriate in any government departments. Nor does the present fiscal position really permit such payments. It would be prudent if both Central and State governments discontinue the practice of paying bonus to government employees. Almost all the States give bonuses to their employees at the rate of 29 days salary. Even if a lower estimate of 25 day´s salary is considered the outgo on this account alone is approximately Rs 1500 crore per year.

b. **Subsidies and Transfer Payments**: The policy of subsidies and transfer payments has to play a very important role in any developing economy. In the absence of a proper social security system, there are no safety nets to take care of the vulnerable sections of society. However, it is important to ensure proper targetting of these subsidies. By and large, transfer payments, being directly given to individuals can be properly targetted. `Subsidies´ on the contrary being given to influence price or output decisions of the producers accrue to consumers or the owners of inputs only indirectly, and targetting of these is extremely difficult. Even more difficult is to target the hidden subsidies.

As mentioned earlier, a wide range of social security and welfare payments such as old age pension, widows pension, agricultural labourers pension, nutrition schemes for school children, and subsidies on food, cloth and other necessary items of consumption have been introduced by different States. Unfortunately, in many of the cases the coverage is too wide and a large proportion of the beneficiaries are not really the intended vulnerable groups. The expenditure on these programmes has been increasing at a fast rate. Before any further expansion is done, it is important to review the programmes carefully and design them to reach only the vulnerable sections.

At a time when structural adjustment programme has been undertaken in the country, inflationary pressures are expected to build at least in the next two years. At such times, the poor and vulnerable sections suffer the most. One method of providing some sort of safety net for them is to enhance outlay on poverty alleviation programmes along with making them more effective. For this, the States can take advantage of the recent Constitutional amendment increasing the ceiling on profession tax from Rs 250 to Rs 2500. While one-half of the collections can be earmarked for State initiated poverty alleviation programmes the remaining one half can be assigned to the local bodies. At present, only Maharashtra has a substantial State-initiated poverty alleviation programmes (employment guarantee scheme) with the funds earmarked from the proceeds of the profession tax. Perhaps, even the entire implementation of poverty alleviation programmes can be done at the local level and the entire proceeds of profession tax may be assigned to them with the condition that one-half of the funds will be earmarked for anti-poverty programmes.

Our analysis of hidden subsidies in the previous section underlines the absurdity of levying negligible user charges even for services consumed predominantly by better off sections of society. It is important to levy economic rates on irrigation water and electricity sold to farmers. Similarly, proper fees for post-secondary education and economic rates of user charges for water supply, urban transport and power must be levied. Economic pricing of services is important not only for accountability and equity, but also for reasons of avoiding wastage and improving the quality of services. At the same time to help the really deserving sections for whom the services would have to be rendered free of charge or at subsidised rates, specific methods of subsidisation must be evolved.

It has been pointed out that on higher education alone the subsidy in 1987-88 amounted to Rs 2000 crore and the recovery rate was as low as 1.7 per cent. Quite a large proportion of this subsidy accrues to economically affluent sections. There is a clear case for reducing this subsidy in the next five years by one half, even if the remaining is retained to help economically weaker sections with scholarships. This can be done by reducing assistance to colleges and universities annually by 10 per cent until the next five years, and let the colleges and universities find the remaining resources by enhancing fees. The State government should not interfere in the determination of the fees and the regulatory mechanism should be confined merely to the extent of ensuring that meritorious and economically backward students get the benefit of scholarships. Adequate cost recovery is extremely important to ensure better quality of education.

c. **Budgetary Support to Public Enterprises**: Another important source of implicit subsidy arises from the budgetary support to public sector enterprises, both departmental and non-departmental. Among the departmental enterprises, losses incurred in the irrigation sector is the most important. In 1987-88, the working losses in irrigation alone amounted to about Rs 1500 crore and if depreciation too is considered, the loss works out to Rs 5200 crore (Table 9). The position has worsened in subsequent years. There is an immediate need to phase out these subsidies. In the next three years there must be a phased increase in the water rates so that at least the working losses are completely eliminated.

As regards non-departmental enterprises, a detailed review of their usefulness as well as working should be undertaken immediately. There are a large number of promotional enterprises, which do not really serve the purpose for which they have been set up, but have been used to provide berths to politicians and bureaucrats. They involve large expenditures on the part of the government and the budgetary support to them in the 14 major States itself is almost Rs 500 crore. Actually, these administrative agencies by pre-empting expenditures, reduce the funds for the functions they are set up to promote. There is no reason why they should be continued.

Table 9

Implicit Budgetary Subsidies to Public Enterprises in 14 major States

(Rs crore)

	Cash profit(+) loss (-)	Total profit (+)/ loss (-) (after depreciation and interest)
I. Departmental undertakings		
a. Irrigation*	(-) 1458*	(-) 5200*
b. All departmental undertakings	(-) 1445*	(-) 5485*
II. Non-departmental undertakings		
a. Electricity	749	(-) 691
b. Transport	(-) 30	(-) 142
c. Other non-departmental enterprises	(-) 210	(-) 556
d. All non-departmental enterprises	508	(-) 1389

Note: * Estimated from budget documents

In the case of commercial enterprises, it is even more important to phase out the budgetary support. The detailed review of the enterprises must lead to divesting of the totally unviable units. In respect of those which can be made viable, appropriate means to consolidate, upgrade the technology and improved management practices must be taken. Non-core enterprises, in any case, should not be extended any budgetary support.

The two most important state run enterprises are the SEB's and SRTC's. Implicit budgetary subsidy in the case of SEBs after taking into account the interest cost worked out to about Rs 700 crore in 1987-88 (Table 9) which, by now, must have reached Rs 1000 crore. In the past, the Finance Commissions had stressed the need to phase out these subsidies and provided 5 years for adjustment. Unfortunately, the position, instead of improving, only deteriorated further. If proper measures are undertaken, it is feasible to phase out these subsidies in the next three years. In other words, at the end of three years, the State electricity boards should cover their working expenses and pay the interest on the State government loans, besides providing for their depreciation. This can be achieved if the States agree on a minimum tariff on the electricity sold to the farm sector, which is the main reason for the losses in many of the States. The price charged to electricity consumption for agriculture in 1988-89 was as low as 9 paise per unit in Bihar, Maharashtra and Punjab whereas the operating costs in these States respectively were Rs 1.48, Rs 0.85 and Rs 0.91. It is imperative that price of electricity on the agricultural consumption is revised immediately. With the abandoning of the freight equalisation scheme, the cost of coal used in States farther to the coal belt is likely to increase further, and unless immediate measures to enhance the price of power is taken, these SEBs will end up with very huge losses.

There are, however, areas where subsidisation to a certain degree is unavoidable. One such area is clearly urban transportation. But it is important to specify clearly what should be the extent of subsidisation in such activities. In the case of SRTCs, streamlining of the permit system is necessary. In fact, in suburban and long distance transportation, State governments really have no inherent advantage and perhaps, granting the required permits to the private agencies may serve the purpose better. Again, the power of fixation of rates should be taken away from the governments' purview to avoid political pressure against revision of fares; this should be entrusted to an autonomous agency like the "rate commission". In the case of SEBs, while the generation of electricity can be privatised, the activities of transmission and distribution may have to be continued by the State government. Perhaps decentralisation of these functions through proper public agencies can help in the more effective and economical transmission and distribution function.

d. **Rationalisation and Simplification of Tax Structures:** As already mentioned, the reforms on the tax side would have to address mainly the issue of rationalisation and simplification of the tax structure. In particular, ways have to be found to reduce the number of sales tax rates and levy uniform tax rates in respect of some important commodities. The number of tax rates should be brought down to two in the course of the next two years and this will reduce both administrative and compliance costs significantly. In the medium and long term, it is important to develop the information base through computerisation. Cross checking of returns based thereon could lead to improvements in tax compliance. It is also important to relieve the burden of the tax on inputs through a system of set-offs or tax credits. With better information systems, perhaps attempt could be made to extend the tax base to the stages beyond manufacturing on the principle of value added. Also, the sales tax incentives given for industrialisation in various States need to be rationalised. The most important reform, however, should be to reduce the hindrances on inter-State movement of goods by reducing the tax on inter-State sales. Proper integration of the economy can be achieved only by removing such hindrances. Total removal of the tax must be the ultimate objective, but in the short term, the tax rate could be reduced to, say, 2 per cent and to prevent the evasion of the tax, consignment tax too could be levied at the same rate. Proceeds from both the taxes can be distributed on the basis of a mutually agreed formula to avoid inequity arising from the producing States taxing the consuming States.

Another important tax which needs to be rationalised is the stamp duty and registration fees. The levy of the tax at very high rates of 15 to 20 per cent has resulted in substantial undervaluation of immovable property. This has not only led to the evasion of other taxes like the income tax and the wealth tax, but has made investments in real estates an important source of underground economy. The same amount of tax can perhaps be collected by reducing the tax rate to, say, seven per cent. This would reduce the tendency to undervalue property.

e. **Central Transfers to States**: At a time when the structural adjustment to reduce fiscal deficit is undertaken in the country, the burden of compression must be borne by both the Centre and the States. However, given that the States' flexibility with regard to fiscal matters is lower than that of the Centre, reduction in Central transfers could create severe difficulties. Therefore, in the medium term, the attempt should be to maintain the proportion transfers to Central revenues at the same level. Presently, the transfers in the revenue account form about 36 per cent of gross Central revenues and for the next five years it could be fixed at the same level.

The large transfers made to Centrally Sponsored Schemes have come in for serious criticisms in recent years. Although the Administrative Reforms Committee suggested that the assistance to such schemes should not exceed one-sixth of the assistance given to State plan schemes, this has proliferated to form about 60 per cent. As mentioned earlier, many of the programmes have been of dubious value, they have distorted the States' spending priorities and have contributed to the growth of unproductive employment. Therefore, after a careful review, there is a strong case for discontinuing a number of these schemes; some others which are useful may be transferred to the States and only the extremely important schemes on poverty alleviation, health and family welfare, drinking water supply and education may be continued. The reduced flow of assistance for these schemes may be compensated by giving larger funds for State plan schemes, subject to the overall restriction that the aggregate transfers as a proportion of Central revenues may be fixed at the current level.

The predominance of tax devolution in the form of shares of individual income tax and Union excise duty in Finance Commission transfers has created disincentives for Central government in collecting more of these taxes. With the Central government preferring to increase administered prices in respect of public monopolies, this has also become an important source of irritation in Centre-State relations. It would perhaps be better to determine the share of the States in aggregate Central taxes rather than as a percentage of the two specified taxes. Generally, the shared taxes constitute about 25 per cent of Central taxes, and it would be useful to fix the shares at that level for the next five years. This would, however, require a Constitutional amendment and, therefore, must be discussed in detail by all the concerned parties.

IV. A Concluding Remark

We have suggested various policy measures to compress expenditures, reduce budgetary support to public enterprises and revise user charges and rationalise the tax systems, keeping in view, their feasibility. The suggested measures on the expenditure side alone could result in the savings of the order of about Rs 7000 crore. Levying of proper fees on education, water rates on irrigation and phasing out of subsidies given to electricity and transport enterprises could result in a saving of another Rs 4000 crore. These measures not only will wipe out the revenue deficit, but can also generate surpluses in the revenue account which can reduce the borrowing requirements. What is more, rationalisation in the tax and expenditure measures suggested would, in the long run, be helpful in restoring the incentives and improving the productivity in the government sector.

Annexure Table 1

Growth of State Expenditure (1970-71 Prices) : Economic Categories (1980-81 to 1987-88)

(Percent per year)

	Wages and Salaries	Goods and Services	Interest Payment	Subsidy	Other Current Transfers	Current Expenditure	Total Capital Expenditure	Total Expenditure
I. High Income States								
1. Gujarat	8.34	10.54	14.54	22.91	7.48	8.87	4.08	7.29
2. Haryana	7.85	10.88	13.49	10.30	16.72	10.36	2.02	7.21
3. Maharashtra	7.12	2.46	15.04	4.19	7.67	7.91	4.32	6.64
4. Punjab	4.28	10.50	7.95	12.15	16.83	7.56	10.97	8.81
Aggregate	8.75	7.11	13.39	9.88	8.57	8.37	5.19	7.25
II. Middle Income States								
1. Andhra Pradesh	5.55	2.83	12.69	6.00	12.12	8.84	6.14	8.09
2. Karnataka	4.48	-1.20	13.58	11.10	16.38	9.25	5.22	8.01
3. Kerala	7.48	3.75	15.59	10.16	6.24	7.58	4.55	7.04
4. Tamil Nadu	11.87	2.66	6.62	28.24	0.56	6.34	3.12	5.11
5. West Bengal	6.53	2.97	11.58	2.80	6.42	6.75	2.60	5.74
Aggregate	7.35	2.57	11.69	12.74	0.29	7.69	4.22	6.69
III. Low Income States								
1. Bihar	6.61	1.55	10.88	19.92	9.85	6.91	7.48	7.02
2. Madhya Pradesh	9.47	2.69	7.67	5.15	7.86	8.43	-0.62	5.29
3. Orissa	7.08	-9.36	11.68	10.50	9.11	6.58	1.10	5.12
4. Rajasthan	7.28	8.91	10.64	11.88	11.32	8.82	5.65	7.80
5. Uttar Pradesh	7.43	6.30	13.59	17.56	7.18	8.12	4.91	6.98
Aggregate	7.65	3.07	11.55	13.75	8.41	7.85	4.09	6.61
All Major States	7.35	3.78	12.98	12.10	9.41	7.92	4.44	6.81
IV. Special Category States								
1. Assam	12.97	9.49	18.89	30.15	6.87	11.99	7.33	10.70
2. Himachal Pradesh	6.65	10.35	15.96	30.10	0.67	7.29	8.14	7.56
3. Jammu and Kashmir	7.84	8.46	13.26	19.28	22.18	9.98	4.86	8.30
4. Meghalaya	7.71	8.04	22.81	19.49	10.40	8.94	3.67	6.98
5. Manipur	7.67	1.08	13.16	33.00	10.95	7.40	7.33	7.37
6. Nagaland	11.00	6.78	21.51	13.84	13.25	10.57	5.60	8.85
7. Tripura	9.44	11.31	20.00	19.80	5.87	9.50	7.98	9.13
Aggregate	9.65	8.54	16.65	24.85	8.25	10.04	6.59	8.97
All States	7.63	4.76	12.66	12.61	8.44	8.19	4.73	7.07

Source : Estimated from the unpublished data provided by Central Statistical Organisation, Ministry of Planning, Government of India.

Annexure Table 2

Growth of State Expenditure (1970-71 prices) : Functional Categories (1980-87)

(Percent per year)

	General Services	Social Services	Economic Services	Total Expenditure
I. High Income States				
1. Gujarat	4.67	7.61	6.92	7.29
2. Haryana	10.89	8.38	3.99	7.21
3. Maharashtra	5.13	9.58	2.38	6.64
4. Punjab	7.25	4.18	11.78	8.81
Aggregate	5.91	8.08	5.45	7.25
II. Middle Income States				
1. Andhra Pradesh	4.48	12.58	2.03	8.09
2. Karnataka	5.47	10.85	4.90	8.01
3. Kerala	8.14	6.66	2.44	7.04
4. Tamil Nadu	8.18	8.55	-0.29	5.11
5. West Bengal	5.71	5.34	4.44	5.74
Aggregate	6.20	8.65	2.38	6.69
III. Low Income States				
1. Bihar	6.67	9.49	3.24	7.02
2. Madhya Pradesh	8.22	8.29	-0.58	5.29
3. Orissa	7.39	5.95	0.86	5.12
4. Rajasthan	8.85	9.90	5.47	7.80
5. Uttar Pradesh	8.43	8.18	4.29	6.98
Aggregate	7.98	8.51	3.07	6.61
All Major States	**6.78**	**8.46**	**3.51**	**6.81**
IV. Special Category States				
1. Assam	9.06	12.73	7.23	10.70
2. Himachal Pradesh	7.61	7.22	6.78	7.56
3. Jammu and Kashmir	N.C	8.02	7.75	8.30
4. Meghalaya	6.03	9.13	4.71	6.98
5. Manipur	8.22	6.56	7.02	7.37
6. Nagaland	9.22	9.94	5.82	8.85
7. Tripura	7.60	13.04	7.13	9.13
Aggregate	6.79	10.08	7.02	8.97
All States	**6.93**	**9.24**	**3.93**	**7.07**

Source : Same as annexure Table 1.

Annexure Table 3

Budgetary Subsidies in the States

(Rs. [illegible])

States	Total Cost of Public Services Including Transfers			Cost of Social and Economic Services			Recoveries from Social and Economic Services			Total Subsidy			Recovery Rates from Social and Economic Services		
	1977-78	1987-88	Growth Rate Per annum	1977-78	1987-88	Growth Rate Per annum	1977-76	1987-88	Growth Rate Per annum	1977-78	1987-88	Growth Rate Per annum	1977-78	1987-88	% Change
High Income States															
Gujarat	54418	298853	19.81	43539	235752	16.40	9432	31088	12.67	34107	204663	19.62	21.77	13.19	[illegible]
Haryana	23928	143707	19.63	20073	112291	18.79	6936	31655	16.40	13138	80635	19.88	34.55	28.19	[illegible]
Maharashtra	110533	541904	17.23	78121	389488	17.43	27453	99409	13.73	50668	290079	19.08	35.32	25.52	[illegible]
Punjab	39862	184950	16.59	33746	134718	14.85	5790	16476	11.02	27956	118243	15.51	17.52	12.23	[illegible]
Aggregate-High Income States	228742	1170015	17.73	175480	872249	17.39	49612	170629	13.67	125868	693621	18.61	28.27	20.48	[illegible]
Middle Income States															
Andhra Pradesh	80827	368463	16.38	57454	278998	17.12	13600	44743	12.65	43854	234255	18.24	23.67	16.04	[illegible]
Karnataka	57347	291258	17.65	43455	212281	17.19	12570	39722	12.19	30884	172559	18.77	29.00	18.71	[illegible]
Kerala	43595	187118	15.88	34164	131507	14.43	6760	13017	6.77	27404	118490	15.77	19.83	9.90	[illegible]
Tamil Nadu	72965	348151	16.81	48065	260958	18.43	8385	22968	10.80	39680	237990	19.62	18.41	8.80	[illegible]
West Bengal	74007	301468	15.08	55133	214336	14.54	5903	12030	7.38	49230	202305	15.18	16.75	5.61	[illegible]
Aggregate-Middle Income States	328741	1496458	16.36	238271	1098080	16.51	47218	132481	10.87	191053	965600	17.59	19.82	12.06	[illegible]
Low Income States															
Bihar	59566	346577	19.26	46632	257618	18.64	4513	13604	11.67	42119	244006	19.20	9.68	5.28	[illegible]
Madhya Pradesh	65483	344973	18.08	50557	262962	17.08	15317	51605	12.81	35239	211357	19.62	30.54	19.62	[illegible]
Orissa	36072	158588	15.96	28302	120339	15.57	7122	11850	5.22	21180	108489	17.75	25.17	9.85	[illegible]
Rajasthan	47878	273589	19.04	36109	197422	16.52	8204	23212	10.88	27905	174211	20.10	23.08	11.76	[illegible]
Uttar Pradesh	117231	545074	16.01	92581	400083	15.76	12133	51078	15.46	80447	349005	15.81	13.29	12.77	[illegible]
Aggregate-Low Income States	326227	1668881	17.73	254181	1238417	17.18	47290	151348	12.34	206890	1087068	18.05	18.61	12.22	[illegible]
All States	883710	4335773	17.24	667931	3208746	16.88	144120	462458	12.37	523811	2746288	18.02	21.77	14.41	[illegible]

Note :1.Classification of the States has been done on the basis of per capita net State Domestic Product estimates for (1982-85). The same classification was followed by the Ninth Finance Commission to estimate taxable capacities of the states.

Annexure Table 4

Financial Results of State Electricity Boards, 1990-91

(Rs Crore)

	Capital base (Net fixed assets	Gross revenue receipts	Working expenses	Depre- ciation	Total working expenses	Gross operating surpluses	Interest due	Surplus/ Deficit	Ratio of gross operating surp- lus to capital base (6 of 1)	Ratio of commercial profits to capital base (8 of 1)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1. Andhra Pradesh	1,785	1,188	879	88	967	219	197	22	12.3	1.2
2. Assam	595	151	167	29	196	-45	201	-246	-7.5	-41.3
3. Bihar	1,348	579	619	60	679	-100	123	-223	-7.4	-16.5
4. Gujarat	2,053	1,355	1,354	99	1,453	-98	211	-309	-4.7	-15.1
5. Haryana	1,099	478	553	42	595	-117	128	-245	-10.6	-22.2
6. Himachal Pradesh	367	106	81	12	92	14	75	-61	3.8	-16.8
7. Jammu and Kashmir	401	64	116	12	128	-64	51	-115	-16.0	-28.6
8. Karnataka Board	720	803	757	30	787	16	132	-116	2.2	-16.1
9. Karnataka Power Corporation	1,032	334	160	52	212	122	156	-34	11.8	1.9
10. Kerala	594	327	265	27	293	34	82	-48	5.7	-8.2
11. Madhya Pradesh	3,018	1,346	967	136	1,103	242	367	-125	8.0	2.6
12. Maharashtra	3,511	2,652	2,236	178	2,414	148	432	-284	4.2	-7.2
13. Meghalaya	69	18	15	5	20	-2	24	-26	-2.8	-37.5
14. Orissa	775	328	215	31	246	82	84	-2	10.5	0.6
15. Punjab	2,646	763	863	100	963	-200	559	-759	-7.6	-28.6
16. Rajasthan	1,985	793	772	75	847	-54	193	-247	-2.7	-11.7
17. Tamil Nadu	2,099	1,183	1,451	91	1,550	-367	277	-644	-17.5	-30.3
18. Uttar Pradesh	3,319	1,596	1,528	150	1,678	-82	580	-762	-2.5	-20.0
19. West Bengal	541	619	639	30	669	-50	160	-210	-9.2	-38.9
Total	27,957	14,595	13,637	1,248	14,886	-291	4,030	-4,321	-1.0	-14.4

Source: Annual Report on the working of State Electricity Boards and Electricity Departments, Planning Commission, Government of India, September, 1990.

Annexure Table 5

Working of State Road Transport Corporations

(Rs. Crore)

	Capital Invested As on 31.3.1988	Gross Receipts 1988-89	Operating Expenditure Including Depreciation	Gross Profit/ Loss	Interest Payment	Net Profit/ Loss	Percent Return on Capital Invested
Andhra Pradesh	400.76	577.99	556.77	21.21	19.06	2.15	0.54
Assam	22.68	17.77	25.33	-7.56	3.08	-10.64	-46.91
Bihar	122.95	25.92	37.64	-11.72	11.81	-23.53	-19.14
Gujarat	191.65	390.57	370.89	19.68	24.88	-5.20	-2.71
Karnataka	315.13	387.91	419.83	-31.92	22.08	-54.00	-17.14
Kerala	94.39	149.46	154.33	-4.87	10.54	-15.41	-16.34
Madhya Pradesh	79.18	110.17	113.87	-3.70	11.29	-15.00	-18.94
Maharashtra	729.06	795.36	829.64	-34.28	34.95	-69.23	-9.50
Orissa	18.54	29.54	32.74	-3.20	4.15	-7.35	-39.64
Punjab	48.97	90.44	122.26	-31.83	8.91	-40.74	-83.19
Rajasthan	76.67	146.59	141.67	4.92	4.82	0.10	0.13
Sikkim	17.15	4.92	4.42	0.50	0.17	0.33	1.92
Tamil Nadu	100.90	668.36	656.78	11.58	24.65	-13.06	-12.10
Tripura	9.82	1.67	3.61	-1.94	0.74	-2.68	-30.40
Uttar Pradesh	255.80	247.68	250.22	-2.54	20.73	-23.27	-9.10
West Bengal	46.99	22.13	45.90	-23.77	0.25	-24.02	-51.12
All States	2536.65	3666.47	3765.90	-99.43	202.12	-301.54	-11.89

Source: Performance Statistics of STUs, 1987-88 and 1988-89 and Review of Performance 1988-89. Central Institute of Road Transport, Pune, 1989.

Annexure Table 6

Price Charged for Consumption and the Cost of Supplying Power

S. No.	Board	Average Rate		Total operating cost (Paise/kwh sold)
		Paisa/ kwh overall	Agricultural consumption	
(1)	(2)	(3)	(4)	(5)
1.	Andhra Pradesh	61.7	4.5	64.3
2.	Assam	92.4	50.0	233.5
3.	Bihar	91.5	9.4	148.4
4.	Gujarat	86.1	27.7	101.9
5.	Haryana	54.4	28.0	79.3
6.	Himachal Pradesh	59.2	20.0	117.3
7.	Jammu & Kashmir	41.0	10.0	108.4
8.	Karnataka	71.2	11.6	74.5
9.	Kerala	52.9	22.0	67.2
10.	Madhya Pradesh	73.8	23.2	82.5
11.	Maharashtra	79.1	9.0	84.9
12.	Meghalaya	50.0	21.0	82.3
13.	Orissa	65.1	22.1	72.3
14.	Punjab	44.0	9.2	94.4
15.	Rajasthan	74.6	29.5	92.6
16.	Tamil Nadu	63.7	11.2	86.5
17.	Uttar Pradesh	64.4	22.7	101.4
18.	West Bengal	94.5	26.9	122.1

Source: Annual Report on the Working of State Electricity Boards and Electricity Departments, May, 1989.

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