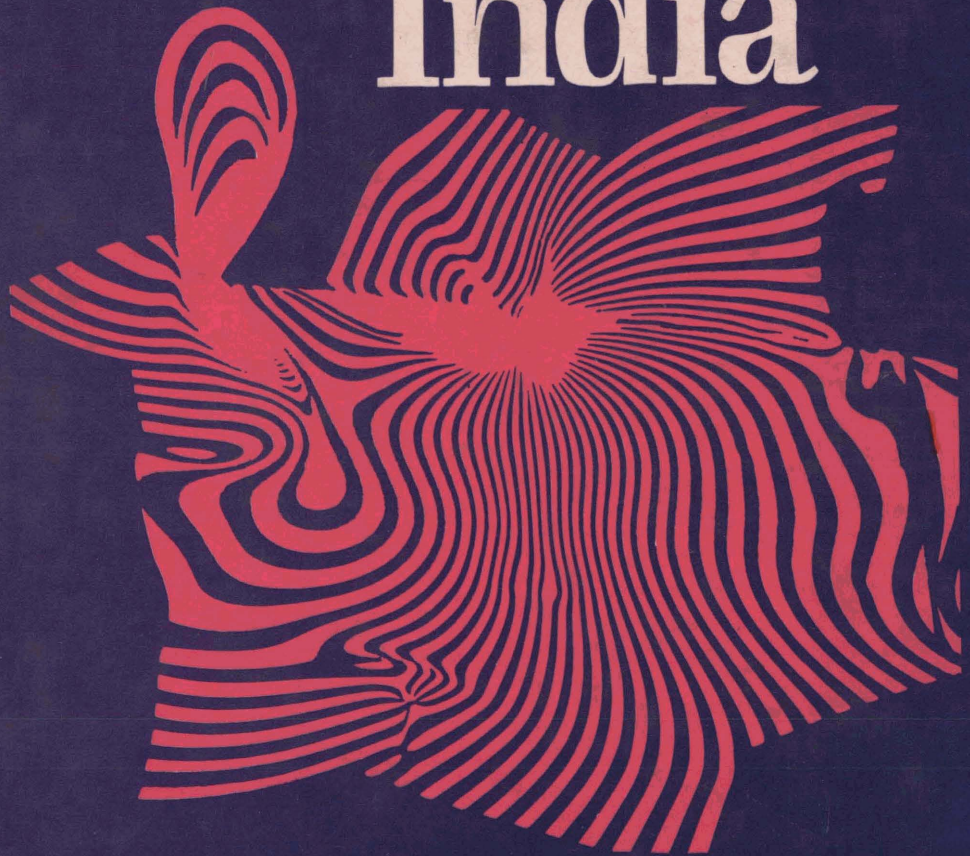


State Finances in India



Edited by
Amaresh Bagchi J L Bajaj
William A Byrd

NATIONAL INSTITUTE OF PUBLIC FINANCE AND POLICY

This book, based on the contributions of a number of distinguished scholars and government officials, provides a comprehensive overview, description, and analysis of state finances in India, with an accent on recent trends, current problems, and policy issues facing state governments.

State finances comprise a very important part of India's federal public finance system. In recent years the states have faced increasingly serious problems in balancing their revenues and expenditures; moreover, capital investment and other development-oriented spending have been squeezed by the rapid growth of current expenditure, wages and other establishment costs in particular. Cost recovery for many services provided by state governments has been low and declining. State taxes are narrowly based, and there are imbalances between overexploitation of certain revenue sources and neglect of others. Such trends need to be reversed for the states to be able to play their Constitutionally-mandated role in India's development. In addition, there are a host of important issues such as the nature and adequacy of revenue bases, tax composition and buoyancy, plan implementation and financing, central transfers and centrally-sponsored schemes, local government finances, externally aided projects, and others, which deserve serious attention from researchers and policymakers.

The book is based primarily on eight in-depth studies prepared for a seminar on state finances in India, held under the auspices of the National Institute for Public Finance and Policy and the World Bank in New Delhi on April 19-20, 1991. The papers examine a broad range of topics, including both general research covering all states and case studies providing comprehensive analyses of individual states. The volume starts with an introduction and overview. Budgetary trends and plan financing, state government subsidies, local government finances, and issues related to externally-funded projects are the subjects of the papers on general aspects in Part I of the book. Part II provides detailed analyses of the state finances of Tamil Nadu, Uttar Pradesh, Gujarat, and Kerala. Part III includes a summary of conference proceedings and two additional short papers circulated at the seminar.

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Preface

This book represents the fruits of the Seminar on State Finances, held in New Delhi on April 19-20, 1991, under the joint auspices of the National Institute of Public Finance and Policy (NIPFP) and the World Bank. The subject of state finances in India is a central focus of the research and policy analysis conducted at NIPFP. State finances have also become a matter of growing interest and concern to international financial institutions.

The possibility of holding a seminar on state finances was first discussed by the Department of Economic Affairs (DEA) of the Ministry of Finance and the World Bank at the annual Paris meeting of the Aid-India Consortium held in June 1990. NIPFP came to play a primary role in the organization of the seminar, contributing its expertise on Indian state finances. A number of papers were commissioned to be prepared for presentation and discussion at the seminar, revised versions of which form the main body of this volume. Some papers dealt with general topics in state finances, others with the experiences of individual states.

The seminar brought together a group of about forty scholars, researchers and officials of the government and international financial institutions for open and lively discussions on various topics and issues related to state finances. (The proceedings of the seminar are summarized in chapter 10; a list of seminar participants and their institutional affiliations is appended at the end of the book.) In addition to extensive commentary on the papers, a number of policy issues and topics for future research emerged in the discussions.

Subsequent to the seminar, papers were revised by their authors and then edited by the editors. It was felt by the editors that, given the timeliness of the papers and the importance of state finances in

India's current fiscal adjustment, the volume should be brought out as expeditiously as possible. This goal has been achieved, with its publication occurring about one year after the holding of the seminar.

Both the Seminar on State Finances and the resulting book relied on the support and assistance of numerous people. The editors would like to thank the contributors for their efforts and the other seminar participants for generating a lively interplay of ideas. The contributions of Bimal Jalan, who inaugurated the seminar, and Jochen Kraske, who made opening remarks, are especially appreciated. Financial support from the World Bank's India Department to cover seminar costs is gratefully acknowledged; Javad Khalilzadeh-Shirazi, Chief of the Country Operations Division, organized this support, provided overall supervision of the World Bank effort, and also helped conceptualize and design the project. Organization of the seminar involved substantial work by NIPFP and World Bank (New Delhi Office) staff, whose indispensable contribution is hereby acknowledged. Processing of the manuscript for publication was handled mainly by Shahnaz Rana, R. Parmeswaran and V. Umashankar. Final editorial preparation and coordination with the publisher were the responsibility of Tapas Sen.

It should be stressed that the views, findings, interpretations, and conclusions as well as factual representations in the various chapters of this volume are those of the authors and should not be attributed to the editors or to NIPFP, the World Bank, or any other institution to which contributors are affiliated. Editors, contributors, and other seminar participants articulated their personal views. The editors do, however, take responsibility for any typographical or other similar errors which may have escaped their attention.

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PART I

THE BROADER PICTURE

Chapter 1

Introduction and Overview

AMARESH BAGCHI, J.L. BAJAJ and WILLIAM A. BYRD¹

State finances, which form the subject of this volume, comprise an extremely important and complex topic within the broader area of public finance in India. Under India's federal system, as set forth in its Constitution, the states have important functions and responsibilities in various economic and social sectors, in addition to their more narrow governmental roles. They also have access to substantial revenue flows, including both taxes they collect themselves and shares in certain taxes collected by the central government. Various transfers from the central government augment the states' own revenues.

A number of difficult issues and vexing problems are evident in India's state finances, which have suffered from adverse trends in the 1980s. State governments have been facing a worsening budgetary squeeze, which has severely affected their developmental expenditures. Inadequate, overutilized revenue sources are part of the problem, and central transfers have generally failed to grow as fast as the states' own revenues. But rapid growth of current expenditures, particularly on salaries and other establishment costs, has been a major factor behind the squeeze on state finances. Burgeoning subsidies and declining cost recovery rates for economic and social services provided by state governments have been responsible for the anemic performance of state nontax revenues and have contributed to budgetary problems in a major way. Numerous problems emerge from the structure of center-state transfers and the incentives and distortions created thereby. The proliferation of centrally-sponsored

1. Extensive assistance from Tapas Sen in preparing this chapter is gratefully acknowledged.

schemes and the increasing reliance on this source of funding by states have led to certain problems and distortions. Finally, the states have come to play an increasingly important role in the implementation of externally-aided projects, and problems concerning implementation delays, "crowding out" of other projects, possible distortion of investment programs, and slow disbursements of foreign exchange needed by the central government are of growing concern.

To set a basis for what follows in the rest of the volume, this chapter first outlines the basic structure of state finances in India and then reviews broad budgetary trends. Brief summaries of the other chapters then follow.

INTRODUCTION TO STATE FINANCES IN INDIA²

The Constitution of India sets forth in detail the political and governmental structure of the country, based on distinct central and state governments with specified spheres of activity, revenue-raising roles, and areas of authority.³ Practice over the past four decades has further defined and modified the roles of central and state governments. Successive Finance Commissions, appointed normally at five-year intervals, have set parameters governing center-state flows. Some extra-Constitutional institutions and mechanisms, most notably the Planning Commission and associated center-state transfers, also have emerged and assumed great importance over the years.

The Constitution employs a three-fold classification in the division of expenditure responsibilities between the center and the states: some are exclusively subject to the jurisdiction of one or the other and others are concurrently within the jurisdiction of both. The central government is exclusively responsible for 84 categories, including defense; foreign affairs; international economic relations; atomic energy; aviation; shipping; posts and telecommunications; highways; banking and insurance; oil, petroleum, and petroleum products; certain industries that are within the jurisdiction of the center; and numerous other activities. The states are assigned exclusive juris-

-
2. This discussion of Constitutional aspects is based largely on P.D. Mukherji, "Centre-State Financial Relationship in India -- A Note" (in S.P. Gupta, Nicholas Stern, Athar Hussain, and William Byrd, editors, *Development Experiences in China and India: Reforms and Modernization*; Bombay, Allied Publishers, 1991).
 3. Lower levels of government in both urban and rural areas have played a much more limited role than is typical in other large countries. See chapter 4.

diction over 47 items, most prominently public order, police, prisons, local governments, irrigation, agriculture and related activities, land, public health, industries other than those assigned to central jurisdiction, trade and commerce within the states, etc. Another 47 areas are under the concurrent jurisdiction of central and state governments, such as economic and social planning, forests, electricity, education, labor and others.

The Constitution also sets forth the respective taxation powers of central and state governments. Among the 13 types of taxes vested with the central government, the most important are taxes on income other than that from agriculture; corporate income tax; Customs duties; and excise duties on most goods.⁴ Among the 19 taxes placed under the control of state governments are direct taxes on land and agricultural income; excise duties on alcohol and certain other goods; sales tax on all goods but newspapers; taxes on mineral rights; taxes on vehicles; taxes on sale of electricity; luxury taxes; and various others. It is generally perceived that the states' taxation powers are inadequate in relation to their expenditure responsibilities and that this imbalance has been worsening over time.

In addition to center-state transfers based on tax collections and tax sharing, the Constitution mandates resource transfers to the states through various mechanisms, determined by the Finance Commissions. These include transfers to states in need of such assistance and those for public purposes. The Finance Commissions play a key role in determination of center-state tax sharing and transfers; though their recommendations are not formally binding on the central government, in most cases they have been accepted.

The Planning Commission and the device of five year and annual plans, not originally mandated in the Constitution, have become a very important part of center-state fiscal relations. Transfers to support state plans have been determined by the "Gadgil formula"⁵,

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4. Sharing of proceeds of excise duties and personal income taxes collected by the central government with the states occurs, at rates mandated by successive Finance Commissions. Certain other, minor taxes are collected by the central government but are supposed to be turned over to the states in their entirety.
 5. During the reference period of this volume, the factors included in the formula were population, per capita state domestic product (SDP) (for those states which had a per capita SDP below the national average), tax effort and special problems of individual states. In the recently modified formula, tax effort has been substituted by "fiscal management", and relative weights assigned to other factors have been changed.

and in addition numerous centrally sponsored plan schemes of various kinds have been established, usually involving matching contributions by the central government in response to state spending. Centrally-sponsored schemes have become an increasingly important source of funding for state government budgets, but since they are time-bound and subsequent recurrent expenditure responsibilities devolve wholly on the states, the schemes are argued to worsen the long-term fiscal situation of states.

Another problem has been emulatory behavior on the part of the states, under pressure from their employees, with respect to wage increases for central government employees. The latter have been subject to much less discipline in the 1980s than in the 1970s, and as a result of "catch-up" demands by their employees, state government salary costs have increased sharply. This factor, however, should become less important in the future, as many states have come into line with the latest central Pay Commission awards.

The revenue sources put under the direct control of the states by the Constitution have turned out to be insufficiently elastic, even when rising sharing rates for states from central excise duties and income tax are taken into account. This has led to demands on the part of the states that they be given access to more buoyant tax sources. But the respectable growth of states' own tax revenues and the failure to utilize some important taxes assigned to the states, as well as problems on the expenditure side, suggest that a more comprehensive approach to resolving the states' budgetary imbalances is called for.

Constitutionally, as long as they are indebted to the central government, states can borrow from the market only with its concurrence. Since plan transfers have had a substantial element of loans and the states have never been able to repay their debt to the central government fully, this has meant effective central control over the ability of the states to borrow; there has been nothing to prevent an arbitrary use of this power. States can borrow from foreign lenders only through the central government under the conditions stipulated by the same, perhaps with good reason; but this fact has also limited the access of states to borrowed funds. This is not to say that the states' problems would have been fewer if the institutional setup was different. Greater freedom for the states in borrowing might have resulted in further problems, as all loans have not been invested in assets yielding sufficiently high rates of return in fact. However, greater freedom in obtaining loans might have led to greater responsibility in their use. Overdrafts from the Reserve Bank of India (RBI) were intended to be short-term ways and means advances, but

these were liberally resorted to by the states until 1985. The Overdraft Regulation Scheme put into practice by the RBI has hardened the soft budget constraint that the states faced earlier.

The central government has been from time to time accused of manipulating taxes to its own benefit, through a variety of means such as raising rates on taxes that it keeps in their entirety and neglecting tax sources that are shared with the states or required to be turned over to them. The use of surcharges on shared taxes is a similar phenomenon. While these and other practices may have exacerbated states' budgetary problems, it is hard to argue that they are the fundamental cause.

While center-state relations obviously comprise a critical component of state finances and raise many Constitutional and political as well as economic and financial issues, this volume focuses on state finances in their own right. To set a foundation for the rest of the book, a review of broad trends in state finances and in state plan financing follows.

BUDGETARY TRENDS AND PLAN FINANCING IN THE STATES

This section first looks at overall budgetary trends in the states. It then reviews patterns of plan financing, both aggregate and statewise. The financing of the Sixth and Seventh Five Year Plans also is touched on.

Budgetary Trends

Aggregate budgetary data of the states show that during the Sixth Plan period (1980-85), the current budgets taken together were not in the red and some surpluses were available to finance investment. The aggregate surplus was 0.4 percent of state domestic product (SDP) (as shown in Table 2.11). Shortfalls in plan outlays as compared to targets occurred mainly because the targets were unrealistic. In the Seventh Plan period (1985-90), while the outlay targets of the plan were met, state budgets showed a deficit in the aggregate (0.4 percent of SDP). There was, however, large variation in the size of surplus/deficit. In the Sixth Plan, while the fourteen states as a whole had a surplus in the current budget, West Bengal had a deficit. In the Seventh Plan, while others had a deficit, Haryana and Bihar had surpluses. Although the surpluses/deficits in revenue budgets do not correspond with those in the balance from current revenues (BCR), as the latter reflects the excess (deficit) of revenue in relation to nonplan

expenditure only, it is fair to say that the BCR position depends primarily on the state of the current budget. In investigating the reasons behind the poor contribution of BCR in plan financing of the states, one has to go into the trends and factors affecting their current receipts and current expenditures.

In the Sixth Plan, for the fourteen large states, revenue receipts and expenditures comprised 15.8 and 15.2 percent of GDP, respectively. In the Seventh Plan, these proportions went up to 17.9 and 18.2 percent, respectively. This was the outcome of faster growth of current expenditures (over 13 percent) than of revenue (about 11 percent). In some states like Haryana and Uttar Pradesh, revenue expenditure grew at the rate of about 16 percent per annum, whereas their revenue grew at rates 10 to 12 percent.

Over the decade of the 1980s, tax receipts, which account for about two-thirds of states' total revenue receipts, grew at 15.1 percent per annum, while total revenue receipts grew at 14.9 percent. Own tax revenue showed a slightly faster growth (15.7 percent per annum) while the states' share of central taxes grew at 13.7 percent per year. Overall growth of own tax revenue seems to have been at a similar rate in all states, but that of individual taxes varied. Agricultural taxes and entertainment tax are on the decline (although in some states the growth in agricultural taxes was high, as the base was small). The significance of entertainment taxes is declining because of videos and resistance to increases in the tax rates. Sales tax, the most important tax source for the states, showed fairly high growth varying between 13.7 percent and 18 percent.

In all states, buoyancy of total revenue receipts and tax revenue was greater than unity during the decade. Sales tax shows high buoyancy in most states (the highest being in Andhra Pradesh, 1.51). In Punjab, buoyancies are relatively low for almost all taxes except electricity duty. Gujarat is not doing well in stamp duties and registration fees; in Tamil Nadu and West Bengal motor vehicles taxes seem to be sluggish.

The per capita tax burden varies considerably across the states (in the Sixth Plan, from Rs. 126 in Bihar to Rs. 331 in Punjab). In the Seventh Plan, the spread came down somewhat: Rs. 231 in Bihar to Rs. 552 in Punjab. Per capita taxation seems to be related to per capita GDP. But there is little evidence to show that per capita plan expenditure is determined by per capita tax burden.

Of non-tax revenues, which comprise 33 percent of the total revenue receipts of the states, 16.4 percent and 18.4 percent came from the central government as grants in the two plan periods respectively.

The contribution of states' own nontax revenue to total revenue receipts has been declining (15.4 percent in the Seventh Plan against 17.6 percent in the Sixth). The prospects for a substantial increase in any of the heads in this category do not seem to be bright.

By and large, revenue receipts of the states seem to have grown fairly uniformly at about 15 percent per annum in the 1980s. It was the faster growth of expenditure which resulted in the poor BCR position. The shares of selected categories of revenue expenditure in total revenue expenditure of the states in the Sixth and Seventh Plans are indicated below.

	<i>General Adminis- tration</i>	<i>Interest payment & appropria- tion to revenue against debt</i>	<i>Compensa- tion and assignment to local bodies</i>	<i>Social services</i>	<i>Economic services</i>
Sixth Plan	18.0	9.7	1.4	41.1	29.9
Seventh Plan	16.4	11.7	1.3	41.3	29.6

Over the two Plans, the share of interest payments has gone up, while that of general administration has declined and that of other heads has remained more or less the same (with a small increase under social services). The fastest growth was recorded by debt servicing in most states (there was a decline only in Punjab and Orissa). In Punjab, the share of general administration registered an increase. The obvious cause of the rapid growth of debt servicing is the increase in the debt burden (at over 15 percent per annum between 1985 and 1990). The ratio of outstanding debt to SDP increased from 20.9 percent in March 1980 to 23.7 percent in March 1985. This has been the trend in all the states except Tamil Nadu. The share of loans from the central government in the total debt has declined from about 72 to 69 percent, reflecting greater reliance on market and other borrowings. The ratio of repayments of principal to fresh loans seems to be declining and may be expected to decline further with the reliefs recommended by the Ninth Finance Commission, provided that the states manage to eliminate deficits in their current budgets.

The economic and functional classification of state budget (available up to 1987-88) also shows that it is interest payments (not included in these data) which show the largest increase in the growth

rate in the 1980s as compared to that in the 1970s. Compensation to employees grew at 17.1 percent per annum in 1980s, as against 14.8 percent in the 1970s, with considerable variation across states (Tamil Nadu, Madhya Pradesh and Maharashtra recorded a sharp increase in the growth rate in the 1980s under this head (see Table 2.18), while in Andhra Pradesh, Bihar and Karnataka there was a deceleration).

The detailed analysis of state finances presented in chapter 2 brings out the fact that the genesis of the resource constraint of the states lies in the growth of current expenditures outpacing that of revenues. Arguably, more rapid growth of revenue might have helped to avert this situation. While there is scope for better exploiting some of the revenue sources of the states, such as urban property tax and agricultural taxes, more attention needs to be paid to rationalization of existing taxes. Even more urgent is the need for cutting down wasteful expenditures and recovering costs of providing public services from those who can pay. The low buoyancy of states' shares in Central taxes also calls for some attention. With better management on the expenditure side and a little more effort on the revenue side, the states should be able to restore the balance in their budgets and undertake their vital tasks vigorously once again.

Plan Outlays and Financing

In the strategy of planning adopted by India in the post-independence era, a large role was assigned to the public sector. During the forty years spanning seven Five Year Plans, roughly 45 percent of gross domestic capital formation took place in the public sector. This was perhaps to be expected, as the initiative for laying the foundations for growth in the form of infrastructure and development of key industries was supposed to come from the public sector. While the lead for drawing up the blueprints for development -- the "Plans" -- was taken by the central government, as is to be expected in a federal polity, the states were involved in the task of promoting development almost in equal partnership. Until about the Seventh Five Year Plan (1985-90) nearly 50 percent of the total public sector plan outlay was undertaken by the states. In recent years, however, the states' share in the public sector plan outlay has declined. In the Seventh Plan, it fell to 41 percent (Table 1.1). The decline appears to have been even more pronounced in the capital component of plan outlay. The states seem to be experiencing difficulty in fulfilling even relatively modest targets. This is a matter for concern as planning needs to be decentralised if it is to serve the objectives of balanced growth and bring into full play local aspirations, potential and

Table 1.1

**Public Sector Outlay Under Five Year Plans
(Actuals at current prices)**

	<i>Center</i>	<i>States and Union Territories</i>	<i>(Rs Crore)</i>
			<i>Total</i>
First Five Year Plan (1951-52 to 1955-56)	706 (36.02)	1294 (63.98)	1960 (100.00)
Second Five Year Plan (1956-57 to 1960-61)	2534 (54.24)	2138 (45.76)	4672 (100.00)
Third Five Year Plan (1961-62 to 1965-66)	4212 (49.11)	4365 (50.89)	8577 (100.00)
Annual Plans (66-67, 67-68, 68-69)	3379 (51.17)	3224 (48.83)	6603 (100.00)
Fourth Five Year Plan (1969-70 to 1973-74)	7826 (49.60)	7952 (50.40)	15778 (100.00)
Fifth Five Year Plan (1974-75 to 1978-79)	13893 (48.21)	14986 (51.79)	28819 (100.00)
Annual Plan (1979-80)	10558 (46.02)	12383 (53.98)	22941 (100.00)
Sixth Five Year Plan (1980-81 to 1984-85)	57825 (52.91)	51467 (47.09)	109292 (100.00)
Seventh Five Year Plan (1985-86 to 1989-90)	129764 (58.77)	91009 (41.23)	220773 (100.00)

- Note:*
1. Figures for 1989-90 are revised estimates.
 2. Figures within parentheses are percent to total.
- Source:*
1. CSO, *Statistical Abstract of India* (various issues).
 2. Planning Commission, *Annual Plan* (various issues).

initiatives.

Difficulties in meeting the plan targets on the part of the states have been evident even in the Sixth Plan period. As Table 1.2 shows, the states' outlay under the Sixth Plan fell short of estimates by nearly 26 percent, as compared with a shortfall of 12 percent at the center. In the Seventh Plan too, the states' outlay registered a shortfall of about 11 percent from the original estimates, while the central government's outlay exceeded targets by about 12 percent. The

Table 1.2

**Estimates and Actuals of Plan Outlay
(Sixth and Seventh Plans)**

(Rs Crore)

	Sixth Plan			Seventh Plan		
	Original estimates	Actuals*	Shortfall (-)	Original estimates	Actuals*	Excess (+) Shortfall(-)
Center	47,250	41,444	(-) 5,806 (-12.3)	95,534	1,06,817	(+) 11,277 (11.80)
States	48,600	36,022	(-) 12,578 (-25.9)	80,698	71,857	(-) 8,841 (-10.96)
Total	95,850	77,466	(-)18,384 (-19.9)	1,76,232	1,78,674	(+) 2,442 (1.38)

Note: * At prices of base year.

(Figures in parentheses indicate percentages of respective original estimates.)

Source: Planning Commission, Annual Plan, various issues and the two plan documents.

shortfall in the Seventh Plan outlay occurred despite only a modest increase in targets for 1985-90. In some crucial sectors (irrigation and power, in particular) the shortfalls were much larger in the Sixth Plan, both at the center and in the states. In the Seventh Plan, while the targets at the center were overfulfilled under most heads, large shortfalls occurred in the states, again in irrigation and flood control, power, and water supply and sanitation (25 percent or more), although the targets were modest. In contrast, general economic services and general services recorded an excess of 40 percent over targets (Table 1.3).

The probable reasons underlying these trends include relatively large contributions by the central government to the anti-poverty programmes, growing involvement of the central government in the power sector for technological and other reasons, and public resistance to large multipurpose irrigation projects due to apprehensions of environmental degradation and preference for less capital intensive dry farming techniques. Failure to meet even modest investment targets in vital areas like irrigation and power during the Seventh

Table 1.3

Plan Performance by Major Heads of Development : Center and States (Sixth and Seventh Plan)

(Rs. crore)

Heads	Center (Sixth Plan)				States (Sixth Plan)				Center (Seventh Plan)				States (Seventh Plan)			
	Actual Expen-@		Shortfall (%)		Plan Outlay		Actual Expen-@		Shortfall (%)		Plan Outlay		Actual Expen-@		Shortfall (%)	
	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto	ditto
I. Agriculture*	2450.1	2213.6	9.7	3119.0	2493.2	20.1	3556.7	4040.9	-13.6	5732.1	6477.2	13.0				
a. Animal Husbandry and Dairies	398.0	250.9	37.0	430.6	318.9	25.9	410.0	278.8	32.0	622.6	591.2	5.1				
b. Forestry	105.0	69.5	33.8	559.5	486.9	13.0	446.7	295.2	33.9	1340.1	1306.0	2.5				
c. Investment in Agricultural Financial Institutions	664.4	972.9	-46.4	156.7	82.3	47.5	195.0	743.6	-281.3	158.6	134.2	15.4				
II. Rural Development*	2314.9	2222.7	4.0	3020.0	2809.8	7.0	5401.6	7809.6	-44.6	4491.0	5689.1	-26.7				
a. Cooperation	330.1	260.4	21.1	566.0	458.0	19.1	500.0	443.7	11.3	870.2	828.3	4.8				
Special Area Programmes	0.0	0.0		1480.0	1145.0	22.6	0.0	0.0		2803.6	2938.3	-4.8				
Irrigation & Flood Control	635.0	353.3	44.4	11395.5	7524.0	34.9	834.9	701.6	16.0	15949.8	11868.3	25.3				
Energy	11995.0	12358.8	-3.0	14293.6	9436.9	34.0	31492.1	33718.9	-7.1	22786.2	17284.3	24.2				
a. Power	4725.0	3517.3	25.6	14293.6	9429.8	34.0	11051.5	13639.8	-23.4	22686.8	17213.3	24.1				
VI. Industry and Minerals	12771.5	10247.6	19.8	2185.9	1881.0	13.9	18553.0	20642.3	-11.3	3785.9	3897.8	-3.0				
a. Village & Small Industries	923.4	690.8	25.2	815.1	668.3	18.0	1284.8	1302.7	-1.4	1378.5	1343.2	2.6				

Heads	Center (Sixth Plan)			States (Sixth Plan)			Center (Seventh Plan)			States (Seventh Plan)		
	Plan Outlay	Actual Expen. @ ditire	Shortfall (%)	Plan Outlay	Actual Expen. @ ditire	Shortfall (%)	Plan Outlay	Actual Expen. @ ditire	Shortfall (%)	Plan Outlay	Actual Expen. @ ditire	Shortfall (%)
VII. Transport*	8418.6	7076.6	15.9	3707.3	2967.2	20.0	16459.4	18878.5	-14.7	5772.5	5322.9	7.8
VIII. Communications, Information and Broadcasting*	3102.0	2440.8	21.3	28.6	36.1	-26.3	6365.8	8042.1	-26.3	99.3	91.9	7.5
IX. Science and Technology	848.2	699.5	17.5	17.1	23.7	-38.8	2303.4	2293.8	-0.4	157.3	133.9	14.8
X. Social Services*	4453.4	3700.5	16.9	8830.9	7086.6	19.8	10350.9	9897.3	4.1	17692.1	16146.4	8.7
a. Education	734.8	474.2	35.5	1624.1	1444.9	11.0	2388.6	2756.5	-15.4	3488.7	3862.0	-10.7
b. Health	601.0	445.0	26.0	1091.2	937.4	14.1	897.3	816.0	9.1	2240.3	2032.4	9.3
c. Housing	300.0	247.3	17.6	1065.9	979.5	8.1	457.9	152.9	44.8	1928.9	1905.0	1.2
d. Urban Development	110.0	69.9	36.5	780.8	562.4	28.0	*	99.7	*	1352.2	1374.4	-1.6
e. Water Supply & Sanitation	614.2	654.6	-6.6	3123.6	2057.0	34.2	1236.8	1566.3	-26.6	4848.1	4012.3	17.2
XI. Others	261.3	130.6	50.0	522.2	464.1	11.1	216.1	786.3	-263.8	1428.3	2006.7	-49.5
XII. Total	47250.0	41444.1	12.3	48600.0	36022.3	25.9	95534.0	106811.2	-11.8	80698.0	71856.7	11.0

Note: Negative signs under "shortfall" signify excess over the estimates.

Data for the Seventh plan period have been adjusted to roughly correspond those for the Sixth plan period.

@ Total of the values for five years, each converted to values at prices comparable to the original estimates.

* Included in housing.

Source: Planning Commission, Annual Plan, various issues, and the two plan documents.

Table 1.4

Financing Pattern of Plan (Sixth and Seventh) - Center and States

(Rs Crore)

Item	CENTER						ALL STATES					
	Sixth Plan			Seventh Plan			Sixth Plan			Seventh Plan		
	Esti- mates	Actuals ¹ Short- fall (per cent)	Short- fall (per cent)	Esti- mates	Actuals ² Short- fall (per cent)	Short- fall (per cent)	Esti- mates	Actuals ¹ Short- fall (per cent)	Short- fall (per cent)	Esti- mates	Actuals ² Short- fall (per cent)	Short- fall (per cent)
1. Balance from current revenue	9568	6427	32.83	10479	3807	63.67	22312	14826	33.55	28974	17368	40.06
2. Contribution of PSEs	13811	12815	7.21	37454	26872	28.25	-516	-4620	795.42	-1969	-3757	90.81
3. Market borrowing including those by PSEs.	15000	12626	15.83	20620	34026	-65.01	4500	3406	24.30	9942	9242	7.04
4. Small Savings and Provident Funds	3772	4049	-7.34	8677	8751	-0.85	6393	5901	7.70	16566	19070	-15.12
5. Drawing down of foreign exchange reserves	1000	-	-	-	-	-	-	-	-	-	-	-
6. Term loans from financial institutions	-	-	-	-	-	-	2722	1887	30.67	4639	4445	4.18

Item	C E N T E R				A L L S T A T E S							
	Sixth Plan		Seventh Plan		Sixth Plan		Seventh Plan					
	Esti- mates	Short- fall (per cent)	Esti- mates	Actu- als ²	Esti- mates	Short- fall (per cent)	Esti- mates	Short- fall (per cent)				
7. Miscellaneous capital receipts (net)	6170	6388	-13.26	19809	29039	-46.59	-2161	-2012	-6.91	-7191	-5113	-28.90
8. Budgetary deficit	5000	7955	-59.10	14000	28381	-102.72	0	3497	-	-	-	-
9. Net inflow from abroad	9929	6239	37.17	18000	16348	9.18	-	-	-	-	-	-
10. Total resources	64250	57098	11.13	129039	147224	-14.09	33250	22885	31.17	50961	41255	19.05
11. Central assistance to States	-15350	-13619	-11.28	-29737	-33554	12.84	15350	13690	10.82	29737	33264	-11.86
12. Resources available for the Plan	48900	43479	11.09	99302	113670	-14.47	48600	36575	24.74	80698	74519	7.66

Notes: 1. Calculated by adding up the annual latest estimates, deflated to 1979-80 prices using the wholesale price index.

2. Calculated by adding up the annual latest estimates, deflated to 1984-85 prices using the wholesale price index.

Caution: Figures given in this table may not tally with those in Table 1.3 as the present table is concerned with "resources" while 1.3 shows the "expenditures", the difference arising from a convention followed in the Planning Commission whereby actual expenditures are determined after taking note of diversions.

Source: 1. Ministry of Finance (1988), *Indian Economic Statistics (Public Finance)*.

2. Reserve Bank of India (1991), *Annual Report*.

Plan, however, resulted mainly from acute constraints on funds available for development, as reflected in shortfalls in resources available for the plans compared to estimates. This was partly due to a larger proportion of plan funds being allocated to the revenue component of the plan. Rural development, which has a large component of revenue expenditure on anti-poverty programmes, did better.

Table 1.4 shows the actual pattern of plan financing as compared with plan estimates for the center and the states. While the constraints faced by the central government in financing the plans are not the same as those operating in the states, at both levels of government shortfalls in resources available for the plan are accounted for largely by the inadequacy of the balance from current revenue (BCR) and the contribution of public sector enterprises (PSEs), leading to heavy reliance on market borrowings and miscellaneous capital receipts. In the Seventh Plan, the central government was able to exceed its overall resource target, but mainly through market borrowings, miscellaneous capital receipts and budgetary deficits.

Shortfalls in the case of the states stemmed mainly from failure to generate surpluses from current revenues to the extent stipulated in plans. Massive losses of PSEs were also a major contributory factor. In the Seventh Plan, the aggregate losses of state PSEs turned out to be Rs. 3,757 crore, as against an estimate of Rs. 1,969 crore. Receipts from small savings and provident funds and miscellaneous capital receipts were appreciably higher than the estimates. Even so, there was a shortfall of about 19 percent. Central assistance to states brought down this deficiency by about 12 percentage points, leaving a resource gap of about 8 percent. Actual outlays, however, fell short of the original estimates by a larger margin, presumably because of diversion to other uses. Evidently, large surpluses would have to be generated especially by the states if they were to undertake development through planning on any significant scale.

Chapter 2 presents a detailed review of state finances and plan financing in the states during the Sixth and Seventh Plans, in an attempt to identify the factors underlying their increasing resource problem, so that remedial measures could be proposed. This is a matter of some importance, as the persistence of regional inequalities and the slow absorption of assistance from external agencies are attributable at least partly to the weakening of the states' ability to undertake investment for development.

Statewise Patterns

While the aggregate data indicate the worsening of the finances of

the states as a whole in relation to the plan, there are wide variations among states in the scale of planning undertaken by them (Table 1.5). Indeed, the level of plan expenditures per capita varies widely across States. Despite thirty years of planning, it appears that per capita plan outlays in states are related closely and not inversely to their per capita SDP, contrary to what one might expect under planning aiming at balanced growth for all regions. In the Sixth Plan, the highest per capita plan outlay was that of Haryana (Rs. 235) and the lowest (Rs. 81) that of Bihar. In the Seventh Plan, the highest was Rs. 356 (Punjab) and the lowest Rs. 137 in West Bengal, followed closely by Bihar (Rs. 148). It is not surprising that planning has not been able to make much of a dent on regional disparities. While for the states taken together, the shortfall in aggregate outlay in the Sixth Plan was 26 percent, West Bengal could meet only about 52 percent of the target. Other states with less than average performance were Haryana (36 percent shortfall) and Bihar (33 percent shortfall). Karnataka, Tamil Nadu, Assam, Himachal Pradesh and Tripura had done better than the average.

In the Seventh Plan, shortfalls of varying magnitudes also occurred in all states (except Orissa), though the extent was smaller, thanks partly to the modest targets set. Some states did remarkably well in the Seventh Plan, however (Bihar for instance). This, coupled with the impressive performance of Orissa and the fact that the poor states had an above average growth rate in plan expenditure, helped to achieve a slightly more equitable distribution of plan outlay in the Seventh Plan.

Sectorwise shortfalls and overfulfillments in plan performance also varied considerably across states both in the Sixth and in the Seventh Plans. For instance, in the Sixth Plan the target for agriculture was exceeded in Bihar, Orissa, Tamil Nadu and Uttar Pradesh, while West Bengal and Haryana fell short by 30 percent. Among the major sectors, fairly large shortfalls occurred in energy in almost all states (the largest, 44 percent, in Haryana). Interestingly, large excesses of actual expenditure over targets occurred under the heads communication, information and publicity, and "others". "District planning" accounted for the bulk of the excess under the last head. In the case of some states, shortfalls could be attributed to overambitious targets (e.g. in Tamil Nadu, Uttar Pradesh and Maharashtra) but that could not be said of West Bengal and Kerala. In the Seventh Plan, shortfalls do not seem to be attributable to enlargement of the targets, though in some instances (e.g. in Madhya Pradesh), the plan was clearly too large.

Table 1.5

Shortfalls and Average Annual Growth in Real Plan Expenditure During Sixth and Seventh Plans

(Per cent)

	Agriculture and Allied Services		Rural development		Irrigation and Flood Control		Power		Industry and Minerals		Transport		Social and community Services		TOTAL	
	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan
	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan
1. Andhra Pradesh																
Shortfall	16.7	19.7	27.9	-41.8	22.1	18.9	9.6	24.1	22.5	17.96	26.4	-54.0	13.5	-0.6	24.8	6.3
Average growth	18.5	3.9	29.3	9.2	13.2	-2.2	0.5	2.4	19.9	-10.6	2.5	-6.7	14.1	4.2	8.2	0.9
2. Bihar																
Shortfall	34.8	-30.3	20.6	-5.0	36.6	12.2	-4.2	20.1	19.6	-17.0	12.5	3.7	26.2	4.6	33.1	2.3
Average growth	9.2	8.5	20.9	9.1	7.9	-3.9	-3.8	9.7	4.3	2.6	1.9	-2.8	3.6	6.9	4.1	2.6
3. Gujarat																
Shortfall	-4.1	9.5	36.8	-19.1	33.2	-4.2	27.8	26.5	0.1	-38.2	12.8	18.1	9.6	32.1	23.1	28.5
Average growth	7.0	1.4	0.7	6.7	5.9	5.3	10.9	2.7	5.2	3.0	-9.0	-1.9	6.2	4.0	5.0	2.7
4. Haryana																
Shortfall	25.7	30.5	14.2	-24.0	-44.6	13.6	35.8	43.9	25.3	31.2	41.5	33.5	28.6	4.0	36.2	28.3
Average growth	19.5	-1.2	12.8	7.8	2.7	-20.6	3.1	0.4	-4.2	-4.4	-5.2	-2.8	12.9	28.3	3.8	0.9
5. Karnataka																
Shortfall	11.8	15.9	-40.4	-50.6	28.8	12.0	13.2	16.7	-14.8	7.6	3.3	24.6	22.5	11.2	14.5	11.0
Average growth	12.1	4.7	16.5	15.2	2.5	4.5	1.9	-1.3	9.3	0.1	6.3	-11.5	17.4	4.8	7.5	1.0
6. Kerala																
Shortfall	-42.2	23.8	5.0	13.0	30.8	25.3	22.3	21.0	24.9	13.6	23.2	-13.9	6.5	9.9	22.0	15.5
Average growth	5.7	-2.1	-0.1	-0.3	2.3	-6.0	1.1	9.5	-2.6	1.2	4.8	1.6	1.7	2.5	0.4	0.2

	Agriculture and Allied Services		Rural development		Irrigation and Flood Control		Power		Industry and Minerals		Transport		Social and community Services		TOTAL	
	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan
	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan	Plan
7. Madhya Pradesh																
Shortfall	12.6	1.1	23.1	5.0	34.6	28.3	32.3	31.6	-11.0	-25.2	11.4	26.8	4.1	-5.5	26.0	18.4
Average growth	16.0	12.0	10.0	9.4	5.1	1.6	2.1	9.4	27.6	5.2	-4.9	2.6	19.9	10.1	6.6	8.5
8. Maharashtra																
Shortfall	-2.0	20.3	-206.4	-146.2	21.3	3.9	40.4	32.2	15.3	10.3	29.6	37.3	20.6	33.5	23.2	15.3
Average growth	28.4	3.0	128.7	-7.5	6.1	-0.5	-5.5	1.4	14.7	7.8	3.1	-2.6	11.9	7.4	8.6	0.8
9. Orissa																
Shortfall	16.4	-22.9	26.7	-12.3	30.5	3.5	27.6	34.2	-15.6	-43.8	24.6	1.0	14.1	-31.2	24.0	-0.6
Average growth	7.9	18.0	31.3	6.1	-0.7	5.3	-2.2	14.8	22.5	1.6	21.4	-1.0	11.4	11.8	5.8	9.1
10. Punjab																
Shortfall	32.5	27.1	16.6	29.8	46.7	21.0	15.4	6.0	33.7	0.9	24.8	33.4	38.7	33.4	29.2	13.2
Average growth	3.2	8.4	3.4	-3.5	-4.4	-0.5	11.7	4.5	11.4	5.2	-8.3	0.6	-1.4	13.1	2.3	7.9
11. Rajasthan																
Shortfall	15.9	9.4	16.8	1.7	22.4	29.7	37.6	13.3	26.1	39.1	-37.4	25.6	20.0	6.6	22.4	15.0
Average growth	-0.4	13.3	15.0	12.4	1.5	-2.5	-6.0	7.9	3.6	13.5	11.6	5.2	11.4	20.7	0.3	9.1
12. Tamil Nadu																
Shortfall	16.6	-30.5	-35.1	18.6	24.2	11.6	31.5	26.2	-11.0	-32.9	12.7	-2.8	19.8	13.6	17.4	11.8
Average growth	23.1	5.9	13.3	2.0	29.9	-9.5	3.4	-0.3	28.5	10.6	8.5	3.6	18.5	2.5	12.0	1.6
13. Uttar Pradesh																
Shortfall	-4.2	-12.9	-59.5	-27.9	33.6	23.9	35.8	35.5	4.3	8.9	-11.7	15.1	2.6	-6.0	19.0	14.0
Average growth	11.4	15.4	21.5	13.6	-2.6	-0.2	6.5	-7.8	33.3	-5.3	14.7	-4.4	19.8	15.0	9.1	1.5
14. West Bengal																
Shortfall	49.3	30.6	37.3	22.9	61.6	5.2	49.9	17.8	59.1	2.2	44.9	-8.1	40.1	5.0	48.9	14.0
Average growth	5.9	2.6	9.2	-2.8	-6.0	4.2	-2.1	12.7	5.6	9.2	7.7	2.8	1.3	2.6	0.0	5.0

Note: Figures for Sixth Plan are in 1979-80 prices and figures for Seventh Plan are in 1984-85 prices.

Table 1.6

Shortfall in Resources for the States : Sixth and Seventh Plans

State	(Percentages)										
	Balance from current revenue	Contribution of public enterprises	Small savings	Provi- dent Funds	Miscel- laneous capital receipts	Adjust- ment of over- drafts etc.	Market borro- wings and negotia- tible loans	Total State resour- ces	Central assis- tance	Total resour- ces	
Andhra Pradesh	6th Plan	37.9	118.8	-8.7	6.3	2.6	-280.3	42.5	37.4	13.2	30.3
	7th Plan	24.6	-10.5	1.2	-11.5	-47.3	-247.3	N.A	N.A	N.A	N.A
Bihar	6th Plan	40.9	719.1	3.0	32.6	46.7	27.4	23.1	62.6	15.4	44.1
	7th Plan	6.1	98.6	-1.6	-50.6	13.4	-131.0	N.A	N.A	N.A	N.A
Gujarat	6th Plan	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A
	7th Plan	51.4	214.4	-31.0	-15.6	-295.7	-934.7	N.A	N.A	N.A	N.A
Haryana	6th Plan	48.0	472.9	7.5	17.1	-173.0	-580.7	24.3	41.9	-1.2	36.3
	7th Plan	64.0	819.1	-90.5	-73.6	40.2	-184.2	N.A	N.A	N.A	N.A
Karnataka	6th Plan	23.9	-9.3	-0.3	18.1	20.1	-42.2	35.1	24.1	22.8	23.8
	7th Plan	54.3	-60.6	-46.5	-27.4	-52.6	-200.8	N.A	N.A	N.A	N.A
Kerala	6th Plan	46.1	-59.2	-1.3	-4.7	38.6	21.5	42.3	30.3	24.0	51.1

State	Balance from current revenue	Contribution of public enterprises	Small savings	Provi- dent Funds	Miscel- laneous capital receipts	Adjust- ment of over- drafts and nego- tiable loans	Market borro- wings	Total State resour- ces	Central assis- tance	Total resour- ces
	7th Plan	-101.3	-127.1	-30.4	-21.3	-186.2	N.A	N.A	N.A	N.A
Madhya Pradesh.	6th Plan	14.1	24.8	60.1	-257.8	-388.8	34.4	36.9	22.4	33.0
	7th Plan	8.8	-33.1	28.6	56.7	-548.2	N.A	N.A	N.A	N.A
Maharashtra	6th Plan	N.A.	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A
	7th Plan	31.4	-10.7	16.8	16.3	-	N.A	N.A	N.A	N.A
Orissa	6th Plan	24.9	36.4	3.6	32.4	60.2	48.5	44.8	20.4	27.6
	7th Plan	56.6	-17.6	-87.6	-64.1	-41.4	N.A	N.A	N.A	N.A
Punjab	6th Plan	50.2	24.3	23.4	309.3	-62.7	12.8	32.1	16.7	29.8
	7th Plan	107.6	-144.1	-252.6	294.1	-329.7	N.A	N.A	N.A	N.A
Rajasthan	6th Plan	51.0	-26.2	10.0	-61.8	-160.2	13.6	37.2	-9.9	22.7
	7th Plan	100.8	-1.5	-45.6	150.9	-	N.A	N.A	N.A	N.A
Tamil Nadu	6th Plan	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A
	7th Plan	39.4	-11.7	-175.7	14.1	43.5	N.A	N.A	N.A	N.A
Uttar Pradesh	6th Plan	28.5	8.7	31.8	117.8	18.8	37.4	33.8	15.9	27.9
	7th Plan	84.0	-57.1	-310.1	-78.4	-187.7	N.A	N.A	N.A	N.A
West Bengal	6th Plan	92.8	20.5	-9.3	-203.8	2473.7	30.6	81.4	7.5	67.0
	7th Plan	83.5	6.2	21.9	25.3	-243.7	N.A	N.A	N.A	N.A

While there were inter-state variations, five sectors (agriculture, irrigation and flood control, energy, transport, sanitation and water supply), which accounted for 75 percent of total plan outlay, experienced heavy shortfalls in the Sixth Plan in many states and also in the Seventh Plan (though the shortfalls were smaller). In social services, on the other hand, shortfalls were relatively small in general in the Seventh Plan. In some states as much was laid out on social services as on energy. It is thus not surprising that the share of revenue expenditure in total plan expenditure financed through the budget went up from 42 percent in the Sixth Plan to 51 percent in the Seventh. Punjab, however, deployed 70 percent of the plan for investment expenditure while Tamil Nadu spent only 27 percent. While the shrinking of the states' investment in the power sector could be due to the greater involvement of the center, stagnation of investment in heads like irrigation was due presumably to resource constraints.

Financing Pattern of State Plans

The financing pattern of the Sixth and Seventh Plans for the central government and for the states as a whole was depicted in Table 1.4. The main factor underlying the resource shortfall is the inadequate generation of public saving, which consists of surpluses of current revenues over current expenditure in the budget and the contribution of PSEs (Table 1.6). In the Sixth Plan, the shortfall in BCR was the main factor underlying the resource shortage in most states; in fact, in Haryana, Punjab and Rajasthan, the overall shortfall was almost equal to that in BCR, while in some states (Uttar Pradesh) PSE contributions also fell far short of the estimates. Surprisingly, variations from estimates occurred also in central assistance, ranging from a shortfall of 24 percent in Kerala to an excess of nine percent in Rajasthan. In the Seventh Plan, although the full picture of the financing pattern that emerged is not available, it is evident that deficiencies in BCR and PSEs' contribution were again at the root of the resource problem of the states. Large shortfalls in BCR occurred in Punjab, Bihar, Haryana, Karnataka, Uttar Pradesh and West Bengal; Punjab and Kerala actually had a negative BCR. Problems were compounded by the heavy losses of PSEs. These deficiencies were made up largely with accruals to small savings, state provident funds and in some cases (West Bengal) large overdrafts, accentuating the already heavy burden of state government debt.

OVERVIEW OF THE VOLUME

Brief summaries of the eight papers presented at the Seminar on State Finances and included in this volume, as well as two shorter papers circulated but not discussed at the seminar, are presented below. The summary of the seminar proceedings (Chapter 10) is not discussed here.

Chapter 2

This paper, written by Amaresh Bagchi and Tapas Sen, examines overall budgetary trends and plan outlays and financing in the states. It seeks in particular to ascertain the determinants of plan spending in the states and the reasons for shortfalls in relation to plan targets as well as slow growth of plan expenditure in real terms. There is also some analysis of trends on both revenue and expenditure sides, providing a foundation for the topical and state-specific analysis in subsequent chapters.

The paper starts out by looking at statewise and sectorwise patterns of plan expenditure, in terms of real growth as well as in relation to original plan projections. Performance in relation to targets was considerably better on the whole in the Seventh Plan period than during the Sixth Plan, in part due to more modest targets in the Seventh Plan. There was, however, great variation across states and sectors. Heavy shortfalls occurred in crucial sectors like power and irrigation under both Plans, although in the case of power this, to some extent, reflected a trend of increasing centralization of investment. Among the states, West Bengal, Haryana, and Bihar exhibited the largest shortfalls during the Sixth Plan, whereas Gujarat and Haryana suffered from relatively large shortfalls during the Seventh Plan.

States have exhibited an increasing tendency to allocate plan resources to "current" or "revenue" expenditure, especially in direct poverty alleviation and employment schemes, as opposed to capital investments in various kinds of infrastructure. Hence shortfalls of plan spending in relation to targets were relatively small in the social sectors. The shift toward current expenditure within the plan has been encouraged by the availability of central funding of various kinds for such schemes.

The paper then turns to an analysis of the pattern of financing the plan. Balance from Current Revenue (BCR) and contributions from state public enterprises have suffered from severe shortfalls as compared with plan targets. By and large, revenue receipts of state

governments have grown at least as fast as state domestic product (SDP), although the growth of nontax revenue has not been satisfactory. This means that declining BCRs have been due primarily to rapid growth of nonplan expenditure, particularly subsidies and interest payments, the latter resulting from the burgeoning of state debt outstanding. Compensation of state government employees also recorded rapid growth (14.8 percent p.a. in the 1970s and 17.1 percent p.a. in the 1980s). Declining BCRs and weak contributions from public enterprises have meant that states have increasingly relied on borrowings of various kinds to finance their plans, including assistance related to externally-aided projects (see chapter 5).

The pattern of plan financing that emerged in the 1980s is argued to be unsustainable. One of the main conclusions of the paper is that without better control over expenditures, states' plans will be further squeezed, and planning at the state level will cease to be a meaningful activity.

In looking at the buoyancy of different revenue sources, the paper finds that indirect taxes have been relatively buoyant, whereas agricultural direct taxes and entertainment taxes have largely lost their significance. Nontax revenues also have declined in importance. A harmful tendency noted in the paper is that of states on the one hand trying to "export" their tax burdens, in a distortionary manner that goes against the principles of sound taxation, and on the other hand losing revenues through competitive "rate wars".

The paper undertakes an econometric analysis of the determinants of plan spending at the state level as a ratio to SDP, leading to some interesting findings. First, the dependent variable is negatively related to per-capita income, other things equal, suggesting that plan spending to some extent has had an equalizing influence. Interest expenditure not surprisingly is negatively related to lagged plan spending, as the former appropriates funds that would presumably otherwise be available for the latter. Political variables turned out to be a significant determinant of plan spending, as was ability to raise own resources (proxied by the share of manufacturing in SDP).

Chapter 3

In their paper, M. Govinda Rao and Sudipto Mundle undertake a detailed analysis of subsidies at the state government level, building on their earlier work on fiscal subsidies more generally. The paper covers budgetary subsidies for the fourteen major states at two points of time: 1977-78 and 1987-88. The aggregate level of subsidies and the sector composition are calculated, and differences across states and

sectors as well as trends over time are documented.

The first part of the paper examines revenue trends and shows that nontax revenue has accounted for a small and declining share of total revenue and has made only a negligible contribution to ameliorating the fiscal problems of state governments. This provides a strong indication of inadequate cost recovery for services provided by state governments. The next section puts forward a definition of subsidy for use in the analysis and outlines how levels of subsidies are calculated for different activities. Subsidies as defined in the paper include imputed interest and depreciation costs, as well as current (or "revenue") expenditures.

The paper finds that levels of subsidies grew phenomenally over the decade between 1977-78 and 1987-88, with growth of recoveries lagging far behind the increase in costs. This pattern is common to all states. It is interesting to note, however, that both aggregate and per-capita subsidies went disproportionately to the better-off states. Relative shares of states in total subsidies remained remarkably stable between the 1970s and the 1980s.

The authors then examine subsidies in major functional categories. Social services claimed a predominant share of subsidies in all of the major states, with education accounting for the largest share within social services, followed by health. Per-capita subsidies tend to be higher in states where levels of provision of education and health services also are higher. The paper documents the extremely low rates of cost recovery prevalent in social services, even in sectors like higher education where distributional and other justifications for subsidies are weak.

Turning to economic services, the authors note that irrigation and agriculture subsidy costs account for more than half of the total, while power and transport also involve substantial subsidies. Analysis of trends suggests that distortions induced by subsidized provision of various economic services have been increasing over time. As in the case of total subsidies and those on social services, subsidies on economic services are skewed in favor of the more developed states. Inefficiency in state public undertakings as well as inadequate tariff increases, resulting in worsening rates of return, have been major factors contributing to the rise of subsidies.

The paper concludes by reiterating that the total volume of subsidies in fourteen major states amounted to a staggering 8.3 percent of GDP in 1987-88. Rapid growth of expenditures on social services (which carry low cost recovery rates) and declining rates of cost recovery for economic services both have contributed to the rapid

growth of subsidies. Moreover, the volume of budgetary subsidies to state public enterprises has been increasing. Subsidies have been maldistributed across states and across income groups within states, indicating that the federal transfer mechanism has failed to achieve fiscal equalization objectives. The authors argue that redistributive objectives would in some cases be better served by pure income transfers.

Chapter 4

This paper, by Abhijit Datta, surveys the crucial area of local government finances (both urban and rural). It highlights the colonial legacy of local government in India, onto which was grafted a Soviet-style system of local government in the rural areas. By international standards, India is well below the norm in terms of the share of total government expenditures handled by local bodies (about six percent in 1986-87). Moreover, local government functions have increasingly been usurped by higher levels of government, and in many cases local bodies have actually been superseded for periods of time.

There are great dissimilarities between rural and urban local government in terms of the structure of revenues. For rural local governments, as much as 88 percent of total revenue flows from state governments, whereas for urban local governments, less than a quarter of revenue consists of assistance from outside. This pattern reflects the dearth of meaningful tax sources for rural governments. There are major differences across states in local revenue mobilization. Three states, Maharashtra, Gujarat, and West Bengal, account for about two-thirds of total rural government revenue. Constrained by their limited tax powers, urban local governments are also experiencing increasing state intrusions into their tax domains. The productivity of local taxes is generally low. One promising potential revenue source would be local professions taxes, which have been increasingly taken over by the states. Datta also makes a number of suggestions for improving property taxes, which are argued to have considerable revenue mobilization potential.

Octroi has been a primary revenue source for urban local governments in many states. There have been widespread calls for its abolition, because of its distortionary effects on internal trade and high costs in terms of delays and corruption. Datta points out that the pattern is actually quite mixed: while some states have abolished octroi, sometimes with adverse consequences for local revenue, some non-octroi states have imposed octroi or are considering doing so. Unless certain preconditions are met, argues Datta, abolition of octroi

will not have beneficial result, and readily available alternatives may be worse.

Despite very low physical levels of various local services, many local governments are nominally in surplus year after year. This is argued to be not a healthy phenomenon, reflecting in part the lack of stable revenue sources and consequent conservatism in incurring expenditure liabilities.

Considerable attention is devoted in the paper to cost recovery for local government services. In general, Datta argues that the potential for enhanced cost recovery will not be very good until basic community needs have been met. Alternative private provision is a possibility in many cases, however.

Transfers and grants to local government need to be revamped and consolidated, in a manner that will enhance local autonomy, argues the author. Local governments have virtually no independent role in plan development, although they are often forced to bear the burden of implementing or continuing plan schemes. Datta also argues that local authorities should be given more access to borrowing to finance projects.

The paper closes with some policy recommendations. Datta asserts that major reforms are needed, starting from political decentralization and moving to a more market-based economy. Local fiscal autonomy needs to be promoted judiciously. Reforms in the environment faced by local government, it is asserted, will be more important than internal local government reforms in the immediate future.

Chapter 5

Bajaj's paper on externally aided projects in the state sector is of particular relevance in the light of recent concerns about the utilization of aid commitments and their effectiveness. External financing assumed an increasing role in the financing of development spending in the 1980s, a trend which is likely to continue over the medium term. The bulk of Official Development Assistance (ODA) flows have been linked to pre-identified, project-specific investments in the governmental sector; a significant (and increasing) proportion of ODA transfers are on the basis of activities by the states. With the emergence of newer sectors in which the states have primary implementation responsibilities, the role of states in utilizing external assistance has increased. At the same time, the search for additional funds to finance investments (and liberalization of transfer provisions from the central government) has led many state governments to actively seek external assistance.

Disbursements in the state sector have been slower than in the central or autonomous sectors. This can partly be attributed to the sectoral characteristics of projects undertaken at the state level, which typically have a longer implementation span, are multi-component, and entail complex and interlinked investments in infrastructure and staff. On the other hand, there is evidence of limitations in planning, design, financing and implementation capabilities in the states, which have tended to constrain disbursement performance. In sectors where comparisons are possible (for instance energy), SEB performance has lagged behind that of NTPC. Nevertheless, given India's federal structure and the Constitutional assignment of developmental responsibilities, it would not be possible to exclude the state sector from the sphere of external financing.

Bajaj traces the evolution of current policies on transfer of external resources to the states. These have undergone significant changes in less than a decade and a half. Before 1975 the states derived no additional resource benefits from externally aided projects; the funds flowing from external agencies were fully retained by GOI and "internalized". At present such resources are transferred, to the extent of 100 percent in most sectors, and substantially in the remaining few, as identifiable additionality. External flows are therefore no longer neutral in their inter-regional and inter-sectoral impacts; implementing states and sectors have gained at the expense of others.

External aid (and therefore additionality) was concentrated in a few states in the Fifth and Sixth Plans. In the Seventh Plan there has been relatively greater dispersion of projects; despite this, 71 percent of additionality flows in 1989-90 were disbursed to only five states (Maharashtra, Gujarat, Tamil Nadu, Madhya Pradesh and Uttar Pradesh). The pattern of external transfers to the states in this period has diverged increasingly from the principles of the Gadgil Formula which governs the allocation of "normal" plan assistance among states. Special Category States (for whom the Plans are effectively centrally funded) have little incentive to seek additional resources; their share of external transfers has been less than two percent in the 1980s (as against their access to 1/3 of the "divisible" pool of plan resources). The major gainers from external flows have been Gujarat and Maharashtra, along with other largely better placed states.

There have been reservations in India about the possible distortionary impact of external funding on inter-sectoral allocations. (The direct impact would be expected to be confined to the state sector, since additionality provisions do not formally operate in the central sector). In the aggregate such a problem is not immediately

apparent, since external transfers have been small in comparison with the overall Plan outlays. The displacement or "crowding out" effect of externally aided projects is, however, clearly visible in sub-sectoral allocations. External assistance is not only significantly availed of by only a few states; it has been concentrated in a few sectors in these states. This has been a factor in the inability and at times the reluctance of states to assign counterpart funds for such projects.

Within the planning framework, the states have tended to over-estimate, ex-ante, additionality flows, resulting in implementation slippages and utilization delays. Reinforcing this have been the design and other characteristics of externally aided projects: they tend to be relatively expensive, their costs are under-projected, and they are started with inadequate attention to project detail.

Chapter 6

The paper by S. Guhan reviews Tamil Nadu state finances in the period 1960-1990, with particular emphasis on developments in the 1980s. It highlights the dramatic growth (more than 13-fold) of receipts and outlays, which now represent 20 percent of net state domestic product (NSDP). The state has assumed important functions in many spheres; adequate funding for these activities in the future is, however, contingent on the containment of current outlays. Tamil Nadu has one of the most impressive records of resource mobilization among the states, a fact recognized by successive Finance Commissions; this will be difficult to sustain in the future, however. Tamil Nadu has been relatively disadvantaged in its access to central transfers. The paper also examines issues of cost recovery for publicly provided services and returns from investment in state enterprises.

The decline in outlays for capital formation since the mid-1970s provides grounds for concern in the context of capital formation; 75 percent of total outlays are now devoted to current consumption. At the same time, there has been, in the 1980s, an increase in direct subsidies, even as the state government is increasingly burdened with a high-cost administration.

Tamil Nadu's tax revenues almost doubled as a proportion of NSDP from less than 6 percent to 11.5 percent between 1960 and 1985; among major states, Tamil Nadu is one of the most heavily taxed. In the tax structure, sales taxes predominate (67 percent); along with excise and stamp duties, motor vehicle and entertainment taxes, they represented 97 percent of total tax receipts in 1985. Other direct taxes, including electricity duties, constituted two percent and direct taxes on income and property only 1.4 percent. Sales taxes have

also shown the fastest rate of growth, rising from 48 percent in 1960-70 to 66 percent in 1980-90. The adverse impact of sales taxes arises from their regressiveness, possible inflationary effects, and from the taxation of both final goods and intermediates. Tax rates are high and have been largely stable in recent years. Additional taxation is unlikely to realize major dividends in the future, as are other taxes, including motor vehicle and entertainment taxes and stamp duties. Excise duties, currently significant at around 11 percent, have been volatile as a result of repeated changes in prohibition policy. Agricultural taxation is low (and politically difficult to enhance), not progressive, and unresponsive to the growth of incomes in the sector. Nontax revenues have steadily lost relative share, including recoveries of outlays on the social services.

Guhan highlights the problem of access to central transfers of a middle income, low-deficit state like Tamil Nadu. The state's status has limited its access to Finance Commission transfers -- its overall share of the divisible pool has dropped with successive Finance Commissions; at the same time per-capita plan assistance has been below the average for major states. Not being a post-devolution deficit state, Tamil Nadu has not qualified for "gap" grants, either.

On the expenditure front, consumption outlays increased from 66 percent of the total in 1960-70 to 75 percent in 1985-90, with a corresponding reduction in capital outlays. There has, however, been relative stability in sectoral shares: currently social services receive about 40 percent, economic services 35 percent, and general services 25 percent. Guhan confirms that in relation to other states, the ratio of plan spending to total expenditure has been higher in Tamil Nadu. There is a trend of declining plan outlays for agricultural activity matched by an increase in spending on social and community services. The power sector, despite a dip in the early 1980s, has maintained a share of 35 percent. Tamil Nadu has opted for larger current outlays at the expense of capital outlays, reflecting the state's commitment to basic needs and welfare programmes.

Excluding current transfers and committed liabilities, salaries and establishment costs consumed more than 72 percent of the state's direct revenue expenditures, showing the heavy burden of employee compensation. In fact, this figure may be an underestimate, since a large part of grant-in-aid transfers actually goes to meet salary liabilities. The average employee cost has risen appreciably, as has the level of staffing, and most areas of governmental activity tend to be overstaffed.

Recoveries constitute about 12 percent of net state expenditures,

that is, direct unrecovered costs comprise about 88 percent. Guhan's paper incorporates a detailed analysis of unrecovered costs. Recoveries varied from 2.3 percent in the social services (1.5 percent in education) to 18 percent in administrative services (mainly representing recovery for roads, with less than one percent recovery in irrigation and power). In particular, power subsidies to the agricultural sector have been significant. Food and nutrition comprise almost 35 percent of total direct subsidies, followed by power (through TNEB, 16 percent) and agriculture (14 percent). More than half of the direct unrecovered costs consist of untargeted or undifferentiated subsidies.

Among the state enterprises, TNEB has been the largest recipient of state government loans. Its financial position has deteriorated sharply in the 1980s. Government subsidies for power rose from negligible levels in 1960-70 to Rs. 181 crores in 1970-80 and to Rs. 523 crores in 1989-90 alone. TNEB's large losses are attributable to high costs (inputs, wages, debt servicing); inefficiency (transmission and distribution losses and a plant load factor, which though high in comparison with many other states, is still too low); and tariff policies which have not kept pace with cost escalation. Cross-subsidization is heavy and has shown an increasing trend in favor of agricultural and domestic consumers at the expense of industry. For the other state enterprises, the aggregate net loss in the period 1986-89 (after depreciation, interest, and taxes) was 7.2 percent; only two corporations (out of a total of 62) paid nominal dividends.

Tamil Nadu's reliance on the central government for borrowing has been less than the average for major states, but it is still sizeable at 96.5 percent of outstanding debt in 1988-89. The growth of borrowing in the 1980s has been rapid, though significantly slower than the growth of revenue receipts. There has been a perceptible shift in borrowing from the Government of India to other sources. In the case of borrowings from the central government, it appears that 40 percent of fresh loans are used to repay past borrowings. Tamil Nadu is one of the relatively less indebted states, possibly due to availability of current account surpluses and the lack of major capital projects (especially in irrigation).

Chapter 7

The paper by J.L. Bajaj and O.P. Aggarwal on Uttar Pradesh state finances also highlights the major expansion in the scope and scale of budgetary operations, following from and sustaining the expanding dimensions of state activity. In the 25-year period covered (1965-90),

aggregate receipts increased 28-fold to Rs. 9213 crores, with current revenues as the most significant resource. There has, however, been a decline in the contribution of state taxes to total receipts, and also of nontax revenues. At the same time there has been greater recourse to borrowing to finance increasing expenditures (and deficits). Uttar Pradesh's tax effort, despite major absolute increases, has not been at the same level as that of many in other states, including comparably backward ones.

In terms of tax structure the importance of direct taxes has secularly declined, whereas among indirect taxes, sales taxes have become increasingly dominant, their share rising from 38 percent in 1965-70 to 53 percent in 1985-90. Excise duties have oscillated and were 19 percent in 1985-90. These trends are similar to those in other states. The scope for further increases in sales taxes is circumscribed by the high existing prevalent rates (and by the incidence of central taxes), as well as by the fear of trade diversion to neighboring states. Sales and indirect taxes, which have been shown to be inherently regressive, have been even more so in rural areas.

Among direct taxes, there appears to be a strong case for restoration of the professions tax (abolished in 1971). The only significant direct tax in agriculture is land revenue, which has been declining in importance. But other levies collected from the agricultural sector have been buoyant, including purchase taxes on foodgrains and sugarcane and mandi (agricultural market) fees. The contribution of the agricultural sector increased, as a result, from Rs. 78 crores in 1980 to Rs. 250 crores in 1990.

The relative contribution of nontax revenue to total receipts has sharply declined. Dividends from state enterprises are insignificant; the major sources are interest receipts, followed by departmental receipts. Interest receipts represented only 30 percent of interest outpayment in 1989-90, however, and over 95 percent of such receipts represented only accounting adjustments from departmental budgets (mainly irrigation projects).

The Uttar Pradesh State Electricity Board (UPSEB) is the largest state public sector undertaking, with capital and current assets at the end of 1987-88 of over Rs. 5000 crores. UPSEB showed gross operating surpluses until 1987-88; taking into account depreciation and interest payments, however, losses have averaged Rs. 400 crores annually since 1980. The causes of poor financial performance have been in part systemic (increases in thermal generation and of purchased power) and in part due to increased costs, low efficiency and productivity, low tariffs, and overstaffing. Subsidies on power

supply to agriculture are extremely heavy; currently rural areas consume 40 percent of power but contribute only 15 percent of revenue from power. The Uttar Pradesh State Road Transport Corporation (UPSRTC) has also been incurring major losses, including Rs. 68 crore in the Seventh Plan alone. There has been a proliferation of state public enterprises (increasing in number from 11 in 1970 to 56 in 1984), to which the state's financial commitment was Rs. 975 crores in 1984. The returns from this investment have been negligible. Excluding UPSEB and UPSRTC, state public enterprises incurred an average annual loss of Rs. 25 crores in 1980-83. Their negative contribution has further eroded the resource base of the state. Among the contributory factors to poor performance are poor management, overstaffing, subsidized pricing of output, outdated technology, and lack of clarity of institutional objectives.

Irrigation works have represented a major area of state investment. However, even on "commercial" work, receipts contributed only 17 percent of maintenance costs. (If maintenance were to be carried out according to the norms, this figure would be even lower.) The subsidy on commercial irrigation in the period 1983-88 averaged Rs. 456 per irrigated hectare (Rs. 1145 per hectare for state tubewells). In addition, the irrigation potential has been seriously underutilized; of the 18 lakh hectares of potential created in the 1980s, only 5 lakh hectares were utilized.

On the expenditure front, consumption outlays have shown a rising trend as compared to capital outlays. As in other states, the social sectors dominate current spending, and economic services receive the bulk of capital outlays. Annual average per-capita budgetary outlays were about the lowest among major states, though the capital component of budgetary spending was higher than the major-states average. In current outlays, establishment costs represent the major portion; if grant-in-aid transfers for salaries are taken into account, this could be as high as 65 percent.

Direct subsidies have increased in importance to Rs. 2600 crores in 1985-90, particularly in agriculture and allied activities where they are concentrated. Indirect and largely untargeted subsidies are also provided in the social sectors, for which cost recovery is insignificant. In the education sector, per-capita expenditures (almost entirely subsidy) ranged from Rs. 440 at the primary level to Rs. 1815 in higher education.

Per-capita plan expenditures in Uttar Pradesh have risen at rates approximating the major states average; the increasing constraint to larger plan outlays is the limitations on the state's own resources.

Plan spending now represents over a third of Uttar Pradesh's total expenditures; over 40 percent of plan expenditures consist of revenue expenditures. The longer-term impact of centrally sponsored schemes is a cause of concern, in the context of the burden that they place on state finances. Expenditures in the Seventh Plan on centrally sponsored schemes averaged Rs. 825 crores annually; clearly, in the Eighth Plan, Uttar Pradesh will have to meet substantial nonplan liabilities on this account.

Central government loans were the main source of borrowing for the state (52 percent) in 1987-88, followed by market loans (17 percent) and small savings loans (15 percent); the balance represented Provident Fund and other deposits and institutional loans. Uttar Pradesh's indebtedness is low relative to that of many other major states, possibly explained by low per capita plan assistance and lack of access to market borrowing. At the end of 1989-90, assets, in the form of cumulative capital expenditures, loans advanced by government, and other investments, amounted to over Rs. 15,500 crores, well in excess of "liabilities" in the form of outstanding debt (Rs. 11,600 crores). This does not, however, give an accurate picture, since part of loans was specifically intended for consumption, while the other assets created have not resulted in cash flows to amortize investment.

Current revenues, excluding tax transfers from the Government of India, have been inadequate to finance current outlays, resulting in a trend of increasing deficits over time. Tax transfers from the central government have doubled in each five-year period. In the 1980s the current deficit increased sharply, and as a result incremental capital formation stagnated.

Chapter 8

This paper by Nizar Jetha reviews the structure and trends of Gujarat's finances in the period 1973-87. In particular, budgetary transactions in 1986-87 and 1987-88 have been analyzed. The paper highlights the emergence of current account deficits in the mid-1980s, in part a consequence of rapid growth of expenditures. The paper also reviews trends in the structure and composition of receipts and expenditures and examines in detail the state's own revenue efforts, their sustainability, and their potential for growth.

The bulk of Gujarat's current account receipts are derived from its own tax and nontax revenues; only about a quarter originate from central grants and transfers. State taxes predominate in own revenues (about four-fifths) and sales taxes in turn comprise about two-thirds of total tax receipts. Central loans, on the other hand,

cover a significant proportion of capital receipts, financing about 50 percent of the overall deficit. The balance is met by domestic borrowing, and from recoveries and net contributions from provident funds. Interest receipts, dividends, and oil and mineral royalties constitute the major part of nontax revenues. User charges, particularly in the social sectors, are relatively less important as sources of revenue.

Within current expenditure, the social services predominate (42 percent), with education alone accounting for 20 percent. A further 35 percent is expended on economic services; general administration and debt servicing make up the rest. In capital expenditure, however, economic services dominate -- spending on irrigation alone represents 46 percent of total capital spending. Because of the importance of loans and advances made to state enterprises, budgetary transactions provide only a partial picture of the composition of investment. The Annual Plans provide a clearer picture, with irrigation and energy together garnering 54 percent, and social services 22 percent of plan resources.

Between 1973 and 1984, state expenditures rose by five times, while per-capita real expenditures rose by two-thirds. Capital expenditures rose rapidly initially, then slowed down in relative terms, reflecting resource constraints, while current expenditures increased rapidly and continuously. The growth of the latter is a consequence of ambitious development plans, the rising interest burden, expansion of poverty alleviation programmes, and "indexing" of state government salaries.

To finance rising expenditures, Gujarat increased its tax efforts substantially, without altering basic tax structure. State taxes as a proportion of SDP grew steadily. Electricity duties and sales taxes showed considerable buoyancy, while land revenue, motor vehicle and other taxes were less buoyant. There was also a moderate increase in central transfers, reflecting the growth of central loans for capital expenditures. The increase in the Government of India's contribution to the state did not result in a slowdown of Gujarat's own resource mobilization efforts.

In the context of emerging deficits and an increasingly inflexible pattern of state expenditures, Jetha examines in detail the structure of state revenues, specifically their potential for further expansion, without increased reliance on user charges or better performance on the part of public enterprises. The paper examines the distortionary impact of state and central sales tax on the allocation of resources (through changes in the relative prices of goods); at the same time input taxation affects the costs of production of user industries. The

paper reviews land revenue, professions tax, stamp duties, and other taxes; it shows that there is scope for more efficient tax administration and collection.

Among Jetha's findings are the non-sustainability of recent trends of a 20 percent annual rate of growth of current expenditures (to which poverty alleviation, centrally sponsored schemes, and the state's own welfare schemes have contributed). He suggests that beneficiary targeting and greater cost effectiveness are required. The paper also suggests that maintaining Gujarat's impressive record in growth of tax collections may be difficult, due to concentration on a narrow range of taxes and the need to coordinate/compete with neighboring states. Continued and increased taxation of inputs would be anomalous, and even deleterious to economic efficiency. A significant suggestion in the context of coordinating state sales taxes is to abolish the central sales tax and adopt a destination principle. Among possible growth areas identified are professions tax and motor vehicle taxes. User charges represent a potentially important and at present greatly under-utilized source of revenue, including charges for publicly provided energy and irrigation services, as well as transportation and access to higher education. The agricultural sector, which is distinctly undertaxed, is another area of potential growth for future resource mobilization.

Chapter 9

This paper, by R. Ramalingom Aiyer and K.N. Kurup, looks at state finances in Kerala. Kerala is most interesting because of its paradoxical pattern of development -- slow growth of economic activity and per-capita income juxtaposed with high achievements in terms of social indicators of development, which in some cases match developed country standards. The paper explains this paradox in terms of the fiscal position and choices of the state. It also engages in extensive comparative analysis of Kerala and other southern states as well as aggregates for all states.

A central theme of the paper is that Kerala has suffered as a result of its emphasis, ahead of time, on social development (especially in education and health) and resulting inability to provide adequate funds for economic infrastructure or manufacturing development. Kerala's social achievements in certain respects themselves have worsened the fiscal picture, e.g. through increased pension costs or health expenditures. But most important, the slow rate of economic growth has squeezed the budget and weakened development prospects.

Despite its success in social development, Kerala's achievements

are argued to be precarious and unsustainable. In education, for example, the government has taken over the bulk of institutional funding, even though the private sector had played the major role in earlier development of education. Such a pattern of financing cannot be maintained. Fees for education are minimal and are in urgent need of major revisions (the same is true of health). The budgetary situation overall is argued to be substantially worse than that of neighboring states.

The paper points out some interesting innovations by the state in various areas of tax and expenditure, which have resulted in improvements in the fiscal situation and may be worthy of emulation by other states. In education, for example, the spread of higher education in the 1980s occurred mainly through private "parallel" colleges, attended by students who subsequently passed state university exams and earned degrees in this manner, avoiding massive additional expenditures by the state government. On the tax side, Kerala has achieved substantial increases in agricultural income taxation and has rationalized sales tax rates to some extent.

An argument reiterated several times in the paper is that Kerala has suffered unjustifiably due to neglect on the part of the central government in terms of transfers. In effect, not only has the state not been helped fiscally as a result of its social achievements, but it has been penalized. Central investment funding at least in the same proportion as Kerala's share in the national population is strongly recommended.

Chapter 11

In his short paper, B.P.R. Vithal examines three critically important aspects of public expenditures at the state level: grants-in-aid, emoluments of government employees, and state subsidized services.

Grants-in-aid were a device inherited from the British, which involved partial government support to private entities providing social and other public services deemed important by the government, primarily education. The objective was to enhance provision of the services concerned while limiting government expenditure and gaining the efficiency advantages of private sector management. However, under the "net deficit" approach adopted several decades ago, the state government prescribed the fees that could be charged for the services and the pay scales for the employees concerned and then committed itself to cover through grants-in-aid the difference between receipts and expenditures of private providers. This is argued to have been very damaging both to expenditure control and to

incentives. The state government took over additional expenditure liabilities from the private sector and at the same time removed incentives for enhanced cost recovery and efficient management.

Trends related to emoluments of state government employees are of concern, most importantly the rapid growth of real incomes. One factor leading to this result has been the increasing tendency for civil servants at different levels of government to demand parity with the best-paid group, culminating in pay scales identical with those of the Government of India. Moreover, the demand for parity in terms and conditions of employment has increasingly permeated lower levels of government and even government-assisted private institutions, regardless of ability to pay on the part of the employer. Thus state governments and ultimately the central government have become in a sense "responsible" for the remuneration of the host of lower-level government employees and those attached to quasi-governmental and even many private organizations, a burden which cannot continue to be borne.

Concerning state subsidized services, Vithal points out that many schemes intended to benefit the poor have been "hijacked" by the nonpoor and in fact mainly serve the latter's interests. Better targeting of services is often difficult and in any case is strongly resisted by the nonpoor, who have great political clout. Providing services to the poor and nonpoor at the same facility, the former free or highly subsidized and the latter on a fee basis, does not seem to work; the poor simply lose access to the services concerned. The only solution would seem to be reserving government facilities only for the poor and forcing the nonpoor to rely on the private sector, recognizing that this may result in further decline in the quality of government services.

Chapter 12

Oberoi's paper on the education sector focusses on a perspective often underplayed in India in the context of sectoral policy -- financial resources. Despite impressive increases in infrastructure, in enrollments, and in investment, the attainment of basic sectoral objectives has lagged. In fact, India's performance in literacy and related endeavours has been poorer than that of several comparably placed countries. Oberoi attributes the mixed success of initiatives in education, at least to an extent, to the failure to adequately integrate resource perspectives in the evolution of education policy. According to him, issues of financing of investments in education and their sustainability have tended to be dealt with as a residual.

Increases in public investment in the sector have supported, since

independence, a manifold expansion of systems and infrastructure. This has rendered the sector, which already absorbs a large part of current government expenditures, increasingly dependent on budgetary support. In the 1990s, in the face of a relatively constrained resource environment, it may not be possible to continue these trends. Expenditure on education currently averages over four percent of GNP. This estimate is, however, based largely on institutional spending; if private direct costs for education are added, as well as subsidies on transportation, text books etc., the figure is likely to be considerably higher.

Education expenditures currently represent over a fifth of all developmental expenditures, comprising the largest single block of spending in governmental budgets. Spending on education is also the fastest growing segment of social service expenditures. A large (and increasing) proportion of sectoral expenditure is met from budgetary sources. Public spending has tended to substitute for community and private spending, a cause for concern. This trend is unlikely to afford a sustainable path for future growth; at the same time it has led to the entrenchment of expensive delivery systems.

The essential characteristic of education spending is a state sector orientation. Despite increased central efforts, the primary spending, financing and management roles are with the states. The central government's effective role would therefore appear to be catalytic and complementary, not over-riding. In the Seventh Plan, enhanced central provisioning of resources for education has partially succeeded in arresting a trend of declining Plan allocations for education. Despite this, the bulk of educational expenditure continues to reflect committed non-plan liabilities. As a result, resources available for incremental investments and quality improvement have declined over time.

The education sector relies almost entirely on exogenously derived resources (increasingly perceived as entitlements). This has inhibited the development of perspectives for financial management in the sector. The education sector has the lowest cost recovery rates, even among the social services. Significantly, unit subsidization is much greater in higher education than in basic education. This intra-sectoral inequity shows the potential for cross subsidization and increased internal resource generation. Other intra-sectoral trends also indicate a relatively disadvantaged primary education component, in terms of per-capita outlays, and the almost total domination by regular recurrent costs.

All of these trends raise important issues for the future content and directions of education policy.

Chapter 2

Budgetary Trends and Plan Financing in the States

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In the federal set up of India, states are usually taken to be equal partners to the centre in the overall development effort. Since planning has been integral to such efforts, it is natural to presume that states would be equal partners in planning as well. The brief analysis in the introductory chapter shows this to be true as far as plan expenditures are concerned. It also brings out the complementary role that the centre and the states play in the promotion of economic development.

Given that planning was expected to provide the initial thrust of economic development, the states' plan efforts are important for both the overall economic development of the country (due to spillover of benefits across states) and, of course, for the individual states concerned. One of the avowed objectives of planning was to bring about balanced regional development by accelerating the process of economic development in the relatively less developed states. This

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does not seem to have taken place even after seven Five Year Plans have been implemented. Taking one of the indicators of development, per capita State Domestic Product (SDP), the coefficient of variation was estimated to be 0.26 for the period 1973-76, 0.33 for the period 1976-79, and 0.30 for 1982-85 (Bagchi, 1988). Taking the averages for the periods 1980-85 and 1985-89, we estimate it to be 0.35 for both the periods using the latest available data. This indicates the persistence and even accentuation of regional disparities. Has this happened despite planning, or has planning been at least partly responsible for this? *Prima facie* evidence shown in Table 2.1, which provides data on states' plan expenditure and per capita SDP, points to the fact that state plan expenditures more or less followed the pattern exhibited by per capita SDP and were not inversely related to this indicator of economic development as one would expect from planning aimed at balanced regional development.

So much is well known now as several studies have reached the same conclusion [e.g. George (1988) and Dandekar (1987)]. What is not always emphasized is the decline in the states' share in total public sector plan expenditure and in total capital expenditure (as brought out in the preceding chapter) during the last decade. The phenomenon of resource constraints assuming primary significance is no longer confined to the relatively less developed states. This in fact has affected the absorption of external assistance available for state projects in several states in recent years.² The question of what underlies the decline in the role of states in planning and capital formation in the public sector and the failure of planning to bring about a reduction in regional disparities calls for some investigation into the way plan expenditures have been incurred and their financing.

The aim of this chapter is to initiate this task. The chapter is divided into six sections. Section II presents an overview of plan performance of the states in terms of targets of outlays and achievements in the aggregate as well as under the main sectoral heads. In Section III, we analyse the financing pattern of the plans as originally envisaged and the actuals, for the states as a whole and for a few major states individually, in an attempt to identify the factors influencing levels of plan outlay. Section IV reviews budgetary trends for the states in the context of plan financing during the Sixth and Seventh Plans. Section V attempts an econometric exercise to assess the relative impact of various determinants of actual plan expenditure during the two plans. The concluding section (Section VI) draws

2. Discussed in Chapter 5 of this volume.

Table 2.1

Annual Averages¹ of Plan Outlay and SDP (in current prices)

(Rs.)

State	SIXTH PLAN PERIOD (1980-85)				SEVENTH PLAN PERIOD (1985-90)			
	Plan Expend.		S.D.P.		Plan Expend.		S.D.P. ³	
	Per	Per	Per	Per	Per	Per	Per	
	Capita	Index	Capita	Index	Capita	Index	Capita	Index
	1	2	3	4	5	6	7	8
Andhra Pradesh	117	86	1785	95	190	93	2659	93
Bihar	81	60	1152	61	148	72	1893	66
Gujarat	218	160	2637	140	258	126	3750	131
Haryana	235	173	2892	154	327	160	4338	152
Karnataka	139	102	2035	108	173	84	3078	108
Kerala	123	90	1785	95	149	73	2641	92
Madhya Pradesh ²	141	104	1463	78	229	112	2263	79
Maharashtra	200	147	2907	155	295	144	4363	153
Orissa	115	85	1496	80	222	108	2255	79
Punjab	217	160	3409	181	356	174	5345	187
Rajasthan	108	79	1563	83	150	73	2293	80
Tamil Nadu	140	103	1883	100	227	111	3134	110
Uttar Pradesh	112	82	1517	81	168	82	2307	81
West Bengal	88	65	1974	105	137	67	2907	104
Correlation Coefficient of columns 2 and 4	= 0.8940				of columns 6 and 8 = 0.8561			
Average	136	100	1878	100	205	100	2861	100

- Notes: 1. Average of per capita SDP for different years.
 2. Based on 1970-71 series SDP, while all other SDP figures are based on the 1980-81 series.
 3. For the period 1985-89.

Sources of data:

- (i) Central Statistical Organisation.
 (ii) Planning Commission.

together the main findings and their policy implications. The focus is on the finances of the fourteen non-special category states, the aim being to address the issue of what constrained their capacity to finance their plans in the recent past. The reference period is the decade of the 1980s, covering the Sixth and the Seventh Plan.

PLAN EXPENDITURE

Taking all states together, the annual growth rate of real total plan expenditure for the period 1980-90 works out to a little above 5 per cent, more or less in line with the growth in GDP. There were, however, substantial shortfalls if actual plan expenditures are compared to the plan targets in base year prices. For the Sixth Plan, the shortfall was a hefty 26 per cent, while it was lower at 11 per cent for the Seventh Plan. These facts together imply that though the planners desired the states to channel an increasing part of GDP through state plans, the states barely managed to keep their plan size constant relative to GDP.

The overall growth of real plan expenditure of all states together does not quite convey the variation in achievement of targets in different sectors and by individual states. Tables 2.2 and 2.3 show this quite clearly. Taking the sectorwise picture first, two striking developments should be pointed out. First, among the quantitatively significant sectors, rural development exhibits the lowest shortfall during the Sixth Plan and a large excess during the Seventh. The annual growth rate of real plan expenditure under this head for the whole ten year period, however, is lower than that in agriculture and social services. Conversely, two sectors -- irrigation and power -- show the highest shortfalls among all sectors for both plans; the ten year growth rates are also low (in fact, negative in the case of irrigation and flood control). The bulk of expenditure under rural development is accounted for by the anti-poverty programmes and is revenue expenditure by nature. Most of the plan expenditures under irrigation and power are, on the other hand, capital expenditures. This, then, partly explains the decline in the states' share in total capital expenditure by government. The trends observed above can perhaps be explained by the following facts:

- i) for a large part of the plan expenditure on anti-poverty schemes, the contribution of the center is substantially higher than for other plan projects/schemes, and this creates a bias in favour of these schemes in the states;

Table 2.2

**Plan Performance by Major Heads of Development
All States (Sixth and Seventh Plan)**

(Rs. lakh)

Heads	Sixth Plan			Seventh Plan			Real Annual Growth Rate 1980-90 (%)
	Plan Outlay	Actual Expenditure ^a	Shortfall (%)	Plan Outlay	Actual Expenditure ^a	Shortfall (%)	
I. Agriculture*	311902	249321	20.1	573210	647723	13.0	11.1
a. Animal Husbandry and Dairies	43056	31895	25.9	62264	59120	5.0	4.3
b. Forestry	55954	48695	13.0	134008	130599	2.5	12.1
c. Investment in Agricultural Financial Institutions	15668	8229	47.5	15856	13415	15.4	0.0
II. Rural Development*	302003	280978	7.0	449100	568908	-26.7	6.2
a. Cooperation	56600	45797	19.1	87018	82829	4.8	2.5
III. Special Area Programmes	148000	114501	22.6	280359	293833	-4.8	10.7
IV. Irrigation & Flood Control	1139548	752398	34.0	1594977	1186826	25.3	-0.6
V. Energy	1429356	943694	34.0	2278615	1728425	24.1	3.0
a. Power	1429356	942976	34.0	2268676	1721325	24.1	2.9

Heads	Sixth Plan			Seventh Plan			Real Annual
	Plan	Actual	Shortfall	Plan	Actual	Shortfall	Growth Rate
	Outlay	Expenditure ⁽ⁱ⁾	(%)	Outlay	Expenditure ⁽ⁱ⁾	(%)	1980-90 (%)
VI. Industry and Minerals	218586	188099	14.0	378588	389779	-3.0	5.8
a. Village & Small Industries	81511	68825	18.0	137852	134320	2.6	5.7
VII. Transport*	370734	296719	20.0	577250	532289	7.8	2.3
VIII. Communications, Information and Broadcasting ^f	2861	3614	-26.3	9933	9186	7.5	11.6
IX. Science and Technology	1705	2366	-38.8	15728	13394	14.8	26.1
X. Social Services	883088	708656	19.8	1769212	1614640	8.7	8.7
a. Education	162407	144485	11.0	348871	386200	-10.7	13.6
b. Health (incl. Medical)	109119	93736	14.1	224033	203244	9.3	7.6
c. Housing	106595	97949	8.1	192891	190501	1.2	3.8
d. Urban Development	78077	56240	28.0	135218	137443	-1.6	9.0
e. Water Supply & Sanitation	312365	205697	34.2	484806	401225	17.2	5.0
XI. Others	52217	46412	11.1	142828	200671	-40.5	21.1
XII. Total	4860000	3602228	25.9	8069800	7185674	11.0	5.1

Note: Negative signs under "shortfall" signify excess over the estimates.

Data for the Seventh plan period have been adjusted to roughly correspond those for the Sixth plan period.

@ Total of the values for five years, each converted to values at prices comparable to the original estimates.

Basic data source: Planning Commission, Annual Plan, various issues, and the two plan documents.

- ii) due to technological and other reasons, the responsibility for investment in the power sector is increasingly being assumed by the center; and
- iii) large irrigation/multi-purpose projects now face increasing public resistance due to possible environmental degradation as well as problems of resettlement, and also dry farming techniques requiring less capital expenditure are now increasingly being considered more important than the traditional large irrigation projects.

Agriculture and social services exhibit relatively large shortfalls in both the plans, but the annual growth rates of plan expenditure on these two heads are well above the overall growth rate. In fact, agriculture and education (included in social services) actually show the highest growth rates among sectors involving large amounts of plan expenditure. Thus, the shortfalls in these sectors probably indicate only the states' reluctance to attach the same amount of weight to these sectors as the Planning Commission does and are not serious problems. Another sector which shows relatively large shortfalls for both the plans is transport; the low annual growth of plan expenditures in this sector indicates genuine neglect.

The statewise picture of overall shortfalls in reaching plan targets coupled with the annual compound growth rates of total plan outlay in constant prices depicted in table 2.3 reveals interesting facts. In the Sixth Plan, while for the states as a whole the shortfall worked out to almost 26 per cent, three states failed to reach the targets by 30 per cent or more. In the case of West Bengal, the shortfall was nearly 50 per cent. The other two states which recorded large shortfalls were Haryana (36 per cent) and Bihar (33 per cent). States with less than the average shortfall were Karnataka (14 per cent), Tamil Nadu (18 per cent), Assam (17 per cent), Himachal Pradesh and Tripura (14 per cent).

Performance was appreciably better in the Seventh Plan for practically all of the states. There were, however, shortfalls of varying magnitudes in all major states except Orissa. These were relatively large in two states, Gujarat and Haryana (28 per cent). While better performance in terms of achieving targeted outlays was aided considerably by the modest increase aimed at in the Seventh Plan, in some states the improvement was indeed remarkable. Bihar is a case in point. Contrasting with its dismal Sixth Plan performance, Bihar came close to achieving its target in the Seventh Plan. The targeted plan outlay for the state was raised by 58 per cent in the Seventh Plan

Table 2.3

Approved and Actual Plan Expenditure

(Rs crore)

State	6th Plan (Approved)	6th Plan (Total Actual)*	3/2 (per cent)	7th Plan (Approved)	7th Plan (Total Actual)*	6/5 (per cent)	Annual Real Growth(%) 1980-90
1	2	3	4	5	6	7	8
Andhra Pradesh	3100	2331	75.2	5200	4871	93.7	5.9
Bihar	3225	2159	66.9	5100	4981	97.7	6.5
Gujarat	3680	2829	76.8	6000	4292	71.5	0.7
Haryana	1800	1148	63.8	2900	2078	71.7	2.7
Karnataka	2265	1938	85.6	3500	3115	89.0	1.5
Kerala	1550	1209	78.0	2100	1773	84.4	-0.6
Madhya Pradesh	3800	2814	74.1	7000	5711	81.6	6.3
Maharashtra	6175	4740	76.8	10500	8894	84.7	4.2
Orissa	1500	1140	76.0	2700	2716	100.6	8.3
Punjab	1957	1384	70.7	3285	2850	86.8	5.1
Rajasthan	2025	1572	77.6	3000	2550	85.0	3.3
Tamil Nadu	3150	2602	82.6	5750	5072	88.2	5.7
Uttar Pradesh	5850	4738	81.0	10447	8982	86.0	4.5
West Bengal	3500	1787	51.1	4125	3547	86.0	3.7
Arunachal Pradesh	--	--	--	--	446	N.C.	N.C.
Assam	1115	928	83.3	2100	2101	100.0	7.1
Goa	--	--	--	--	299	N.C.	N.C.
Himachal Pradesh	560	487	86.9	1050	1057	100.6	6.7
Jammu & Kashmir	900	672	74.6	1400	1653	118.0	8.9
Manipur	240	178	74.0	430	424	98.6	8.6
Meghalaya	235	190	80.8	440	450	102.3	8.8
Mizoram	--	--	--	--	303	N.C.	N.C.
Nagaland	210	167	79.7	400	391	97.8	8.9
Sikkim	122	109	89.0	230	240	104.1	9.0
Tripura	245	212	86.7	440	560	127.4	10.9
All States	47204	35334	74.9	78097	69259	88.7	4.9

N.C. Not computed.

* Total of five years' outlay after deflating each to the prices of the year prior to the first year of the plan using wholesale price index for all commodities.

Basic data source: Planning Commission.

over that of the Sixth, as compared to 65 per cent for the states taken together. The actual plan outlay of Bihar in comparable prices, however, increased by about 140 per cent. In West Bengal, on the other hand, the targeted outlay showed an increase of only 18 per cent. Even so, the state could not achieve the plan target and registered a shortfall of over 15 per cent. The relatively large shortfalls in Haryana and Gujarat during the Seventh Plan could perhaps be due to the fact that their targets were relatively high in the Sixth Plan and increases of the order aimed at in the Seventh Plan were possibly not achievable.

To put the shortfalls in plan expenditures in proper perspective, we have computed the annual average growth of plan expenditure in constant prices for the two plan periods together. Going by these growth rates, the best performance was that of Orissa. The fact that it was the only non-special category state to have exceeded its plan expenditure target is, therefore, not due to a modest target. Bihar also was successful in raising plan expenditures by a large margin. Both of these are relatively poor states and hence it can probably be said that even if the initial distribution of plan expenditure across states was not equitable, there has been a trend toward a more equitable distribution during the last decade. This observation is reinforced by the fact that all of the relatively poor states except Kerala (which experienced a fall in real plan expenditure) and Uttar Pradesh had above-average growth in plan expenditure while the relatively rich states like Haryana, Gujarat and Maharashtra had below average growth rates. It should, however, be noted that population growth rates were higher in the states enjoying high growth rates of plan expenditure, and the picture in per-capita terms can be quite different, as we have already seen in table 2.1.

There were marked variations in sectorwise shortfalls/excesses in plan performance and in growth of plan expenditure among the states in the Sixth as well as in the Seventh Plan. Tables 2.4 and 2.5 show the shortfalls and average annual growth of plan expenditures under major heads of development for selected states in the Sixth and Seventh Plan periods. In the Sixth Plan, while heavy shortfalls occurred in agriculture and allied services, irrigation and flood control, power and transport in most of the states, there were exceptions to the pattern. For instance, shortfalls in agriculture were actually negative (implying excess expenditure) in Maharashtra and Uttar Pradesh, while the shortfall was not too large in Gujarat. Shortfalls in irrigation and flood control were large in all states, but none as large as in West Bengal at above 60 per cent. Similarly,

shortfalls in the power sector were relatively small in Andhra Pradesh, Karnataka, and Punjab. Rajasthan and Uttar Pradesh had excess plan expenditure under transport, while all other states had large shortfalls. In West Bengal, the state with the largest overall shortfall, large shortfalls occurred in all sectors, but in medical and public health the shortfall was relatively small at 16.5 per cent. Another state with large shortfalls in all the quantitatively significant sectors was Haryana.

In the Seventh Plan, the extent of shortfall varied across the states as between different sectors. Bihar, Orissa, Tamil Nadu and Uttar Pradesh overshot the target for agriculture, while in West Bengal and Haryana there was a deficiency of over 30 per cent. Shortfalls in irrigation were small and significantly lower than for the Sixth Plan in Maharashtra, Orissa and West Bengal. Plan expenditure in the transport sector picked up significantly in Andhra Pradesh, Kerala, Tamil Nadu, and West Bengal, with Andhra Pradesh showing an excess of 54 per cent. In energy, Haryana had the largest shortfall of 44 per cent, while in the other states also, shortfalls were fairly large. In the Seventh Plan there was an excess of actual expenditure under communications, information and broadcasting in several states. This category really includes only information and publicity, as the other functions in the broad group are in the exclusive domain of the central government. The "other" item also showed large excesses in quite a few states. This consists of general economic services and general services, with "district planning" accounting for the bulk of the excess, probably due to the added emphasis on this function after the finalization of the plan document.

It is instructive to juxtapose real growth rates of plan expenditure with shortfalls, as this shows up, to some extent, genuine shortfalls as opposed to those due mainly to overambitious targets. Conversely, low targets can result in excess expenditure or small shortfalls, so shortfalls can be viewed in a proper perspective with the help of the growth rates computed. The Sixth Plan targets were clearly too ambitious, as is borne out by the fact that all states had substantial overall shortfalls, including states like Tamil Nadu, Uttar Pradesh, and Maharashtra where real total plan expenditures grew at average annual rates of 12, 9.1 and 8.6 per cent respectively (see table 2.4). The shortfalls in West Bengal and Kerala, however, may be genuine to a large extent, as real total plan expenditures did not grow at all. The scenario is different for the Seventh Plan, as can be seen from table 2.5. Shortfalls are by and large inversely related to growth rates and thus are genuine. There are three exceptions -- Andhra Pradesh,

Table 2.4

Shortfalls and Average Annual Growth in Real Plan Expenditure During the Sixth Plan (in 1979-80 prices)

State/Item	(Per cent)																	
	Agriculture and Allied	Rural Development	Cooperation	Irrigation & Flood Control	Power	Industry and Minerals	Transport	Scientific Services and Research	Social Community Services	Educational & Health	Medical & Public Health	Sanitation & Water Supply	Housing Development	Urban Development	Economic Services	General Services	Total	
Andhra Pradesh																		
Shortfall	16.7	27.9	27.5	22.1	9.6	22.5	26.4	0.0	13.5	19.3	-0.9	11.2	19.1	-26.5	33.1	44.7	24.8	
Average Growth	18.5	29.3	11.6	13.2	0.5	19.9	2.5	78.3	14.1	7.5	8.9	23.0	43.0	-3.4	26.5	19.6	8.2	
Bihar																		
Shortfall	34.8	20.6	25.2	36.6	44.2	19.6	12.5	0.0	26.2	23.3	19.4	32.1	29.0	12.3	8.2	-0.3	33.1	
Average Growth	9.2	20.9	-22.1	7.9	-3.8	4.3	1.9	-27.0	3.6	6.3	9.3	-1.7	-6.5	-11.0	9.6	33.1	4.1	
Gujarat																		
Shortfall	4.4	36.8	-2.3	33.2	27.8	0.1	12.8	0.0	9.6	25.1	20.7	18.7	-26.6	23.8	-110.1	-46.1	23.1	
Average Growth	7.0	0.7	30.6	5.9	10.9	5.2	-9.0	0.0	6.2	11.0	9.8	21.5	-9.2	642.5	801.4	-22.4	5.0	
Haryana																		
Shortfall	25.7	14.2	4.3	44.6	35.8	25.3	41.5	0.0	28.6	21.4	28.8	35.9	38.4	8.8	30.2	43.3	36.2	
Average Growth	19.5	12.8	7.0	2.7	3.1	-4.2	-5.2	0.0	12.9	25.6	4.8	13.2	2.2	26.5	13.8	10.6	3.8	
Karnataka																		
Shortfall	11.8	-10.4	29.5	28.8	13.2	-14.8	3.3	-85.4	22.5	-18.3	33.0	0.8	26.0	60.1	-387.3	-398.0	14.5	
Average Growth	12.1	16.5	1.8	2.5	1.9	9.3	6.3	51.8	17.4	31.4	39.1	10.4	9.4	382.3	376.5	477.7	7.5	
Kerala																		
Shortfall	42.2	5.0	-0.3	30.8	22.3	24.9	23.2	-6.7	6.5	-37.1	13.8	24.0	7.2	16.4	30.2	3.2	22.0	
Average Growth	5.7	-0.1	-7.1	2.3	1.1	-2.6	4.8	-0.6	1.7	27.1	6.7	12.2	-8.5	-4.6	10.3	10.4	0.4	

State/Item	Agricul- ture & Allied	Rural Deve- lop- ment	Coop- eration	Irriga- tion & Flood Control	Power and Minerals	Industry and Transport	Scientific Services and Research	Social & Community Services	Educa- tion# & Health#	Medica- l Services	Sanita- tion and Water Supply#	Housing #	Deve- lop- ment#	Economic Services	General Services	Total	
Madhya Pradesh																	
Shortfall	12.6	23.1	16.7	34.6	32.3	-11.0	11.4	0.0	4.1	7.9	28.5	3.3	24.7	-28.3	52.5	12.5	26.0
Average Growth	16.0	10.0	0.3	5.1	2.1	27.6	-4.9	0.0	19.9	36.9	17.3	11.9	17.9	22.6	4.8	111.4	6.6
Maharashtra																	
Shortfall	-2.0	-206.4	8.1	21.3	40.4	15.3	29.6	0.0	20.6	10.4	-7.3	30.2	15.8	-1.4	63.1	-152.4	23.2
Average Growth	28.4	128.7	126.0	6.1	-5.5	14.7	3.1	0.0	11.9	36.2	15.3	31.7	4.3	12.6	17.0	109.1	8.6
Orissa																	
Shortfall	16.4	26.7	25.7	30.5	27.6	-15.6	24.6	0.0	14.1	12.2	17.0	27.1	34.7	-190.6	3.2	43.8	24.0
Average Growth	7.9	31.3	14.2	-0.7	-2.2	22.5	21.4	0.0	11.4	23.6	-3.8	5.9	5.3	20.5	26.7	53.3	5.8
Punjab																	
Shortfall	32.5	16.6	31.2	-6.7	15.4	33.7	24.8	0.0	38.7	27.6	23.2	54.7	33.4	24.4	67.5	27.4	29.2
Average Growth	3.2	3.4	3.2	-4.4	11.7	11.4	-8.3	0.0	-1.4	19.8	7.3	-9.9	-4.9	9.0	29.4	6.7	2.3
Rajasthan																	
Shortfall	15.9	16.8	17.5	22.4	37.6	26.1	-37.4	0.0	20.0	7.0	3.9	30.8	18.7	28.4	12.5	4.4	22.4
Average Growth	-0.4	15.0	-22.9	1.5	-6.0	3.6	11.6	0.0	11.4	35.0	14.5	2.2	2.9	0.9	17.6	-13.2	0.3
Tamil Nadu																	
Shortfall	16.6	-35.1	8.8	24.2	31.5	-11.0	12.7	0.0	19.8	-19.9	-16.1	54.3	-7.1	8.0	-46.1	-99.2	17.4
Average Growth	23.1	13.3	23.9	29.9	3.4	28.5	8.5	0.0	18.5	20.8	14.0	25.3	0.6	39.8	210.2	2.7	12.0
Uttar Pradesh																	
Shortfall	-4.2	-59.5	-14.6	33.6	35.8	4.3	-11.7	-42.6	2.6	-31.1	0.1	3.9	-23.6	39.6	-10.9	-21.5	19.0
Average Growth	11.4	21.5	27.2	-2.6	6.5	33.3	14.7	-7.2	19.8	27.9	30.5	1.9	12.0	38.7	148.5	95.6	9.1
West Bengal																	
Shortfall	49.3	37.3	66.3	61.6	-9.9	59.1	-4.9	28.3	40.1	46.3	16.5	54.5	38.5	42.7	44.0	41.0	48.9
Average Growth	5.9	9.2	-0.8	-6.0	-2.1	5.6	7.7	16.5	1.3	19.2	0.8	25.8	17.7	-9.1	-3.5	5.2	0.0

#. Included in Social Services.

Basic data source: Planning Commission.

State/Item	Agri. culture	Rural Develop-ment	Irrigation & flood control	Energy	Industry and Minerals	Transport & Communication*	Science & Technology	Social Services	Education*	Medical & Public Health*	Sanitation & Water Supply*	Housing #	Urban Develop-ment #	Others	Total	
Madhya Pradesh																
Shortfall	1.1	5.0	28.3	31.6	-25.2	26.8	32.3	-45.2	-5.5	-87.4	0.2	22.8	32.9	-3.8	-597.3	18.4
Average Growth	12.0	9.4	1.6	9.4	5.2	2.6	19.6	15.4	10.1	22.5	10.9	0.3	0.6	-1.4	1169.1	8.5
Maharashtra																
Shortfall	20.3	-146.2	3.9	32.2	10.3	37.3	29.9	19.2	33.5	16.8	38.9	26.6	7.8	-26.5	-142.9	15.3
Average Growth	3.0	-7.5	-0.5	1.4	7.8	-2.6	10.4	41.9	7.4	35.4	12.3	-8.6	17.1	70.4	178.9	0.8
Orissa																
Shortfall	-22.9	-12.3	3.5	34.2	-43.8	1.0	-105.0	-31.8	-31.2	-21.6	-12.2	-24.8	10.9	-589.7	-88.0	-0.6
Average Growth	18.0	6.1	5.3	14.8	1.6	-1.0	24.7	5.6	11.8	21.2	11.5	10.3	-4.7	6.1	41.1	9.1
Punjab																
Shortfall	27.1	29.8	21.0	6.0	0.9	33.4	-52.5	38.0	33.4	27.3	50.3	41.8	27.5	7.4	-284.9	13.2
Average Growth	8.4	-3.5	-0.5	4.5	5.2	0.6	20.5	23.0	13.1	31.1	23.6	9.4	-4.1	4.6	207.6	7.9
Rajasthan																
Shortfall	9.4	1.7	29.7	13.3	39.1	25.6	19.5	72.7	6.6	-16.1	-21.6	25.3	21.9	58.9	-202.1	15.0
Average Growth	13.3	12.4	-2.5	7.9	13.5	5.2	-2.3	14.4	20.7	28.5	17.2	21.1	-2.7	22.3	241.6	9.1
Tamil Nadu																
Shortfall	-30.5	18.6	11.6	26.2	-32.9	-2.8	74.9	11.1	13.6	10.6	19.3	25.3	-19.5	-4.3	4.5	11.8
Average Growth	5.9	2.0	-9.5	-0.3	10.6	3.6	23.3	-2.4	2.5	6.6	11.1	2.1	10.2	7.7	-1.0	1.6
Uttar Pradesh																
Shortfall	-12.9	-27.9	23.9	35.5	8.9	15.1	-6.8	-18.9	-6.0	-30.9	-19.8	9.6	-1.1	31.6	-149.6	14.0
Average Growth	15.4	13.6	-0.2	-7.8	-5.3	-4.4	20.5	-12.6	15.0	25.8	-0.9	23.6	27.1	24.2	4.0	1.5
West Bengal																
Shortfall	30.6	22.9	5.2	17.8	2.2	-8.1	-43.5	45.1	5.0	25.2	21.2	-26.9	10.3	-14.7	45.8	14.0
Average Growth	2.6	-2.8	4.2	12.7	9.2	2.8	-0.6	48.8	2.6	13.7	2.0	11.7	-18.1	-2.4	6.0	5.0

*. Included in social services.

Basic data source: Planning Commission.

Bihar, and Madhya Pradesh. Both Andhra Pradesh and Bihar show relatively small shortfalls overall, though growth rates are low, while Madhya Pradesh shows a large shortfall despite a high growth rate. In the case of Andhra Pradesh, the low shortfall probably reflects better judgement in fixing the plan size and/or genuine effort by the state. The case of Madhya Pradesh is clearly one of an overly ambitious plan size. In the case of Bihar, the anomaly is explained by the fact that there was a large increase in real plan expenditure in 1985-86 over the figure for 1984-85 (from Rs. 457 crore to Rs. 567 crore in 1979-80 prices); moreover, due to the large initial expenditure base the growth rate for the Seventh Plan period somewhat understates the real achievement. This incidentally explains the fact that the growth rate for the ten year period (as reported in table 2.3) is higher than the growth rates for both the sub-periods.

Despite inter-state variations, a common pattern is that in the Sixth Plan heavy shortfalls occurred in five sectors, namely, agriculture, irrigation and flood control, energy, transport and sanitation and water supply, in most states. Since these five sectors generally had a combined weight of more than 75 per cent in the total plan outlay, shortfalls under these heads largely account for the overall gap between targets and actual expenditures. Though of a much smaller order, shortfalls in these sectors accounted for the bulk of the overall shortfall in plan outlays in the Seventh Plan also.

It is worth noting that shortfalls were relatively small in social services in nearly all states, even though the allocations to this broad category were quite substantial in absolute as well as relative terms. Several states spent almost as much under social services as under energy. This shows the tendency on the part of the states to put in more under the heads where revenue expenditure predominates as compared to those which involve heavy capital expenditure. For the fourteen states taken together, the share of the revenue component in plan expenditure financed through the budget went up from 42 per cent in the Sixth Plan to 51 per cent in the Seventh. The share of capital expenditure was consistently highest in Punjab (70 per cent). At the other extreme is Tamil Nadu (27 per cent in the Seventh Plan -- see Table 2.6). As the table shows, the share of capital expenditure in nonplan expenditure has been much lower and actually falling.

It may not be out of place to note that an NIPFP study on public expenditure trends in India during 1970-85, based on the economic and functional classification of the budget, shows that growth of capital expenditure at the state level suffered a decline in the first half of the 1980s, sharply contrasting with the acceleration in revenue

Table 2.6

Revenue and Capital Expenditure of State Governments as Percentages of Total Expenditure

States	Plan Expenditure				Non-Plan Expenditure			
	Sixth Plan		Seventh Plan		Sixth Plan		Seventh Plan	
	Revenue Expenditure	Capital Expenditure	Revenue Expenditure	Capital Expenditure	Revenue Expenditure	Capital Expenditure	Revenue Expenditure	Capital Expenditure
1. Andhra Pradesh	50.05	49.95	57.71	42.29	89.34	10.66	91.21	8.79
2. Bihar	42.03	57.97	51.92	48.08	82.51	17.49	85.46	13.80
3. Gujarat	34.15	65.85	47.89	52.11	86.63	13.37	87.94	12.06
4. Haryana	36.69	63.31	45.52	54.48	83.21	16.79	87.21	12.79
5. Karnataka	45.95	54.05	53.69	46.31	82.95	17.05	86.45	13.55
6. Kerala	45.26	54.74	48.86	51.14	87.21	12.79	87.98	12.02
7. Maharashtra	35.13	64.87	48.81	51.19	91.71	8.29	91.89	8.11
8. Madhya Pradesh	41.22	58.78	53.09	46.91	86.77	13.23	90.95	9.05
9. Orissa	47.28	52.72	52.32	47.68	83.87	16.13	86.93	13.07
10. Punjab	30.45	69.55	28.28	71.72	74.85	25.15	86.26	13.74
11. Rajasthan	35.27	64.73	52.02	47.98	81.33	18.67	85.21	14.79
12. Tamil Nadu	63.15	36.85	73.27	26.73	74.37	25.63	81.94	18.06
13. Uttar Pradesh	37.07	62.93	46.63	53.37	86.52	13.48	89.63	10.37
14. West Bengal	55.39	44.61	52.82	47.18	83.00	17.00	89.65	10.35
All 14 States	42.05	57.95	51.08	48.92	84.42	15.58	88.26	11.74

Basic data source: Reserve Bank of India Bulletin, various issues.

expenditure. In real terms, capital expenditure of the states grew at only 3.9 per cent per annum between 1980-81 and 1985-86, while revenue expenditure grew at 8.8 per cent per annum [Rao and Tulasidhar (1991)]. At the central level, on the other hand, growth of capital expenditure had picked up from negative growth in real terms of 8.75 per cent per annum in the 1970s to 10 per cent in the first half

Figure 2.1 Plan Expenditure on Energy and other Heads
(Rs. 10 crores)

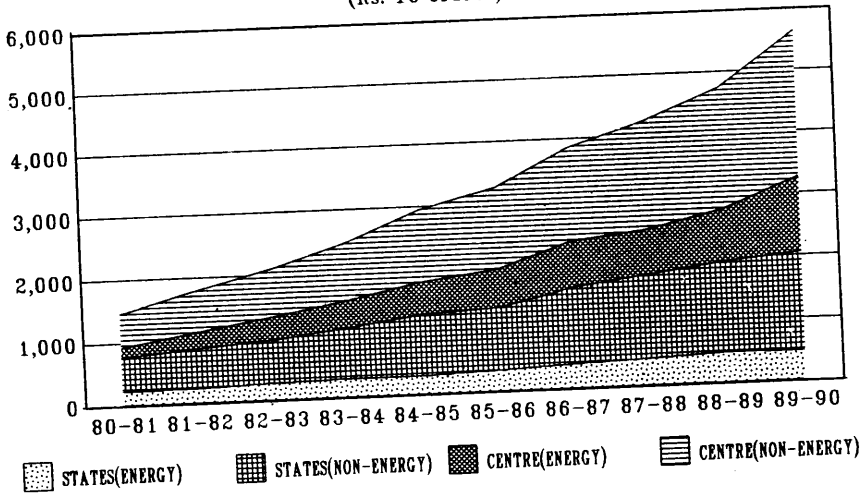
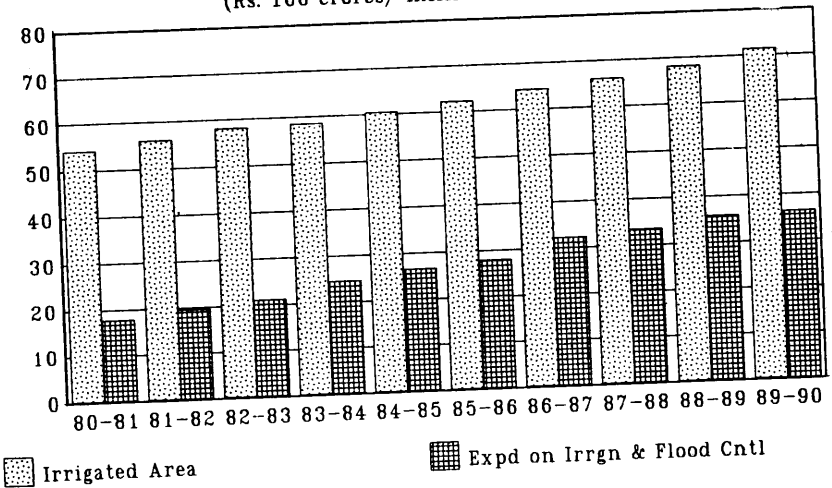


Figure 2.2 Irrigation: Plan Expenditure and Irrigated Area
(Rs. 100 crores/ million hectares)



of the 1980s. One possible reason for this shift could be the gradual centralization of investment in power and other major projects. Central agencies like the National Thermal Power Corporation (NTPC) and National Hydro-electric Power Corporation (NHPC) have been involved increasingly in setting up large power facilities. However, the share of plan expenditure on energy (centre and states combined) seems to be decreasing (Figure 2.1), reflecting perhaps a general tendency to go in for projects and programmes which yield quick results, to the neglect of crucial areas like power.

Shortfalls in outlays on irrigation (and consequent stagnation in growth of irrigation potential created, depicted in Figure 2.2) cannot, however, be explained by intrusion on the part of the central government. Irrigation is primarily in the states' domain, and if they have large shortfalls in expenditure, the reason must lie either in resource constraints or in diversion of resources to other heads. Resource constraints do not fully explain why the states prefer to divert funds to the revenue component of the Plan. Nevertheless, there can be no denying that paucity of resources constitutes a major impediment to plan financing by the states. A look at the financing pattern of the plans as originally envisaged and as it turned out in the end will bear this out and will also help identify the factors responsible.

FINANCING PATTERN

Table 2.7 shows the original and latest estimates of the pattern of financing of the Sixth and the Seventh Five Year Plans by all states together. It is immediately apparent that two of the listed sources of funds have caused the greatest difficulties in financing plans -- balance from current revenue (BCR) and contribution of public sector enterprises (PSEs). The latter caused a huge drain on plan resources during the Sixth Plan; as against the originally estimated negative contribution of Rs 51.6 crore, the price adjusted latest estimates amounted to a negative contribution of Rs 4,620 crore. The shortfall in BCR during the Sixth Plan was 34 per cent; because this was expected to be the major source of funds, the absolute impact of this shortfall was the highest.

During the Seventh Plan, the drain caused by contribution of PSEs was less both in percentage and absolute terms. But the shortfall in BCR actually rose in percentage terms; in absolute terms, instead of an expected contribution of Rs 28,974 crore only Rs 17,368 crore was managed. That the overall plan resources shortfall was only around 8

Table 2.7

Financing Pattern of Plan (Sixth and Seventh) - All States

(Rs. crore)

<i>Items</i>	<i>6th Plan Estimates</i>	<i>6th Plan Latest Estimates^a</i>	<i>Shortfall (Per Cent)</i>	<i>7th Plan Estimates</i>	<i>7th Plan Latest Estimates^b</i>	<i>Shortfall (Per Cent)</i>
1. Balance from Current Revenues	22312	14826	33.5	28974	17368	40.1
2. Contribution of PSEs	-516	-4620	795.4	-1969	-3757	90.8
3. Market Borrowing incl. those by PSEs	4500	3406	24.3	9942	9242	7.0
4. Small Savings and Provident Funds	6393	5901	7.7	16566	19070	-15.1
5. Term Loans from Financial Institutions	2722	1887	30.7	4639	4445	4.2
6. Misc. Capital Receipts (net)	-2161	-2012	-6.9	-7191	-5113	-28.9
7. Budgetary Deficit	0	3497	-	-	-	-
8. Total Resources	33250	22885	31.2	50961	41255	19.1
9. Central Assistance to States	15350	13690	10.8	29737	33264	-11.9
10. Resources Available for the Plan	48600	36575	24.7	80698	74519	7.7

Note: Figures given in this table may not tally with those in Table 2.2 as the present table is concerned with "resources" while 2.2 shows the "expenditures", the difference arising from a convention followed in the Planning Commission whereby actual expenditures are determined after taking note of diversions.

- a. Calculated by adding up the annual latest estimates, deflated to 1979-80 prices using the wholesale price index.
- b. Calculated by adding up the annual latest estimates, deflated to 1984-85 prices using the wholesale price index.

Basic data source: Ministry of Finance, *Indian Economic Statistics (Public Finance)*, various issues and Reserve Bank of India (1991), *Annual Report*.

per cent was due to the fact that small savings and provident funds raised more resources, miscellaneous capital expenditures were lower, and central assistance to states was higher than originally estimated. The obvious problem areas in plan financing thus are BCR and the contribution of PSEs. These are discussed below in greater detail.

Tables 2.8 and 2.9 give the details of the financing pattern for the Sixth and Seventh Plans for the fourteen selected states. A noteworthy feature mentioned earlier is that in all the states, aggregate resources fell short of the stipulated plan targets by substantial margins (see the last column of Table 2.8) for the Sixth Plan. The largest shortfall was in West Bengal (67 per cent). Bihar had a shortfall of 44 per cent, Haryana 36, Kerala 51, Orissa 28, Punjab 30, Rajasthan 23 and Uttar Pradesh 28 per cent. The overall shortfalls do not reveal any clear pattern with respect to plan size or per capita income when all eleven states for which we have data are considered. What seems to have critically affected plan financing in different states is the inadequate generation of public saving, that is, surpluses over revenue expenditure in the budget and the contribution of PSEs.

In fact, of the various sources of funds, BCR³ and contributions of PSEs recorded large shortfalls in most states. The shortfall in BCR was invariably large while that in PSE contribution was small in only one state (Karnataka). In almost all states, the shortfall in BCR was the single largest factor responsible for the shortfall in aggregate resources. In Haryana, Punjab, and Rajasthan the overall shortfall was almost equal to that in BCR, while in West Bengal, out of a total shortfall of Rs. 2,345 crore about Rs. 1,500 crore, or 64 per cent, was attributable to the deficiency in BCR. In Bihar, all categories suffered from substantial shortfalls, but out of an aggregate shortfall of Rs. 1,422 crore, about Rs. 450 crore was on account of inadequate BCR alone. In relation to the targets, shortfalls in PSE contributions ran high, in some cases as high as 3,200 per cent (Uttar Pradesh), but it is the poor outcomes with respect to BCRs which contributed most to the overall resource constraint in the Sixth Plan. The shortfall in PSE contributions was significant in absolute terms in Bihar, Punjab, Madhya Pradesh, Rajasthan, Uttar Pradesh, and West Bengal, but small in relation to plan size.

Receipts from small savings mostly reached the anticipated levels or fell short of targets by a small margin. Provident funds exhibited a

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3. Since a part of the plan resources is spent on current expenditures (e.g., salaries, etc. and other expenses incurred for running schools or health centres set up in the course of a given plan), BCR is not identical with saving of government administration.

Table 2.8

Shortfall in Resources for the States: Sixth Plan

(Rs. crore)

State/Plan	Balance from Current Revenue	Contr. of Public Enterprises	Small Savings	Provident Funds	Misc. Capital Receipts	Adjustment of overdrafts etc.	Market Borrowing and Negotiated Loans	Total State Resou-ces	Central Assistance	Total Resources
Andhra Pradesh										
Plan Estimate	1500.8	203.4	137.1	82.4	-268.3	43.8	495.0	2194.3	905.7	3100.0
Latest Estimates	931.7	-38.2	149.0	77.3	-196.8	166.5	284.6	1374.2	785.8	2160.0
Shortfall(%)	37.9	118.8	-8.7	6.3	26.6	-280.3	42.5	37.4	13.2	30.3
Bihar										
Plan Estimate	1078.2	-45.1	359.7	187.1	-420.1	228.4	576.3	1964.5	1260.5	3225.0
Latest Estimates	637.3	-369.4	349.0	126.1	-616.1	165.7	443.2	735.7	1066.9	1802.6
Shortfall(%)	40.9	719.1	3.0	32.6	46.7	27.4	23.1	62.6	15.4	44.1
Gujarat										
Plan Estimate	1931.1	-85.0	370.5	69.9	27.0	330.4	436.5	3080.3	599.7	3680.2
Latest Estimates	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Haryana										
Plan Estimate	1143.0	23.7	106.9	93.0	-10.6	-10.9	220.2	1565.2	234.9	1800.0
Latest Estimates	594.9	-88.4	98.8	77.2	7.8	52.6	166.6	909.4	237.6	1147.0
Shortfall(%)	48.0	472.9	7.5	17.1	-173.0	-580.7	24.3	41.9	-1.2	36.3

State/Plan	Balance from Current Revenue	Contr. of Public Enterprises	Small Savings	Provident Funds	Misc. Capital Receipts	Adjustment of overdrafts etc.	Market Borrowing and Negotiated Loans	Total State Resou-rces	Central Assistance	Total Resources
Karnataka										
Plan Estimate	1450.4	-236.1	171.5	116.5	-242.4	112.9	352.9	1725.8	539.2	2265.0
Latest Estimates	1104.4	-257.9	172.0	95.4	-193.7	160.5	229.2	1309.8	416.4	1726.2
Shortfall(%)	23.9	-9.3	-0.3	18.1	20.1	-42.2	35.1	24.1	22.8	23.8
Kerala										
Plan Estimate	640.1	-144.9	47.0	147.3	-119.5	233.7	316.2	1119.8	430.2	2265.0
Latest Estimates	345.2	-59.1	47.6	154.2	-73.4	183.5	182.4	780.4	326.9	1107.3
Shortfall(%)	46.1	-59.2	-1.3	-4.7	38.6	21.5	42.3	30.3	24.0	51.1
Madhya Pradesh										
Plan Estimate	1742.4	45.8	177.1	331.6	-79.7	48.3	521.2	2786.6	1013.3	3800.0
Latest Estimates	1497.3	-296.5	133.2	132.5	-285.3	235.9	342.0	1758.9	786.5	2545.5
Shortfall(%)	14.1	747.2	24.8	60.1	-257.8	-388.8	34.4	36.9	22.4	33.0
Maharashtra										
Plan Estimate	3154.2	559.1	824.2	292.4	-232.2	155.9	545.6	5299.1	875.9	6175.0
Latest Estimates	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Orissa										
Plan Estimate	398.1	-43.6	82.4	80.0	-146.8	140.3	330.1	840.5	659.5	1500.0
Latest Estimates	299.0	-90.8	52.4	77.1	-99.1	55.8	169.9	464.2	525.3	1086.2
Shortfall(%)	24.9	-108.3	36.4	3.6	32.4	60.2	48.5	44.8	20.4	27.6

<i>State/Plan</i>	<i>Balance from Current Revenue</i>	<i>Contr. of Public Enterprises</i>	<i>Small Savings</i>	<i>Provident Funds</i>	<i>Misc. Capital Receipts etc.</i>	<i>Adjustment of overdrafts etc.</i>	<i>Market Borrowing and Negotiated Loans</i>	<i>Total State Assistance</i>	<i>Central Assistance</i>	<i>Total Resources</i>
Punjab										
Plan Estimate	1134.8	-16.2	175.0	58.3	94.0	-16.6	227.7	1657.0	300.0	1957.0
Latest Estimates	565.4	-198.4	132.5	44.7	384.7	-2.9	198.7	1124.7	249.8	1374.5
Shortfall(%)	50.2	1124.9	24.3	23.4	309.3	-82.7	12.8	32.1	16.7	29.8
Rajasthan										
Plan Estimate	1027.0	-159.3	114.2	99.9	-114.1	-34.0	464.9	1398.7	626.3	2025.0
Latest Estimates	503.5	-238.3	144.0	90.0	-43.6	20.5	401.8	877.8	688.5	1566.2
Shortfall(%)	51.0	49.7	-26.2	10.0	-61.8	-160.2	13.6	37.2	-9.9	22.7
Tamil Nadu										
Plan Estimate	1784.0	-221.8	241.8	87.7	-101.4	245.6	449.3	2485.2	664.8	3150.0
Latest Estimates	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Uttar Pradesh										
Plan Estimate	1957.3	-32.2	483.4	160.3	-217.8	494.5	1075.5	3921.0	1929.0	5850.0
Latest Estimates	1399.6	-470.4	441.5	109.4	38.8	401.8	673.7	2594.3	1621.6	4215.9
Shortfall(%)	28.5	-1359.4	8.7	31.8	117.8	18.8	37.4	33.8	15.9	27.9
West Bengal										
Plan Estimate	1619.8	-209.1	842.0	100.7	-151.7	-23.8	641.8	2819.7	680.3	3500.0
Latest Estimates	115.9	-360.8	669.5	110.0	157.5	-611.3	445.2	526.0	629.4	1155.5
Shortfall(%)	92.8	72.6	20.5	-9.3	-203.8	2473.7	30.6	81.4	7.5	67.0

Note: The annual figures for latest estimates are deflated to the 1979-80 prices before summing for the plan period.

Table 2.9

Shortfall in Resources for the States: Seventh Plan

(Rs. crore)

State/Plan	Balance from Current Revenue	Contr. of Public Enterprises	Small Savings	Provident Funds	Misc. Receipts	Adjustment of overdrafts etc.	Market Borrowing and Negotiated Loans	Total State Assistance	Central Resources	Total Resources
Andhra Pradesh										
Plan Estimate	1818.7	404.9	671.6	289.8	-397.8	-230.0	1022.6	3579.7	1620.3	5200.0
Latest Estimates	1371.6	447.5	663.2	323.0	-209.7	338.7	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	24.6	-10.5	1.2	-11.5	-47.3	-247.3	N.A.	N.A.	N.A.	N.A.
Bihar										
Plan Estimate	1386.3	-294.8	1007.4	434.3	-922.1	-46.7	1245.7	2810.0	2290.0	5100.0
Latest Estimates	1301.6	-585.4	1023.2	654.2	-1045.7	14.5	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	6.1	98.6	-1.6	-50.6	13.4	-131.0	N.A.	N.A.	N.A.	N.A.
Gujarat										
Plan Estimate	2507.7	174.2	1220.0	109.7	152.8	-6.8	790.6	4948.3	1051.7	6000.0
Latest Estimates	1219.7	-199.2	1598.7	126.8	604.8	56.4	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	51.4	214.4	-31.0	-15.6	-295.7	-934.7	N.A.	N.A.	N.A.	N.A.
Haryana										
Plan Estimate	1883.5	55.0	235.1	151.5	-138.3	-83.3	407.4	2511.0	389.0	2900.0
Latest Estimates	677.9	-395.5	447.9	263.0	-193.9	70.1	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	64.0	819.1	-90.5	-73.6	40.2	-184.2	N.A.	N.A.	N.A.	N.A.

State/Plan	Balance from Current Revenue	Contr. of Public Enterprises	Small Savings	Provident Funds	Misc. Capital Receipts	Adjustment of overdrafts etc.	Market Borrowing and Negotiated Loans	Total State Assistance	Central Assistance	Total Resources
Karnataka										
Plan Estimate	2974.3	-1179.1	493.2	285.4	-385.4	-245.9	683.7	2626.3	873.7	3500.0
Latest Estimates	1360.8	-464.4	722.3	363.5	-182.6	247.7	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	54.3	-60.6	-46.5	-27.4	-52.6	-200.8	N.A.	N.A.	N.A.	N.A.
Kerala										
Plan Estimate	263.4	-52.7	141.0	332.6	-308.3	-174.5	761.5	963.1	1136.9	2100.0
Latest Estimates	-341.3	0.7	320.2	433.8	-242.7	150.5	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	229.5	-101.3	-127.1	-30.4	-21.3	-186.2	N.A.	N.A.	N.A.	N.A.
Madhya Pradesh										
Plan Estimate	2108.3	658.9	402.9	1075.6	-189.7	-30.5	1095.4	5120.9	1879.1	7000.0
Latest Estimates	1922.0	316.9	536.4	768.4	-297.3	136.6	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	8.8	51.9	-33.1	28.6	56.7	-548.2	N.A.	N.A.	N.A.	N.A.
Maharashtra										
Plan Estimate	5903.3	-429.1	2283.0	610.1	-694.9	0.0	1051.0	8723.3	1776.7	10500.0
Latest Estimates	4050.7	357.9	2526.1	507.4	-808.0	449.4	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	31.4	-183.4	-10.7	16.8	16.3	-	N.A.	N.A.	N.A.	N.A.
Orissa										
Plan Estimate	760.4	73.8	213.7	183.2	-297.0	-50.1	672.3	1556.2	1143.8	2700.0
Latest Estimates	329.8	-76.1	251.2	343.5	-106.6	-29.4	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	56.6	203.2	-17.6	-87.6	-64.1	-41.4	N.A.	N.A.	N.A.	N.A.

State/Plan	Balance from Current Revenue	Contr. of Public Enterprises	Small Savings	Provident Funds	Misc. Capital Receipts	Adjustment of overdrafts etc.	Market Borrowing and Negotiated Loans	Total State Resou-ces	Central Assistance	Total Resources
Punjab										
Plan Estimate	2079.6	-228.6	310.3	77.9	264.0	-78.2	393.0	2818.1	466.9	3285.0
Latest Estimates	-156.9	-248.0	757.4	274.7	-512.4	179.6	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	107.6	8.5	-144.1	-252.6	294.1	-329.7	N.A.	N.A.	N.A.	N.A.
Rajasthan										
Plan Estimate	719.6	-402.2	503.6	397.9	-247.2	0.0	888.4	1860.2	1139.8	3000.0
Latest Estimates	-6.0	-9.0	511.2	579.5	-620.1	-22.8	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	100.8	-97.8	-1.5	-45.6	150.9	-	N.A.	N.A.	N.A.	N.A.
Tamil Nadu										
Plan Estimate	3097.9	-320.6	436.5	145.9	-140.9	-19.6	1112.9	4312.1	1437.9	5750.0
Latest Estimates	1877.3	-581.2	487.6	402.2	-160.9	-28.2	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	39.4	81.3	-11.7	-175.7	14.1	43.5	N.A.	N.A.	N.A.	N.A.
Uttar Pradesh										
Plan Estimate	3740.8	-10.9	1343.1	261.9	-274.6	-372.4	2151.5	6839.5	3607.6	10447.0
Latest Estimates	597.5	-865.7	2109.9	1074.1	-59.3	326.6	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	84.0	3267.0	-57.1	-310.1	-78.4	-187.7	N.A.	N.A.	N.A.	N.A.
West Bengal										
Plan Estimate	844.1	-111.5	1749.0	370.0	-885.4	-228.9	1173.8	2911.1	1213.9	4125.0
Latest Estimates	139.3	-113.0	1640.7	289.0	-1109.8	326.8	N.A.	N.A.	N.A.	N.A.
Shortfall(%)	83.5	1.3	6.2	21.9	25.3	-243.7	N.A.	N.A.	N.A.	N.A.

Note: The annual figures for latest estimates are deflated to the 1984-85 prices before summing for the plan period.

similar pattern, though in a few states the shortfalls were larger than in small savings. Miscellaneous capital receipts (generally expected to be negative) and other budgetary resources (adjustment of opening/closing balance and overdrafts) showed wide variation. An important source of funds, market borrowings and negotiated loans, showed shortfalls in all states, varying between 12 and 50 per cent. What is surprising is that even central assistance varied, ranging from a shortfall of 24 per cent in Kerala to an excess of 9 per cent in Rajasthan. While the uniformly large shortfalls in real aggregate resources in all states point to some serious weaknesses in projections or estimates made at the time of formulating the plans, at least central assistance could perhaps have been estimated on a firmer basis, and errors should not have occurred in both directions, as a large part of such assistance flows through the Planning Commission. Thus the large aggregate shortfalls in all states probably reflect overestimation of resources on the part of the Planning Commission as much as failure of the states to fulfill promises made to the Planning Commission at the time of setting the plan targets. That at least appears to have been the case in respect of the Sixth Plan.

Table 2.9 shows the planned and actual financing pattern of the Seventh Plan. In the absence of complete data, the reported figures refer to the states' own sources of funds excluding market borrowings and negotiated loans. The data on all states together reported in Table 2.7 indicate that major shortfalls did not occur in any of the excluded sources of funds but only in states' own resources. Hence the partial coverage of the data does not present any problem in locating the sources of shortfalls. While during the Sixth Plan overall shortfalls were universal, in financing the Seventh Plan several states succeeded in meeting the overall target set for states' own resources for the plan in real terms.

Once again, for the states as a whole, shortfalls were caused mainly by deficiencies in two categories, BCR and the contribution of PSEs. With the exception of Bihar and Madhya Pradesh, in most cases shortfalls in BCR accounted for the largest part of the shortfall in states' own resources. In Punjab, the shortfall in BCR alone was almost equal to the state's own aggregate resources estimated at the beginning of the plan. In Rajasthan too, but for excess accrual from other sources, the state's own resources would have reached only about 25 per cent of the plan estimate. Larger shortfalls in BCR were reported in Haryana, Punjab, Karnataka, Kerala, Uttar Pradesh, and West Bengal. Punjab and Kerala had a negative BCR. Despite large shortfalls in BCR, both Punjab and Haryana had the highest per-

capita plan outlay for the Seventh Plan.⁴ In Bihar, the shortfall in BCR was small, but that in PSE contributions was quite large. West Bengal appears to have made up a large shortfall in BCR (and smaller shortfalls in other items) with increased overdrafts. Accruals to State Provident Funds and small savings also proved helpful in all states. Evidently, states are financing an increasing part of their plans with borrowing, leading to a growing burden of debt. Financing of development through public sector plans cannot possibly be sustained unless the budgets generate surpluses over nonplan current expenditure, that is, a substantial positive BCR.

The upshot of the above analysis is that one must look into BCR and contribution of PSEs further to find major problem areas in plan financing. An important factor affecting the availability of resources for the plan is the losses of PSEs. In both plan periods, these losses turned out to be much larger than assumed in the formulation of the plans. However, in absolute terms these figures are much less significant than the shortfalls in BCRs, though their role in determining the availability of resources for the plans should not be belittled, for the simple reason that poor returns from PSEs affect the revenue of the states (interest and dividends from PSEs form an important component of non-tax revenues) and their losses constitute a drain on the budget. That the poor running of PSEs can have a bearing on resource constraints for state plans is suggested also by the fact that the two states with the lowest per-capita plan outlay (Bihar and West Bengal) figure at the bottom of the rankings in the performance of state electricity boards and state road transport undertakings, the two major areas of investment in PSEs by the states. According to a recent Planning Commission study, in physical parameters and compounded grading, West Bengal scored 37 and Bihar 38, whereas Maharashtra topped with 77, followed by Gujarat (64), Punjab (61), and Madhya Pradesh (59). In the rating of state road transport undertakings, Calcutta State Transport Corporation ranked last with 12 in terms of percentage of marks in overall performance, followed by Bihar (13) and South Bengal STC (15). The three undertakings at the top were Haryana (96), Tamil Nadu (89), and Gujarat (82). Ranking in financial performance, however, differs, presumably because of tariff policies. But since poor financial performance of PSEs ultimately shows up in adverse consequences for the budget, it is not surprising that it is BCR which plays a decisive

4. Data from state government sources indicate that the shortfalls in own sources of funds were made up largely with increased transfers from the centre.

role in determining levels of per-capita plan expenditure. Chapter 4 in this volume looks into the returns from public production and supply of social and economic services while discussing subsidies in the overall context of nontax revenues; we go into further details of BCR to find out what exactly has gone wrong. BCR by definition is current revenue minus nonplan current expenditure. Obviously, we should look into various components of both current revenue and current expenditure to identify factors responsible for shortfalls. Since nontax revenues are analysed in Chapter 4, we look into other factors that determine BCR in the next section.

BUDGETARY TRENDS

When formulating the financial part of a Five Year Plan, the balance from current revenues (BCR) is arrived at after projecting revenue receipts at existing rates of taxation and user charges and nonplan revenue expenditures for a given plan period. Similarly, the contribution of PSEs is worked out by projecting their surpluses or losses at existing tariffs/prices of their products or services. Similar projections are made for other categories of receipts. If the aggregate resources so derived fall short of the estimated requirements to meet the physical targets set in the plan, additional resources are sought to be mobilised (ARM) through various measures like upward revision of tax rates and of tariffs/prices of the products of PSEs or improvements in efficiency. For a true picture of what caused the shortfalls in BCRs and in the contribution of PSEs in the Sixth and Seventh Plans, it is necessary to look behind BCR and see to what extent actuals diverged from projections both on the revenue and on the expenditure side, and similarly for ARM measures. It would be even more salutary to look at projections of each of the major heads of revenue and expenditure and compare them with the actuals.

Unfortunately, data are not available in sufficient disaggregation to pinpoint precisely what went wrong in the estimates relied upon in formulating the financial side of the plans. Another complication arises from the fact that the revenue effect of ARM measures is extremely difficult to quantify, as actual revenue realisations (and additional profit generation or reduction in losses in the case of PSEs) are determined by both the efficiency in collecting taxes, etc. at existing rates (tariffs) and the result of ARM effort. Hence it is more realistic to take the BCR and ARM heads together. These two heads have accordingly been merged in Tables 2.7, 2.8, and 2.9. The main problem in investigating the sources of weakness in plan financing,

Table 2.10

**Budgetary Aggregates of All States
(Sixth and Seventh Plan)**

(Rs. crore)

Descriptions	Average (80-85)	Average (85-90)
1. Total Revenue Receipts	21462.6	44553.8
a. Tax Revenue	14178.6	29533.3
as per cent of 1	66.1	66.3
i. Own Tax Revenue	9469.9	19721.4
as per cent of a.	66.8	66.8
ii. Share of Central Taxes	4708.7	9811.9
b. Non-Tax Revenue	7283.9	15020.4
as per cent of 1	33.9	33.7
i. Own Non-Tax Revenue	3767.0	6846.6
as per cent of 1	17.6	15.4
ii. Grants from centre	3517.0	8173.9
as per cent of 1	16.4	18.4
2. Total Revenue Expenditure	20854.5	45884.2
3. Surplus/Deficit on Rev. A/c.	608.0	-1330.4
as per cent of 1	2.8	-3.0
as per cent of 2	2.9	-2.9
4. Capital Receipts	7760.3	15832.2
i. Loans from the Centre	4274.4	9344.7
as per cent of 4	55.1	59.0
as per cent of 5	46.8	65.7
5. Capital Account Expenditure	9139.9	14223.0
i. Capital Expenditure	3939.3	6654.5
ii. Loans and Advances	2849.1	4220.9
6. Surplus/Deficit on Cap. A/c	-1379.6	1448.3
7. Remittances(Net)	-175.7	-42.9
8. Overall Surplus/Deficit(3+6+7)	-947.3	74.9
Financed by:		
a. Incr./decre. in cash bal.	-619.8	-396.8
b. Withdrawals from/Addt. to cash	-92.8	220.8
c. Incr./decre. in ways & means adv.	-234.6	250.8

Source: Reserve Bank of India Bulletin, various issues.

however, lies in the paucity of disaggregated information on revenue, expenditure, and ARM. In the absence of such data, one can make an overall assessment of state finances in relation to plans only by looking at the revenue and expenditure sides, their trends over time, and inter-state comparisons. This is what is attempted here.

Annual averages of total revenue receipts of all the 14 states combined, with a broad breakup under total tax revenue, nontax revenue, total revenue expenditure and capital receipts together with some further disaggregation under own tax revenue and share of central taxes and grants, are set out in Table 2.10. A striking feature of state finances that emerges from the figures in the table is that although during the Sixth Plan there were large shortfalls in BCR in almost all fourteen states, the revenue or current budgets did not have an aggregate deficit considering the states together. Evidently, much larger surpluses over nonplan revenue expenditure than could be achieved had been stipulated as targets while drawing up the plans. In fact, in the aggregate state finances were still following the prudent course of generating surpluses in the revenue budget to partly finance capital expenditures. In the Seventh Plan, although the overall shortfalls were lower, all the states together had deficits in their current account. This resulted in a reversal of the flow of funds, from the capital budget to the revenue budget. The financing of the budgets shows the asset situation: while the Sixth Plan period saw an accumulation of assets, the Seventh Plan period witnessed a running down of the same. The risks involved in financing revenue expenditure from capital receipts or by running down assets hardly need to be stressed. Unless even revenue expenditures are expected to yield some return (socially productive consumption expenditures), future expenditures to discharge liabilities incurred or to reaccumulate assets run down in the current period, cannot be met easily.

Total revenue receipts and revenue expenditures, along with the surplus or deficit on current account, all as proportions of respective SDP (at comparable prices), are reported in Table 2.11. The revenue surplus of the fourteen states as a whole in the Sixth Plan stood at 0.4 per cent of SDP, while in the Seventh Plan there was a deficit of 0.4 per cent. There was, of course, considerable variation across states. In the Sixth Plan, the revenue surplus ranged from almost two per cent of SDP in Madhya Pradesh to less than 0.1 per cent in Orissa and a deficit of 1.6 per cent in West Bengal. During the Seventh Plan, while there was a deficit for all the states combined, two states had surpluses (Bihar 1.8 per cent and Haryana 1.3 per cent).

It needs to be stressed again that there is no one-to-one

Table 2.11

**Total Revenue Receipts, Expenditure and Surplus/Deficit in Revenue Budget of States
As Proportion of SDP**

(Percentages)

States	As Per Cent of S D P						Planwise Compound Growth rate*					
	Total revenue receipts		Total revenue expenditure		Surplus/Deficit on revenue account		Total revenue receipts		Total revenue expenditure			
	6th Plan	7th Plan	6th Plan	7th Plan	6th Plan	7th Plan	6th Plan	7th Plan	6th Plan	7th Plan	8th Plan	
1	2	3	4	5	6	7	8	9	10	11		
1. Andhra Pradesh	17.33	21.18	17.03	21.42	0.12	-0.20	12.65	10.19	16.23	11.82		
2. Bihar	16.15	18.75	15.72	16.86	0.46	1.84	12.67	10.30	12.69	13.46		
3. Gujarat	14.75	17.42	13.58	18.83	1.10	-1.37	11.54	13.10	13.50	13.04		
4. Haryana	15.70	18.32	14.32	17.11	1.32	1.07	11.44	12.36	13.68	15.81		
5. Karnataka	16.81	18.84	16.14	19.14	0.49	-0.30	12.78	11.18	16.05	10.70		
6. Kerala	18.63	21.21	18.43	23.13	0.10	-1.95	11.93	9.71	11.27	12.24		

	1	2	3	4	5	6	7	8	9	10	11
7. Maharashtra	14.83	16.92	14.39	17.33	0.36	-0.39	12.47	11.73	15.14	11.81	
8. Madhya Pradesh	19.17	20.72	17.09	20.81	1.99	-0.18	9.84	12.40	11.28	12.66	
9. Orissa	18.01	18.91	17.79	19.87	0.06	-0.99	5.78	15.04	10.66	15.21	
10. Punjab	12.98	13.43	12.11	14.19	0.78	-0.92	10.42	10.13	11.37	13.44	
11. Rajasthan	17.83	21.26	17.26	22.89	0.44	-1.71	10.27	12.14	13.64	12.85	
12. Tamil Nadu	18.22	18.12	17.31	18.35	0.81	-0.39	11.72	8.92	13.92	13.25	
13. Uttar Pradesh	14.31	16.31	13.61	16.52	0.54	-0.31	10.62	10.30	13.92	15.80	
14. West Bengal	12.33	14.87	13.84	15.32	-1.64	-0.48	10.25	9.86	14.04	13.34	
15. All States	15.77	17.88	15.23	18.20	0.43	-0.37	11.29	11.02	13.79	13.12	

Note: * Point to point.
Basic data source: Reserve Bank of India Bulletin, various issues.

correspondence between surplus and/or deficit in the revenue account and shortfalls in BCR, since the surplus in the revenue budget and balance from current revenue are not identical, the difference arising from the fact that in the former, the surplus reflects the excess of current revenue over total current expenditure while the latter is the excess of revenue receipts over nonplan revenue expenditure. This is brought out dramatically by the case of Haryana, where the revenue budget had a surplus of 1.3 per cent of GDP but there was a shortfall of 64 per cent in BCR in the Seventh Plan. Even so, the sources of deficiency in BCR lay primarily in the surplus/deficit in the revenue account of the budgets. Hence, while looking for the causes of resource constraints for the plans one has to analyse trends in revenue and expenditure growth.

Table 2.11 also shows growth rates of total revenue receipts and total revenue expenditure over the two Plans. Given the figures presented in this table, it is not difficult to see what brought about the deterioration in the current budgets of the states.

Whereas, for the states as a whole, total revenue receipts and revenue expenditure in the Sixth Plan comprised 15.8 and 15.2 per cent respectively of GDP, in the Seventh Plan the proportions went up to 17.9 and 18.2 per cent, increases of 2.1 and 3 percentage points respectively. The surplus in the current budget was modest in the Sixth Plan (0.4 per cent of GDP). With revenue expenditure growth overtaking that of current receipts during the latter half of the 1980s, the result was a deficit of 0.4 per cent of GDP in the Seventh Plan. For all states combined, revenue receipts grew at about 11.3 per cent per annum in the Sixth Plan and 11 per cent during the Seventh, while current expenditure grew at 13.8 per cent per annum during the Sixth Plan and at 13.1 per cent during the Seventh. In some states (like Andhra Pradesh and Karnataka) current expenditure grew by more than 16 per cent per annum during the Sixth Plan, while revenue receipts increased by about 13 per cent per annum. In the Seventh Plan, the fastest growth in revenue expenditure took place in Haryana and Uttar Pradesh (about 16 per cent per annum), whereas their revenue receipts grew at a much slower pace (12.4 and 10.3 per cent). The gap between revenue and expenditure growth in the Seventh Plan was the largest (5.5 percentage points) in Uttar Pradesh, followed by Tamil Nadu, West Bengal, Punjab, and Haryana. The position of individual states varies, with some showing current budget deficits of as much as 2 per cent of GDP during the Seventh Plan (Kerala). Evidently, there was an increase in revenue receipts but growth of current expenditures was faster.

Growth of Revenue and its Components

Taking the decade of the 1980s as a whole, total revenue receipts of the states grew at a rate of 14.9 per cent per annum and total tax receipts by 15.1 per cent (see Table 2.12). Similar trends in total revenue receipts and total tax receipts are only to be expected as tax revenues form a predominant part (66 per cent on average during the last decade) of total revenue receipts. Generally speaking, own tax revenues grew a little faster than the share in central taxes, but Bihar and Uttar Pradesh are exceptions. The growth rates are strikingly similar in all the states; they vary over the narrow band of 13.1 to 16 per cent per annum for total tax revenues and between 13.7 and 17 per cent per annum for own tax revenues.

Growth rates for major taxes levied by the states, however, show some variations. Two groups of taxes, agricultural taxes (land revenue and agricultural income tax) and entertainment taxes (basic entertainment tax, show tax, and betting tax), are losing their importance. The undertaxation of agriculture has received a lot of attention in the literature (see Sarma and Rao (1988) for a review; there has been at least one opposing viewpoint (Lipton, 1978) based on the incidence of other taxes). In any case, the agriculture-based taxes exhibit very slow growth. As for entertainment tax, the reason for slow growth probably lies in a fall in the tax base -- the major part of the revenue is derived from sales of cinema tickets, and with the advent of videotapes the sales of cinema tickets have not grown much. Attempts to increase taxes on the cinema industry in any form have met with stiff resistance; the last decade has witnessed two major incidents, one in Maharashtra (the strike in the Bombay movie industry against a hike in the tax rate on cinematograph raw stock) and one in Uttar Pradesh (by cinema theatre owners against a hike in entertainment tax rates).

The most important tax from the revenue point of view for the states is sales tax; it shows reasonably high rates of growth, without much inter-state variation. Growth rates vary between 13.7 per cent (Madhya Pradesh) and 18 per cent per annum (Andhra Pradesh).

Buoyancy of Taxes

Table 2.13 presents the buoyancy estimates for revenue receipts and major taxes of the selected states with respect to SDP during the 1980s. It is remarkable that buoyancy of total revenue receipts and tax revenues of the states is more than one or nearly one in all the states. Total revenue receipts exhibit reasonably high buoyancies in general, though some states -- Tamil Nadu, Punjab, and Orissa -- seem to be slowing down in their current receipts generation. Buoyancy in tax

Table 2.12

**Compound Growth Rate of State Taxes
(1980-81 to 1989-90)**

States	(Per cent per annum)										
	Total revenue receipts	Total tax receipts	Own tax revenue	Land revenue & AIT	Stamps and registration	Total sales tax	Taxes on goods, passengers and motor vehicles	Entertainment tax	State excise duty	Electricity duty	Share of Central taxes
1. Andhra Pradesh	15.81	16.04	17.01	-1.86	14.92	18.04	16.15	7.54	16.79	102.62	13.86
2. Bihar	16.94	14.75	14.28	3.58	17.26	13.90	15.21	12.98	18.86	11.71	15.06
3. Gujarat	14.95	14.51	15.97	8.44	12.95	16.70	15.68	4.15	N.C.	18.22	8.62
4. Haryana	15.81	14.74	15.84	-18.68	17.58	15.78	12.26	2.31	21.00	9.74	9.35
5. Karnataka	14.89	15.61	16.42	7.22	19.13	17.99	19.04	5.51	13.51	18.06	13.33
6. Kerala	14.00	15.00	15.83	9.56	16.75	16.17	16.33	N.C.	13.91	19.59	12.91
7. Maharashtra	14.98	14.82	15.72	13.91	22.38	14.99	18.18	-0.51	19.29	19.03	11.15

States	Total revenue receipts	Total tax receipts	Own tax revenue	Land revenue & AIT	Stamps and registration	Total sales tax	Taxes on goods, passengers and motor vehicles	Entertainment tax	State excise	Electricity duty	Share of Central taxes
8. Madhya Pradesh	14.55	15.49	16.26	8.31	16.96	13.73	16.16	4.42	17.51	34.33	14.39
9. Orissa	13.36	15.70	16.58	29.46	15.32	15.36	16.53	9.02 ²	15.57	18.95	14.90
10. Punjab	13.71	13.09	13.72	1.52	9.67	14.18	10.21	-3.13 ²	15.81	19.63	9.95
11. Rajasthan	15.58	15.96	16.89	7.09	17.32	16.12	13.83	6.12	27.83	22.51	14.50
12. Tamil Nadu	13.52	14.11	14.50	9.83 ¹	18.15	14.89	11.54	8.30	19.83 ¹	10.43	13.17
13. Uttar Pradesh	14.61	15.32	15.02	2.03	16.94	14.41	12.89	4.92	19.82	31.99	15.71
14. West Bengal	15.39	15.42	16.58	61.10*	15.48	15.43	10.83	6.22	9.75	11.31	13.22
All 14 States	14.92	15.06	15.73	16.79	16.83	15.56	14.65	4.40	17.02	20.64	13.70

Note: * Not comparable with others due to cess on minerals.

1 For the period 1982-90.

2 For the period 1981-88.

N.C. Not computed.

revenue, particularly own tax revenue, shows the emphasis that each state puts on taxes as a source of current receipts. By this measure, the states which seem to be generating substantially greater resources from nontax revenues are Bihar, Gujarat and Haryana.⁵

As noted above, entertainment tax and agricultural taxes are losing their importance in almost all states, as a result of which buoyancy estimates are generally low, not significant statistically, and sometimes even negative. Some notable exceptions are agricultural taxes in Orissa and Tamil Nadu and entertainment taxes in Bihar. The most important tax from the revenue point of view, sales tax, exhibits reasonably high buoyancies in all states except Bihar (0.96), Madhya Pradesh (1.03), and Tamil Nadu (1.08). The highest buoyancy estimate for sales tax is that of Andhra Pradesh (1.51). Bihar exhibits the lowest buoyancy of own tax revenue (1.0), primarily due to low buoyancies of sales tax and electricity duty. Punjab also exhibits relatively low buoyancies for almost all taxes except electricity duty, resulting in a low buoyancy of own tax revenue. Gujarat appears to be doing badly in the case of stamp duties and registration fees, and Tamil Nadu and West Bengal in the case of motor vehicle taxes; West Bengal has less than unitary buoyancy of state excise and electricity duty as well. Despite these exceptions to the pattern, the performance of states in terms of buoyancy of revenue receipts, and particularly taxes, appears to be remarkably uniform and could not possibly be responsible for differences in plan expenditure.

Per-capita Tax Revenue

Average per capita tax burden for the Sixth and Seventh Five Year Plan periods exhibits substantial variations across states (tables 2.14 and 2.15). During the Sixth plan, annual per-capita total tax revenue varied between Rs. 126 (Bihar) and Rs. 331 (Punjab) on average; the spread during the Seventh plan was from Rs. 231 (Bihar) to Rs. 552 (Punjab)⁶ implying a reduction in the ratio of minimum to maximum

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5. If West Bengal classified the cess on minerals as non-tax revenue as is done in other states like Bihar and Madhya Pradesh, a similar situation may obtain in West Bengal too. Given buoyancy of other taxes, this adjustment is likely to pull down the buoyancy estimates for own tax revenue and total tax revenue substantially; the estimate for revenue receipts, of course, will not change.
 6. Punjab appears not to be doing well when growth rates and buoyancies are calculated. The figures here, however, indicate a fairly high level of taxation, and this might have affected additional resource mobilisation through taxation, even when there were increases in taxable capacity.

Table 2.13

Buoyancy of Major taxes: Non-Special Category States, 1980-89

States/Taxes	Total Revenue		Total Own Revenue		Stamp Duties & Regn. Fees		Total Sales Tax		Motor Vehicle Taxes		Entertainment Taxes		State Excise		Electricity Duty	
	1	2	3	4	5	6	7	8	9	10						
1. Andhra Pradesh	1.32	1.34	1.42	-0.28 ^(e)	1.21	1.51	1.34	0.73	1.42	6.39						
2. Bihar	1.17	0.99	1.00	0.47	1.29	0.96	1.03	1.10	1.27	0.89						
3. Gujarat	1.21	1.14	1.28	0.67	1.00	1.29	1.34	0.50	N.C.	1.64						
4. Haryana	1.24	1.15	1.25	-1.86	1.28	1.25	1.00	0.32	1.61	0.90						
5. Karnataka	1.17	1.21	1.28	0.53	1.39	1.40	1.58	0.50	1.03\$	1.40						
6. Kerala	1.17	1.26	1.35	0.70	1.34	1.38	1.39	N.C.	1.21	1.68						
7. Madhya Pradesh	1.11	1.14	1.20	0.79	1.21	1.53	1.18	0.43	1.32	2.34						
8. Maharashtra	1.26	1.22	1.31	1.06	1.72	1.25	1.62	-2.53 ^(e)	1.55	1.61						
9. Orissa	1.03	1.27	1.37	2.37	1.34	1.23	1.39	0.79	1.34	1.66						

	1	2	3	4	5	6	7	8	9	10
10. Punjab	1.04	1.01	1.07	0.14 [@]	0.68	1.11	0.79	-0.26 [@]	1.24	1.51
11. Rajasthan	1.16	1.15	1.26	0.52 [@]	1.18	1.23	1.09	0.52	2.03	1.61
12. Tamil Nadu	0.99	1.01	1.06	2.00	1.27	1.08	0.83	0.66	1.45	1.07
13. Uttar Pradesh	1.21	1.26	1.25	0.24 [@]	1.40	1.19	1.08	0.42 [@]	1.59	2.81
14. West Bengal	1.25	1.23	1.32	4.59*	1.24	1.23	0.86	0.59	0.75	0.94
15. All 14 States	1.19	1.19	1.25	1.32	1.29	1.24	1.20	0.45	1.36	1.66

N.C. Not Computed.

@ Buoyancy Coefficient not statistically significant at 95% level of confidence.

* Not comparable with other states due to inclusion of cess on minerals in Land Revenue.

‡ Not comparable with other states due to exclusion of revenue from sale of liquor.

Table 2.14

Average Annual per capita Tax Revenue during the Sixth Plan

(Rs.)

State	Total Revenue Receipts	Total Tax Receipts	Own Tax Revenue	Agricultural Taxes	Stamp Duty & Registration Fees	Total Sales Tax	Motor Vehicle Taxes	Entertainment Taxes	State Excise	Electricity Duty	Shared Taxes
1. Andhra Pradesh	309.64	218.42	151.93	4.54	7.88	77.07	12.50	6.02	43.62	0.10	66.49
2. Bihar	185.96	125.69	52.32	2.13	3.64	36.22	3.83	1.03	4.08	1.36	73.37
3. Gujarat	385.33	278.02	213.87	4.18	10.65	139.50	22.92	9.00	1.25	18.88	64.15
4. Haryana	457.67	297.01	241.33	2.78	19.09	111.81	41.99	5.48	46.57	13.34	55.68
5. Karnataka	341.79	240.04	176.49	4.29	9.17	91.93	18.24	7.52	34.95	5.87	63.55
6. Kerala	331.88	244.06	171.64	6.37	12.86	106.96	10.60	0.00*	28.43	6.17	72.44
7. Maharashtra	433.75	307.84	243.31	3.74	8.54	157.65	18.69	11.32	20.30	10.80	64.53
8. Madhya Pradesh	279.99	172.14	102.05	2.48	5.72	54.86	14.69	3.08	15.04	5.24	70.09
9. Orissa	266.74	142.18	65.58	2.32	4.01	37.66	6.26	1.36	4.94	9.02	76.61
10. Punjab	440.96	331.24	273.08	1.73	24.98	124.49	28.68	4.89	77.42	10.20	58.16
11. Rajasthan	276.66	163.55	102.86	5.29	5.01	60.13	13.07	2.60	13.19	3.12	60.70
12. Tamil Nadu	344.46	271.03	197.79	3.04	12.46	127.86	16.71	8.32	27.70	0.94	73.35
13. Uttar Pradesh	216.77	143.69	78.41	2.54	8.57	42.80	8.30	3.85	11.26	1.09	65.28
14. West Bengal	247.27	191.10	122.47	5.92	6.83	72.49	14.04	4.89	11.21	2.88	68.63
All 14 States	296.76	205.84	138.42	3.56	8.46	80.98	13.68	4.88	19.43	4.83	67.42

* Levied by local bodies in Kerala.

Table 2.15

Average Annual per capita Tax Revenue during the Seventh Plan

State	Total Revenue Receipts	Total Tax Receipts	Own Tax Revenue	Agricultural Taxes	Stamp Duty & Registration Fees	Total Sales Tax	Motor Vehicle Taxes	Entertainment Taxes	State Excise	Electricity Duty	Shared Taxes
1. Andhra Pradesh	586.37	419.75	300.44	3.82	14.89	157.92	24.13	6.14	83.22	4.67	119.31
2. Bihar	376.02	230.79	92.66	2.59	6.81	62.76	7.69	1.84	8.39	2.41	138.13
3. Gujarat	675.83	471.23	390.04	5.51	17.30	268.32	37.35	9.29	2.14	35.70	81.20
4. Haryana	853.52	521.66	448.11	1.13	38.34	207.67	65.90	5.63	108.13	18.25	73.55
5. Karnataka	606.49	442.51	335.23	5.52	19.93	187.14	40.19	8.55	56.36	10.85	107.28
6. Kerala	595.10	450.67	330.32	8.91	25.55	210.75	20.54	0.00*	49.57	13.61	120.35
7. Maharashtra	776.03	549.15	454.20	6.33	22.54	285.58	36.20	9.14	44.26	25.47	94.95
8. Madhya Pradesh	496.22	317.96	192.09	3.23	11.34	90.54	28.10	3.38	30.39	22.39	125.88
9. Orissa	464.36	272.12	132.15	9.59	7.53	71.02	12.02	1.09	9.10	21.05	139.98
10. Punjab	760.55	551.53	469.72	1.62	36.48	217.76	40.85	2.56	143.21	25.85	81.82
11. Rajasthan	505.37	294.45	188.83	5.70	9.79	109.41	21.10	2.42	31.69	6.72	105.62
12. Tamil Nadu	597.88	478.80	352.08	4.96	26.97	237.11	28.06	9.38	40.12	1.46	126.72
13. Uttar Pradesh	391.96	271.11	141.64	2.47	17.10	75.09	13.27	4.23	25.76	3.37	129.47
14. West Bengal	472.25	359.40	240.17	35.72	12.75	134.76	21.78	5.70	15.22	5.48	119.23
All 14 States	538.91	374.67	257.45	7.05	16.86	150.04	24.21	5.16	36.88	11.53	117.21

*Tax levied by local bodies in Kerala.

tax burden. This is the result of differential growth rates of tax revenue; if the same trends continue, the spread in per capita tax revenue can be expected to come down further. Much of the credit for this goes to the Finance Commissions, as shares in central taxes contributed to the equalising trend to a greater extent than the states' own tax revenue. Even so, casual observation reveals a clear correlation between levels of per-capita taxation and per capita SDP.

The analysis above indicates that the performance of the states in the area of taxation has not determined plan expenditure to any significant extent. Per-capita tax burden does seem to be positively correlated with per-capita plan expenditure, but since none of the other indicators of tax performance are so correlated, this could simply be due to both per capita plan expenditure and per-capita tax revenue being determined by per-capita SDP.

In sum, revenue receipts exhibited a fairly uniform growth of around 15 per cent per annum during the 1980s. But such growth (and greater than unitary buoyancy) in total revenue receipts did not protect the states from deficits in their current budgets. The probable cause is the faster growth in current expenditure. The exercises conducted so far suggest that the resource constraint facing the states in financing their plans stemmed mainly from deficiencies in BCR, reflecting the fact that expenditure growth outpaced revenue growth. Even reasonable growth in revenue has not been of much avail in providing resources needed for the Plans.

Nontax Revenues

Table 2.10 showed that for both the plan periods tax revenues constituted about 66 per cent of total revenue receipts. Of the 33 per cent that came from nontax revenues, about 16.4 per cent and 18.4 per cent were received from the central government as grants during the two plan periods, respectively. States' own resource mobilisation through nontax revenues comprised only 17.6 per cent and 15.4 per cent of total revenue receipts. It is thus obvious that not only is the contribution of nontax revenues low, but it is declining as well. None of the major components of nontax revenues -- dividends and interest from public undertakings, user charges, interest receipts from local bodies or forest revenues -- have shown any promise of increase. With the widespread forest conservation measures being adopted, it will not be possible to raise revenue from forests much; the other three main sources also cannot be burdened with further financial liabilities for fear that such measures may boomerang on the state government, either financially or politically. Only two items -- receipts from

minerals in some states and profits of liquor corporations set up by some state governments -- show increased receipts. The second item above should not really be considered an increase, as these receipts are simply shifted from those under excise duty after the setting up of the liquor corporations. The prospects for a substantial rise in the contribution of nontax revenues in the states thus appear dim, though the recent revision of royalty rates paid by the central government for mineral exploitation of the states should help a little.

Revenue Expenditures

Nonplan revenue expenditures are made up of spending on general administration, interest payments, and transfers to local bodies, as well as committed expenditure on social and economic services. Of the total current expenditures of the states, general administration, interest payments, and social services account for over 70 per cent (Table 2.16). A part of the revenue expenditure on social services is included under the plans. However, it may not be wrong to think that these three heads constitute over 60 per cent of total nonplan revenue expenditure. The proportion of the five major components of revenue expenditure in the total for the 14 states together and individually are given in the table. It can be seen that only the shares of social services and debt servicing expenditures have risen noticeably during the Seventh Plan period as compared to the Sixth Plan Period. It could, therefore, be said that if expenditure on these two items grew in line with the other expenditure heads, the growth in total revenue expenditure would have been lower. Debt servicing liabilities obviously constitute the fastest growing item. In Orissa and Madhya Pradesh, the share of this item jumped by more than 4 and 3 percentage points respectively. Only Tamil Nadu and Punjab registered a decline. Punjab is a special case because the share of general administration has gone up substantially only in this state, among the fourteen states under consideration, primarily because of increased expenditure on the law and order machinery. The case of Tamil Nadu is commented upon below.

The main propellant in the growth of the debt servicing burden of the states has been the growth in the volume of their outstanding debt (though it could partly be due to an increase in interest rates). Table 2.17 shows the outstanding debt of the 14 states as of the beginning of the two plans. In nominal terms, outstanding debt went up from Rs. 19,511 crore in March 1980 to Rs. 39,951 crore in March 1985, registering a growth of over 15 per cent per annum. Latest available data show that the outstanding debt of the states has

Table 2.16

**Total Revenue Expenditure on Selected Heads
as Percentage of Total Revenue Expenditure**

State	General Administration		Interest Payment and appropriation to reserves against debt		Compensation and assignment to local bodies and Panchayati Raj Institutions		Social Services		Economic Service	
	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan	Sixth Plan	Seventh Plan
1	2	3	4	5	6	7	8	9	10	11
1. Andhra Pradesh	16.97	15.82	6.75	8.76	1.78	1.67	45.66	41.25	28.83	29.32
2. Bihar	19.26	18.75	10.04	12.53	0.45	0.46	44.15	43.92	26.11	26.95
3. Gujarat	15.82	13.67	8.01	10.87	0.61	0.61	42.13	42.93	33.43	33.01
4. Haryana	14.78	14.31	10.24	12.00	0.08	0.06	34.19	34.54	40.72	39.71
5. Karnataka	17.32	17.15	11.57	11.77	3.49	3.21	35.45	35.97	32.17	31.50
6. Kerala	18.91	18.92	8.71	11.01	0.16	0.13	50.03	50.23	22.20	21.30

1	2	3	4	5	6	7	8	9	10	11	
7.	Madhya Pradesh	16.21	16.43	6.50	9.86	2.67	2.54	38.94	40.08	35.68	34.48
8.	Maharashtra	24.14	16.63	10.03	12.36	0.35	0.32	34.96	35.03	30.52	30.48
9.	Orissa	16.40	15.31	10.85	14.91	0.60	0.60	45.79	45.49	26.36	26.05
10.	Punjab	17.35	18.80	13.02	11.99	0.35	0.61	39.39	39.43	29.89	28.77
11.	Rajasthan	18.01	15.99	12.36	13.82	0.62	0.57	41.37	41.47	27.63	27.35
12.	Tamil Nadu	15.26	14.75	8.35	8.24	2.29	2.52	41.12	43.38	32.97	30.88
13.	Uttar Pradesh	18.02	17.48	11.34	14.25	1.00	0.92	38.93	38.35	30.71	31.30
14.	West Bengal	15.86	15.78	10.66	12.60	3.10	3.06	48.39	47.36	22.00	22.73
	All States	18.00	16.43	9.74	11.73	1.35	1.32	41.06	41.32	29.85	29.61

Note: 1. Includes organs of State, Fiscal Services, Administrative Services, Pension and miscellaneous general services.
Basic data source: *RBI Bulletin*, various issues.

Table 2.17

Outstanding Debt of State Governments at the Beginning of Sixth and Seventh Plans

States	Total Outstanding Debt as on 31 March (Rs crore)		Outstanding Debt taken from Centre as on 31 March (Rs crore)		As Percentage of SDP			
	1980	1985	1980	1985	Total Outstanding Debt as on 31 March		Outstanding Debt taken from Centre as on 31 March	
All States	19511	39951	14004	27430	20.94	23.72	15.03	16.29
Andhra Pradesh	1599	2974	1215	1999	22.18	23.09	16.85	15.52
Bihar	1754	3819	1406	2891	26.86	30.16	21.53	22.83
Gujarat	1099	2316	647	1653	15.17	20.74	9.73	14.81
Harayana	552	1219	349	723	18.35	22.19	11.60	13.16
Karnataka	1076	1929	752	1275	20.14	20.79	14.07	13.74
Kerala	914	1858	604	955	26.07	31.40	17.23	16.14
Maharashtra	1901	4209	1231	3171	13.61	17.18	8.81	12.94
Madhya Pradesh	1299	2820	851	1772	21.22	24.77	13.90	15.56
Orissa	1078	1979	814	1321	34.82	35.01	26.29	23.37
Punjab	717	1794	430	1109	16.45	21.36	9.86	13.20
Rajasthan	1381	2756	1046	1933	33.41	35.66	25.31	25.01
Tamil Nadu	1291	2305	871	1574	20.23	18.15	13.65	12.39
Uttar Pradesh	3052	6052	2256	3948	21.87	24.77	16.17	16.16
West Bengal	1888	3921	1532	3106	21.23	24.19	17.23	19.16

Source: 1. Reserve Bank of India, *Report on Currency and Finance*, 1980-81 and 1985-86.

2. C. S. O. - (for 1970-71 series of SDP data).

continued to grow at over 15 per cent per annum between 1985 and 1990. As a ratio to SDP, the total outstanding debt of the 14 states went up from 20.9 per cent in March 1980 to 23.7 per cent in March 1985. Similar trends can be observed in every state except Tamil

Nadu, which probably explains the decline in the share of debt servicing expenditures in the total revenue expenditure of that state.⁷ The proportion of loans due to the central government in total outstanding debt has declined slightly from about 72 per cent to 69 per cent. Evidently, the states are now resorting to market and other borrowings to a greater extent than before. With deficits surfacing in the revenue account of their budgets, the states' debt burden will continue to grow unless corrective action is taken. There is no reverse flow of resources from the states to the centre yet, and net transfers on loan account from the centre to the states have been growing. According to revised estimates for 1989-90, net lending by the centre to the states came to about 3,800 crore, as against Rs. 2,060 crore in 1986-87 (in 1985-86 the amount was about Rs. 4,060 crore, but that was an unusual year). According to statistics given in the Ninth Finance Commission (NFC) Report, the ratio of repayments of principal to fresh loans from the centre has been declining in recent years (it was 31.8 per cent in 1989-90 as against 34.5 per cent in 1987-88). With the reliefs recommended by the NFC, it might be expected that the debt burden would ease. Expectations are unlikely to be realized, however, unless effective steps are taken immediately to arrest the growth of deficits on revenue account. That in turn calls for a hard look at the expenditure side, as resource mobilisation on the revenue front seems to have been of no avail in keeping states' budgets in balance. The point that needs stressing is that not only interest but also several other items are showing rapid growth, and these need to be brought under control.

For a better understanding of the factors that have contributed to the rapid growth in expenditures, it is useful to look at the economic and not merely the functional categories of the budget. Data on the economic and functional classification of the state budgets are not available beyond 1987-88. Figures for expenditures on some of the important categories are reported in Table 2.18. Current expenditure growth accelerated in the 1980s, primarily because of subsidies, which show rates of growth far lower than in the previous decade, but still quite high. The fact that total current expenditures do not show dramatically increased growth in the 1980s indicates that the excluded part -- interest payments -- has grown considerably faster. Within consumption expenditure, compensation to employees recorded a growth of 17.1 per cent in the 1980s, as against 14.8 per

7. Chapter 6 on Tamil Nadu finances sheds some light on this phenomenon.

Table 2.18

Growth Rates of Various Economic Categories of State Expenditure

(per cent per annum)

	Total Current Expenditure*			Total Consumption Expenditure			Salaries and Wages			Subsidies		
	1971-88	1971-81	1980-88	1971-88	1971-81	1980-88	1971-88	1971-81	1980-88	1971-88	1971-81	1980-88
All States	16.1	14.8	16.6	16.0	14.7	16.0	16.2	14.8	17.1	35.2	50.8	20.7
Andhra Pradesh	17.6	17.5	17.6	16.8	17.7	14.0	16.8	17.5	14.8	43.9	80.1	13.6
Bihar	17.0	14.8	15.2	19.1	18.5	14.2	20.6	19.6	15.9	38.9	53.1	28.5
Gujarat	17.3	17.6	17.3	18.1	17.2	18.3	16.1	14.5	17.8	44.6	70.8	31.7
Haryana	17.4	15.4	19.3	16.8	15.2	17.8	16.6	14.5	17.3	47.3	89.1	18.2
Karnataka	17.3	16.6	18.0	15.1	15.4	12.5	15.6	15.5	13.6	44.0	76.3	19.1
Kerala	15.6	14.9	15.7	15.7	14.9	16.0	15.7	14.3	16.9	29.1	49.9	18.1
Madhya Pradesh	16.3	14.4	17.3	15.6	13.2	17.4	15.7	13.0	19.1	32.9	52.1	12.7
Maharashtra	15.5	14.1	16.0	15.5	13.7	14.9	14.9	12.5	16.5	32.0	42.5	11.7
Orissa	14.7	14.5	14.2	14.0	14.4	11.9	15.3	14.7	16.5	39.5	81.2	18.4
Punjab	16.8	16.8	17.0	16.0	16.2	14.4	15.3	15.6	13.4	47.5	87.5	20.2
Rajasthan	16.0	14.7	17.8	15.7	14.2	16.8	15.9	14.6	16.7	42.2	71.6	19.9
Tamil Nadu	15.2	13.0	14.9	16.2	12.6	18.6	16.5	13.9	21.7	35.5	32.8	37.5
Uttar Pradesh	16.6	16.8	16.2	15.5	14.1	16.3	14.8	13.2	16.8	57.3	102.4	26.0
West Bengal	14.2	12.3	14.9	12.7	10.8	14.4	14.4	12.3	15.9	41.5	75.7	10.2

#Does not include unallocable expenditures, mainly interest payments.

Source: NIPFP Database.

cent in the 1970s. The pattern varies considerably among states, however. While some states (e.g. Tamil Nadu, Madhya Pradesh, and Maharashtra) show a jump in the growth rate for the 1980s as compared to the 1970s, others (e. g. Andhra Pradesh, Bihar, and Karnataka) show a fall in the growth rate. Transfers to the nongovernment sector (figures not reported) have also grown faster in the period 1980-88 as compared to the previous decade, though the increase in the growth rate was not substantial.

The preceding analysis shows that several factors are responsible for the shortfalls in the BCRs of the states as compared with the stipulated targets. *Prima facie*, it is the rapid growth in revenue expenditures relative to revenue receipts which underlies this outcome. Revenue growth on the whole has kept pace with growth in output but has been inadequate for generating surpluses over expenditures. It may be argued that greater revenue effort could have met the needs of plan financing, especially since the tax revenue of some states displayed greater buoyancy than that of others. Indeed, in their anxiety to mobilize more and more resources, the states are looking for all possible sources which seem politically feasible, e.g. levying a tax on consignment transfers, which essentially constitutes tax exporting, and stepping up rates of sales tax, a good part of which falls on inputs, going against all sound principles of taxation. There is no doubt scope for raising revenue through extension of the sales tax base to services, as well as higher taxation of urban property and agricultural wealth. The tax structure of the country, however, is almost chaotic, with the states trying to extract taxes from each other's citizens and at the same time, engaging in what has come to be known as "rate wars" in sales taxation (that is, cutting tax rates to attract trade and industry irrespective of the nature of the commodities), while avoiding areas having relatively high tax potential. Aside from rationalisation of tax structure, other ways of strengthening the resource base considerably include cutting down wasteful or unjustifiable subsidies and recovering costs of public services from those who can pay. It should also be possible to augment revenue simply through better administration, that is, without recourse to measures that impose needless efficiency losses on the economy. There is good scope for resource raising also by better management of PSEs and proper pricing of their products/services and better design of subsidies.

It also ought to be noted that the states' revenue growth would have been better, had the share of central taxes shown the same buoyancy as their own tax revenue. This category, which contributes

a sizeable fraction of the states' revenue receipts, appears to be lagging, reflecting the slow growth in collections at the centre. What lies at the root of this phenomenon -- whether it is due to inadequate attention paid by the centre because of the increasingly large share going to the states under the Finance Commissions' dispensation -- remains a moot point.

It hardly needs pointing out, however, that no amount of resource mobilisation is going to help unless restraint is brought to bear on the expenditure side. That requires a fresh look at the debt position of the states on the one hand, and at the policies on subsidies and compensation of employees on the other. If political forces compel a continuation of present trends, economic compulsions will soon rule out any meaningful developmental effort at the state level.

DETERMINANTS OF PLAN EXPENDITURE

The analysis of state finances so far has revealed several factors that could have, and probably did, affect the plan expenditure of the states. In this section, we try to quantify the variables that affect plan expenditure and measure their impact statistically. To do this, it is first necessary to postulate an empirical relationship involving the determinants of plan expenditure.

To begin with, because the plan size for any state depends to a considerable extent on its ability to raise the necessary resources on its own, major determinants of the current receipts of the state should determine plan expenditure also to some extent. Furthermore, a large part of the state plan is usually financed by plan transfers, implying a future debt burden, given the Gadgil formula for non-special category states. Thus, it can be expected that the existing interest burden on the state is likely to affect its plan size by affecting its ability to shoulder further interest (and repayment) burden. Another factor indicating the states' ability to incur plan expenditure in the current year is the ratio of revenue expenditure to revenue receipts for the past few years; this would show the general ability of the state to finance the current plan from revenue surpluses of previous years. Of course, all three variables are inter-related; while the last one is an indicator of general financial capacity, the other two are specific to the revenue and expenditure side.

Apart from the ability to raise resources, another factor that ought to influence plan expenditure is the need for such expenditure as judged by the planning authorities. Such need is usually judged by the extent of poverty in a state. Indeed, a large part of plan expenditure --

that on poverty eradication schemes -- is directly related to the number of poor in a state. However, poverty estimates are made before a Five Year Plan begins, and these estimates are adopted for the whole plan period. This has some significance for the estimation of the empirical relationship, which is discussed below.

A third factor influencing the distribution of plan expenditure is the efficiency of allocation. Given an overall plan size, and given the effectiveness of plan expenditure in promoting development in different states, an efficient allocation of plan expenditure would require equalisation of benefits across states from marginal units of plan expenditure, much like an output maximising multiunit firm equating marginal output of factors of production in different units. Although this factor, like all other factors, cannot be expected to determine plan expenditures by itself, it cannot be excluded from a list of probable determinants.

The fourth and final factor that may be relevant in the determination of plan expenditure is the political factor. While it is probably unanimously accepted that political factors are important, it is difficult to take these into account in a systematic analysis. The estimation below takes account of only one aspect of the political factor, the identification of a state with respect to its political leanings vis-a-vis the ruling party. The equation postulated for actual estimation, keeping the above discussion in mind, is:

$$\text{PLAN} = a_0 + a_1\text{SEATS} + a_2\text{D.SEATS} + a_3\text{CEXP/CREC} + a_4\text{INT} + a_5\text{PCSDP} + a_6\text{MANG} + a_7\text{CHSDP}$$

in the linear form, and

$$\log\text{PLAN} = a_0 + a_1\log\text{SEATS} + a_2\text{D} + a_3\log(\text{CEXP/CREC}) + a_4\log\text{INT} + a_5\log\text{PCSDP} + a_6\log\text{MANG} + a_7\log\text{CHSDP}$$

in the double log form. The underlying equations of the above two are:

$$\text{PLAN} = a_0 + a_1\text{SEATS}(1 + kD) + a_3\text{CEXP/CREC} + a_4\text{INT} + a_5\text{PCSDP} + a_6\text{MANG} + a_7\text{CHSDP}, \text{ and}$$

$$\text{PLAN} = A_0(\text{SEATS}.kD)^{a_1} (\text{CEXP/CREC})^{a_3} \text{INT}^{a_4} (\text{PCSDP})^{a_5} \text{MANG}^{a_6} \text{CHSDP}^{a_7}$$

The variables are defined as follows:

- PLAN = Plan expenditure as a ratio of SDP,
 SEATS = Ratio of members of parliament (MP) from the ruling party (at the centre) in total MPs from the state,
 k = a constant, indicating the extent of impact of D,
 D = dummy for the same party (or its political ally) ruling at the centre and the state,
 CEXP = Current expenditure of the state,
 CREC = Current receipts of the state,
 INT = ratio of interest payments to CREC,
 PCSDP = Per capita SDP,
 MANG = SDP from manufacturing as a ratio of total SDP, and
 CHSDP = Percentage change in SDP as a ratio of average change in plan expenditures for the previous five years.

The dummies for states are arranged in alphabetical order of states, e.g., DI for Andhra Pradesh. Averages of the previous five years of the ratio CEXP/CREC have been used in the estimation. The pooled sample consist of all five years data for 14 selected states for the Sixth Plan period and for the first four years of the Seventh Plan period. The estimation has been done separately for the two plan periods to avoid heteroscedasticity problems. Because of this fact, coupled with the customary use of state dummies for pooled data to begin with, poverty estimates were not required to be put in as a variable in view of their constancy over the plan period; the state dummies can pick up inter-state variation in poverty adequately.

During the estimation of the above equations, use of the required number of state dummies simultaneously resulted in breakdown of the estimation procedure with near singular matrices. Hence, the dummies were 'scanned' by using them one by one and finally using only those which were statistically significant. The variables CHSDP and CEXP/CREC were not significant statistically and were dropped. The final equations estimated are:

$$\begin{aligned} \log \text{PLAN} = & - 1.27 + 0.33 \log \text{SEATS} - 0.14 \text{D} - 0.07 \log \text{INT} \\ & \quad (11.45) \quad \quad (-3.58) \quad \quad (-1.99) \\ & - 0.21 \log \text{PCSDP} + 0.12 \log \text{MANG} - 0.30 \text{D1} \\ & \quad (-5.16) \quad \quad (3.75) \quad \quad (-6.42) \\ & + 0.29 \text{D4} - 0.26 \text{D5} - 0.17 \text{D10}, \quad \quad \text{R}^2 = 0.82 \\ & \quad (6.39) \quad \quad (-5.69) \quad \quad (-2.77) \end{aligned}$$

and,

$$\begin{aligned}
 \log\text{PLAN} = & - 2.36 + 0.87\log\text{SEATS} + 0.15\log\text{INT} \\
 & \quad (9.86) \qquad \qquad (1.63) \\
 & - 0.24\log\text{PCSDP} + 0.75\log\text{MANG} - 1.86\text{D1} \\
 & \quad (-3.33) \qquad (4.07) \qquad (-8.69) \\
 & + 0.23\text{D2} - 0.38\text{D3} - 0.33\text{D5} + 0.13\text{D6} - 0.21\text{D7} \\
 & \quad (3.09) \quad (-3.51) \quad (-5.22) \quad (2.00) \quad (-1.80) \\
 & + 0.17\text{D8} + 0.66\text{D9} + 0.71\text{D10} - 0.11\text{D11} - 0.34\text{D12} \\
 & \quad (2.40) \quad (4.99) \quad (6.87) \quad (-1.65) \quad (-3.17)
 \end{aligned}$$

$$R^2 = 0.90$$

(All the coefficients are significant at 95 per cent level of confidence).

The first comment that can be made on the results reported above is that the inverse relationship between per-capita income and the dependent variable seems a bit odd. Per-capita SDP has been entered along with MANG as a variable representing ability to raise resources for plans. However, it happens to be an indicator of need also, and thus could be inversely related to PLAN; the estimated coefficient represents the net impact of the conflicting effects. The equity with respect to SDP in a dynamic sense has been commented upon earlier. The estimated coefficient of SDP seems to confirm that.

The political variables are significant, though D is not for the Seventh Plan period. The negative coefficient of D does not imply a negative effect, but a positive but less than unity value of k in terms of the underlying equation. The estimated negative coefficient is, by hypothesis, $a_1 \log k$, and $\log k$ would be negative for any positive a_1 . A negative value for $\log k$ implies $0 < k < 1$, which is a reasonable presumption.

The fact that CEXP/CREC turned out to be insignificant should not cause too much worry, as MANG and INT are probably representing the budgetary position adequately. After all, these two variables represent the predominant parts of the two sides of current accounts - tax revenue and interest payments. The positive coefficient for INT for the Seventh Plan period, however, is perplexing. A possible explanation lies in the substantial rise in borrowing as a source of plan finance during the Seventh Plan.

It would be of interest to see the "beta coefficients"⁸ of the variables

8. These are the regression coefficients standardised for the scale of independent variables by multiplying with the ratio of the standard deviations of the dependent and the independent variable concerned.

other than dummies found to be significantly affecting the plan expenditure to SDP ratio. Table 2.19 provides the estimates. These figures indicate that during the Sixth Plan, the negative effect of SDP and the positive effect of the political lobby of state MPs in the ruling party were almost equally dominant. During the Seventh Plan, political lobbying seems to have become even more important, but less important than the ability to raise own resources, as denoted by MANG.

While the empirical analysis carried out above cannot be claimed to be a definitive one, it does open up a few interesting lines of thought. The political economy of planning has hitherto been paid very little attention; this aspect clearly needs more analysis. A full scale model of state finances seems to be called for if answers to several questions on state finances are to be answered categorically. However, the exercise does indicate the growing importance of states' own resources in planning and of interest payments (or borrowings).

Table 2.19

Estimated Beta Coefficients					
	<i>SEATS</i>	<i>D</i>	<i>INT</i>	<i>PCSDP</i>	<i>MANG</i>
Sixth Plan	0.11	-0.06	-0.04	-0.12	0.06
Seventh Plan	0.35	-	0.14	-0.16	0.44

CONCLUSIONS AND SOME POLICY IMPLICATIONS

The main conclusions that emerge from this chapter may be summarised as follows:

- (1) There have been shortfalls in the outlays under the Plans in all states in both Sixth and Seventh Plans. The extent of shortfall was much smaller for most states in the Seventh Plan, possibly because of more modest targets.
- (2) Heavy shortfalls occurred in crucial sectors like irrigation and power under both Plans.
- (3) There is an increasing tendency on the part of the states to allocate a larger share of their plan outlay to "revenue" or "current" expenditure.
- (4) One possible explanation is the practice of including new

welfare and poverty allevation programmes under the plan. Once introduced, they pre-empt revenue expenditures affecting vital services like health, education and maintenance of assets.

- (5) The tendency on the part of the states to put in a larger component of plan outlays under "revenue" undermines the role of planning. Available data show that a good part of capital spending in the states is taking place under the "non-plan" head. This makes little sense. The rationale for drawing distinctions between "plan" and "non-plan", "revenue" and "capital", and "developmental" and "nondevelopmental" needs reconsideration.
- (6) There are wide variations in the plan performance of the states. Per capita plan outlay varies considerably. Shortfalls in achieving plan targets also vary across states.
- (7) What accounts for the variation in plan size and in plan expenditure does not admit of a straightforward answer. Per capita SDP is highly correlated to per-capita plan outlay, but this is partly accounted for by the population factor. As the statewise growth rates of plan expenditure show, plan expenditures are becoming more equitable across states over time. However, what determines the level of plan outlay at the state level (as opposed to inter-state variations), needs further study.
- (8) By and large, revenue receipts of state governments have kept pace with increases in SDP. Except in one state, buoyancy coefficients of major revenue heads all exceeded unity. There are a few taxes which could be exploited further, but the scope for raising additional revenue through more intensive taxation does not seem very promising. More attention needs to be paid to rationalisation of the tax structure, extension of the tax base to cover services, etc. and harmonisation of state taxes to minimise efficiency losses (which cannot but be considerable, given the present chaotic state of commodity taxation). All this might help to improve the revenue productivity of the tax system and equity in the distribution of its burden. Local taxation is another neglected area. Resource mobilisation efforts may be directed more fruitfully to areas like recovery of costs of providing public services and better running of PSEs.
- (9) If meaningful planning is to be practised, determined efforts are needed to control the growth of revenue expenditure on

both plan and nonplan accounts. The items of current expenditure growing most rapidly are subsidies and interest payments. Apart from subsidies flowing explicitly through the budget there are many hidden subsidies provided by the central and state governments. In containing the growth of current expenditure, remedial action is needed to relieve the burden of debt servicing and a hard look at the cost and benefit of all major subsidies should be taken. The entire system of expenditure control also needs overhaul.

- (10) The system of intergovernmental transfers needs to be restructured to impart a greater sense of responsibility to the spending agencies. This applies to the fiscal relations between the centre and the states and those between the states and local bodies. Decentralisation of fiscal powers combined with decentralisation of responsibilities for providing public services could help move in that direction, even though regional disparities might be accentuated. A balance would have to be struck between the conflicting goals of equity and efficiency. The present arrangements whereby a higher level authority practically underwrites the expenditure of governments at levels below promote fiscal irresponsibility.
- (11) The empirical exercise undertaken reaches the conclusion that political factors play a significant role in planning. It confirms the trend toward more equitable distribution of plan expenditure across states. It also indicates the growing importance of own revenue in determining the plan size of states.

From trends in state finances and the experience of plan financing it is evident that the involvement of the public sector at the state level will soon be in jeopardy unless the seriousness of the imbalances in state budgets is recognised by the community as a whole and a certain discipline and restraint is accepted by all powerful groups in the society, in the common interest. That seems to be a tall order in the present socio-political environment. If, however, 'social choice' dictates otherwise and persists in underplaying the need for discipline in government expenditures, the growth strategy itself has to undergo a radical change. In their present state, government finances not only at the centre but also in the states are not viable. Nor is planning of the kind the country has practised so far.

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Chapter 3

An Analysis of Changes in State Government Subsidies: 1977-87

M. GOVINDA RAO and SUDIPTO MUNDLE¹

Correcting fiscal imbalances is today the single most important task of macroeconomic management in India in the face of rising inflation, burgeoning public debt, a severe paucity of resources for plan financing and a deepening balance of payment crisis. Each of these problems is traceable either directly or indirectly to the growing gap between government expenditure and revenue. Budgetary subsidies are obviously one of the specific instruments of policy requiring careful analysis in the drive toward prudential financial management, since subsidies now constitute one of the largest items of public expenditure.

We have, in an earlier paper, analysed the volume and composition of total subsidies arising from the budgetary operations of the central government and 14 major states in the year 1987-88 (Mundle and Rao, 1991). This chapter focuses on the trend over time in the flow of

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subsidies at the state level. The analysis is confined to the 14 major states.

At the state level, the problem of fiscal imbalance has a special feature which must be noted. As the states do not have independent powers to borrow, particularly after the Overdraft Regulation Scheme was introduced in 1985, they in fact face a hard budget constraint. Given the political difficulties in raising larger resources and the prior claim of non-plan revenue expenditure, plan expenditure (particularly capital expenditure under the plan) has tended to grow slowly in recent years. During the Seventh Plan, for example, while total public sector outlay in the country exceeded the planned outlay by about 4.5 per cent, at the state level the total outlay fell short of the planned outlay by about 8 per cent. The shortfall was mainly on account of budgetary contributions (i.e., balance from current revenue and additional resource mobilisation). As against a planned share of 36 per cent of total outlay for budgetary contributions, the actual was only about 23 per cent.

An important reason for the worsening budgetary situation in the states is the negligible contribution of non-tax revenues. While the states over the years have made substantial investments in social and economic services, recoveries have not only been insignificant but even have been on the decline as a proportion of states' own revenues. The composition and growth of states' own non-tax revenues, presented in Table 3.1, clearly bring out three salient features.²

First, the share of non-tax revenues in states' own total revenues is not only small, but it has also declined over time. Second, all major items of non-tax revenues, i.e., administrative receipts from general, social and economic services, surpluses from departmentally run undertakings as well as interest receipts and dividends from non-departmental enterprises, have grown at rates lower than the rate of growth of states' revenue expenditure as well as own tax revenue. The only exception is the royalty and cess on mines and minerals, which grew at over 30 per cent per annum. Non-tax revenues excluding royalty and cess grew at an average annual rate of only 7.4 per cent per annum, and when royalty and cess are included, the growth rate was 10.5 per cent. Clearly, compared to other sources of non-tax

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2. We have excluded interest receipts of the states from departmental undertakings, as these are merely book adjustments and do not represent real transfers. These are shown as revenue receipts under the major head 'Interest Receipts' and as an expenditure item under the respective major head under which the account of the undertaking is shown (e.g. irrigation).

revenue, the states have found it easier to effect recoveries from royalty and cess on minerals, (which is a form of tax on natural resources), the burden of which is substantially exported to the residents of other states. Third, the inflows from all items of non-tax revenues are less stable than the inflow of tax revenues. As may be seen from the F values in Table 3.2, the variance of non-tax revenues was significantly higher than those of both tax revenue and revenue expenditure. Fluctuation in the returns from departmental undertakings was particularly large, ranging from a surplus of Rs 119 crore in 1980-81 to a deficit of Rs 9.8 crore in 1988-89. This small and unstable pattern of non-tax revenue flows suggest that this is virtually a residual item of revenue, not seriously considered as a source of financing expenditure by the states.

Within this overall pattern there are of course large variations across states, the rate of growth of non-tax revenue ranging from as little as 0.2 per cent per annum in the case of West Bengal to as much as 33 per cent in the case of Bihar (see Table 3.3). In the states where non-tax revenues grew at high rates, it was largely due to the buoyancy of revenues from royalty and cess on mines and minerals. When royalty and cess are excluded, there is a sharp fall in the growth of non-tax revenues in Bihar, Gujarat, Madhya Pradesh and Orissa.

Thus, while revenue expenditures in the states have been increasing at very high rates, the growth of revenue receipts, especially non-tax revenues, has lagged behind. Clearly, where the high growth of state government expenditures relates to services other than pure public goods, it is necessary to analyse how far the cost of these services is recovered and, if not, how far the flow of subsidies can be linked to identifiable policy objectives.

The present study does not address all important issues relating to states' cost recoveries, the implicit subsidies involved and their incidence. Here, an attempt is made to estimate the volume of subsidies involved in the provision of various social and economic services only and to examine how these have changed over the last decade. The concept of 'subsidy' employed in this paper is discussed in section 2, and some issues of estimation are explained. Section 3 presents estimates of cost recovery and the volume and composition of subsidies. Section 4 summarises the important conclusions of the study.

THE CONCEPT OF SUBSIDY AND THE METHOD OF MEASUREMENT³

Definition and Scope

In the economics literature, there is no single accepted definition of subsidy. Definitions vary depending on the purpose in view (Wiseman, 1981). We have, for the purpose of this study, defined budgetary subsidies as the difference between the cost of delivering publicly provided goods or services (henceforth referred to as services) and the recoveries arising from such deliveries.⁴

This definition includes subsidies arising only from those departments which come directly under the state governments. Subsidies arising from the operation of non-departmental public enterprises are included only to the extent that they are reflected in the difference between financial assistance extended to such enterprises by the state governments and the returns which these governments receive from them.

The analytical framework underlying our analysis is detailed in the paper cited above. Briefly, we may classify the public services provided by the government as pure public goods, pure private goods and 'merit' goods. In the case of pure public goods, non-excludability in consumption implies that true consumer preferences will not be revealed. Since these services cannot be easily priced, their costs have to be met out of the general budget. Therefore, the concept of a subsidy in the provision of pure public goods does not seem appropriate. Could we say, for instance, that the entire expenditure on defence is a subsidy? 'Merit goods' can be priced. However, the existence of externalities may necessitate subsidisation to ensure optimal provision of such services. Finally, in the case of private goods which can be priced and have zero externality by definition, if subsidies are provided, they should be justifiable on distributional considerations.

It is difficult to operationalise these concepts, in particular the classification of services as pure public goods, merit goods or private goods and the measurement of externality. In this exercise, we have followed a conservative rule of thumb, of treating only expenditures on general administrative services, relief on account of natural calamities, the general secretariat expenses of social and economic

3. For more detailed discussion of these issues, see Mundle and Rao (1991).

4. We ignore, for the moment, the issue of differences between the actual cost and efficiency cost of public services.

services and the compensation and assignment of resources to Local Bodies and Panchayat Raj institutions as pure public services. The expenditure incurred on these items has accordingly been excluded from the computation of subsidies.

Public expenditure on transfer payments has also been excluded, since these cannot be treated as costs incurred in the provision of a service. We have also excluded the tax-expenditure or revenue losses incurred on account of tax incentives from the computation of subsidies, though these are sometimes treated as subsidies in the literature.

Method of Measurement

This exercise estimates the subsidies involved in the provision of public services by the fourteen major state governments in 1977-78 and 1987-88. In all, there are 123 major heads of account identifiable from the budget classification, of which 37 are in general administrative services, etc., and are treated as pure public services as explained above. For each of the remaining 86 social and economic services, subsidy has been computed as

$$s_j = v_j + i (K_j + L_j) + d.K_j - y_j - r_j - t_j \quad (1)$$

where $j = 38 \dots 123$, indicates the services. For the j^{th} service

s_j is the subsidy;

v_j is the variable cost or revenue expenditure on the service;

K_j is the capital stock in the sector;

L_j is the stock of investments made outside government under the budget head j in the form of loans or equity;

i is an imputed interest rate representing the opportunity cost of money for government;

d is the depreciation rate;

y_j is revenue receipt from service j ;

r_j is income by way of interest or dividend on loans and equity under budget head j ; and

t_j is a transfer payment under budget head j to individual agents.

The total volume of subsidies on all services is given by

$$S = \sum_{j=38}^{123} s_j \quad (2)$$

Similarly the cost of any service $j(j = 1 \dots 123)$ is given by

$$c_j = v_j + i(K_j + L_j) + dK_j - t_j. \quad (3)$$

The total cost of all services, including transfer payments and pure public services, is given by

$$C = \sum_{j=1}^{123} c_j + \sum_{j=1}^{123} t_j \quad (4)$$

The imputed interest rate or the average cost of money to the government, calculated as the ratio of interest payments by central and state governments taken together to the stock of total public debt, works out to 5 per cent in 1977-78 and 7 per cent in 1987-88. The depreciation rate has been set at 2 per cent in real terms, assuming an average life of fifty years for capital stock in government activities as on 31st March, 1987. Allowing for an inflation rate of 7.4 per cent, depreciation in nominal terms works out to 9.4 per cent.

The data used for the exercise have been drawn primarily from the Finance Accounts of the state governments published by the Office of the Comptroller and Auditor General. This has been supplemented by additional information drawn from budget documents and from *Indian Economic Statistics: Public Finance* published by the Ministry of Finance.

STATE BUDGETARY SUBSIDIES: VOLUME AND COMPOSITION

A comparative analysis of the cost of public services, cost recoveries and the volume of subsidies involved in 1977-78 and 1987-88 are presented in Table 3.4. In 1987-88, the total cost of public services and transfers together amounted to Rs 43,358 crore. Of this, the cost of administrative services (public goods) and transfers together was of the order of Rs 11,271 crore and the cost of social and economic services amounted to Rs 32,087 crore. After deducting cost recoveries of Rs 4,625 crore, the budgetary subsidy amounted to Rs 27,463 crore. This works out to about 8.3 per cent of GDP or over 63 per cent of the total cost of public services and transfers.

These orders of magnitude, when compared with the base values for 1977-78, indicate that subsidies grew phenomenally over the decade 1977-78 to 1987-88. The increase in cost recoveries lagged substantially behind the rising cost of social and economic services, resulting in rapid growth of subsidies. Thus, in the aggregate, while the cost of social and economic services provided by state governments

increased at an average annual rate of 17 per cent per annum, cost recoveries increased only by 12.4 per cent, causing subsidies to grow at 18 per cent (See Table 3.4). This pattern is seen uniformly in all states and hence also for the groupings of high income, middle income and low income states.

Another feature worth noting is the variation in subsidies across states. It may be seen from Table 3.5 that a more than proportionate share of subsidies accrued to high and middle income states. In 1987-88 the four high income states, with only a 20 per cent share of population, claimed almost 25 per cent of all-state level subsidies, while the share of the 46 per cent of the population in low income states was less than 40 per cent. In fact, all high and middle income states, with the sole exception of West Bengal, claimed a share of subsidies higher than their respective population shares. The per capita subsidy in high income states worked out to Rs 481, as against only Rs 323 per capita in low income states. This reflects higher per capita expenditures on social and economic services in these states, which are, in turn, a direct reflection of their greater revenue raising capacities. It is also seen that, in 1987-88, per capita subsidies were highly correlated with both per capita state domestic product (SDP)⁵ and the Ninth Finance Commission's estimate of per capita taxable capacity.⁶ This implies that the federal transfer mechanism has failed to achieve its major objective of offsetting the fiscal disadvantages of the states. In other words, the transfer mechanism has not succeeded in *enabling* the fiscally disadvantaged states to provide a normatively determined level of public services at a uniform tax effort. Consequently, both levels of services and per capita subsidies in the fiscally disadvantaged states were lower than in the better off states.

The third important feature of the inter-state distribution of subsidies in 1977-78 and 1987-88 is a remarkable stability in the relative shares of different states over the decade (Table 3.6). The share of the five low income states remained virtually unchanged at about 40 per cent. The high income states gained one percentage point in 1987-88 at the cost of the middle income states, as compared to the shares in 1977-78. This stability in relative shares is somewhat surprising as there is a general impression that since the Seventh Finance Commission, the statutory transfers have been distributed on the basis of more progressive formulae. Therefore, the shares of low income states should have shown an increase. However, non-statutory transfers, particularly those for central sector and centrally

5. This refers to the comparable estimates of SDP averaged for 1982-85.

6. The correlation coefficients were respectively 0.78 and 0.80.

sponsored schemes, have grown in importance, and their less progressive distribution seems to have, by and large, neutralised any increase in the progressivity of statutory transfers awarded by the recent Finance Commissions.⁷

Subsidies in Social Services

Subsidies in the provision of social services in all the major states taken together amounted to Rs 14,540 crore, forming about 53 per cent of total subsidies flowing through state governments. The share of subsidies on education alone accounted for about 30 per cent, and the share of subsidies on protective and preventive health care (medical, public health, water supply and housing) services constituted another 17 per cent of total state subsidies.

The estimates presented in Table 3.7 show that in each of the 14 major states, social services claimed a predominant share of subsidies, ranging from 46 per cent in Haryana to about 67 per cent in Kerala. The broad similarity in the relative shares of various sub-sectors of social services among the states is also notable. In every state, the highest share of subsidy was in education, followed by medical and public health, water supply and sanitation and housing.

In the case of both education and health care, the two largest subsidy items, the most striking feature that emerges from the analysis is that, generally, per capita subsidies were higher in the states where levels of educational and health services were also higher and *vice-versa*. In the case of education, for example, the coefficient of correlation between per capita subsidy and literacy rate was 0.76. In Kerala, both the literacy rates and per capita subsidies were the highest. Similarly, in the states of Gujarat, Karnataka, Maharashtra, Punjab and Tamil Nadu, where literacy rates were higher than the all-states average, per capita subsidies were also substantially higher. Subsidy levels were the lowest in Bihar, Madhya Pradesh, Orissa and Uttar Pradesh, all of which had very low literacy rates.

A similar association between levels of service and per capita subsidy is noticed also in the case of preventive and protective health care (medical, public health, water supply, sanitation and housing). In Haryana, Karnataka, Kerala, Maharashtra, Punjab and West Bengal, where infant mortality rates were much below the average, per capita subsidies on protective health care (medical and public health) were higher. In Kerala, which had the lowest infant mortality rate (27 per

7. It may be noted that the share of grants for central sector and centrally sponsored schemes in total current central transfers increased from 13.5 per cent in 1977-78 to 20 per cent in 1987-88.

1000 births), the per capita subsidy in protective health care was higher than the average by 33 per cent. Similarly, in Punjab, where per capita subsidies were 54 per cent higher than the average, the infant mortality rate was much lower than the average. A similar pattern can be observed in the case of subsidies in preventive health care services. The correlation coefficient between infant mortality and per capita subsidy on medical and public health worked out to (-)0.72.

We have pointed out above that per capita subsidies on social services were higher in states where the levels of these services were higher. It is quite likely that it is because of higher levels of subsidy that the consumption of social services was higher in these states. If so, an egalitarian Federal transfer policy would require that such subsidies be enhanced over time in states having lower consumption of social services relative to those with higher social services consumption. Unfortunately, the actual experience belies this expectation.

Per capita subsidies on major social services in 1977-78 and 1987-88 at constant (1977-78) prices are shown in the Table 3.8. It turns out that per capita subsidies on social services in real terms increased at very high rates in all states and under each of the major social service items. However, there is little evidence to suggest that there was any attempt at redressing inter-state inequities in the allocation of subsidies on social services over time. In fact, the five states having the highest per capita subsidies on social services in 1977-78 continued to hold their position in 1987-88. Similarly, the four states which had the lowest per capita subsidy on social services in 1977-78 remained at the bottom of the ordering in 1987-88 also. The only major rank shift was in the case of West Bengal, which slipped from the sixth position in 1977-78 to the tenth in 1987-88. The rank correlation coefficient of the ordering of states by per capita social service subsidy in the two years was as high as 0.89. The pattern was also broadly similar in the case of the largest social service subsidy item, namely, education. In fact, there was no change at all in the ranks of the first 10 states. The rank correlation coefficient of the education subsidy ordering of states between the two years was as high as 0.95. It is thus clear that during the period considered, there was no equity improvement in the inter-state allocation of subsidies on social services.

The inequitable distribution of social service subsidies between states is probably reinforced by inequity in the inter-personal allocation of such subsidies within states. Illiteracy itself is a barrier to accessing such services as, for example, non-primary education. This point is rather important in view of the fact that user charges in social

services are not only very low but also declining over time (Table 3.9). The recovery rate on social services for all the states taken together declined from 5 per cent in 1977-78 to only 2.8 per cent in 1987-88. A declining trend is also evident in every state. In 1987-88, the recovery rate was less than 6 per cent in all states; in Bihar and West Bengal, it was just a little over 1 per cent. The pattern of low and declining recovery rates appears in both education and health.

Low recovery rates in education and health services presumably reflect a deliberate policy of providing these services free or at very low prices for both externality and distributional considerations. However, when there are barriers to access to these services, such that a disproportionate share of subsidies accrues to a relatively small and privileged section of population, it implies that some of the external benefits of the subsidy are lost and the distributional objective is substantially undermined. Ensuring greater accessibility of subsidies to economically disadvantaged groups requires massive expansion in the levels of these services and also requires much more effective targeting and complete elimination of such subsidies for those who can afford to pay for them.

Low and declining recovery rates in social services are a major factor accounting for the sharp increase in real per capita subsidy noted earlier. Since the recovery rate on social services is much below the average and expenditure on these services has been increasing faster than expenditure on other services (Mundle, 1988 and Rao and Tulasidhar, 1991) in recent years, the average per capita subsidy has tended to increase over time. Of course, this tendency has been reinforced by the general trend of declining recovery rates in all government services across the board.

The education sector alone accounts for about a third of total budgetary subsidies in the states, so it would be instructive to analyse it in greater detail. The disaggregated picture of subsidies and recovery rates in the education sector in the 14 major states, presented in Table 3.10, reveals three important features. First, in 1987-88 the subsidy on primary education constituted about 46 per cent of the total subsidy on education, despite the fact that almost 65 per cent of the population in the states was illiterate (according to the 1981 census). Over 54 per cent of the education subsidy was allocated to higher levels of education. The pattern was broadly similar in all the states. Second, the subsidy on higher, technical, medical and agricultural education, which accrues mainly to the literate section of population, amounted to a staggering Rs. 2,000 crore in 1987-88, comprising 23 per cent of the total education subsidy. This amount

could easily have financed augmentation of outlay on primary education by about 50 per cent! Some degree of subsidisation at higher educational levels may be desirable. However, there is clearly a very strong case for pruning these to provide more subsidies at the primary level, in view of the high rate of illiteracy that still prevails in India. Only a small and relatively better off section of the population benefits from subsidies on education at higher levels. Thus, our analysis underlines the inequitable distribution of the education subsidy not merely in terms of its inter-regional spread but also in terms of its inter-personal distribution within regions.

In contrast to the required direction of reform described above, we find that the proportion of subsidies at higher educational levels has, in fact, been increasing over the years. While the share of primary education in the total subsidy on education declined from 49 per cent in 1977-78 to 46 per cent in 1987-88, that of higher education increased from 20.5 per cent to 22.9 per cent during the period. The pattern was broadly similar across most individual states except Karnataka, Orissa, Uttar Pradesh and West Bengal, where the share of subsidies on higher education showed a marginal decline. The increase in the share of subsidies on higher education was primarily due to a very large decline in the recovery rate from 6.7 per cent in 1977-78 to only 1.7 per cent in 1987-88. Recovery rates for higher education showed a significant decline in every state; in 1987-88, in as many as 11 states, higher education had become virtually free, with a recovery rate of less than 2 per cent!

Subsidy in Economic Services

The volume of subsidies in economic services in the states totalled Rs 15,950 crore in 1987-88, accounting for about 47 per cent of the total bill of subsidies. The largest component of this, amounting to over Rs 4,700 crore, was in irrigation, and Rs 4,100 crore was in agriculture and allied activities. Other important sectors involving significant subsidies included power and transport.

As in the case of social services, a disproportionately large share of subsidies on economic services has accrued to more developed states (Table 3.11). In Punjab, for example, the per capita subsidy on economic services amounted to Rs 345, which was more than double the per capita subsidy of Rs 163 in Bihar, the least developed state. In the more developed states of Gujarat, Haryana and Punjab, subsidies were appreciably higher than the average, whereas in the less developed states like Uttar Pradesh, Bihar and Madhya Pradesh they were substantially lower. This pattern is also apparent in subsidies to

important individual economic services, with large inter-state variations both in recovery rates and in per capita subsidies. In the case of agriculture and allied activities, for example, the per capita subsidy in advanced states like Gujarat, Haryana, Maharashtra and Punjab were much higher than the all states' average. For irrigation and power, the per capita subsidy in better off states like Gujarat (not for power), Haryana and Punjab were significantly higher than the average for all states. Incidentally, power in Karnataka and Kerala are the *only* cases across all social and economic services in all states where no subsidy is involved.

The subsidy to power consumption is largely on account of the very low rates of tariff for electricity consumed in irrigation. The two subsidies taken together could therefore be interpreted as the total direct and indirect subsidy on irrigation. Along with the subsidy under 'agriculture and allied activities', the total flow of subsidies to the farming sector may be placed at about Rs 10,400 crore, out of a total flow of subsidies to economic services from state budgets amounting to approximately Rs 13,000 crore.

Subsidies implicit in the underpricing of economic services also have important allocative effects. Underpricing of both irrigation and power, for example, can lead to overuse of water. This is likely to distort cropping patterns in favour of water-intensive crops. Similarly, underpricing of forest products leads to excessive depletion of forest resources, with undesirable effects on the environment. The adverse distributional and resource allocation effects of the existing pattern of subsidies do not imply that the subsidies should be wholly eliminated. What they do imply is that subsidies should be made transparent and carefully targeted explicitly, keeping in view the distributional and resource allocation effects. It is important that subsidisation should be done as a conscious policy to alter resource allocation or income distribution along intended lines, and unintended effects should be avoided.

The pattern of subsidy flows in 1987-88 presents a snapshot at one point of time. From a dynamic reform perspective, it is interesting to ask whether the picture in 1987-88 represents an improvement or a deterioration over time in terms of the adverse distributional and allocative effects. The analysis of subsidies in 1977-78 and 1987-88 shows that if anything, the distortions have been increasing over time. Table 3.12 shows that in real terms the per capita subsidy in economic services grew at higher than average rates in some of the economically advanced states like Gujarat, Haryana, Karnataka, Maharashtra and Tamil Nadu. To a large extent, this was due to a very high increase in

per capita subsidies on agriculture and allied activities and also irrigation in the case of Gujarat and Haryana.

Per capita subsidies on economic services, in all 14 states taken together, increased at an annual average rate of 7.7 per cent, which was higher than the growth rate for social services, despite the fact that expenditures on social services increased at a faster rate in recent years. This implies that though the recovery rates on economic services were higher, they declined more than the recovery rates on social services during this period. The recovery rates on economic services in the two years presented in Table 3.13 confirm this. The average rate for the major states taken together for economic services as a whole declined from 36 per cent in 1977-78 to about 25 per cent in 1987-88. Decreases of varying magnitudes occurred in all the states and in almost all the sectors, the maximum decrease being from 52 per cent to about 29 per cent in agriculture and allied services. A few conspicuous exceptions include the rates on irrigation in Maharashtra, Tamil Nadu and Uttar Pradesh and on power in Haryana.

In this context, it should be noted that all the Finance Commissions since the Seventh have fixed certain normative rates of return for departmental and non-departmental enterprises of the states. In the case of a major departmental enterprise like irrigation, for example, while the seventh Finance Commission proposed that it should yield at least one per cent interest on the capital invested, the Eighth Finance Commission proposed that at least working expenses should be covered. The analysis of the rates of return shown in Table 3.14 shows not only that these norms have not been met but also that there was a further deterioration of the position in 1987-88 as compared to 1977-78. The loss on account of irrigation deteriorated from (-)2 per cent of the capital invested to (-)6 per cent over the period, the deterioration being particularly marked in Gujarat, Haryana, Karnataka, Punjab, Rajasthan and West Bengal.

The important non-departmental undertakings at the state level are electricity boards and road transport corporations. In the case of electricity boards, the eighth Finance Commission fixed the norm at 7 per cent rate of interest on capital invested. Although strict comparison with the Commission's norm is difficult⁸, it is quite evident that the rate of return declined in 1987-88 as compared to 1977-78 in a number of states, as well as in the aggregate. The decline in the rate

8. Certain adjustments have to be made before the rates are compared with the Finance Commission norms. In particular, capital outlay on work in progress and rural electrification should be deducted before computing the rate of return.

was particularly marked in Tamil Nadu and West Bengal. Even Punjab and Tamil Nadu generated very high negative rates of return. Similarly, the return from Road Transport Corporations declined from 3 per cent in 1977-78 to (-2) per cent in 1987-88.⁹ The deterioration in rates of return occurred in all states except Andhra Pradesh and was particularly sharp in Gujarat, Orissa, Punjab and West Bengal.

CONCLUSIONS

The search for policy options to correct fiscal imbalances in India calls for a careful analysis of budgetary subsidies, with a view to making them more transparent and facilitating better targeting. Benefits to intended beneficiaries of a tax-transfer system can be provided either through pure income transfers or through subsidies on goods and services. Direct transfer payments are transparent, and their beneficiaries are explicitly targeted. As a pure redistributive device, this should be the preferred policy instrument. However, if the intention is to induce higher absorption of specific public services, specific subsidies would be necessary. The problem with this, however, is that the total volume of subsidies involved is often not known. Its allocative and distributive implications remain unclear, and therefore, targeting and avoiding unintended distributional or allocative effects, difficult.

In this context, the following important conclusions which emerge from our analysis of non-tax revenues and budgetary subsidies should be noted.

- (i) The states have not used non-tax revenues except cess and royalty on mines and minerals as a significant source of finance. Non-tax revenues formed not only a low and declining share in states' revenues but have also been highly volatile.
- (ii) The estimated total volume of subsidies in the 14 major states in 1987-88 amounted to a staggering Rs 27,463 crore, or 8.3 per cent of GDP. Since the growth of recoveries lagged behind increases in expenditures, subsidies increased at a phenomenal rate of 18 per cent per year between 1977-78 and 1987-88. Per capita subsidies at constant prices increased at an annual rate of 6 per cent in the case of social services and almost 8 per cent in the case of economic services. In all the

9. The Eighth Commission had set the norm at 3 per cent rate of return.

states, subsidies formed a high and increasing proportion of the cost of public services.

- (iii) One major reason for the high rate of growth of subsidies was the rising share of expenditure on social services, which generally have very low recovery rates. However, a more disturbing reason was the declining rate of cost recoveries both in social and in economic services. The decline was sharper in the case of economic services, and therefore, subsidies on these services grew at a faster rate than those on social services even though expenditures on the latter increased more rapidly. Declining recovery rates was a common feature across all the states though, of course, the magnitudes have varied.
- (iv) At present the distribution of subsidies appears to be highly inequitable. In the interregional dimension, federal transfer policies have failed to adequately offset low revenue raising capacities of poorer states. As a consequence, per capita subsidies were much higher in the better off states. Particularly in the case of social services, if higher subsidies were associated with higher literacy, better health etc., it would be desirable that per capita subsidies in poorer states should gradually catch up with those in the richer states. But, there has been no improvement in the inter-state distribution of per capita subsidies over time.
- (v) Inequitable distribution of subsidies across states is reinforced by inequitable distribution within states. Better-off sections of population are appropriating a disproportionate share of subsidies, whether in education, agriculture, irrigation or power.
- (vi) The undesirable distributional effects of subsidies are compounded by undesirable resource allocation effects, e.g., in the underpricing of water for irrigation. Both types of adverse effects, which have worsened over time, call for a much wider application of the user charge concept to lend greater transparency to subsidies, combined with careful targeting of subsidies to intended beneficiaries in line with distributional and allocative objectives.
- (vii) In spite of the Finance Commissions fixing normative rates of return, the workings of both departmental and non-departmental undertakings have become increasingly unsatisfactory, as revealed by declining rates of return on states' investments. Again, there is a need for greater clarity regarding the policies or practical measures that should be set in

motion when public enterprises fail to meet even the minimum norms set by various Finance Commissions with regard to the rates of return. The issue requires urgent attention in view of the severe resource constraint faced by the states, its effect especially on the erosion of plan finance and the marginal contributions which non-tax revenues make at present to states' resource mobilisation.

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Table 3.1

**States' Own Revenue Receipts - Growth and Composition
All Major States**

	States' Own Revenue (Rs. lakh)		Share in Total Revenue (%)		Annual Average Growth Rate (%)
	1980-81	1988-89	1980-81	1988-89	(%)
1. States' Own Tax Revenue	645989	2135682	77.83	83.95	15.59
2. States' Own Non-Tax Revenue					
a. Administrative Receipts :					
(i) General Services	34636	53057	4.17	2.09	7.02
(ii) Social Services	24903	56378	3.00	2.22	9.36
of which					
Education	7136	12784	0.86	0.50	7.21
Medical, Public Health and Family Welfare	9001	14674	1.08	0.58	5.69
(iii) Economic Services	41273	178368	4.97	7.01	20.13
of Which					
Royalty and Cess on Minerals	11929	104563	1.44	4.11	30.08
b. Surplus(+)/ Deficit(-) of Departmental Enterprises	11973	-9767	1.44	-0.38	-54.58
c. Interest and Dividends from Non-Departmental Enterprises and Cooperatives	40432	77099	4.87	3.03	11.69
d. Other Interest Receipts*	30756	53801	3.71	2.11	11.23
2. Total Own Non-Tax Revenue#	172045	304374	20.73	11.96	7.39
\$	183974	408937	22.17	16.07	10.50
3. Total Revenue	829963	2544619	100.00	100.00	15.03

Note: # Excluding Royalty and Cess on Minerals

 \$ Including Royalty and Cess on Minerals

*Does not include interest receipts from departmental undertakings which are merely in the nature of book adjustments.

Table 3.2

**Variance of Revenue and Expenditure
All Major States**

	<i>Trend Coefficient</i>	<i>Variance</i>	<i>F-Statistic With Respect to Variance of States' Own Tax Revenue</i>	<i>F-Statistic With Respect to Variance of States' Expenditure</i>
1. States' Revenue				
Expenditure	0.1553	0.0003	-	-
2. States' Own Tax Revenue	0.1449	0.0006	-	-
3. States' Own Non- Tax Revenue				
a. Administrative Receipts:				
(i) General Services	0.0678	0.0180	28.5	61.5
(ii) Social Services	0.0895	0.0061	9.7	21.0
of which				
Education	0.0696	0.0024	3.8	8.3
Medical and Public Health and Family Welfare	0.0553	0.0056	8.8	19.0
(iii) Economic Services	0.1834	0.0015	2.4	5.1
of which				
Cess on Royalty	0.2630	0.0080	12.6	27.2
b. Surplus (+)/Deficit(-) of Departmental Enterprises	-0.7891	6.6008	10421.2	22507.8
c. Interest and Dividends from Non-Depart- mental Enterprises and Cooperatives	0.1105	0.0155	24.5	52.8
d. Other Interest Receipts*	0.1064	0.0203	32.1	69.3
4. Total Own Non-Tax Revenue#	0.0942	0.0016	2.4	5.3
\$	0.1331	0.0014	2.2	4.8
5. Total Revenue	0.1434	0.0005		-

Note: # Excluding Royalty and Cess on Minerals

 \$ Including Royalty and Cess on Minerals

*Does not include interest receipts from departmental undertakings which are merely in the nature of book adjustments.

Table 3.3

Inter-State Differences in Growth of Non-Tax Revenues

(per cent)

	Andhra Pradesh	Bihar	Gujarat	Haryana	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal	All States
I. Total Revenue Expenditure	17.66	15.42	17.96	17.04	16.81	16.10	17.51	16.75	14.90	16.72	18.76	15.88	17.63	16.75	16.79
II. Non-Plan Revenue Expenditure	16.77	13.89	18.39	16.77	16.01	16.76	16.95	15.24	13.34	16.44	16.34	15.07	16.89	14.60	15.95
III. States' Own Tax Revenue	17.81	14.34	15.09	15.66	16.47	16.31	16.40	15.36	16.88	13.47	16.87	14.57	15.01	15.19	15.59
States' Own Non-Tax Revenue															
a. Administrative Receipts :															
(i) General Services	11.65	20.03	13.69	14.23	7.69	-3.11	9.27	16.29	8.15	10.66	6.99	14.56	15.76	-16.08	7.02
(ii) Social Services	9.58	9.80	13.42	14.37	10.29	6.42	12.75	6.37	10.05	7.85	11.63	17.37	0.10	8.10	9.36
Education	8.65	6.21	12.79	14.03	7.89	10.64	2.09	10.75	-0.29	4.71	0.19	5.89	3.04	8.21	7.21
Medical and Public Health	8.95	5.02	8.78	10.84	7.56	3.01	8.94	0.17	4.16	5.82	8.44	14.78	7.62	2.92	5.69
(iii) Economic Services	20.96	36.50	20.68	11.07	16.08	10.62	17.92	11.75	17.69	7.22	10.05	12.18	15.11	3.43	20.13
Cess on Royalty	14.84	38.53	28.78	20.06	12.11	20.34	23.21	22.79	-22.01	12.92	21.13	11.18	13.54	21.13	30.08
b. Surplus (+) / Deficit (-) of Departmental Enterprises	-12.16	3.45	-45.01	11.21	-49.83	-23.13	6.04	-18.57	-7.38	-39.87	-32.45	-35.60	-48.07	-7.09	-54.58

	Andhra Pradesh	Bihar	Gujarat	Har- yana	Karna- taka	Kerala	Madhya Pradesh	Mahara- shtra	Orissa	Punjab	Rajas- than	Tamil Nadu	Uttar Pradesh	West Bengal	All States
c. Interest and Dividends from Non-Departmental Enterprises and Cooperatives	8.70	12.10	2.10	28.81	10.84	37.83	12.86	24.51	3.92	19.26	12.62	-5.68	17.29	15.14	11.69
d. Other Interest Receipts *	8.76	11.91	-8.58	51.63	11.94	42.06	12.80	25.69	29.59	21.84	-13.83	-6.48	50.43	1.77	11.23
IV. Total Own Non-Tax Revenue#	16.68	15.18	11.30	12.44	13.24	1.68	10.61	11.01	12.40	8.58	6.66	14.26	10.20	-0.64	9.88
	\$ 16.41	32.99	17.82	13.16	13.18	1.82	15.73	11.53	10.06	8.59	8.68	14.19	10.60	0.18	14.23
V. Total Revenue	17.68	20.14	15.46	15.48	16.12	14.14	16.29	15.02	14.81	13.17	14.63	14.52	14.60	13.89	15.42

Note: # Excluding Royalty and Cess on Minerals
 \$ Including Royalty and Cess on Minerals

*Does not include interest receipts from departmental undertakings which are merely in the nature of book adjustments.

Table 3.4

Budgetary Subsidies in the States

(Rs. lakh)

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	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88					
	Rate Per annum(%)	Rate Per annum(%)	Rate Per annum(%)	Rate Per annum(%)	Rate Per annum(%)	Rate Per annum(%)	Rate Per annum(%)	Rate Per annum(%)	%	Change					
High Income States															
Gujarat	54418	29995	18.61	43539	235752	18.40	9432	31088	12.67	34107	204663	19.62	21.77	13.19	-39.42
Haryana	23928	14370	19.63	20073	112291	18.79	6936	31655	16.40	13138	80635	19.89	34.55	28.19	-18.41
Maharashtra	110533	54190	17.23	78121	389488	17.43	27453	99409	13.73	50668	290079	19.06	35.32	25.52	-27.74
Punjab	39862	18495	16.59	33746	134719	14.85	5790	16476	11.02	27956	118243	15.51	17.52	12.23	-30.20
Aggregate-High Income States	228742	1170515	17.73	175480	872249	17.39	49612	178629	13.67	125868	693621	18.61	28.27	20.48	-27.56
Middle Income States															
Andhra Pradesh	80827	368463	16.38	67454	278998	17.12	13600	44743	12.65	43854	234255	18.24	23.67	16.04	-32.25
Karnataka	57347	291258	17.65	43455	214996	17.31	12570	39722	12.19	30884	175274	18.95	29.00	18.48	-36.29
Kerala	43595	187118	15.68	34164	131507	14.43	6760	13017	6.77	27404	118490	15.77	19.83	9.90	-50.07

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		1977-88		1987-88		1977-88		1987-88		1977-88		1987-88		1977-78		1987-88	
	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)	Rate Per annum(%)	Growth Rate Per annum(%)
Tamil Nadu	72965	348151	16.91	48065	260958	18.43	8385	22968	10.60	39680	237990	19.62	18.41	8.80	-52.19					
West Bengal	74007	301468	15.08	55133	214336	14.54	5903	12030	7.38	49230	202305	15.18	10.75	5.61	-47.81					
Aggregate-Middle Income States	328741	1496458	16.36	238271	1100795	16.55	47218	132481	10.87	191053	968315	17.66	19.82	12.03	-39.12					
Low Income States																				
Bihar	59566	346577	19.26	46632	257610	18.64	4513	13604	11.67	42119	244006	19.20	9.68	5.28	-45.44					
Madhya Pradesh	65483	344973	18.08	50557	262962	17.93	15317	51605	12.91	35239	211357	19.62	30.54	19.62	-35.73					
Orissa	36072	158588	15.96	28302	120339	15.57	7122	11850	5.22	21180	108489	17.75	25.17	9.85	-60.87					
Rajasthan	47876	273589	19.04	36109	197422	18.52	8204	23212	10.96	27905	174211	20.10	23.20	11.76	-49.33					
Uttar Pradesh	117231	545074	16.61	92581	400083	15.76	12133	51078	15.46	80447	319005	15.81	13.29	12.77	-3.95					
Aggregate-Low Income States	326227	1668801	17.73	254181	1238417	17.16	47290	151348	12.34	206890	1087068	18.05	18.61	12.22	-34.31					
All States	883710	4335773	17.24	667931	3211461	16.99	141120	462458	12.37	523811	2749003	18.02	21.77	14.41	-33.81					

Note: 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.

Table 3.5

Budgetary Subsidies in the States in 1987-88

<i>States</i>	<i>Per Capita Subsidy</i> <i>(Rs)</i>	<i>Share of Individual State's Subsidy in All States' Subsidy</i> <i>(Per cent)</i>	<i>Share of Individual State's Population in All States' Population</i> <i>(Per cent)</i>
High Income States			
1. Gujarat	529.94	7.45	5.3
2. Haryana	527.37	2.94	2.1
3. Maharashtra	406.67	10.56	9.8
4. Punjab	625.29	4.31	2.6
Aggregate High Income States	481.18	25.26	19.8
Middle Income States			
1. Andhra Pradesh	388.55	8.53	8.3
2. Karnataka	406.79	6.28	5.8
3. Kerala	416.19	4.31	3.9
4. Tamil Nadu	443.60	8.67	7.4
5. West Bengal	327.51	7.37	8.5
Aggregate Middle Income States	391.57	35.16	33.9
Low Income States			
1. Bihar	305.01	8.88	11.0
2. Madhya Pradesh	353.38	7.70	8.2
3. Orissa	367.14	3.95	4.1
4. Rajasthan	429.20	6.34	5.6
5. Uttar Pradesh	275.94	12.71	17.4
Aggregate Low Income States	323.12	39.58	46.3
All States	377.66	100.00	100.0

Note: To estimate per capita subsidies, mid-year population estimates of Registrar General of India are employed.

Table 3.6

**Relative Shares of States in Budgetary Subsidy
1977-78 and 1987-88**

(per cent)

States	Share in Total Subsidy		
	1977-78	1987-88	Difference
High Income States			
Gujarat	6.51	7.45	0.94
Haryana	2.51	2.94	0.43
Maharashtra	9.67	10.56	0.89
Punjab	5.34	4.31	-1.03
Aggregate High Income States	24.03	25.26	1.23
Middle Income States			
Andhra Pradesh	8.37	8.53	0.16
Karnataka	5.90	6.28	0.39
Kerala	5.23	4.31	-0.92
Tamil Nadu	7.58	8.67	1.09
West Bengal	9.40	7.37	-2.03
Aggregate Middle Income States	36.47	35.16	-1.31
Low Income States			
Bihar	8.04	8.88	0.84
Madhya Pradesh	6.73	7.70	0.97
Orissa	4.04	3.95	-0.09
Rajasthan	5.33	6.34	1.02
Uttar Pradesh	15.36	12.71	-2.65
Aggregate Low Income States	39.50	39.58	0.09
All States	100.00	100.00	

Table 3.7

State-Wise Details of Budgetary Subsidies in Social Services (1987-88)

	Andhra Pradesh	Bihar	Gujarat	Haryana	Kerala	Maharashtra	Madhya Pradesh	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal	All States
I. Education														
(i) Total Subsidy (Rs. lakh)	67597	77455	57677	22092	56119	50782	53079	104998	29076	33390	47238	65336	94197	830925
(ii) Per Capita Subsidy (Rs.)	112.12	96.82	149.34	144.49	132.29	178.37	88.75	147.20	98.40	176.57	116.38	121.78	74.48	114.27
(iii) Share of Total State Subsidy (%)	28.86	31.74	28.18	27.40	32.52	42.86	25.11	36.20	26.80	28.24	27.12	27.45	26.99	30.26
(iv) Recovery Rate (%)	1.92	0.26	1.08	2.91	1.69	3.37	0.66	0.97	1.37	0.71	0.57	1.95	2.18	0.82
(v) Literacy Rate (%)	29.90	26.20	43.70	36.10	38.50	70.40	27.90	47.20	34.20	40.90	24.40	46.80	27.20	40.90
Medical and Public Health														
(i) Total Subsidy (Rs. lakh)	22331	17511	14187	6376	17998	13557	19019	31945	9529	10658	15139	20046	37180	259120
(ii) Per Capita Subsidy (Rs.)	37.04	21.89	36.74	41.70	42.43	47.62	31.80	44.78	32.25	56.36	37.30	37.36	29.40	35.63
(iii) Share of Total State Subsidy (%)	9.53	7.18	6.93	7.91	10.43	11.44	9.00	11.01	8.78	9.01	8.69	8.42	10.65	9.44
(iv) Recovery Rate (%)	1.36	1.98	3.73	1.16	2.37	2.79	3.73	1.71	0.41	2.29	0.76	8.83	3.19	1.26
(v) Infant Mortality Rates (per 1000 Births)	82	101	107	85	74	27	118	63	123	68	107	90	132	71

	Andhra Pradesh	Bihar	Gujarat	Haryana	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal	All States
3. Water Supply and Sanitation and Housing															
(i) Total Subsidy (Rs. lakh)	16732	11528	19770	5764	10385	8943	22463	32714	8236	5957	16814	18268	16864	16678	211117
(ii) Per Capita Subsidy (Rs.)	27.75	14.41	51.19	37.70	24.48	31.41	37.56	45.86	27.87	31.50	41.42	34.05	13.33	27.00	29.03
(iii) Share of Total State Subsidy (%)	7.14	4.72	9.66	7.15	6.02	7.55	10.63	11.28	7.59	5.04	9.65	7.68	4.83	8.24	7.69
(iv) Recovery Rate (%)	3.15	1.66	5.71	7.22	2.66	1.18	4.94	7.21	5.39	5.82	20.41	5.28			5.93
4. Other Social Services															
(i) Total Subsidy (Rs. lakh)	25476	7460	11182	2709	12174	6420	18225	11835	8685	2939	3268	10735	22209	9484	152802
(ii) Per Capita Subsidy (Rs.)	42.26	9.33	28.95	17.72	28.70	22.55	30.47	16.59	29.39	15.54	8.05	20.01	17.56	15.35	21.01
(iii) Share of Total State Subsidy (%)	10.88	3.06	5.46	3.36	7.06	5.42	8.62	4.08	8.01	2.49	1.88	4.51	6.36	4.69	5.56
(iv) Recovery Rate (%)	3.51	9.60	10.49	6.52	4.33	2.35	3.59	10.44	1.93	11.57	5.70	8.50	3.95	1.13	5.42
5. All Social Services															
(i) Total Subsidy (Rs. lakh)	132138	113954	102817	36941	96676	79702	112786	181491	55527	52944	82459	114385	170449	121697	1453963
(ii) Per Capita Subsidy (Rs.)	219.17	142.44	265.23	241.60	227.90	279.95	188.57	254.44	187.91	279.98	203.15	213.21	134.76	197.02	199.95
(iii) Share of Total State Subsidy (%)	56.41	46.70	50.24	45.81	56.02	67.26	53.36	62.57	51.18	44.78	47.33	48.06	48.84	60.15	52.94
(iv) Recovery Rate (%)	2.29	1.34	3.46	3.59	2.33	2.95	2.54	2.94	1.91	2.2	95.61	4.39	2.53	1.18	2.75

Note: Estimates of literacy rates are according to 1981 census.

Estimates of infant mortality rates are taken from Sample Registration System, Registrar General of India.

Table 3.8

Per capita Subsidy in Social Services at Constant Prices

		Per capita Subsidy at Constant (1977-78) Prices (Rs.)																			
		Education				Health				Water Supply, Sanitation and Housing				Other Social Services				All Social Services			
		1977-78		1987-88		1977-78		1987-88		1977-78		1987-88		1977-78		1987-88		1977-78		1987-88	
		Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth	Rate(%)	Growth
Andhra Pradesh	30.18	51.38	5.47	10.89	16.98	4.54	4.41	12.72	11.18	8.13	19.37	9.06	53.62	100.44	6.48						
Bihar	20.28	44.37	8.14	4.45	10.03	8.46	2.99	6.60	8.25	2.23	4.27	6.71	29.95	65.28	8.10						
Gujarat	42.48	68.44	4.88	12.68	16.84	2.87	6.07	23.46	14.47	5.25	13.27	9.72	66.49	122.01	6.26						
Haryana	36.80	66.22	6.05	15.16	19.11	2.35	2.97	17.28	19.25	3.66	8.12	8.30	58.58	110.73	6.57						
Karnataka	34.54	60.63	5.79	11.48	19.44	5.41	3.69	11.22	11.75	4.61	13.15	11.05	54.32	104.45	6.76						
Kerala	57.93	81.75	3.50	15.03	21.82	3.80	6.38	14.40	8.49	2.56	10.33	14.98	81.90	128.30	4.59						
Madhya Pradesh	24.88	40.67	5.04	9.41	14.57	4.47	4.69	17.21	13.88	6.15	13.96	8.55	45.12	86.42	6.71						
Maharashtra	40.44	67.46	5.25	10.18	20.52	7.26	10.61	21.02	7.07	2.37	7.60	12.35	63.61	116.61	6.25						
Orissa	26.89	45.09	5.30	9.65	14.78	4.35	5.43	12.77	8.93	4.85	13.47	10.76	46.82	86.12	6.28						
Punjab	51.76	80.92	4.57	16.04	25.83	4.88	11.27	14.44	2.51	9.61	7.12	-2.95	88.68	128.31	3.76						
Rajasthan	32.33	53.34	5.13	12.40	17.09	3.26	5.58	18.98	13.02	0.63	3.69	19.25	50.95	93.10	6.21						
Tamil Nadu	33.48	55.81	5.24	12.55	17.12	3.16	6.11	15.60	9.84	1.00	11.43	27.59	50.87	97.71	6.74						
Uttar Pradesh	23.42	34.13	3.94	7.76	13.47	5.67	2.06	6.11	11.46	2.63	8.05	11.82	35.88	61.76	5.58						
West Bengal	29.29	53.34	6.18	13.23	17.54	2.86	9.74	12.37	2.42	3.85	7.04	6.23	56.11	90.29	4.87						
All States	31.39	52.37	5.25	10.34	16.33	4.67	5.47	13.31	9.29	3.56	9.63	10.47	50.76	91.63	6.08						

Table 3.9

Recovery Rates in Social Services

	per cent)											
	Education		Health		Water Supply, Sanitation and Housing		Other Social Services		All Social Services			
	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88		
Andhra Pradesh	2.76	1.92	1.83	1.36	18.35	3.15	3.74	3.51	4.23	2.29		
Bihar	1.58	0.26	18.05	1.98	4.56	1.66	10.89	9.60	5.43	1.34		
Gujarat	1.28	1.08	5.65	3.73	12.77	5.71	16.87	10.49	4.68	3.46		
Haryana	4.34	2.91	2.76	1.16	15.65	7.22	14.08	6.52	5.25	3.59		
Karnataka	3.87	1.69	3.72	2.37	20.78	2.66	5.04	4.33	5.31	2.33		
Kerala	4.76	3.37	2.78	2.79	12.75	1.18	6.05	2.35	5.12	2.95		
Madhya Pradesh	1.56	0.66	3.31	3.73	14.74	4.94	3.55	3.59	3.74	2.54		
Maharashtra	1.14	0.97	8.13	1.71	19.37	7.21	20.58	10.44	6.65	2.94		
Orissa	6.41	1.37	0.93	0.41	12.08	5.39	13.59	1.93	6.84	1.91		
Punjab	1.65	0.71	8.35	2.29	5.55	5.82	5.53	11.57	3.85	2.29		
Rajasthan	2.91	0.57	2.75	0.76	35.01	20.41	27.56	5.70	8.22	5.61		
Tamil Nadu	6.33	1.95	2.46	8.83	11.04	5.28	-38.94	8.50	6.76	4.39		
Uttar Pradesh	3.51	2.18	5.40	3.19	5.30	1.14	6.86	3.95	4.28	2.53		
West Bengal	0.64	0.82	3.17	1.26	3.03	2.63	5.31	1.13	1.99	1.18		
All States	2.89	1.41	4.85	2.73	13.81	5.93	9.24	5.42	5.05	2.75		

Table 3.10

State-Wise Details of Subsidies in Education

Sub-Sector Under Education	Andhra Pradesh	Bihar	Gujarat	Haryana	Karnataka	Kerala	Madhya Pradesh	Madhya Pradesh	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal	All States
I. Literacy Rate (per cent) 1981	29.90	26.20	43.70	36.10	38.50	70.40	27.90	47.20	34.20	40.90	24.10	46.80	27.20	40.90	36.20
II. Total Education Subsidy (Rs. lakh)															
1977-78	15271	13320	13707	4857	12184	14828	12767	23571	7105	8129	10350	15824	24279	15996	187999
1987-88	70305	80714	61047	24393	58874	54034	54915	111380	30461	36070	49681	67967	90622	74498	870961
III. a. Share of Subsidy in Education 1977-78 (Per cent)															
(i) Primary Education	43.60	62.26	54.88	35.50	52.75	55.60	46.27	46.07	39.45	36.12	54.50	49.01	47.82	37.10	49.11
(ii) Secondary Education	27.34	15.70	27.09	35.92	21.41	22.68	32.43	33.85	35.83	42.39	25.53	32.95	31.34	36.00	30.45
(iii) Higher, Agricultural, Medical, Technical and Other Education	29.06	22.04	18.02	28.58	25.84	21.72	21.30	20.07	24.72	21.50	19.97	18.04	20.84	26.90	20.45
III. b. Share of Subsidy in Education 1987-88 (Per cent)															
(i) Primary Education	44.85	55.05	48.49	35.69	49.27	48.12	55.60	43.31	54.72	30.53	49.10	43.93	47.13	38.01	46.37
(ii) Secondary Education	26.48	18.96	31.34	35.50	27.59	26.27	22.06	35.83	21.56	43.19	31.56	35.11	35.03	37.63	30.74
(iii) Higher, Agricultural, Medical, Technical and Other Education	28.67	25.99	20.17	28.81	23.14	25.62	22.34	20.86	23.73	26.29	19.34	20.95	17.84	24.37	22.89

<i>Sub-Sector Under Education</i>	<i>Andhra Pradesh</i>	<i>Bihar</i>	<i>Gujarat</i>	<i>Haryana</i>	<i>Karnataka</i>	<i>Kerala</i>	<i>Madhya Pradesh</i>	<i>Maharashtra</i>	<i>Orissa</i>	<i>Punjab</i>	<i>Rajasthan</i>	<i>Tamil Nadu</i>	<i>Uttar Pradesh</i>	<i>West Bengal</i>	<i>All States</i>
IV. a. Cost Recovery Rate 1977-78 (per cent)															
(i) Primary Education	0.08	0.17	0.29	0.32	0.79	0.05	0.00	0.50	0.00	0.27	2.74	0.00	0.19	0.13	0.38
(ii) Secondary Education	6.85	0.11	0.67	7.39	9.81	10.20	0.83	0.58	6.47	1.86	2.69	2.22	5.98	0.34	3.64
(iii) Higher, Agricultural, Medical, Technical and Other Education	2.56	6.13	4.92	3.41	4.23	9.59	5.83	3.66	3.53	3.48	3.82	5.01	6.56	1.76	6.74
(iv) Total Education	2.73	1.54	1.26	3.83	3.75	4.67	1.56	1.18	3.28	1.65	1.83	1.82	3.43	0.65	2.30
IV. b. Cost Recovery Rate 1987-88 (per cent)															
(i) Primary Education	0.47	0.01	0.32	3.48	0.00	0.25	0.00	0.15	1.25	0.05	0.36	0.02	0.11	0.02	0.26
(ii) Secondary Education	4.38	0.23	0.34	2.80	4.73	6.32	0.20	0.24	0.00	1.06	0.58	2.82	3.93	0.09	2.00
(iii) Higher, Agricultural, Medical, Technical and Other Education	1.36	0.30	5.23	2.13	0.00	7.34	1.63	0.61	1.87	0.99	0.83	2.92	0.13	1.30	1.68
(iv) Total Education	1.92	0.26	1.08	2.91	1.69	3.37	0.66	0.97	1.37	0.71	0.57	1.95	2.18	0.82	1.14

Note: 'Total Education' includes agricultural and medical education.

Table 3.11

State-Wise Details of Budgetary Subsidies in Economic Services

	Andhra Pradesh	Bihar	Gujarat	Haryana	Karnataka	Kerala	Madhya Pradesh	Maharastra	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal	All States
1. Agriculture and Allied Services															
a. Total Subsidy (Rs. Lakh)	53525	36786	36479	11937	25155	11112	10981	40082	12770	11760	23080	43483	57515	31868	406530
b. Per Capita Subsidy (Rs.)	88.78	45.98	94.46	78.07	59.30	39.03	18.36	56.19	43.21	62.19	56.86	81.05	45.47	51.59	55.90
c. Share of State Subsidy (%)	22.85	15.08	17.82	14.80	14.58	9.38	5.20	13.82	11.77	9.95	13.26	18.27	16.48	15.75	14.80
d. Recovery Rate (%)	11.49	17.26	12.07	10.82	27.95	32.25	77.50	56.19	35.17	11.33	6.88	18.06	17.79	13.96	28.57
2. Irrigation															
a. Total Subsidy (Rs. Lakh)	37781	57109	42386	18810	34690	14202	49791	41210	26839	18440	36442	10579	63331	18873	470481
b. Per Capita Subsidy (Rs.)	62.67	71.39	109.75	123.02	81.78	49.88	83.25	57.77	90.82	97.51	89.78	19.72	50.07	30.55	64.70
c. Share of State Subsidy (%)	16.13	23.40	20.71	23.33	20.10	11.99	23.56	14.21	21.74	15.59	20.92	4.45	18.15	9.33	17.13
d. Recovery Rate (%)	21.51	2.24	30.05	26.30	26.01	7.03	3.51	39.24	2.52	18.09	21.15	29.82	25.74	12.88	20.60

	Andhra Pradesh	Bihar	Gujarat	Haryana	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal	All States
3. Power and Energy															
a. Total Subsidy (Rs. Lakh)	3923	15089	9672	6315	-400	-466	11441	9615	825	25134	9104	38425	27547	7113	163338
b. Per Capita Subsidy (Rs.)	6.51	18.86	25.04	41.30	-0.94	-1.64	19.13	13.48	2.79	132.91	22.43	71.62	21.78	11.52	22.46
c. Share of State Subsidy (%)	1.67	6.18	4.73	7.83	-0.23	-0.39	5.41	3.31	0.76	21.26	5.23	16.15	7.89	3.52	5.95
d. Recovery Rate (%)	73.34	0.25	0.03	56.68	104.21	125.49	38.95	58.96	69.68	5.74	0.85	0.00	0.04	5.61	26.48
4. Industry and Minerals															
a. Total Subsidy (Rs. Lakh)	5140	6566	6378	1251	8161	4216	5743	7325	4439	2859	2856	7043	2052	6441	70470
b. Per Capita Subsidy (Rs.)	8.53	8.21	16.51	8.18	19.24	14.81	9.60	10.27	15.02	15.12	7.04	13.13	1.62	10.43	9.69
c. Share of State Subsidy (%)	2.19	2.69	3.12	1.55	4.73	3.56	2.72	2.53	4.09	2.42	1.64	2.96	0.59	3.18	2.57
d. Recovery Rate (%)	39.73	24.16	19.61	9.66	26.22	8.20	5.81	9.64	11.06	13.99	45.88	23.15	82.38	15.98	28.39

	Andhra Pradesh	Bihar	Gujarat	Har- yana	Karna- taka	Kerala	Madhya Pradesh	Orissa	Punjab	Raja- sshan	Tamil Nadu	Uttar Pradesh	West Bengal	All States	
5. Transport and Communication															
a. Total Subsidy (Rs. Lakh)	9290	13189	5988	5385	10924	9150	20011	9983	7787	7164	21818	11761	27212	14875	174537
b. Per Capita Subsidy (Rs.)	15.41	16.49	15.51	35.22	25.75	32.14	33.46	14.00	26.35	37.88	53.75	21.92	21.51	24.08	24.00
c. Share of State Subsidy (%)	3.97	5.41	2.93	6.68	6.33	7.72	9.47	3.44	7.18	6.06	12.52	4.94	7.80	7.35	6.36
d. Recovery Rate (%)	11.36	1.72	2.25	69.88	0.71	4.35	3.66	5.83	3.01	48.76	0.30	8.28	2.84	3.32	12.71
6. Total Economic Services															
a. Total Subsidy (Rs. Lakh)	102118	130052	101847	43694	78598	38788	98571	108588	52962	65299	91752	123605	178556	80609	1295040
b. Per Capita Subsidy (Rs.)	169.38	162.57	263.72	285.77	185.29	136.21	164.81	152.23	179.23	345.32	226.05	230.39	141.17	130.50	178.09
c. Share of State Subsidy (%)	43.59	53.30	49.76	54.19	45.55	32.74	46.64	37.43	48.82	55.22	52.67	51.94	51.16	39.85	47.16
d. Recovery Rate (%)	28.97	8.49	21.20	40.93	32.29	21.45	33.05	46.37	16.90	18.92	16.64	12.53	20.71	11.60	24.64

Table 3.12

Per Capita Subsidy in Economic

	Per capita Subsidy at								
	Agriculture and Allied Services			Irrigation			Power and Energy		
	1977-78	1987-88	Growth rate(%)	1977-78	1987-88	Growth rate(%)	1977-78	1987-88	Growth rate(%)
Andhra Pradesh	10.41	40.69	14.61	16.32	28.72	5.81	-0.64	2.98	NA
Bihar	8.45	21.07	9.57	19.10	32.72	5.53	2.03	8.64	15.58
Gujarat	12.70	43.29	13.04	18.50	50.30	10.52	1.00	13.83	30.04
Haryana	16.02	35.78	8.37	16.07	56.38	13.38	8.17	18.93	8.76
Karnataka	9.56	27.18	11.02	17.48	37.48	7.93	-0.38	-0.43	NA
Kerala	1.33	17.89	29.67	11.67	22.86	6.96	2.40	-0.75	NA
Madhya Pradesh	-0.69	8.41	NA	14.25	38.15	10.35	2.79	8.77	12.12
Maharashtra	0.76	25.75	42.29	14.28	26.48	6.37	0.46	6.18	29.79
Orissa	11.05	19.81	6.01	11.70	41.62	13.54	-4.81	1.28	-12.40
Punjab	28.65	28.50	-0.05	34.34	44.69	2.67	18.08	60.91	12.92
Rajasthan	10.03	26.06	10.01	18.21	41.15	8.49	3.39	10.28	11.72
Tamil Nadu	8.21	37.14	16.29	9.47	9.04	-0.47	5.96	32.82	18.60
Uttar Pradesh	14.58	20.84	3.64	16.07	22.95	3.25	6.05	9.98	5.14
West Bengal	12.19	23.64	6.85	13.49	14.00	0.37	1.29	5.28	15.10
All States	9.30	25.62	10.67	15.88	29.65	6.45	3.06	10.29	12.88

Services at Constant(1977-78) Prices

<i>Constant(1977-78) Prices (Rs.)</i>											
<i>Industry and Minerals</i>			<i>Transport and Communication</i>			<i>Other Economic Services</i>			<i>Total Economic Services</i>		
<i>1977-78</i>	<i>1987-88</i>	<i>Growth rate(%)</i>	<i>1977-78</i>	<i>1987-88</i>	<i>Growth rate(%)</i>	<i>1977-78</i>	<i>1987-88</i>	<i>Growth rate(%)</i>	<i>1977-78</i>	<i>1987-88</i>	<i>Growth rate(%)</i>
3.09	3.91	2.38	7.98	7.06	-1.22	-0.34	-5.73	NA	36.82	77.62	7.74
1.57	3.76	9.15	3.98	7.56	6.62	0.96	0.75	-2.43	36.09	74.50	7.52
1.55	7.57	17.20	13.87	7.11	-6.47	0.10	1.12	27.09	44.86	120.86	10.42
2.22	3.75	5.40	15.80	16.14	0.22	-2.72	-0.01	NA	55.55	130.97	8.96
3.77	8.82	8.86	7.30	11.80	4.92	0.90	0.07	-22.09	38.63	84.92	8.20
4.14	6.79	5.06	9.83	14.73	4.13	1.31	0.92	-3.43	30.69	62.44	7.36
1.58	4.40	10.80	8.33	15.33	6.29	0.41	0.46	1.25	26.67	75.53	10.97
2.92	4.71	4.89	6.88	6.41	-0.70	-0.11	0.24	NA	25.19	69.77	10.72
2.42	6.88	11.03	7.69	12.08	4.61	-0.27	0.47	NA	37.39	82.14	8.19
3.45	6.93	7.21	12.37	17.36	3.45	-0.03	-0.14	NA	96.86	158.26	5.03
-1.42	3.22	NA	8.73	24.63	10.93	1.50	-1.75	NA	40.45	103.60	9.86
3.99	6.02	4.18	8.53	10.05	1.66	0.95	10.52	27.20	37.12	105.59	11.02
1.94	0.74	-9.14	6.31	9.86	4.56	-0.17	0.33	NA	45.37	64.70	3.61
2.94	4.78	4.98	8.40	11.04	2.77	0.73	1.07	3.89	39.04	59.81	4.36
2.37	4.44	6.48	7.90	11.00	3.36	0.30	0.61	7.18	38.82	81.62	7.71

Table 3.13

Recovery Rates in Economic Services

	Agriculture and Allied Services		Irrigation		Power and Energy		Industry and Minerals		Transport and Communication		Total Economic Services	
	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88
Andhra Pradesh	36.77	11.49	34.71	21.51	109.21	73.34	20.18	39.73	7.63	11.36	41.09	28.97
Bihar	28.35	17.26	6.62	2.24	0.00	0.25	2.99	24.16	4.53	1.72	12.92	8.49
Gujarat	31.95	12.07	37.35	30.05	131.64	0.03	40.49	19.61	12.65	2.25	38.03	21.20
Haryana	22.25	10.82	57.62	26.30	0.00	56.68	7.68	9.66	64.21	69.88	50.65	40.93
Karnataka	54.45	27.95	34.69	26.01	107.40	104.21	65.90	26.22	5.82	0.71	47.38	32.29
Kerala	91.75	32.25	10.24	7.03	57.89	125.49	8.67	8.20	5.35	4.35	43.21	21.45
Madhya Pradesh	102.86	77.50	6.95	3.51	49.26	38.95	14.17	5.81	4.38	3.66	52.48	33.05
Maharashtra	97.50	56.19	35.51	39.24	91.61	58.96	-1.17	9.64	7.70	5.83	63.37	46.37
Orissa	45.32	35.17	53.49	2.52	5.22	69.68	9.50	11.06	7.52	3.01	39.95	16.90
Punjab	12.44	11.33	16.17	18.09	0.00	5.74	25.73	13.99	63.45	48.76	26.47	18.92
Rajasthan	20.81	6.88	39.92	21.15	0.00	0.85	130.01	45.88	0.43	0.30	35.55	16.64
Tamil Nadu	47.77	18.06	23.92	29.82	2.04	0.00	15.10	23.15	14.62	8.28	28.65	12.53
Uttar Pradesh	26.03	17.79	18.10	25.74	0.94	0.04	23.23	82.38	10.78	2.84	19.01	20.71
West Bengal	32.84	13.96	14.01	12.88	0.00	5.61	20.33	15.98	2.46	3.32	20.82	11.60
All States	52.05	28.57	26.57	20.60	40.85	26.48	32.88	28.39	17.85	12.71	36.12	24.64

(per cent)

Table 3.14

Rates of Return of Public Enterprises

	(per cent)													
	Departmental Enterprises				Non-Departmental Enterprises				Cooperatives				All Public Enterprises	
	Irrigation		All Departmental Enterprises		Electricity		Transport		All Non-Departmental Enterprises		Cooperatives		All Public Enterprises	
1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	1977-78	1987-88	
Andhra Pradesh	-3.98	-3.14	-3.44	-8.24	5.72	15.23	4.87	5.07	4.47	8.22	-2.37	-6.01	0.17	-3.30
Bihar	-1.17	-3.92	0.17	-1.94	2.84	1.24	0.00	0.02	2.11	1.63	-6.43	-4.56	0.43	-0.99
Gujarat	-3.13	-16.37	-2.62	-14.17	15.31	5.05	4.73	-0.09	12.68	3.52	-1.60	-8.11	3.46	-3.61
Haryana	-0.94	-10.26	-1.46	-11.88	2.67	3.17	9.99	7.85	3.37	2.78	3.41	0.62	1.36	-2.74
Karnataka	-1.32	-7.32	1.44	-7.21	7.19	10.32	3.92	0.00	5.85	7.61	-1.35	-3.54	3.15	-0.86
Kerala	-2.92	-3.42	14.74	-1.39	4.83	23.60	1.71	-1.68	3.16	6.58	-0.82	-9.88	6.57	1.73
Madhya Pradesh	0.42	-2.62	10.74	1.27	3.44	7.58	6.37	0.00	3.24	8.18	0.12	-0.82	6.88	3.94
Maharashtra	-1.94	-3.25	0.87	-2.07	10.38	11.65	5.21	2.81	8.62	9.16	-2.41	0.65	3.96	3.13
Orissa	0.50	-2.39	3.95	-0.04	2.03	29.68	7.31	0.01	1.87	12.72	-1.02	-2.20	3.03	3.42
Punjab	-3.44	-8.18	-4.18	-9.34	1.54	-3.04	8.56	-11.49	2.89	-2.48	-2.50	-0.25	0.55	-3.98
Rajasthan	-1.67	-12.32	2.11	-14.89	1.44	3.60	1.13	0.12	-2.39	3.11	-4.13	-2.35	0.31	-7.28
Tamil Nadu	-6.51	-8.69	-3.80	-6.16	-3.90	14.14	5.75	1.66	-3.50	-20.84	-0.68	-7.22	-3.27	-16.48
Uttar Pradesh	-1.88	-6.76	1.67	-4.92	0.58	1.07	6.73	-0.17	0.96	0.95	-3.29	14.32	1.00	-0.79
West Bengal	-6.50	-17.92	-6.37	-20.34	13.17	2.32	-4.21	-9.62	4.73	-1.25	-4.25	-13.71	-1.01	-6.51
All States	-2.19	-6.37	0.77	-5.67	4.15	3.64	3.02	-1.88	3.48	1.88	-2.18	-2.03	1.83	1.79

Chapter 4

Local Government Finances: Trends, Issues and Reforms

ABHIJIT DATTA

An understanding of the effectiveness of local government is incomplete without an insight into its financial arrangements and practices. In India, this is somewhat complicated due to divergent institutional features of rural and urban local government systems. Data limitations render the task more difficult: information on the finances of rural local governments is almost completely lacking, and coverage of financial data on urban local governments is inadequate. Some information is available from periodic official reports; but these are neither up-to-date nor even complete. Paucity of local government financial data results from a lack of effective demand due to (1) confusion on the role of local government; (2) lack of understanding of its institutional status; and (3) limited financing of the necessary statistical work.

GENERAL BACKGROUND

Role and Status

Indian local government has a colonial past; it was introduced toward the end of the last century to provide relief to the Imperial exchequer by financing essential community services out of local taxation, supplemented by limited grants for social services and rural works. Local governments were created as delegated authorities of the central (later provincial) government. Within their delegated sphere the local authorities were to be autonomous and rarely interfered with.

After independence in 1947, following an influential report chaired by Balwantraj Mehta (India, 1957), rural local government, called *panchayati raj* institutions (PRI), was completely reorganised and modelled on the Soviet pattern. The divergence of the PRI in the rural areas from the generic system of local government in the urban areas, called the municipal authorities (MA), occurred with the implementation of the Mehta report in the 1960s. A marked change in state-local relations also took place through increased centralization, with the adoption of the Soviet system of planning and resource mobilization. Since the MAs remained outside this arrangement, they were left to their own devices to meet their increased fiscal needs.

As a corollary to the general trend of centralization, local governments have been subjected to arbitrary supersessions. About half of the local authorities in the country since independence have been superseded at any point of time. All local authorities have had this fate at one time or another, sometimes lasting for more than a decade. This problem was sought to be controlled by conferring constitutional status to local governments through two bills which, however, failed to secure the required majority in the Parliament (India, 1989b).

Organizational System

During the colonial era, local authorities were of five types: three in the urban areas (municipal corporations, municipal councils, and town or notified area authorities) and two in the rural areas (district boards and union boards). All of these authorities functioned separately and were directly controlled by the state governments. The PRIs are layered on the Soviet pattern, where the lower tier is organically linked with the next higher tier: *gram panchayats* at the village level, *anchal* (or *taluk* or *mandal*) *panchayats* at the area (or block) level, and the *zila parishads* at the district level. The PRIs are attached to the states' field administration, while the MAs continue to be detached from the states, as their English counterparts. (The present numbers of different types of local authorities are shown in Table 4.1).

Administrative, financial, and executive control of local governments by higher levels -- based on a distrust of their elected councillors -- was a feature of colonial local government in India. Further tightening occurred after independence. State government cadres of officials occupy key positions in local government, while the local executive functionary is a state-appointed civil servant. The only exception to this arrangement is the municipal councils in a few states, where the chief executive functionary is the elected chairman

(weak-mayor), and the municipal corporations in West Bengal with a cabinet-type executive headed by an elected mayor (strong-mayor).

Operational control over local authorities stems from the states' power of approval and sanction of both administrative and financial decisions, as well as the parallel delivery of local services and usurpation of local tax powers by the states. The concept of autonomy in local government decisionmaking is thus severely limited, both in law and in practice.

LOCAL GOVERNMENT FUNCTIONS AND FINANCES

The relative importance of local government in a country is usually judged by the share of its expenditure in total government expenditure; the accepted norm in the developed countries ranges between 20 per cent and 29 per cent (Marshall, 1969). India is well below the norm, with local government accounting for only 8.6 per cent of total government expenditure in 1976-77 and 6.4 per cent in 1986-87 (Table 4.2), even though during the same period its share in GNP rose from 1.6 per cent to 2.1 per cent. A minimum target of 15 per cent of total expenditure for local government is desirable and achievable if the proposed 1989 bills are passed, allowing for the federal nature of the Indian polity. The desired increase in the ratio of local government expenditure to GNP should be at the expense of the central government rather than that of the states.

Functions

Functional delegation of powers to local governments is made in terms of the English doctrine of *ultra-vires* -- meaning that the local authorities are to operate strictly within the scope of delegated functions. Most municipal legislations, however, contain a general clause to cover local welfare and well-being, and this residual functional delegation could approach the continental doctrine of "general competence". Nevertheless, state governments are not averse to undertaking parallel local functions without amending local government legislations. Another peculiar aspect is a process of division of labor between state and local government functions in terms of development and maintenance, whereby local authorities are supposed to take over state-financed projects for operation and maintenance using their own resources. This is fairly common in metropolitan and district development, creating undue financial strain on the fragile revenue base of local governments and distorting local expenditure priorities.

The narrow range of functional jurisdictions of local authorities, as distinct from their permissible functional domain, is more evident in the PRIs than in the MAs, due to: (1) parallel local service provision by state agencies, (2) the role specification of the local authorities mainly for maintenance tasks, and (3) inadequate arrangements for financing their assigned services. In any scheme of reform, therefore, the function-finance nexus needs to be considered in a wholistic manner.

An analysis of the functional domain of local governments (in Appendix 4.1) shows that the exclusive functions for rural authorities are only five, with another six being concurrent with the states; for the urban authorities the exclusive functions are 14, with another 16 being state-concurrent. All of these are civic services, and some of them are of a regulatory nature, especially the urban services. Although the rural authorities are also supposed to undertake social, welfare and agricultural services, these are largely provided by the states, sometimes through the agency of the rural governments at the area and district levels, despite the long list of functions allotted to the various categories of rural authorities (Table 4.3).

Expenditures

Local functions are usually divided into obligatory and discretionary categories, but such a distinction is only notional in the absence of any quantitative specifications. Urban authorities are reported to be equally dividing their expenditures on these two categories (NIUA, 1989).

Available data on local government expenditures (Table 4.4) show similar functional coverage by urban and rural authorities, despite their differences in functional competence. Such similarities also appear in expenditures on civic and social services, although their relative importance varies. Rural authorities spend relatively more on social services due to the greater availability of function-specific grants for education, health, and welfare. Urban authorities, being financially self-reliant, spend more on community services like public health and sanitation. With increased financial strain resulting from rising staff salaries, urban authorities are cutting down their expenditure on social services and concentrating more on community services and on their core or obligatory services to cope with financial strain. Among rural authorities, the village and area-level authorities are more effective in providing local services than those at the district-level.

The search for economy and effectiveness in local government

expenditures seems to lie in the direction of obtaining "value for money" through : (1) cheaper technology, (2) greater productivity, (3) increased competition, and (4) promotion of joint services. In such efforts, local government manpower issues have a critical significance which sometimes takes on political overtones. Yet there are isolated success stories from various local authorities in this regard, which need to be collected and widely disseminated for replication elsewhere.

Revenues and Taxation

The dissimilar nature of rural and urban governments is apparent from their differing revenue structures: in the former about 89 per cent of revenues are derived from the states, while in the latter about 81 per cent of revenues are internally generated, with local taxation claiming about 55 per cent and nontax revenues about 27 per cent in 1976-77 (Table 4.4). By 1986-87 the dependence of urban local governments on external assistance had increased from 19 per cent to 23 per cent. This was related to the declining share of nontax revenues -- a trend which is likely to continue. On the other hand, a substantial reduction of external dependence in the revenue structure of rural governments must await a radical restructuring of their tax competence, mainly through the assignment of land revenues. Until this happens, rural local government will not develop its own personality, while urban local governments will continue to be marginalised in a generally unified Soviet-type fiscal arrangement.

A state-wise breakdown of local government revenues indicates that three states (Maharashtra, Gujarat, and West Bengal) account for about two-thirds of rural government revenue, while among urban authorities the situation is more variegated, with only one state (Maharashtra) claiming a disproportionate share of 39 per cent (Table 4.5). This is mainly due to the importance of octroi in internal revenue (Maharashtra and Uttar Pradesh) and larger external assistance (Maharashtra, Madhya Pradesh, and West Bengal). In Madhya Pradesh the urban authorities claim more external assistance (43 per cent) due to their share of compensation for the state entry tax. Maharashtra's dominant reliance on internal revenue for both tax and nontax sources (86 per cent both rural and urban) also is striking.

The internal revenue mobilization picture of local authorities is diverse: among rural governments the best performers are Kerala and Uttar Pradesh (61 per cent each), followed by Himachal Pradesh (53 per cent), while among urban governments the highest ratings belong to Haryana (99 per cent), Karnataka (95 per cent), and Punjab (92 per

cent). The worst states in terms of rural government revenue mobilization are West Bengal and Orissa (3 per cent each), followed by Bihar (8 per cent); in urban government the worst state is again Bihar (less than 40 per cent), while others are way above (Table 4.5).

Per-capita revenues of the various tiers of rural government and types of urban government show their relative fiscal resilience: the village and area authorities are more effective in rural government, while the municipal corporations and councils are effective in urban government. The town and notified authorities are a shade better than the village councils in terms of revenue performance (Table 4.6). On an overall basis, there seems to be a need to enhance minimum revenues of rural authorities substantially (at least five-fold), while the urban authorities need a minimum of half of this level of revenues. This would imply increased tax devolution to the rural authorities and increased assistance for the urban authorities (Table 4.7). A detailed look at the revenue competence of rural authorities shows the need for strengthening their compulsory taxation capabilities through assignment of land revenue and devolution of land cess (Table 4.8).

Local government tax powers include 27 state taxes for rural governments (20 exclusive and 7 concurrent) and 20 state taxes for urban governments (9 exclusive and 11 concurrent), as detailed in Table 4.9. Only minor state taxes have been allocated to rural governments, while urban governments have access to 9 major taxes (including the central terminal tax). Only two taxes, octroi (exclusive) and property taxes (concurrent) account for about 90 per cent of municipal tax revenues -- 70 per cent under octroi and 20% under property taxes (NIUA, 1989).

Apart from limited tax powers, urban local governments are experiencing increasing state intrusions into their tax domains, covering virtually all the important taxes devolved to them. Earlier, under the Government of India Act, 1919, there was a separate "local tax list" for exclusive utilization by local governments; this was abolished with the introduction of provincial autonomy under the Government of India Act, 1935, reaffirmed in the Constitution of 1951. Various commissions and committees have suggested revival of the local tax list through a consensus or under a constitutional amendment. Under the 1989 bills this is left to the judgment of the mandatory state finance commission for each state.

The productivity of local taxes is low. In rural governments, this is partly due to the absence of a compulsory list of taxes and a prescribed minimum rate of levy; in urban governments, there is reluctance to levy high rates of compulsory direct taxes (property and

service taxes). The tax collection performance of local governments is also low (around 30 per cent for rural governments and 50 per cent for urban governments). In the non-octroi states in the eastern and north-eastern areas, the tax collection performance of the urban governments is relatively unsatisfactory (NIUA, 1989). The remedy seems to lie in a variety of directions. On the internal side, innovative management and a system of incentives and penalties are important (Delhi Municipal Corporation achieved a 96 per cent improvement in 1986/87); on the external side, local tax performance could be included as a factor in determining the level of general or incentive grants to local government (as in Gujarat).

Considering the small share of local taxes in the total taxes levied in India (5 per cent), it is unlikely that greater utilization of these taxes would materially affect total tax incidence. In any case, the per capita tax incidence of octroi is negligible and the incidence of property tax may be mildly progressive (NCAER, 1980). The buoyancy of local taxes also compares well with similar state and central taxes.

Among possible tax-related reforms, there is a case for imposition of a poll tax to defray the cost of providing a package of local community services that emphasizes local voter-accountability. Such a tax has replaced domestic rating in the UK and is being levied in Nigeria and Papua-New Guinea. In the Indian context, a poll tax would have considerable merit in the PRIs and in the smaller MAs where either the land rate or the property tax is difficult to operate. Its extension to larger MAs would, however, be difficult in the absence of requisite information on assessable adults "resident" in a local area. This is apart from the requirement of large exemptions to unemployables and acceptance of the tax in cash or in labour. Once poll tax succeeds in the smaller MAs, its extension to the larger MAs could be considered to partly relieve the burden of property tax.

The local taxes on professions, trades, callings and employment are being increasingly taken over by the states, and, in spite of the recent increase in their taxable limit to Rs. 2,500 from the earlier Rs. 250, they are rarely utilized to their full potential. There is a need to raise the taxable limit of the professions tax to the full extent of income exempted from income-tax (now Rs.18,000) and utilise this as a lower level income-tax (LLIT), as is done in many countries in southern Africa. Municipal corporations at least should be allowed to use the professions tax as an assigned tax, leaving the rest for sharing with other local authorities on derivative principles. This would widen the local tax base and the own income of the local authorities in a

situation when the other two major local taxes (octroi and property tax) are faltering.

The issue of abolition of local octroi came up almost simultaneously with the introduction of local government in the country. During the colonial era the central government pressed for its abolition, while the provincial governments steadily extended its scope (Tinker, 1967). The debate continued after independence, and a few state governments are now actively considering its abolition, mainly due to the pressure of the transport lobby. Octroi was replaced by a state-wide entry tax in Madhya Pradesh (1977) and Karnataka (1979); by a terminal toll in Jammu & Kashmir (1990); and by a surcharge on the state sales tax in Uttar Pradesh (1991). Abolition of octroi has been advocated because of several problems associated with it: (1) hindrance to trade, (2) corruption at the checkpoints, (3) high cost of collection, and (4) wastage of time and fuel. The present emphasis is on: (1) the adverse effect of local trade barriers on the national economy and (2) avoidance of the cascading effect of the tax due to its coverage of raw materials and intermediate goods. Despite these shortcomings, octroi continues to be levied in 8 out of the 25 states in the country (Table 4.10). It is interesting to note that while some of the major octroi-states are now thinking of its abolition (Gujarat, Maharashtra and Rajasthan), some other non-octroi states have either opted for it (Manipur, Meghalaya, and Orissa), or imposed trans-local octroi or entry tax to mobilize additional local revenue (West Bengal and Assam).

The experience with the working of the state entry tax in Madhya Pradesh shows several shortcomings, including (1) its limited nature, (2) its coverage of intermediate goods, (3) its partial revenue retention by the state, the compensation being based on a fixed percentage of revenue growth, (4) its adverse effect on the liquidity of local finances, and (5) its erosion of local fiscal autonomy. The other two basic objections against the entry tax are that (1) it is of doubtful constitutional validity, since octroi is a local tax whereas entry tax is not, and (2) the replacement of check-post collection by return-based collection does not remove the adverse economic consequences of internal trade restrictions. Substitution of octroi by terminal toll is a retrograde step since the latter is imposed not only on goods but also on passengers carried by road. A surcharge on sales tax makes the impost too heavy on the existing dutiable goods already subjected to the state sales tax.

Replacement of octroi by a new tax is contingent on the following conditions: (1) the replacement should be return-based, (2) it should

be revenue neutral, (3) it should not be more regressive, (4) it should ensure free flow of internal trade, and (5) it should be a local levy. So far the search for a viable local tax substitute for octroi has proved elusive, as all of the possible alternatives -- with the exception of a business property tax -- entail overlapping tax jurisdictions (Nath and Sen, 1989). The business property tax cannot be counted upon due to the lack of evidence of market value for property use or transfer. A local surcharge on sales tax could be allowed to the metropolitan cities, unless terminal taxes are imposed therein; for the other local authorities, a state surcharge seems to be a practical replacement. Both these may eventually entail the transformation of state indirect taxes into a retail value-added tax, shared between the states and local governments under a fixed formula, as in France.

Overall Situation

The surplus syndrome in local government budgets is a familiar phenomenon (Table 4.4), despite the very low physical level of various local services. Partly it is a legal fiction, since local authorities are required to present a surplus budget to meet contingent liabilities and actual shortfalls in revenues. However, there is evidence that these surpluses could be quite large, and there is no discernible cycle of their accumulation and utilization. The reasons could be that (1) local revenue expenditures are pegged at a lower level due to uncertainties in external assistance and (2) there is a desire on the part of urban authorities to finance part of their capital expenditure from revenue surpluses (Datta, 1990a).

Financing of local government services is linked with the issue of a normative level of local expenditures. Attempts have been made to define such norms for urban services in terms of assumed physical standards by a committee of state ministers headed by Rafiq Zakaria (India, 1963b), although local resource availability (both internal and external) and shifts in local expenditure priorities (toward personal rather than property-related services) would make nonsense of such assumed standards. On the basis of Zakaria norms, the MAs would require at least Rs.5,363 million of grants annually during 1990-91 to 1994-95 on the assumptions of constant (1986-87) prices, stable population growth (1971-81 rate), and municipal fiscal stability (at 1986-87 levels). This requirement may increase or decrease depending on the choice of methods adopted to bridge municipal fiscal gaps (NIUA, 1989). No such commitment to underwrite municipal fiscal gaps has been made by the states.

LOCAL LAND AND PROPERTY TAX REFORMS

Rural Land Tax

Rural land tax refers to the local land cess or levies on vacant land in rural habitations (*lal dora*), as distinct from taxes on agricultural land (land revenue or agricultural income tax). The cess is imposed as a surcharge on land revenue, although it is also levied on presumed rental value in West Bengal, Bihar, and Orissa (where this is combined with property taxes). So far the rural land tax has been a minor local tax, as it is generally an assigned or a shared tax. A case could be made that its linkages with land revenue should be severed, along with its devolution to rural government. Ultimately, the tax should be completely merged with property taxes, as in urban government, to resemble its rating characteristics. Earlier thinking of the Santhanam Committee to separate the land rate from a combined property and circumstances tax seems somewhat short-sighted in this context (India, 1963a). However, the suggestion for a change in the method of its valuation from a rental to a capital value base appears to be sound, in view of the difficulties in ascertaining rental evidence in the rural areas.

Property Tax

Property tax, also known as house tax, is a tax on buildings, along with appurtenant land, imposed on owners. The tax is narrower than the UK rate which includes "hereditaments". Property tax, therefore, resembles wealth tax as in the USA and differs from the excise-type UK rate. The concept of ability to pay has limited applicability for this tax due to its *in rem* nature; moreover, the concept of benefit taxation is not quite relevant here (unlike in the case of service taxes) due to the general nature of the tax. These characteristics are important from the angles of its treatment in national accounts, assessment of tax incidence, tax harmonisation arrangements, and tax policy considerations. The major aspects of property tax reform are considered below.

Vacant urban land is generally exempted, except in a few cities (such as Delhi, Calcutta, KAVAL cities in U.P., Ahmedabad, and Visakhapatnam). Where property tax is levied on vacant land, it is at the same rate as the basic tax, but with a poor collection record. There is a case for its wider use in the rapidly growing towns and cities, particularly in the municipal corporations, to combat land speculation and to ensure optimum land use in urban areas. As a measure to mop up increments in urban land values, this is probably not very effective

(e.g. the urban land tax in Tamil Nadu). Domestic owner-occupied property is lightly taxed through lower assessment, lower rates, or rebates -- usually as a matter of convention. The extent of revenue leakage on this count is sometimes substantial (e.g. in Gujarat), although there is probably a case for a lower tax rate where valuation is not depressed due to a rent freeze or for limiting the extent of revision during two valuations.

Taxation of government properties also needs a review. Central government properties are exempt under the Constitution (Article 285) until the manner and extent of its imposition is permitted by Parliamentary legislation. No such law has been enacted so far, and the present arrangement is based on a central executive decision exempting these properties from the basic tax but allowing imposition of notional service charges. As for state government properties, practice varies; usually there is a notional contribution on this count as an *in lieu* grant. The Indian practice, therefore, differs from that of the UK of full *in lieu* compensation for tax exemption of Crown properties. There is no reason why the same arrangement should not be adopted in India for taxation of both central and state properties.

The properties of foreign embassies and legations are also exempt, although it is curious to note that exact reciprocity is not insisted upon (for example, the USA does not give any such exemption, while it enjoys this advantage in India). The situation may be easily corrected through central action; but the question remains as to whether this should also be compensated through an *in lieu* grant by the centre.

The basic property tax is usually accompanied by a number of service taxes, for water supply, drainage, conservancy, lighting, fire, education, and so on. These service taxes are to be distinguished from service charges: they are levied where the particular service is made available to residents, irrespective of its actual consumption. Here one has to make a distinction between excludable and non-excludable services, since only in the case of the latter is the concept of service tax relevant. Hence service taxes correspond to benefit taxation. Where there is a consolidated property tax combining basic and service taxes, as in West Bengal, there is scope to withdraw the concession for non-provision of particular services. An alternative method of property taxation would be to impose a variety of taxes on a detailed classification of properties, rather than on a classification of functions, and impose full user charges for consumption of local services, as prevalent in the USA (K.S.R.N. Sarma, in Datta, 1983). This may not, however, be immediately feasible under Indian conditions.

Valuation of rural property is generally based on capital value; where it is based on rental value, this is largely notional. The rural property market is not bedeviled by black money, so the capital value base is probably realistic. Urban property valuation, however, poses formidable problems without much hope for an immediate solution. It is generally based on the notional rental, or net annual ratable value (ARV). Properties incapable of producing rent are valued by the cost method, but this is mistakenly termed as capital value.

In a few states (Orissa, Assam, and Kerala) a combination of plinth area, structural characteristics and location is used for urban property valuation to produce the legally mandated ARV. In Andhra Pradesh this practice has recently received legal sanction (Andhra Pradesh, 1989), although one could still question the validity of defining ARV in terms of a set of composite criteria rather than the legally mandated rental under rent control legislation. As an informal guideline, however, such composite criteria could be used for operational and training purposes for property valuation and assessment (Rakesh Mohan, in Datta, 1983). In Tamil Nadu, plinth area is a permissible method of valuing rural property. So far these aberrations have gone unchallenged in the courts, but in recent years (since 1961) the Supreme Court has systematically struck down legal provisions based on the floor area or a composite method of property taxation (see, M.K. Balachandran, in Datta, 1983). The reason for attempted substitution of the rental method by the area method, at least in urban areas, is the virtual freezing of the rental market under rent control legislations. The mandated "standard rent" is the upper limit of rental for valuation purposes, irrespective of the actual or prevalent rent. Since rent control is a politically explosive subject, the states are reluctant to substantially liberalize it to allow a relatively free rental market. Some sporadic efforts have been made, however, to introduce a rent control holiday for new constructions or to exempt high rentals from rent control. At the same time, there is an active search for replacing the rental value method by other methods, such as the capital value method and the plinth or area or composite method.

Capital value method. Since the capital value method is based on the comparable sale value of property in a free property market, there are formidable problems hindering its introduction in urban areas, due to a mix of black and white money in urban property transactions, usually in a ratio of 3:2. As the urban property market is even more distorted than the rental market, introduction of the capital value method is not considered to be a feasible proposition for

urban property valuation under Indian conditions (West Bengal, 1982; Delhi, 1990).

Area or composite method. The area or composite valuation method implies a tax on quantity rather than on value. As a tax base, it is medieval in nature (like a window tax or a hearth tax) and does not fit into modern monetized economies. Additionally, it offends the constitutional guarantees on equality (Article 14) and holding of property (Article 19). At least two official committees (West Bengal, 1982; Delhi, 1990) have rejected the method after detailed examination of its implications and practicability. Earlier in the UK, the Layfield Committee came to the same conclusion due to the "insurmountable difficulties in deciding the weights to be attached to the less tangible factors" under the composite method (UK, 1976).

The future direction for reform of the property tax base in India seems to lie in liberalizing rent control legislation, so that the rental market can generate realistic data for tax purposes. The method of valuation needs to be easily and widely understood by the taxpayers, tax officials, and the courts.

The rate structure of property taxes is generally flat or proportional, with enabling provisions for progression. In the municipal corporations the rate is usually progressive, with a separate higher schedule for non-domestic properties. There are problems inherent in such a progressive rate structure: (1) high exemption limit resulting in a narrow tax base, (2) crowding of most properties in the lower rate brackets, with higher cost of assessment, (3) a step system of rating resulting in tax evasion and inequality at the margin, and (4) nontransparency of the average effective rate. There is an attempt to moderate the multiplicity of the step system through the introduction of marginal relief, as in income tax (e.g. in the Delhi municipal corporation) or linking the floor and ceiling rates by a straight line (e.g. in West Bengal).

An examination of the flat rating practices shows a notionally higher rate (e.g. in the Bombay municipal corporation) than could be sustained by normal property rental, leading to derating of properties to counter rent control. Its wider use may lead to extreme inequities in the distribution of property tax burden; the long-term goal needs to be to reduce the effective rate to reasonable levels, say 10-15 per cent for domestic and 15-20 per cent for non-domestic properties (Delhi, 1990).

Taxation of nondomestic properties, now being attempted through higher rentals or rates, is not adequate on business properties, which should contribute a larger share in property tax revenues. Following

the UK practice, one could suggest a state-wide rate determination of properties used for industry, trade and commerce, entertainment, and professions. Also, it may be easier to remove these from the purview of rent control legislation so that their valuations could be related to market, rather than standard, rent.

COST RECOVERY FOR LOCAL PUBLIC SERVICES

Merit Goods

In theory, direct cost recovery for merit goods is possible where: (1) the minimum needs of merit goods are met through specific grants, (2) the extent of cross-subsidization of users is limited, and (3) the charging method is both feasible and cheap. None of these conditions applies in the local government sphere in India. The case for charging for local services becomes strong only after the basic community and social service needs are met. A few illustrations of specific local services are attempted below.

Water supply. The public health and environmental needs for potable water supply comprise a basic community service need that is still to be met. Since water charges are related to assessed households, the non-assessed household population has to be subsidized either from increased property taxes or from a higher charge level, or a combination of both. It is also not feasible to levy differential charges based on the nature of consumption -- for drinking, household use, gardening, etc. However, it may still be worthwhile to shift a part of the burden to nondomestic consumers in the larger cities, even when water supply charges are tagged to the property tax base. Service charges for disposal of liquid wastes and sewerage suffer the same disabilities of the basic charge, since these are piggy-backed on water charges. Differential charges on domestic consumers for water and related services are inequitable if only the property tax payers are made to pay for consumption by others.

Solid wastes and garbage disposal. Collection and removal of solid wastes and garbage are examples of public goods and are supposed to be met from tax revenues, except where there is an excess generation for special purposes regarded as merit goods (e.g. building construction, land clearing, markets, slaughter houses, hospitals, waste-discharging industries, etc.). Special charges could be and usually are made for these activities by the local authorities, within the constraints of collection cost.

Education and health. So long as the local authorities are concerned with extension of basic social services through universal coverage and access, it is difficult to see how direct cost recovery is a relevant consideration. There is, of course, a possibility of reducing the operational cost if voluntary agencies are involved in service delivery. The experience of charging for these services under the World Bank (IDA)-financed Calcutta slum improvement programme has not been successful. Where local authorities undertake provision of personal social services, like education and health, there are possibilities of charging fees under private auspices, unless means-testing of the beneficiaries is practicable for local public services.

Private goods. Local governments deal with very few private goods. Where city transport and electricity are under municipal ownership, as in Bombay, the gains from electricity make up for the transport losses. There are examples of revenue success of isolated municipal ventures, such as sanitary land-fill (Delhi Municipal Corporation); pay toilets (Tamil Nadu); bus and cart stands (Kerala and Tamil Nadu); markets, shopping centers and slaughter houses (Kerala); and so on. Urban authorities in Kerala have relied the most on income from municipal property (12 per cent of total revenue). Again, the New Delhi Municipal Committee has achieved notable success in raising substantial revenue from real estate development on *nazul* (government) land through joint ventures with the private sector.

During the 1960s, local governments in India were encouraged to rely on revenues from local enterprises, following the practice in the socialist economies, but the results have fallen far short of expectations in the absence of protected markets for their products.

Alternative Private Provision

Deregulation prospects for local government services are not too obvious, as these authorities undertake very few market-related activities. On the other hand, there are opportunities for joint or cooperative ventures with the private sector, especially in real estate development on the urban fringes and in urban renewal. Where municipal undertakings are losing concerns (e.g. city transport in Pune, milk supply in Ahmedabad), their privatization or deregulation could be considered.

Some municipal services may also be contracted out, such as road works, parks maintenance, and garbage disposal -- this is being practised in several cities. Even where a particular local government service is operated through private management, the franchising

method could be adopted to retain local government control.

REVENUE TRANSFERS TO LOCAL GOVERNMENTS

Tax-revenue Transfers. Tax-revenue transfers include assigned and shared state tax revenues for local governments. While all the major taxes of the rural authorities are either assigned or shared, it is somewhat paradoxical that revenue grants should dominate their current income. For urban authorities, the assigned taxes are compensatory in nature, except entertainment taxes in two states (Tamil Nadu, Kerala); on the other hand, the shared taxes cover entertainment tax, stamp duty, motor vehicles tax, and now entry tax. Additionally, transfer of tax revenues is discretionary and is regarded as proxy grants, rather than local government entitlements, as in the case of the states. Assigned tax revenues, when compensatory, tap the local tax base and are to be distributed on the derivative principle; shared taxes invariably tap the state tax base, so revenue-sharing assumes the nature of tax-aid. But these principles are not respected while making tax-revenue transfers to local governments.

Three issues are relevant here: (1) tax-revenue transfers to local governments need to be legally prescribed, along with their method of distribution; (2) these are to be the principal means of revenue transfers to local governments; and (3) these are to be regarded as internal local revenues based on entitlements of local governments (West Bengal, 1982).

Revenue Block Grants

From the angle of local fiscal responsibility, there is a need for a block revenue grant to local authorities which should not exceed their internal revenues. International experience suggests a revenue grant component of about one-third of total local government revenue. This is exceeded in the UK due to a single local tax (poll tax) and a single tax assignment (non-domestic property tax), and in the sub-national entities of the Soviet group of countries due to deficit grants. Grants are not relevant for local authorities in Holland where they share a fixed proportion of revenues from a national tax pool. If Indian budgetary practices are to be followed, then both the rural and urban authorities in India should receive about 50 per cent of their total revenue from grants. On the other hand, if the practice of the Western economies is to be emulated, then the reform must start with the gradual abolition of the practice of deficit (or gap-filling) grants to the states. The implications of these approaches are now

considered for local government finances.

In most western countries, general grants are supposed to equalize local tax bases (vertical equalization) and tax efforts (horizontal equalization) to meet a desired level of local expenditure in various categories, and also to meet the needs of especially disadvantaged local authorities. A minimum level of local revenue surplus (say, 10 per cent) for capital expenditure might also be specified. These requirements generally result in the adoption of a formula-based block revenue grant to the local authorities.

In the Soviet Union, block grants to local authorities are determined on the basis of a normal level of revenue expenditure for the local authorities on the one hand and an estimation of revenues from transferred taxes and local internal sources on the other. This may also be accompanied by normative expenditure specifications and normative levels of local tax base utilization. The difference between the projected approved expenditure and the desired income would be the permissible local revenue deficit or gap, to be met by a general grant.

The present Indian practice of general grants, as distinct from block grants, to local governments combines both of these methods. The urban authorities follow the Western practice by covering the needs elements through a per-capita grant and emphasizing the tax effort element through an incentive grant (e.g. in Gujarat). The rural authorities receive a part of the general grant as a deficit grant of the Soviet variety, without any entitlement. The pure Soviet variety of grants is also operated for urban authorities in the Calcutta metropolitan area under a deficit grant system -- called the Revised Grants Structure (RGS) -- introduced on the advice of the World Bank (see World Bank, 1984).

Specific Grants

There is a need to consolidate the bewildering variety of specific grants to local government into a basic needs grant covering select items of civic and community services. This grant ought to be conditional in terms of functional standards, coverage criteria, and matching local contributions. Not more than one-third of total grants should be of the specific variety, to enhance local fiscal autonomy. Under the 1989 constitution amendment bills, the provision of direct central fiscal transfers to local governments (Article 282) for both revenue and plan purposes could be activated, despite political resistance by the states. The same result might also be achieved if part of the central fiscal transfers to the states is earmarked for local

governments with "pass-through" provisions.

Machinery of Fiscal Transfers

The accepted machinery of fiscal transfers to local governments for both revenue transfers and Plan assistance is the state finance commission (India, 1989b). The state commissions should have permanent secretariats to oversee the implementation of their quinquennial awards made by experts well before the appointment of the federal finance commission (India, 1983). This is to ensure the necessary financial commitment of the states to implement the state finance commissions' recommendations. In view of the observed local tax-displacement effect of deficit grants, federal grants to the states may have to be gradually brought in line with the Western practice, subsequently to be replicated by the state commissions.

The state finance commissions should also have the responsibility for suggesting the distribution of local development assistance and local functional and tax authority adjustments for various categories of local authorities. One associated gain from state finance commissions would be the availability of local financial data and the possibility of inter and intra-state comparisons of such data. Local budgetary and accounting structures could be standardized through the supervision of the Comptroller and Auditor-General, as envisaged under the proposed bills (India, 1989b). Until this happens, there would at least be standardization for all categories of local authorities in a state through the working of its finance commission.

Local Government Plan Financing

Since local governments are not integrated with national planning efforts, the term Plan financing in their context means implementation of state Plan projects and schemes by local authorities. These are somewhat sporadic and *ad hoc*, depending on the choice of plan implementation machinery by the states and resource availability. The rural authorities hardly have any capital projects of their own, while their urban counterparts incur capital expenditures on water supply, slum improvement, markets, and a variety of civic facilities financed by (1) their own revenue surplus and (2) capital grants and borrowings from central and state Plan funds. The larger urban authorities rely mainly on revenue surpluses, while the smaller urban authorities meet their development needs from Plan grants and loans.

Local Borrowings

Plan loans are of a soft variety, so their repayment is not tied to the

financial viability of projects. Such loans, when accumulated, are either rescheduled through injection of further loans or written off. Since institutional financing of local projects is also routed through the states, the distinction between Plan loan (soft) and institutional loan (hard) is somewhat weak. The only exception to this arrangement is market borrowings to finance self-liquidating projects of the larger urban authorities with repayments ensured through the creation of mandated sinking funds. Such local market borrowings are few, due to the need for state guarantee and the increased borrowing needs of the states to finance their own Plans. There is no earmarking of such state borrowings for utilization by local authorities, as is permitted for state undertakings. Effective access of local authorities to market loans would imply either waiving the need for state guarantee by the Reserve Bank of India or earmarking a part of state borrowings for exclusive use by local authorities. Market borrowings by local authorities would necessitate their credit ratings for loan eligibility. At the same time, local authorities may be allowed floating of tax-free bonds, as in the case of state undertakings.

Plan Financing

Under a reformed system of local government finances, local plans could consist of: (1) the local component (for which block Plan assistance is relevant) and (2) the state-sponsored component (for which specific or tied schemes could be made to reflect state priorities). Identification of especially disadvantaged local authorities eligible for various categories of Plan assistance would also be necessary to promote vertical equalization. This might involve separation of the state Plan into state and local sectors. At least 50 per cent of the local sector plan could thus be underwritten from a mix of central and state Plan assistance. Plan assistance for local plans could be financed entirely from capital grants, as soft loans are but a variant of the same. For self-liquidating projects, local authorities could be encouraged to obtain direct institutional loans or permitted to make market borrowings. Only the larger local authorities (municipal corporations and district councils) should be eligible for hard loans.

The Soviet system of Plan financing, as practised in India, has a tendency to increase its size in subsequent periods to cover the mounting burden of maintenance for Plan projects created earlier. The consequent increase in the revenue gap thus arises partly due to separate determination of Plan assistance and the quantum of revenue deficit-grants. Although local authorities are outside this financing arrangement, once they are integrated with national

planning it would also mean increasing their dependence on external fiscal assistance and erosion of local accountability. At the same time, it is necessary to end the duality of Plan financing through unification of existing arrangements between the states and local governments, so that subsequent measures to strengthen fiscal responsibility of the states and the local governments could be uniformly applied to both.

Cost-Effectiveness

Initiatives for cost-effectiveness under World Bank - funded urban projects have been attempted through: (1) efficiency in investment programming, (2) review of design standards, and (3) improved project implementation. However, operation and maintenance of large projects tend to impose undue financial strain on the municipal authorities due to increased maintenance costs and, as a consequence, they prefer low-cost and high pay-off projects. Such investments have both hardware (workshops, vehicles, equipment) and software (accounting systems, legal and technical assistance, training) components.

Economy in local government capital expenditures is closely related to manpower issues. The prevailing attitude of the urban authorities of playing Father Christmas to their low-productivity manpower ought to be reviewed and the possibilities of engaging professional consultants explored in the case of the high-skill areas, leaving low-skill activities to be largely contracted out. By far the most widespread experience of contracting out a specific urban development responsibility for the private sector lies in the field of low-cost sanitation (Sulabh International). Similar methods could also be tried out in urban slum improvement and for a miscellany of rural development projects.

FUTURE PROSPECTS AND POLICY OPTIONS

Future Prospects

Future prospects for local fiscal reform are contingent on generic reforms in (1) the pattern of political decentralization and (2) the nature of the economic system, which are intimately linked with subnational fiscal arrangements.

Devolved decentralization. India follows a devolved, rather than an aggregative, nature of decentralization. Since decentralization extends mainly to the states and not to local governments, further decentralization has to be largely directed to the latter. This needs to be

pursued as a national agenda for balancing the political power centres in a federal set-up. Ultimately, this would mean a relative reduction of central expenditures and a corresponding increase in local government expenditures (see Table 4.2).

The prospects for strengthening local governments through unification and decentralization are brighter now than ever before. The major national political parties are committed to local-level decentralization, although differing on sequencing its vertical (state-local) and horizontal (rural-urban) application. The desired balancing of multi-level governments might accompany a reduction in the share of total government expenditure to GNP (see Table 4.2). It is also suggested that reform in fiscal federalism in larger countries, like India, might emulate the Canadian system (tax overlapping), rather than that of Australia (tax separation) or that of Brazil (tax sharing). Obviously, this has to be of the piggy-backing variety and would mean enabling local surcharges on state taxes.

Reliance on market mechanism. In a country long used to a directed economy, a move toward reliance on the market mechanism is not a one-shot exercise but has to be achieved in stages. Such a change in the orientation of the economy has far-reaching consequences for the role, structure, and functioning of the government system, including: (1) the role limitations of both national and sub-national governments, (2) a reduction in the size of governments and in the number of parastatals, (3) relating public resource allocation to match market signals, and (4) basing taxation on realized, rather than on presumptive values.

Policy Options

Following the basic policy parameters of decentralization and economic liberalisation, we now consider three sets of options for policy instruments affecting local government finances: (1) local autonomy versus control, (2) private provision versus local public services, and (3) internal versus external financing.

Local autonomy versus control. Traditionally, local governments in India enjoyed limited autonomy due to their colonial origins. Rural authorities are even more circumscribed than their urban counterparts, owing to the parallel functioning of the field administration in districts and lower-level jurisdictions. Of late, urban authorities are being hemmed in due to the creation of the special area and functional authorities, which sometimes cut across local

jurisdictions. These tendencies are sought to be reformed under the proposed constitutional amendment bills, through wider local functional domains, new local planning responsibilities, and creation of joint local authorities. There are also opportunities to contract out local responsibilities to state agencies. Local fiscal autonomy will also be promoted through the twin machineries of the state finance commissions and the Comptroller and Auditor-General, as provided for under the 1989 bills. These changes, when effected, would gradually replace the tutelary controls over local governments by measures supportive of local autonomy and accountability (Datta, 1990b).

Private provision versus local public services. In the case of existing local functions, privatization prospects are not self-evident. Future devolution of various functions to local governments -- for distributive-social and supportive-economic services -- will have to consider the alternative of private provision through contracting out, deregulation, and privatization. Local utilities, wherever these are operated, might be the first to involve private participation; later, community and social services also could be provided under cooperative or voluntary auspices. The road to becoming an enabler, rather than a provider, of local services may lead into many blind alleys. However, the associated local-level problems would probably be far more tractable than those facing higher levels of government.

Internal versus external financing. The need for a greater degree of external in relation to internal financing for rural governments would presumably continue for some time, but there are no obvious obstacles to a gradual reduction of undue self-financing of urban governments. Again, through the working of the state finance commissions, it would be possible to bring about a reasonable degree of uniformity in means of financing local services, including a readjustment of local functions and taxes on the one hand and relations vis-a-vis the local and state governments on the other. Success in achieving a desired ratio of internal to external financing of local services is also associated with other non-fiscal measures for achieving local autonomy and accountability. Ultimately, all subnational governments ought to have a similar ratio of internal and external financing of their services.

Conclusion

The scenario for local fiscal reforms outlined above has at least two

implications. First, most local fiscal issues are manifestations of problems in the environment of local government; therefore, internal reform attempts are likely to have only a marginal impact on their finances. Second, international experience with local government reforms suggests that a partial attempt at improving certain aspects of local government (organization, finance, personnel, decisionmaking, and external relations) could be counter-productive; hence a comprehensive effort at local government reform would be more fruitful, even if the associated fiscal success is moderate, but durable. in nature.

Appendix 4.1

Functional Domain of Local Governments:
Exclusive and Concurrent with States

VII Schedule of Constitution		Rural		Urban	
		Existing	Proposed ^a	Existing	Proposed ^b
	<i>Nature of Functions</i>				
<i>Lists/items</i>	<i>Description</i>				
1. II/1	Public order	-	-	M	-
		-	-	mS	M
		-	-	M	-
		p	-	M	-
2. II/6	Public health and sanitation; hospitals and dispensaries	-	P	Ms	M
		p	-	M	-
		-	P	Ms	M
		-	-	mS	M
		-	-	mS	M
3. III/18	Adulteration of food-stuffs and other goods	-	-	mS	M
4. III/20A	Family welfare	-	P	mS	M
5. II/7	Pilgrimages.	-	-	-	M

VII Schedule of Constitution

<i>Lists/items Description</i>	<i>Nature of Functions</i>	<i>Rural</i>		<i>Urban</i>	
		<i>Existing</i>	<i>Additional Proposed^a</i>	<i>Existing</i>	<i>Additional Proposed^b</i>
6. II/9 Relief of the disabled and unemployable	12 Social welfare including welfare of handicapped and mentally retarded	-	P	-	M
	13 Women and child development	-	P	-	M
7. II/10 Burials and burial grounds; cremations and cremation grounds	14 Disposal of the dead	p	-	m	M
8. III/30 Vital statistics including registration of births and deaths	15 Vital statistics, including registration of births and deaths	-	-	m	M
9. II/11 Education...	16 Primary education	pS	P	mS	M
	17 Secondary education	-	P	-	M
	18 Adult and non-formal education	-	P	-	M
10. III/25 Vocational and technical training of labour	19 Vocational and technical training	-	P	-	M
11. II/12 Libraries, museums and	20 Libraries	-	P	mS	M

VII Schedule of Constitution

<i>Lists/items Description</i>	<i>Nature of Functions</i>	<i>Rural</i>		<i>Urban</i>	
		<i>Existing</i>	<i>Proposed^a</i>	<i>Existing</i>	<i>Proposed^b</i>
other similar institutions..., ancient and historical monuments and records...	21 Museums and monuments	-	-	-	M
12. II/13 Communications, that is to say, roads, bridges, ferries and other means of communication....municipal tramways; ropeways; inland waterways and traffic thereon..., vehicles other than mechanically propelled vehicles	22 Roads, culverts, bridges 23 Ferries, waterways and other means of communication 24 Trams, city transport	pS pS	- P	Ms mS	- M
13. II/14 Agriculture including agricultural education and research, protection against pests and prevention of plant diseases	25 Agriculture, including agricultural extension	pS	P	-	-
14. II/15 Preservation, protection	26 Animal husbandry	-	P	-	-

VII Schedule of Constitution

<i>Lists/items Description</i>		<i>Rural</i>		<i>Urban</i>	
		<i>Existing</i>	<i>Proposed^a</i>	<i>Existing</i>	<i>Proposed^b</i>
	<i>Nature of Functions</i>				
15. III/17	and improvement of stock and prevention of animal diseases; veterinary training and practice		P	-	-
	Prevention of cruelty to animals		-	-	M
16. II/16	Pounds and the prevention of cattle trespass	p	P	m	M
17. II/17	Water, that is to say, water supplies, irrigation and canals, drainage and embankments, water storage and water power...	p	P	Ms	-
	Drinking water supply		-	Ms	-
	Industrial and commercial use of water		P		
	Minor irrigation, water management and watershed development	pS	P		
18. II/18	Land, that is to say, rights in/over land, land tenure including the relation of land-		P	-	-
	Land improvement		-		
	Colonisation		-	mS	-
	Town planning, including heritage conservation,		-	mS	M

VII Schedule of Constitution

Lists/items Description

		Rural		Urban	
<i>Nature of Functions</i>		<i>Existing</i>	<i>Proposed^a</i>	<i>Existing</i>	<i>Proposed^b</i>
lord and tenant and the collection of rent; transfer and alienation of agricultural land; land improvement and agricultural loans; colonisation					
37	urban arts and aesthetics	-	-	mS	M
38	Slum improvement	-	P	-	M
39	Housing	-	-	m	M
40	Land use and building control	-	-	m	M
41	Parks, playgrounds and recreational facilities	-	-	-	-
42	Minor forest produce	-	P	-	M
43	Local forestry	-	P	-	M
44	Social forestry	-	P	-	-
45	Fuel and fodder	-	P	-	-
46	Fisheries	-	P	-	-
47	Small scale, including food processing, industries	-	P	-	-
48	Khadi, village and cottage industries	-	P	-	-
	Industrial and commercial estates	-	-	-	M

VII Schedule of Constitution

<i>Lists/items Description</i>	<i>Nature of Functions</i>	<i>Rural</i>		<i>Urban</i>	
		<i>Existing</i>	<i>Proposed^a</i>	<i>Existing</i>	<i>Proposed^b</i>
23. II/25 Gas and gas-works	49 Non-conventional energy (bio-gas)	-	P	-	M
24. II/28 Markets and fairs	50 Markets, fairs and slaughter houses	pS	P	M	-
25. I/31 Inns and inn-keepers	51 Inns and inn-keepers	-	-	m	-
26. II/33 Theatres and dramatic performances, entertainments and amusements	52 Licensing of theatres and dramatic performances	-	-	m	M
27. II/35 Works, lands and buildings vested in or in the possession of the State .the municipalities	53 Cultural activities	-	-	-	M
	54 Maintenance of community assets	-	P	-	M
	55 Property vested in or in the possession of the municipalities	-	-	m	M
28. III/23 Social security and social insurance; employment and	56 Welfare of weaker sections, especially of the scheduled castes and tribes	-	P	-	M

VII Schedule of Constitution

<i>Lists/items Description</i>	<i>Nature of Functions</i>	<i>Rural</i>		<i>Urban</i>	
		<i>Existing</i>	<i>Proposed^a</i>	<i>Existing</i>	<i>Proposed^b</i>
unemployment	57 Poverty alleviation programmes	-	P	-	M
29. III/33 Trade and commerce in, and the production, supply and distribution of.... (essential commodities)	58 Public distribution system	-	P	-	M
30. III/38 Electricity	59 Electrification; including distribution of electricity	-	P	-	M
	60 Non-conventional energy sources	-	P	-	M
31. II & III	61 General welfare and well-being	-	-	M	-

^a11th Schedule, Panchayats Bill (1989).

^b12th Schedule, Nagarpalika Bill (1989).

Note: Panchayats (P/p); Municipal (M/m); State (S/s). Capital letter indicates major responsibility, while small letter indicates minor involvement.

Source: India (1963 and 1989); Datta (1984).

Appendix 4.2

**Tax Powers of Local Governments:
Exclusive and Concurrent with States**

<i>List/ items</i>	<i>Description of Taxes</i>	<i>Nature of Tax</i>	<i>Rural</i>	<i>Urban</i>
1. I/89	Terminal taxes on goods on passengers, carried by railway, sea or air; taxes on railway fares and freights.	- Terminal taxes on goods	p	Ms
2. II/45	Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenues.	- Tax on agricultural land - Land cess - Surcharge on land less - Surcharge on seigniorage - Tax on cultivable fallow land	pS pS ps pS pS	- - - - -
3. II/46	Taxes on agricultural income	- Tax on commercial crops	pS	-
4. II/49	Taxes on lands and buildings	- Property and circumstances tax	p	-

<i>List/ items</i>	<i>Description of Taxes</i>	<i>Nature of Tax</i>	<i>Rural</i>	<i>Urban</i>
8. II/55	Taxes on advertisements other than advertisements published in the newspapers	- Tax on advertisements/hoardings	-	M
9. II/56	Taxes on goods and passengers carried by road or on inland waterways	- Terminal toll - Pilgrim tax	- p	Ms -
10. II/57	Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars....	- Non-motorised vehicle tax - Wheel tax	p	Ms
11. II/58	Taxes on animals and boats tax on animals brought for sale	- Tax on cattle fairs, - Cattle tax - Tax on ferries - Road tolls - Tolls on new bridges	p p p - pS	- m m mS
13. II/60	Taxes on professions, trades, callings and employments (subject to a maximum of Rs.2500 per annum)	- Profession tax - Labour tax	p p	Ms -

<i>List/ items</i>	<i>Description of Taxes</i>	<i>Nature of Tax</i>	<i>Rural</i>	<i>Urban</i>
14. II/61	Capitation tax	Poll tax	p	-
15. II/62	Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling or cess thereon	Tax on fairs, festivals and entertainments Entertainment tax Show tax or cess thereon	p p -	- mS m
16. II/63	Rates on stamp duty in respect of documents....	Duty on transfer of property	p	-
17. II	...	Any permitted state tax		m ^b

^aOnly in Bombay municipal corporation.

^bOnly in Uttar Pradesh.

Note: Rural (p/P), Urban (m/M), State (s/S) : Capital and small letters indicate major or minor utilisation respectively.

Source: India (1963); Datta (1984).

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Table 4.1

Local Government Authorities by Tiers/Types, 1986

<i>Rural Government: Tiers</i>	<i>Numbers</i>
- District Councils	369
- Area Councils	5,199
- Village Committees	2,43,582
Total	2,49,150
<i>Urban Government: Types</i>	
- Municipal Corporations	73
- Municipal Councils	1,767
- Town/Notified Committees	946
Total	2,786

Source: India (1989a and 1989c).

Table 4.2

**Government Revenue Expenditure and GNP
1976/77 and 1986/87**

(percentages)

	<i>Share of GNP</i>			<i>Share of Total Expenditure</i>		
	<i>1976/77</i>	<i>1986/87</i>	<i>Desired</i>	<i>1976/77</i>	<i>1986/87</i>	<i>Desired</i>
All Governments	18.9	33.2	30.0	100	100	100
1 Central	6.2	16.3	12.0	32.3	49.2	40.0
2 States	11.1	14.8	14.0	59.1	44.4	45.0
3 Local ^a	1.6	2.1	4.0	8.6	6.4	15.0
- Rural	0.7	0.9	1.4	4.0	2.9	5.0
- Urban	0.9	1.2	2.6	4.6	3.5	10.0

^aEstimated

Source: India(1981) and (1989a).

Table 4.3

Expenditure Items for Rural Local Authorities (Panchayats) in Selected Major States, 1961-62

States	Admn.		Comm. services		Social services		Public works		Agr./Irrg. & allied services		Industry, marketing		Revenue Enterp.		Others	
	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD
1. Andhra Pradesh	Y Y Y	Y Y Y	Y - -	Y Y Y	Y Y Y	Y Y Y	Y Y Y	- Y Y	- Y Y	- Y -	- Y -	- Y -	- Y -	- Y -	- Y -	Y Y -
2. Bihar	Y - -	Y - -	- - -	- - -	- - -	Y - -	Y - -	Y - -	- - -	- - -	- - -	- - -	- - -	- - -	- - -	Y - -
3. Tamil Nadu	Y Y -	Y Y -	- - -	Y Y -	Y Y -	Y Y -	Y Y -	Y - -	- Y -	- - -	- - -	- - -	- - -	- - -	- - -	Y - -
4. Maharashtra	Y - Y	Y - Y	Y - Y	Y - Y	Y - Y	Y - Y	Y - Y	Y - Y	- - Y	- - Y	- - -	- - -	- - -	- - -	- - -	Y - Y
5. Karnataka	Y Y -	Y Y -	Y - -	Y Y -	Y Y -	Y Y -	Y Y -	Y Y -	- - -	- - -	- - -	- - -	- - -	- - -	- - -	Y Y -
6. Orissa	Y Y -	Y Y -	- - -	Y Y -	Y Y -	Y Y -	Y Y -	Y Y -	- Y -	- Y -	- Y -	- Y -	- - -	- - -	- - -	- - -
7. Punjab	Y - -	Y - -	Y - -	Y - -	Y - -	Y - -	Y - -	Y - -	- - -	- - -	- - -	- - -	- - -	- - -	- - -	Y - -
8. Rajasthan	Y Y Y	Y Y Y	Y - -	Y Y -	Y Y -	Y Y -	Y Y -	Y Y -	Y - -	Y - -	- Y -	- Y -	- - -	- - -	- - -	Y Y Y
9. Uttar Pradesh	Y Y Y	Y Y Y	Y - -	Y Y Y	Y Y Y	Y Y Y	Y Y Y	Y Y Y	- Y Y	- Y Y	- Y Y	- Y Y	- - -	- - -	- - -	Y - Y

Note: V = Village councils; A = Area councils; D = District councils; - = Nil; Y = Yes.

Source: Maddick (1970).

Table 4.4

**Income and Expenditure of Local Governments,
1976-77 and 1986-87**

(Rs. Million)

Income	Rural		Urban			
	1976/77		1976/77		1986/87	
	Amount	%	Amount	%	Amount	%
1. Taxes	591	8.1	3,228	54.4	3,377	54.3
2. Nontax revenues	199	2.7	1,594	26.9	1,443	23.2
3. Assigned/shared taxes	533	7.4	216	3.6	361	5.8
4. Grants	5,942	81.8	895	15.1	1,038	16.7
Total	7,265	100	5,933	100	6,219	100
Expenditure						
1. <i>General services</i>	605	8.3	852	14.3	796	12.8
- Administration	582	8.0	584	9.8	547	8.8
- Tax collection	23	0.3	268	4.5	249	4.0
2. <i>Community services</i>	430	5.9	1,770	29.9	2,618	42.1
- Water Supply	145	2.0	690	11.6	796	12.8
- Public health and sanitation	9	0.1	436	7.4	1,231	19.8
- Roads	276	3.8	644	10.9	591	9.5
3. <i>Social services</i>	3,303	45.5	1,199	20.2	827	13.3
- Education	3,081	42.4	580	9.8	653	10.5
- Health	222	3.1	619	10.4	174	2.8
4. <i>Other services*</i>	1,884	25.9	1,526	25.7	1,443	23.2
5. <i>Revenue surplus</i>	1,043	14.4	586	9.9	535	8.6
Total	7,265	100	5,933	100	6,219	100

*Public safety, recreation, welfare, and loan repayment.

Source: India (1979); NIUA (1989).

Table 4.5

Structure of Revenue of Local Governments in Larger States, 1976-77

(percentages)

States	Rural				Urban				
	Tax	Non-tax	Assigned/Shared Taxes	Grants Total	Tax	Non-tax	Assigned/Shared Taxes	Grants Total	
1. Andhra Pradesh	9.3 (20.5)	1.2 (7.6)	4.2 (10.1)	85.3 (18.6)	100 (17.8)	31.0 (4.6)	44.7 (13.2)	4.8 (10.5)	19.5 (8.0)
2. Assam	20.1 (2.1)	9.2 (2.8)	27.0 (3.0)	43.7 (0.5)	100 (0.8)	37.0 (0.7)	55.0 (2.0)	.. (..)	8.0 (1.0)
3. Bihar	6.8 (0.3)	0.8 (0.1)	20.4 (1.0)	72.0 (0.3)	100 (0.3)	39.3 (1.6)	0.5 (..)	8.4 (5.2)	51.8 (7.9)
4. Gujarat	7.6 (21.5)	1.0 (8.3)	9.5 (29.6)	81.9 (22.9)	100 (22.9)	67.9 (11.0)	21.9 (7.1)	NA (NA)	10.2 (8.8)
5. Haryana	NA (NA)	NA (NA)	66.3 (2.3)	33.7 (0.1)	100 (0.3)	76.0 (2.8)	23.3 (1.5)	0.8 (0.4)	2.9 (0.4)
6. Himachal Pradesh	30.8 (1.0)	22.0 (2.0)	1.6 (0.1)	45.6 (0.2)	100 (0.3)	64.3 (0.4)	19.0 (0.3)	.. (..)	16.7 (0.4)
7. Karnataka	NA (NA)	NA (NA)	.. (..)	.. (..)	.. (..)	60.4 (6.4)	34.6 (7.3)	.. (..)	5.0 (1.9)

States	Rural				Urban			
	Tax	Non-tax	Assigned/Shared Taxes	Total	Tax	Non-tax	Assigned/Shared Taxes	Total
8. Kerala	29.6 (5.9)	31.4 (18.3)	27.7 (6.1)	11.3 (0.2)	61.9 (2.0)	23.9 (1.6)	8.6 (4.2)	5.6 (0.7)
9. Madhya Pradesh	18.5 (2.4)	.. (..)	16.1 (2.3)	65.4 (0.8)	48.6 (6.5)	14.5 (3.9)	16.1 (32.3)	20.8 (10.3)
10. Maharashtra	8.6 (24.5)	3.1 (26.2)	3.7 (11.7)	84.6 (23.9)	54.6 (39.1)	31.0 (44.7)	2.5 (26.3)	11.9 (31.4)
11. Orissa	0.3 (0.2)	2.8 (4.4)	6.5 (3.8)	90.4 (4.8)	36.8 (1.1)	25.9 (1.5)	7.3 (3.1)	30.0 (3.2)
12. Punjab	36.2 (2.9)	13.3 (3.2)	.. (..)	50.5 (0.4)	84.3 (3.6)	7.9 (0.7)	.. (..)	7.8 (1.2)
13. Rajasthan	3.7 (1.8)	7.7 (11.0)	1.9 (1.0)	86.7 (4.1)	62.2 (4.8)	27.4 (4.3)	.. (..)	10.4 (3.0)
14. Uttar Pradesh	44.5 (10.7)	16.3 (11.5)	3.1 (0.8)	36.1 (0.9)	53.6 (9.0)	26.9 (9.0)	.. (..)	19.5 (12.1)
15. West Bengal	2.4 (6.3)	0.6 (4.6)	9.9 (28.2)	87.1 (22.3)	54.0 (6.4)	12.1 (2.9)	10.2 (18.0)	23.7 (10.3)
Total	8.1 (100)	2.8 (100)	7.3 (100)	81.8 (100)	54.4 (100)	27.1 (100)	3.7 (100)	14.8 (100)

Note: .. = Negligible; NA = Not Available
Source: India (1979).

Table 4.6

Revenue of Local Governments by Tiers/Types, 1976-77

(percentages)

	<i>Tax</i>	<i>Non-tax</i>	<i>Shared taxes/ Grants</i>	<i>Total</i>
Rural Tiers				
- District Councils	6	1.2	92.0	100
- Area Councils	14.2	0.2	85.6	100
- Village Committees	34.8	18.2	47.0	100
Total	8.1	2.7	89.2	100
Urban Types				
- Municipal Corporations	72.3	14.1	13.6	100
- Municipal Councils	58.4	19.2	22.4	100
- Town/Notified Committee	49.0	18.0	33.0	100
Total	54.4	26.9	18.7	100

Source: India (1978 and 1979).

Table 4.7

**Per Capita Revenue Income of Local Governments by
Tiers/Types, 1975-76**

	Average Population (000)	Actual Income		Minimum Desired (x5) Income	
		Per Capita (Rs.)	Per Authority (Rs.000)	Per Capita (Rs.)	Per Authority (Rs.000)
Rural Tiers					
- District Councils	1500	17.3	25,950	86.5	1,29,950
- Area Councils	15	11.0	165	55.0	825
- Village Councils	1.5	2.5	3.75	18.75	28
Urban Types					
- Municipal Corpns.	500	125.0	62,500	312.5	1,56,250
- Municipal Councils	50	66.0	3,300	165.0	8,250
- Town/Notified Comms.	7.5	46.0	345	115.0	863

Source: India (1978) and (1979).

Table 4.8

Revenue Competence of Rural Local Authorities (Panchayats) by Types in Selected Major States

States	Taxes			Non-tax Revenue			Assigned/ Shared taxes			Grants		
	Compulsory		Optional	Fees	Property/ Enterprise	Stamp duty	Land revenue	Land cess	Other Tiers	State		
	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	VAD	
1. Andhra Pradesh	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	
2. Assam	---	Y--	Y--	Y--	Y--	Y--	Y--	Y--	---	Y--	Y--	
3. Bihar	---	Y--	Y--	Y--	Y--	---	Y--	Y--	Y--	Y--	Y--	
4. Gujarat	---	Y--	Y--	Y--	Y--	Y--	Y--	---	Y--	Y--	Y--	
5. J. & K.	---	Y--	Y--	Y--	Y--	---	---	Y--	---	---	Y--	
6. Kerala	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	---	---	Y--	
7. Madhya Pradesh	Y--	Y--	Y--	---	---	Y--	Y--	Y--	---	---	Y--	
8. Tamil Nadu	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	
9. Maharashtra	Y--	Y--	Y--	Y--	Y--	---	Y--	Y--	Y--	Y--	Y--	
10. Karnataka	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	
11. Orissa	---	Y--	Y--	Y--	Y--	---	Y--	Y--	Y--	Y--	Y--	
12. Punjab	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	Y--	
13. Rajasthan	---	Y--	Y--	Y--	Y--	Y--	Y--	---	---	---	Y--	
14. Uttar Pradesh	---	Y--	Y--	Y--	Y--	---	Y--	---	---	---	Y--	
15. West Bengal	---	Y--	Y--	Y--	Y--	---	---	---	---	---	Y--	

Note: V = Village councils; A = Area councils; D = District councils; - = Nil; Y = Yes

Source: Maddick (1970).

Table 4.9

Tax Powers of Local Governments, 1990

<i>Powers</i>	<i>Rural taxes</i>			<i>Urban taxes</i>		
	<i>Major</i>	<i>Minor</i>	<i>Total</i>	<i>Major</i>	<i>Minor</i>	<i>Total</i>
Exclusive	-	20	= 20	2	7	= 9
Concurrent	-	7	= 7	7	4	= 11
Total	-	27	= 27	9	11	= 20

Source: Detailed information in Appendix 4.2.

Table 4.10

Octroi and Non-octroi States, 1990-91

	Octroi states			Non-octroi states			
	Recently introduced Regional	Statewide	Thinking of abolition	Recently abolished	Substituted by		
					Local terminal toll	State Entry tax	Sales tax
1. Assam	Y ^a	-	-	1. Andhra Pradesh	-	-	-
2. Gujarat	-	-	Y	2. Arunchal Pradesh	-	-	-
3. Haryana	-	-	-	3. Bihar	-	-	-
4. Maharashtra	-	-	Y	4. Goa	-	-	-
5. Manipur	-	Y	-	5. Himachal Pradesh	Y	-	-
6. Meghalaya	-	Y	-	6. Jammu and Kashmir	Y	-	-
7. Orissa	-	Y	-	7. Karnataka	Y	-	Y ^c
8. Punjab	-	-	-	8. Kerala	-	-	-
9. Rajasthan	-	-	Y	9. Madhya Pradesh	Y	-	Y
10. West Bengal	Y ^d	-	-	10. Mizoram	-	-	-
				11. Nagaland	-	-	-
				12. Sikkim	-	-	-
				13. Tamil Nadu	-	-	-
				14. Tripura	-	-	-
				15. Uttar Pradesh	Y	-	Y

^aOnly on petroleum produce.^bUsed to cover the Telengana region.^cOnly on items subjected to central excise in lieu of sales tax.^dOnly in the Calcutta metropolitan area.

Note: - = No; Y = Yes

Chapter 5

Externally Aided Projects and State Finances

J.L. BAJAJ

In the early years of development planning in India, external assistance played a significant role in financing public sector investment. Official Development Assistance (ODA) financed, on average, 27 per cent of plan expenditure in the first three Five Year Plans and about 15.5 per cent in the Fourth and Fifth Plan periods (Table 5.1). External assistance has also been a stable source of balance of payments support to the economy. Since 1985 it has financed 12-15 per cent of total imports.

In the first half of the 1980s, foreign savings accounted for 6-7 per cent of Gross National Savings (Table 5.2). In recent years, this figure has increased to 10-11 per cent. The dependence on foreign savings for financing public sector investment has become significant. Foreign savings have accounted for less than three per cent of GDP, but between 1980-81 and 1984-85 they financed about 15 per cent and between 1985-86 and 1989-90 more than 22 per cent of gross fixed capital formation in the public sector. However, with declining access to foreign aid in the 1980s, the contribution of foreign aid to foreign saving fell from 103.2 per cent in 1980-81 to 47.1 per cent in 1985-86, followed by a light rebound to 54.8 per cent in 1989-90.

Within the overall framework of ODA, most inflows of funds are linked to pre-identified and mutually agreed investments. The bulk of these investments are project-specific and are in the public or governmental sectors; therefore they are incorporated into the respective plans of the central and state governments. Resource flows from external agencies in support of these investments are necessarily routed

to implementing agencies through the mechanism of plan transfers. The project-based framework of external funding is in consonance with the essentially schematic pattern of the plans, and, in fact, has reinforced the latter.

In recent years, several issues related to the external funding of development have been raised, reflecting increasing concerns among donor agencies and the Government of India (GOI) about the efficiency of utilization of foreign aid and its effectiveness. Issues relating to the adequacy of commitments, their composition and the terms and conditions on which they are extended have been highlighted by GOI. At the same time, the absorption of commitments in many sectors has been slower than expectations. Of growing concern to GOI in the light of its resource transfer objective, this is also indicative of less than adequate implementation performance. Continued slow absorption of external assistance may tend to undermine the rationale for expanding commitment levels. There is also at present an emphasis on the qualitative dimensions of aid transfers, based on an increasing recognition of the catalytic and complementary aspects of external assistance. These extend beyond the purely quantitative perspectives of resource support at the macro level.

The State Sector: Role and Performance

It is in this context that the role of the States of the Union and of the state sector in development assume significance. In the apportionment of developmental responsibilities, the states have been assigned a primary role. (The assignment of resources has not been commensurate, reflecting a Constitutionally mandated vertical imbalance in the federal structure.) In most spheres of developmental activity, including the critical areas of poverty alleviation, rural development, health, nutrition and education, the implementation role lies essentially, if not wholly, with the states. In the assigned sectors the states are called upon to develop and maintain infrastructure. In other sectors, the effectiveness of development initiatives is to a large extent dependent on interlinkages with state efforts and on the absorptive capacity of the states.

Table 5.3 shows the shares of developmental expenditures of the central government and the states, based on actual budgetary transactions. In some sectors, including many that have received relatively large support through external financing, the state sector dominates budgetary transactions (Table 5.4)

A significant (and increasing) proportion of ODA transfers are based on activities and expenditures in the state sector. This is partly

attributable to evolving changes in the composition of the external assistance portfolio. In the Fourth and Fifth Five Year Plans (1969-80), commitments of external assistance were concentrated in a limited range of sectors and activities within these sectors. The relatively rapid build up of commitments in the 1980s, in conjunction with emerging domestic resource constraints, brought to the fore limitations of absorptive capacity in several subsectors. The emergence of new sectors for external assistance was accentuated by continuing unresolved sectoral issues and also by shifts in donor policy. In many of the newer areas, the states are directly responsible for implementation, for instance in rural water supply, forestry and watershed management. In others, despite strong elements of central funding and policy guidance, state delivery mechanisms and infrastructure play a major role, for instance in family welfare. This trend is likely to continue, with the prospect of external financing of investments in education and health.

At the same time, the states have been increasingly constrained by adverse trends in their finances. This has led to a growing demand for "allocation" of externally aided projects, particularly from states that are less assured of central resource transfers. In the aggregate, the central government and the states have been in deficit on revenue account since 1982. This means that plans are being financed entirely through borrowing, as are also a portion of current and maintenance expenditures. The continuance of fiscal deficits has in turn impaired the ability of governments to finance developmental activities. In this environment, externally aided projects represent an additional source of development finance for the states and a means for them to take up projects.

The implementation and disbursement performance of state sector projects, however, seems to have been poorer than that of projects in the central or autonomous sectors. It appears, on the basis of a comparison of disbursement ratios for the period 1980-90, that state projects tend to take longer to implement than central projects (see Table 5.5 for some examples). State projects include those which are state financed and state implemented, for instance in the urban development and agriculture and irrigation sectors. They also include projects that are centrally funded but are implemented by state governments, for instance in the social forestry and family welfare sectors. In contrast, projects in the oil, railways and industry sectors exhibited a better performance from the perspective of utilization of commitments.

Cross-sectoral comparisons of this nature may not present a completely accurate picture. In addition to the respective capabilities

of the centre and the states, sectoral strategies and project design influence implementation performance. The slower implementation of state sector projects is partly due to project characteristics and those of the sectors in which they are concentrated. Typically, a state project has a longer implementation span and incorporates a complex set of interlinked investments in infrastructure and staff. A larger proportion of project costs in state-dominated sectors may need to be set aside for improvement of management and delivery systems and for training. Internal financing is likely to be uncertain, and access to external funds is gained through a time-consuming process of reimbursement, involving the accounting and compilation of disaggregated disbursements.

One of the few sectors where a comparative assessment can be made is electric power. Central and state governments both received external funding for similar types of power projects, for instance for investments in power generation by the National Thermal Power Corporation (NTPC) and the State Electricity Boards (SEBs). A comparison of disbursement ratios for World Bank assisted projects in the period 1980-90 shows a markedly better utilization performance by NTPC as compared with the SEBs (Table 5.5). To a considerable extent, NTPC's success is due to relatively assured funding and to the fact that its operations are confined to power generation. SEBs, on the other hand, conduct a range of operations, including generation, transmission and retail distribution, with far less organizational, infrastructure and resource support.

In many ways the SEBs are representative of state sector capabilities. The states are generally disadvantaged in comparison with the central government in terms of access to planning, design, technical and management expertise. (This is true as a general proposition, but it is more true of some states and some sectors than others.) These disadvantages have an impact not only at the institutional and project levels, but also at state planning and resource management levels. Planning, monitoring and evaluation capabilities tend to be limited; this in turn encourages ad-hocism and inhibits the development of longer-term sectoral perspectives. Similarly (and also partly as a consequence of tightening resource constraints), state finance departments devote the major part of their efforts to ways and means management.

Despite this, the state sector represents the pivot of developmental activities. It is difficult to envisage, given India's federal structure, a successful development strategy that does not significantly enhance the role of the state sector and its performance. Within the framework

of externally financed investments, there is also a need to factor in the state sector to a greater extent, and to compensate for deficiencies and disadvantages in project design, preparation and implementation.

The Framework of Centre-State Transfers

Despite the importance of the state sector in enabling external aid flows, until the mid 1970s there did not exist a formal mechanism for effecting centre-state transfers on this account. The need for such a mechanism stems from the fact that the states are not primary recipients of external resources. India's federal and fiscal framework, through a combination of statute and evolved practice, has effectively precluded the states from direct access to external borrowing or to the country's foreign exchange resources. (The management of both is highly centralized and is vested with GOI). It was only in 1976 that a system of clearly identifiable transfers on account of externally aided projects was initiated. Prior to this the disbursement cycle in external financing terminated with GOI, even for state sector projects.

The states did derive additional benefits from external assistance, to the extent that such assistance augmented the totality of plan resources. This in turn enhanced the capacity of the central government to spend on developmental activities and its ability to transfer resources to the states. Transfers to the latter were determined largely by the size of the "divisible pool" of plan resources and were allocated each year on the basis of the "Gadgil formula". A not unintended consequence, strengthened by the reimbursement characteristic of most external financing, was that this arrangement preserved an internally determined pattern of intersectoral and inter-regional distribution of plan resources. The additional resources generated by external flows were therefore shared among all states, not only those that undertook and implemented externally aided projects.

The initial modification of this equity-oriented and compartmentalized system took place in the Fifth Five Year Plan (1974-79). It took the form of an explicit resource incentive to prepare and implement externally aided projects. This measure was termed as "additionality" (ACA). Its introduction represented a break with established practices, since external assistance flows would no longer be overtly neutral in their impact on intersectoral and interstate allocations. Since then, through successive plan periods, the scope and extent of these incentives have been enhanced. ACA has progressively increased in size, as has also its relative significance as a resource for state plans.

Transfers of ACA were Rs 297 crores in 1975-80 and Rs 1551 crores in 1980-85. In the next five years (the Seventh Five Year Plan),

ACA transfers doubled to Rs 3,159 crores. Undoubtedly contributing significantly to the increases was the evolving policy on ACA, which has consistently moved toward a greater liberalization of its provisions. From initial coverage of a limited range of World Bank aided projects with predominantly local currency expenditures, the scope has been gradually widened to cover all externally aided projects in the state sector irrespective of their financing source and import intensity. Similarly, from an initial figure of 25 per cent of external receipts in 1975, the proportion transferred has been raised to 100 per cent for most implementing sectors from 1989 onwards. In 1989-90 ACA flows to the states increased by almost 55 per cent over the preceding year. A large part of the increase was due to full transfer of external receipts in the agriculture, rural development, irrigation and social service sectors.

Motivating the continuing liberalization of the incentive framework have been not only trends in government finances but also a related, gradual, and continuing build-up of committed but undisbursed resources for externally aided projects, including those in the state sector. Undisbursed commitments of external assistance by countries that are members of Aid India Consortium have grown steadily from Rs 20,016 crores in 1985-86 to Rs 25,665 crores in 1989-90 (Table 5.6). These figures, in conjunction with gross commitments and disbursement figures over the same period, indicate that utilization of external assistance has often not kept pace with commitments of external resource. Disbursements grew at marginally more modest rates, but they exhibited an accelerating trend between 1985 and 1989. An increasing proportion of disbursements were related directly or indirectly to the state sector, reflecting also a changing sectoral composition in favour of the social sectors and poverty alleviation programs.

The continuing liberalization of ACA should therefore be seen not only as a facilitating measure for the states and as a central transfer, but also in the light of the central government's own resource position and its need to gain access to additional foreign exchange flows. Of relevance here is the fact that this is an essentially incentive-based response by the centre, but the centre faces limits in continuing to expand these incentives. A related issue is the extent to which this solely incentive-based framework has improved project performance and facilitated the maintenance of an effective pipeline of projects for external funding.

Periodic liberalization of ACA provisions has led to increasing transfers to the states. In 1982-83 and 1989-90, there were discontinuous rises in ACA releases, undoubtedly largely as a result of

facilitating measures taken by the central government in the immediately preceding years. It would ordinarily be assumed that this would be a major factor in improving project performance, since counterpart funding (or the lack of it) has been singled out as a key factor in implementation delays. The actual impact of these measures on the implementation performance of individual projects is not very clear, however. ACA transfers serve (1) to augment the state plan size *ex-ante* and (2) to increase overall state receipts *ex-post*, but they do not necessarily flow to the sector of origin. Moreover, a large part of the efforts of state finance departments is currently devoted to ways and means management, at the expense of planning and longer-term resource perspectives. Hence the states may not be in a position to ensure that rising ACA inflows translate into enhanced resource availability for the projects concerned.

In this environment, it is possible that alternatives to an exclusively incentive-oriented framework may need to be considered, to provide a more direct linkage with project performance. For instance, earmarking of project resources for externally aided projects by the Planning Commission could be strengthened. While this has existed as a principle of allocation since the Seventh Plan, in practice it has been difficult to enforce. A related measure could be the formulation of explicit disincentives to diversion of project outlays to other sectors, or even to different schemes within the same sectors. These disincentives, to be effective, would need to be resource based. For example, linkage of plan transfers, or even a part of them, to adherence to an agreed project implementation and disbursement schedule could be envisaged.

In its present form, the ACA mechanism does not free the states from the obligation to put in their own resources upfront and to expend them on project activities prior to reimbursement. The benefits of pre-financing, or of advance disbursements in the form of revolving funds, are not always passed on to the states or to the implementing entities. If passed on and adequately earmarked, such funds may prove more useful in addressing project-specific counterpart fund issues than a further expansion of the incentive framework.

Terms and Conditions of Central Transfers

ACA is presently made available to the states on the same terms and conditions as other forms of central plan assistance. On several occasions the states have suggested that ACA transfers should instead be related to the terms on which they are received from donor agencies. Variations of this include the passing on of concessional

credits (for instance IDA) at the same rates of interest at which they are received or alternatively with a higher grant component. The Ninth Finance Commission (NFC, 1990) considered this issue and made specific recommendations to GOI, namely, that (1) for IBRD assistance the repayment period should be the same as prescribed by the Bank and (2) IDA assistance should be passed on as a loan at a rate of interest of six per cent per annum, with a repayment period of 30 years (including a grace period of five years). Until recently, plan assistance (and ACA) was extended by the central government at a rate of 9.75 per cent per annum, with a repayment period of 15 years. As a consequence of the acceptance of other recommendations of the NFC, the repayment period has been increased to 20 years, with 50 per cent of the loans carrying a grace period of five years.

The effective cost of borrowing from the World Bank includes the nominal rate of interest, commitment and service charges, front-end fees, and the additional costs due to variations in the exchange rate. In the period 1985-90, the cost of borrowing, including costs attributable to exchange fluctuations, averaged 12.97 per cent per annum for IDA credits and 19.97 per cent for IBRD loans. The weighted average cost of World Bank group borrowing was 17.89 per cent per annum, taking into consideration the respective commitments of IDA and IBRD in this period. ADB assistance also is expensive, closer to IBRD costs than to IDA. In the case of bilateral credits, if the interest rate structure, exchange risks and higher costs associated with source-tied supplies are taken into account, the overall costs are higher than those of borrowing from multilateral institutions.

The NFC assumed that the effective cost of borrowing of the states on account of ACA transfers was 6.8 per cent per annum, given the fact that such assistance is available in a 70-30 loan-grant mix. This calculation would only be valid however if 70 per cent is assumed to be a loan at 9.75 per cent rate of interest and the balance of 30 per cent an interest free loan. In fact, the latter is a non-recoverable grant, so the effective cost of borrowing is therefore less than six per cent. The NFC recommendation for IDA borrowings (which is based on a 100 per cent loan component), contrary to intent, would therefore imply raising the costs to the states of IDA transfers. For special category states (admittedly with a relatively low profile in external assistance), which receive plan funds as 90 per cent grant and only 10 per cent loan, the difference and additional costs would be considerable.

Similarly, the suggestion with respect to repayment periods for IBRD loans advocated by the NFC is unlikely to benefit the states. IBRD repayment periods commence with loan effectiveness, irres-

pective of the actual pattern of disbursements of funds. On the other hand, states repay ACA loans over 20 years from the date of disbursement of funds. State sector projects have average disbursement periods, depending on the sector, of 6-9 years, indicating a loan repayment period of 20-26 years. This is to their advantage in comparison with the IBRD repayment profile of 20 years.

There appears to be little advantage in seeking to further refine the terms and conditions associated with internal flows of externally originated assistance. Despite increasing flows, they still represent a relatively small proportion of aggregate central transfers (3.1 per cent in 1989-90). The issues of state indebtedness and of debt relief are much wider. In the more limited perspective of implementation of externally aided projects, it is unlikely that such measures would facilitate and expedite project implementation to any significant degree.

Aggregate ACA Transfers

An examination of aggregate annual net central transfers to the states and of flows of ACA in the period of 1980-90 shows near-stability in their relative proportions over the decade (Table 5.7). Despite major annual fluctuations in both, ACA flows ranged consistently between two and three per cent of net central transfers, tending to attain the upper end of the range toward the end of plan periods. The extraordinary growth of net transfers in 1982-83 and 1985-86 was on account of term loans (Rs 1,743 crores in 1982-83 and Rs 1,628 crores in 1985-86) extended by the central government for clearing overdrafts.

In the Sixth and Seventh Plans, aggregate ACA transfers increased, as did their role in plan financing. Transfers of ACA represented 3.2 per cent of aggregate intended state plan outlays in the Sixth Plan; this figure rose to 3.9 per cent in the Seventh Plan. If plan outlays and ACA transfers of special category states and union territories are excluded, i.e. only the major states are considered, the figures are 3.5 per cent and 4.3 per cent for the Sixth and Seventh Plans respectively. The unusual growth of ACA in the period from 1982-83 and in 1989-90 is essentially attributable to the impact of additional incentives, that is (1) extension of ACA coverage to import-intensive projects and activities in 1983 and (2) raising of the proportion passed on to the states from 70 per cent to 100 per cent in most sectors in 1989.

Interstate Allocations of ACA

Table 5.8 shows the pattern of actual releases of ACA to state governments in the mid- and late 1970s. While ACA amounted to Rs

135.20 crores during the Fifth Plan, in one year -- 1979-80 -- it increased to Rs 162.02 crores. In the period 1975-80 more than half of ACA was given to three states only, namely Andhra Pradesh, Karnataka and Maharashtra.

Table 5.9 provides similar data for the Sixth and Seventh Five Year Plans (1980-90). Two states (Maharashtra and Gujarat) accounted for over a third of ACA releases in the Sixth Plan. Four states (Maharashtra, Gujarat, Uttar Pradesh and Madhya Pradesh) received more than half of the releases in the Seventh Plan and, in particular, over 60 per cent of the releases in the last year of the Seventh Plan, 1989-90. (If the releases to Tamil Nadu are also taken into account, then almost 71 per cent of ACA flows went to just five states.) It is reasonably clear from the figures that external assistance flows are concentrated in few states.

In the Sixth Plan period Maharashtra received the largest ACA (Rs 326.1 crores), followed by Gujarat (Rs 208.49 crores) and Madhya Pradesh (Rs 119.70 crores). They accounted for 20.68 per cent, 13.45 per cent and 7.72 per cent respectively of total ACA released to the states. In the Seventh Plan, Uttar Pradesh displaced Maharashtra and was the largest recipient of ACA, amounting to Rs 492.16 crores (15.58 per cent of total ACA). Maharashtra got Rs 460.92 crores (14.59 per cent), Gujarat Rs 354.92 crores (11.24 per cent) and Madhya Pradesh Rs 338.90 crores (10.73 per cent). Punjab, on the other hand, got only Rs 33.78 crores as ACA in this period. Another way of looking at the importance of ACA is to relate it to normal central assistance. In the 1980s ACA has been a very important source of central transfers to Maharashtra, Haryana, Karnataka and Gujarat, as is evident from Table 5.10.

The concentration of external assistance is also illustrated by Table 5.11, which provides information on Gadgil formula based allocation and ACA transfers in the Seventh Plan period (1985-90). Among the states, the gainers were undoubtedly Gujarat and Maharashtra and, to a lesser extent, Orissa, Haryana, Madhya Pradesh and Karnataka. The special category states were clearly disadvantaged, as were Bihar, Andhra Pradesh, Punjab and Rajasthan. In some sense, however, the inclusion of special category states in this analysis is distortionary. The plans of these states are already heavily centrally funded, ranging from 81 per cent for Himachal Pradesh to 94 per cent in the case of Assam and full coverage of plans for Jammu and Kashmir, Manipur, Nagaland, Sikkim, Arunachal Pradesh and Mizoram. In per-capita terms plan transfers to these states are impressive multiples of transfers to other states. They are intended to compensate for their many

disadvantages, of which one is the relative lack of access to external funding sources. (In fact, since the plans are in effect wholly centrally financed, as is a major share of nonplan expenditures, there is little real incentive to seek external funding as an additional resource.)

Table 5.12 provides information for only the major states, excluding Gadgil allocations (and actual ACA flows) to the special category states. Clearly, there has been some impact on the pattern of regional distribution of central plan transfers among major states. This has only marginally, if at all, affected the special category states. The major beneficiaries have been Gujarat, Maharashtra, Orissa, Haryana, Karnataka, Madhya Pradesh and Tamil Nadu. In fact, if Punjab is excluded (for obvious reasons), the only major state with a per-capita income above the national average that has not gained ACA resources in excess of what it would otherwise have received is West Bengal.

ACA Allocations: A Sectoral Perspective

Planners in India traditionally have been sensitive to the possible distortionary effects of external financing. A related issue is the impact of external transfers on the sectoral allocation of resources. It is often claimed that the composition of external assistance extended by donor agencies has altered domestic priorities and the pattern of inter-sectoral allocations. At first glance this does not appear to be so. Since the additionality provisions are not formally operative for the central sector, the incremental impact of external flows should logically exist only in the state sector. Table 5.13 shows the pattern of ACA releases disaggregated by sector. In comparison of aggregates for all states of plan outlays and ACA trends, the displacement effect of externally aided projects is not readily apparent. This is because of the large absolute magnitudes of plan outlays and the relatively small size of ACA transfers.

An examination of disaggregated central and state data (Table 5.14) also confirms that externally aided projects have in general had little displacement effect. The largest disbursement of ACA in the Sixth Plan period was to the irrigation sector. This constituted only 8.18 per cent of total expenditure by the states on irrigation projects. In the Seventh Plan, external assistance was spread out and did not have a dominating influence on any sector.

Disbursements (and therefore ACA transfers) represent only a portion of total project costs, however. The proportion of state sector project costs eligible for foreign assistance has ranged between 50 and 70 per cent. In addition, there may be project-related costs that are either

not reimbursable at all (such as land acquisition costs) or are excluded from the formal definition of the project, perhaps because they are not incremental in nature. The corresponding state outlays are therefore likely to have been at least twice the volume of ACA transfers.

Moreover, not only is access to external assistance largely availed of by only a few states, but such assistance has been concentrated in a few sectors, namely, agriculture, irrigation, power and urban development. The irrigation sector accounted for over 50 per cent of external assistance flows in the Sixth Plan and 40 per cent in the Seventh Plan. More significantly 50 per cent of ACA flows based on expenditures on irrigation in 1989-90 went to only two states (Madhya Pradesh and Uttar Pradesh). Similarly, almost 65 per cent of power sector flows were attributable to expenditures of just two states (Uttar Pradesh and Maharashtra), as were 56 per cent of flows of ACA in the social services sectors (Gujarat and Tamil Nadu).

Equity considerations apart (for which there are several compensating mechanisms in India's framework of centre-state transfers), this concentration of external assistance has implications for the sustainability of the present pattern of externally aided projects in the state sector. The dilemma of the states is best illustrated by a few examples. In the Seventh Plan (1985-90), Karnataka spent approximately Rs 66 crores in the environment, forests, wildlife and soil conservation sectors. Of this expenditure, 74 per cent was accounted for by externally aided social forestry projects. (Despite this, the World Bank assisted project, which commenced in 1982-83, did not achieve its assigned targets and has required three annual extensions). In 1990-91, 73 per cent of allocations for the sector were earmarked for the World Bank assisted projects, resulting in only token provisioning for the other schemes.

In Uttar Pradesh in the Seventh Plan, plan expenditures on irrigation (major and minor) were Rs 1,834 crores. The Eighth Plan (1990-95) outlay is envisaged as Rs 2,720 crores. This is, however, likely to be reduced significantly in view of the state's difficulties in financing the plan. The actual availability of plan resources may therefore be at best around Rs 2,100 crores. There are as many as 44 ongoing projects, at various states of execution. The requirement of funds for ongoing projects has been conservatively estimated by the Planning Commission at Rs 4,100 crores (at 1989-90 prices). It is likely, according to the Commission, taking into account escalation factors, that the requirement of funds in the Eighth Plan on this account would be Rs 7,000 crores. Even if these resources were available, some of the projects (and therefore an additional requirements of funds) would

spill over further into Ninth Plan. Some of the currently ongoing projects actually commenced even before the Fifth Plan (1974-79). In its discussions with the state government on the Eighth Plan, the Commission laid down priorities for the projects. At the top of the list, ahead of interstate projects, pre-Fifth Plan projects and other ongoing projects, was the lone externally aided project in the subsector. This project commenced in 1982-83 and would still require an additional Rs 248 crores in the Eighth Plan.

This situation, to varying degrees, arises for externally aided projects in different sectors. The "crowding out" effect is to a great extent a consequence of ambitious but insufficiently funded plans. It is accentuated by project design factors, exchange rate fluctuations and implementation delays. This last problem in particular adds to both costs and resource requirements.

ACA and the Plans

An analysis of ACA in the context of the financing of state plans reveals substantial *ex ante* overestimation of ACA flows as an intended plan resource (see Table 5.15). Most states increased their intended aggregate plan outlays as reflected in the difference between revised and original Seventh Plan provisions, the exceptions being Gujarat (Rs 411 crores shortfall) and Haryana (Rs 34 crores). Most states also raised the intended contribution of ACA. ACA was revised downward only for Punjab (where there were no fresh projects in the Seventh Plan), Madhya Pradesh and Maharashtra (where extremely large initial provisions had been made). Aggregate normal central assistance to the states grew by 37 per cent to Rs 22,600 crores; ACA increased correspondingly (39 per cent) to Rs 5,120 crores. Aggregate plan sizes, however, increased by only nine per cent to Rs 78,250 crores. This shows that a larger component of state plans was being sought to be financed through central transfers. At almost Rs 28,000 crores, the latter represented 35.5 per cent of the revised total plan outlays, compared to 28 per cent of the original provisions.

With the exception of Rajasthan, no state actually attained its revised target for ACA, including the states which had revised their provisions downward. The closest state in this respect to Rajasthan was Punjab (which, however, is clearly exceptional), whose central plan assistance increased by over 500 per cent, but which had the lowest actual ACA provisioning (Rs 34 crores). Most states in the end did not even attain their original targets for ACA. The actual aggregate achievement was 84 per cent of the original target, or 60 per cent of the revised target.

These figures are particularly significant because (1) the revised

plan projections were formulated in 1988-89, with the knowledge of actual expenditures and trends for three plan years, and (2) at that stage, the further liberalization of ACA transfers, from 70 per cent of external disbursements to 100 per cent for most externally assisted projects in the state sector, was not anticipated. (This provision provided an estimated Rs 200 crores of ACA to the states in 1989-90 as unanticipated transfers.)

The above data clearly confirm the fact of substantial ex-ante overestimation of ACA as a plan resource and of "own" resources in state plans. This is largely explained by the desire to have larger plans and a corresponding political and systemic inability to confront or attempt to ameliorate a situation of inadequate resources. In modern India's development lexicon, a plan "cut" is often viewed as a management failure, particularly since the exercise of plan formulation takes place through a prolonged process of negotiations and accommodation. On the resources side, this has consistently resulted in overestimation, not only of ACA but of other relatively flexible funding sources, for instance the impact of Additional Resource Mobilization (ARM) measures put forward by the states and the contribution of state public enterprises and undertakings.

At the same time, the states (and for that matter, center) have been unable to stem the rising tide of nonplan expenditure, particularly (but not confined to) nonplan spending on revenue account. Revenue expenditures, in the aggregate, have consistently exceeded revenue receipts throughout the Seventh Plan. Negative balances from current revenue for most states have eroded the resource base of state plans. This has another implication for developmental activities and for externally aided projects: in the prevalent scheme of things, nonplan revenue expenditures get preference over plan expenditures and even within plan spending, revenue expenditures tend to displace capital expenditures, which therefore effectively get the lowest priority.

In this situation, externally aided projects are vulnerable on a number of counts. In the first place, they tend to be relatively expensive compared to domestically financed projects, partly on account of the need for additional project-specific management and support systems. Where the project is limited to a defined geographical area, or to only a part of the state, this may lead to duplication and the creation of costly parallel administrative structures. While many of the additional costs associated with such projects do lead to better and more sustainable project implementation, this may not always be so.

Equally important, the success of the preparation process for externally aided projects is often measured, by donor agencies and implementing departments alike, by the extent to which incremental plan resources are committed. For development-oriented depart-

ments, access to an externally aided project represents an opportunity to secure additional resources, administrative structures and staff (and thereby promotional avenues), vehicles, etc.

Departments consequently tend to underestimate project costs at the preparation stage. Also underplayed is the longer-term impact of recurrent liabilities that will be created by the project, partly intentionally and partly on account of inadequate attention to project financing, cost-effectiveness and viability at the preparation stage. This tendency, often encouraged by donor attention to the project, is to some extent offset by formal investment clearance procedures. More often, the skepticism of Finance Departments on the relative costs and benefits of externally aided projects plays a moderating role.

In the state plans, therefore, the impact of externally aided projects is sought to be inflated on the resources side. At the same time, there is a tendency to underplay the counterpart resources required in the form of state plan outlays. The latter phenomenon occurs essentially for three reasons: (1) limited resources; (2) many competing demands from different sectors (also reflective of the relative inability of a system of planning and allocation by consensus to prioritize); and (3) multiple priorities and schemes within sectors. Despite these issues, some of which can be ascribed to operational complexities of the planning process, external assistance has been of undoubted benefit to the states.

One of the key areas that require attention is procurement procedures and contract management. Contracting and procurement organizations in the states tend to work with outdated systems unsuitable to present-day project management techniques. There is a tendency to split contracts into very small lots. Contract sizes have to be sufficiently large for efficient execution. In addition, procedures are often not transparent and are inadequately publicized. There has been inevitable resistance from operational levels to the procurement process for externally aided projects. In fact, this is a major contributory factor delaying implementation.

Another area where action is required is project accounting and management systems. Government accounts are designed for different purposes and are often delayed in compilation, leading to reimbursement delays. As a result, externally aided projects have incorporated project-specific accounting systems.

In recent years, externally aided projects have become more attractive to the states on account of liberalized ACA provisions. In most states balance from current revenues is negative. At the same time, the central government's capacity to increase plan assistance is limited. There is consequently a growing need in the states to utilize external assistance for financing their projects.

Table 5.1

Flows of ODA, 1950-90

(Rs crores)

	<i>Gross ODA</i>	<i>Aggregate plan</i>	<i>Gross imports</i>	<i>ODA as per cent of plan</i>	<i>ODA as per cent of imports</i>
I-III Plan	4080.49	15208.5	14743	26.8	27.7
IV-V Plan	8615.91	55205.0	37552	15.6	22.9
VI Plan	8713.43	110467.3	73415	7.9	11.9
1985-86	2428.22	33059.9	19658	7.3	12.4
1986-87	3022.17	39149.7	20096	7.7	15.0
1987-88	4396.30	42920.6	22244	10.2	19.8
1988-89	4385.42	48069.8	28235	9.1	15.5
1989-90	4766.77	57016.9	35412	8.4	13.5

Table 5.2

Foreign Resources, Gross Savings and Investment

Item/year	1980-81	81-82	82-83	83-84	84-85	85-86	86-87	87-88	88-89	89-90
GDP (mp)	136013	159760	178132	207589	231387	261920	291974	332616	394992	442769
Gross National Savings	30880	36089	36634	41488	45450	57898	60093	74386	94432	106501
GNS as % of GDP	22.7	22.9	20.6	20.0	19.6	22.1	20.6	22.4	23.9	24.1
Foreign Savings (FS)	2094	2611	2566	2517	3292	6234	6355	6825	11134	10584
FS as % of GDP	1.5	1.6	1.4	1.2	1.4	2.4	2.2	2.1	2.8	2.4
FS as % of GNS	6.8	1.2	7.0	6.1	7.2	10.8	10.6	9.2	11.8	9.9
GFCE	26276	31455	35769	39991	45568	54255	61260	70838	83205	94837
GFCF-Public Sector (GFCFPS)	22693	14598	18586	20450	23396	27501	33254	34561	39542	46067
FS as % of GFCFPS	17.9	17.9	13.8	12.3	14.1	22.7	19.1	19.1	28.2	23
Foreign Aid	2162	1865	2252	2266	2359	2936	3605	5052	5304	5803
FA as % of Foreign Saving	103.2	71.4	87.8	90	71.7	47.1	56.7	74	47.6	54.8

Abbreviations:

GDP = Gross Domestic Product; FS = Foreign Savings; GFCF = Gross Fixed Capital Formation; GFCFPS = Gross Fixed Capital Formation in the Public Sector; and FA = Foreign Aid.

Note:

Estimates of GDP, savings and investment are the latest revised figures released by the CSO. The figures for 1989-90 are quick estimates. Foreign savings have been derived as the difference between the estimates of gross domestic capital formation (GDCF) and gross domestic savings (GDS), GNS is defined as the sum of GDS and FS. Foreign aid represents the latest information on gross disbursement of external assistance made available by CAA&A.

Table 5.3

Developmental Expenditure, 1985-90^a

(Rs. crore)

	1985-86	1986-87	1987-88	1988-89	1989-90	Total
Revenue Expenditure						
Center	11731 (45.1)	14067 (46.2)	16803 (46.2)	19971 (47.3)	25214 (47.3)	87786 (46.6)
States	14254 (54.9)	16408 (53.8)	19436 (53.6)	22208 (52.7)	28098 (52.7)	100404 (53.4)
Total	25985 (100.0)	30475 (100.0)	36269 (100.0)	42179 (100.0)	53312 (100.0)	188190 (100.0)
Capital Expenditure						
Center	6876 (55.2)	7820 (55.7)	6150 (48.3)	6548 (47.9)	8116 (50.8)	35510 (51.6)
States	5575 (44.8)	6225 (44.3)	6587 (51.7)	7118 (52.1)	7851 (49.2)	33356 (48.4)
Total	12451 (100.0)	14045 (100.0)	12737 (100.0)	13666 (100.0)	15967 (100.0)	68866 (100.0)
All Expenditures						
Center	18607 (48.4)	21887 (49.2)	22953 (46.9)	26519 (47.5)	33330 (48.1)	12396 (48.0)
States	19829 (57.6)	22633 (50.8)	26023 (53.1)	29826 (52.5)	35949 (51.9)	133760 (52.0)
Total	38436 (100.0)	44520 (100.0)	48976 (100.0)	55845 (100.0)	62927 (100.0)	257056 (100.0)

^a Figures in parentheses are percentages to the total expenditure in the relevant category. Data for states include the union territories.

Source: *Indian Economic Statistics (Public Finance)*, 1990, Department of Economic Affairs, Govt. of India.

Table 5.4

Developmental Expenditure by Sector, 1985-90

(Rs. crore and percent)

	Central government		State and Union Territories		Total
	Amount	Share of Total	Amount	Share of Total	
Education	7290	13.3	47702	86.7	54992
Health Water Supply	2537	10.9	20814	89.1	23351
Family Welfare	2870	86.2	4591	3.8	3329
Agriculture and allied services	8141	22.6	27885	77.4	36026
Power	7568	61.7	4704	38.3	12272
Irrigation	450	3.6	1199	96.4	12441
Other developmental expenditure	94440	82.4	20205	17.6	114645
Total	123296	48.0	133760	52.0	257056

Source: *Indian Economic Statistics (Public Finance)*, 1990; Department of Economic Affairs.

Table 5.5

Disbursement Performance of Externally assisted Projects in Selected Sectors

(Rs. crore and percent)

	<i>Urban development and water supply (State financed and implemented)</i>			<i>Forestry (centrally financed, state implemented)</i>			<i>Railways (centrally financed and implemented)</i>		
	<i>Open- ing</i>	<i>Dis- bursed</i>	<i>Clos- ing (incl. commit- ment)</i>	<i>Open- ing</i>	<i>Dis- bursed</i>	<i>Clos- ing (incl. commit- ment)</i>	<i>Open- ing</i>	<i>Disb- bursed</i>	<i>Clos- ing (incl. commit- ment)</i>
1980-81	1359	49	1428	420	4	452	996	17	1066
1981-82	1428	43	1509	452	11	408	1066	18	1140
1982-83	1509	68	1572	480	18	503	1140	60	1179
1983-84	1572	51	1657	503	22	524	1179	34	1247
1984-85	1657	88	1713	524	34	535	1247	40	1309
1985-86	1713	84	1777	535	33	548	1309	50	1373
1986-87	1777	177	1753	548	76	519	1373	91	1401
1987-88	1753	128	1777	519	70	494	1401	136	1386
1988-89	1777	196	1735	494	104	433	1386	270	1235
1989-90	1735	160	1729	433	119	351	1235	245	1098
	<i>National Thermal Power Corporation</i>						<i>State Electricity Boards (states)</i>		
	<i>Undisbursed commitments</i>	<i>Disburse- ments</i>	<i>Disburse- ment ratio</i>	<i>Undisbursed commitments</i>	<i>Disburse- ments</i>	<i>Disburse- ment ratio</i>			
1985-86	8905	253	3.7	3899	209	5.4			
1986-87	7252	415	5.7	4029	133	3.3			
1987-88	7467	703	10.3	4245	111	2.6			
1988-89	7413	887	11.9	4503	234	5.2			
1989-90	7031	1222	17.4	4661	215	4.6			

Table 5.6

ODA Commitments and Disbursements (1985-90)

(Rs. crore)

<i>Year</i>	<i>Aid India consortium pledges</i>	<i>Undisbursed commitments beginning of the year</i>	<i>Disbursements during the year</i>	<i>Disbursement ratios (percent)</i>
<i>1985-86</i>				
Multilateral	3357	14577	1264	8.7
Bilateral	1405	5439	999	18.4
Total	4762	20016	2263	11.3
<i>1986-87</i>				
Multilateral	3904	13313	1740	13.1
Bilateral	1816	4440	1430	32.2
Total	5720	17753	3170	17.8
<i>1987-88</i>				
Multilateral	4237	12127	2997	24.7
Bilateral	2835	3620	1770	48.9
Total	7072	15747	4767	30.2
<i>1988-89</i>				
Multilateral	5295	18367	3233	17.6
Bilateral	3738	4818	1373	28.5
Total	9033	23185	4606	19.9
<i>1989-90</i>				
Multilateral	6383	17194	3267	19.0
Bilateral	3721	8471	1808	21.3
Total	10104	25665	5075	19.8

Table 5.7

Central Transfers of Resources to States and Union Territories, 1989-90

	1980-81	81-82	82-83	83-84	84-85	85-86	86-87	87-88	88-89	89-90
	(Rs. crore)									
Total GOI receipts	23572	27074	31598	36434	44705	54359	64665	70486	61791	90155
Net transfers to the states and UTs	9010	9395	12822	13882	14720	22262	21195	24870	27485	30794
ACA flows	181	211	302	424	433	462	545	603	609	939
Net transfers as a proportion of total receipts	37.9	34.7	40.6	36.7	32.9	40.9	32.8	35.3	33.6	34.2
ACA flows as a proportion of net transfer	2.0	2.2	2.4	3.2	3.0	2.1	2.6	2.4	2.2	3.0
Rate of growth of ACA flows	--	16.6	43.1	40.4	2.1	6.7	18.0	10.6	1.0	54.2
Rate of growth of net transfers	--	4.3	36.5	4.4	10.0	51.2	4.8	17.3	10.5	10.7

Table 5.8

ACA Releases to Different States, 1974-80

(Rs. crore)

	<i>Fifth Plan (1974-75 to 1978-79)</i>	<i>Plan Holiday (1979-80)</i>	<i>Total</i>	<i>Percent of total ACA</i>
Andhra Pradesh	43.81	44.21	88.02	29.6
Bihar	1.09	1.84	2.93	1.0
Gujarat	1.73	16.84	18.57	6.3
Haryana	2.91	11.04	13.95	4.7
Karnataka	20.02	14.51	34.53	11.6
Kerala	3.20	2.08	5.28	1.8
Madhya Pradesh	10.29	3.33	13.62	4.6
Maharashtra	6.88	23.98	30.86	10.4
Orissa	4.72	7.44	12.16	4.1
Punjab	1.00	4.77	5.77	1.9
Rajasthan	16.28	4.65	20.93	7.0
Tamil Nadu	2.46	4.01	6.47	2.2
Uttar Pradesh	15.39	6.30	21.65	7.3
West Bengal	2.39	16.17	18.56	6.2
Major States	132.09	161.17	293.26	98.7
Other states	3.11	0.89	4.00	1.3
Total	135.20	162.06	297.26	100.0

Table 5.9

ACA Releases to States 1989-90

	1980-81	81-82	82-83	83-84	84-85	85-86	86-87	87-88	88-89	89-90
Andhra Pradesh	28.14	17.03	18.91	21.70	23.68	7.55	15.24	13.67	35.78	38.09
Bihar	2.63	3.89	8.94	8.39	10.63	14.58	37.98	25.34	32.37	12.62
Gujarat	17.40	28.41	45.31	56.19	61.18	37.12	42.28	76.71	62.87	135.99
Haryana	14.81	9.91	12.62	22.56	21.46	20.74	21.17	16.79	13.76	21.55
Karnataka	11.21	10.25	13.38	22.23	38.09	44.70	39.50	23.39	31.03	44.81
Kerala	0.14	0.20	9.83	21.26	13.00	20.39	24.11	29.66	35.35	24.87
Madhya Pradesh	1.72	4.13	22.19	39.14	52.52	60.95	63.38	71.86	53.32	89.39
Maharashtra	44.87	54.06	60.43	86.12	75.13	98.54	89.67	88.18	81.45	103.08
Orissa	12.34	15.65	14.89	23.30	29.38	37.26	56.93	52.20	62.07	58.13
Punjab	11.95	15.04	12.55	11.63	14.32	12.76	14.29	3.56	3.13	--
Rajasthan	2.70	10.15	18.83	18.45	12.42	19.29	23.15	16.42	28.13	9.35
Tamil Nadu	5.64	11.16	12.62	26.48	28.20	23.72	38.51	58.25	52.04	95.49
Uttar Pradesh	8.96	11.12	29.07	34.36	30.06	34.60	44.67	96.55	76.55	239.79
West Bengal	16.72	17.46	20.92	22.50	13.42	14.84	23.55	18.93	27.24	49.15
Major States	179.21	208.27	300.48	414.30	423.50	447.04	534.42	591.36	595.10	922.29
Other States	1.42	2.45	1.85	9.58	9.59	15.26	10.96	11.82	13.82	16.76
Total	180.63	210.72	302.33	423.89	433.08	462.30	545.38	603.17	608.92	939.05

(Rs. crore)

Table 5.10

ACA in Relation to Total Central Plan Assistance*(Rs. crore)*

	<i>Central assistance released in the Sixth Plan</i>		<i>Percent of central assistance</i>		<i>Central assistance released in the Seventh Plan</i>		<i>Percent of central assistance</i>	
		ACA				ACA		
1. Andhra Pradesh	898	109	12.13		1628	110	6.75	
2. Arunachal Pradesh	--	--	--		--	--	--	
3. Assam	1216	9	0.07		2521	6	0.23	
4. Bihar	1400	34	2.42		2545	123	4.83	
5. Goa	--	--	--		--	--	--	
6. Gujarat	438	208	47.48		781	355	45.45	
7. Haryana	210	81	38.50		339	94	27.72	
8. Himachal Pradesh	449	12	2.67		945	35	3.70	
9. Jammu & Kashmir	1054	4	0.37		2157	20	0.92	
10. Karnataka	469	95	20.25		829	183	22.07	
11. Kerala	439	44	10.02		1067	134	12.55	
12. Madhya Pradesh	965	120	12.43		1531	339	22.10	
13. Maharashtra	748	321	42.90		1257	461	36.67	
14. Manipur	287	--	--		606	--	--	
15. Meghalaya	249	--	--		525	--	--	
16. Mizoram	--	--	--		--	--	--	
17. Nagaland	291	--	--		706	--	--	
18. Orissa	663	96	14.47		1060	267	25.18	
19. Punjab	272	65	23.89		420	34	8.00	
20. Rajasthan	661	63	9.53		1259	96	7.62	
21. Sikkim	136	--	--		288	--	--	
22. Tamil Nadu	673	84	12.48		1408	268	18.25	
23. Tripura	267	--	--		660	9	--	
24. Uttar Pradesh	2094	114	5.44		3498	492	14.00	
25. West Bengal	670	91	13.58		1134	134	11.81	
Total	14549	1550			27164	3160		

Table 5.11

ACA Allocations and Gadgil Transfers

	(Rs. crore)				
	Allocations (Gadgil formula)	Actual ACA releaseses	Hypothetical ACA transfers	Difference	Difference as a proportion of transfers
Special Category States	7102.05	68.62	944.45	-875.83	-12.3
Major States	16932.37	3055.74	2179.91	875.83	5.3
Andhra Pradesh	1483.47	110.34	197.28	86 94	-5.9
Bihar	2134.74	122.88	283.88	-161.00	-7.5
Gujarat	607.63	354.97	80.80	274.17	45.1
Haryana	323.46	94.01	43.01	51.00	15.8
Karnataka	767.72	183.42	102.09	81.33	10.6
Kerala	923.57	123.37	122.82	11.55	1.3
Madhya Pradesh	1400.35	338.90	186.22	152.68	10.9
Maharashtra	1169.82	460.91	155.57	305.34	26.1
Orissa	910.43	266.59	121.07	145.52	16.0
Punjab	383.73	33.74	51.03	-17.29	-4.5
Rajasthan	1096.46	96.34	145.81	-49.47	-4.5
Tamil Nadu	1238.49	268.00	164.70	103.30	8.3
Uttar Pradesh	2944.85	457.55	391.61	65.94	2.2
West Bengal	1007.65	133.72	134.00	-0.28	--
Total	23494.42	3124.36	3124.36	--	--

Note: The first column indicates the allocations in the Seventh Plan resulting from an application of the modified Gadgil formula and incorporated in the original resource exercise of the plan. From the divisible pool of plan resources, the needs of the special category states were first catered to, and the balance allocated amongst major states, on the basis of population, per-capita income, special needs and relative tax effort. The second column indicates the actual ACA releases, while the third column provides an alternative, hypothetical allocation of the ACA resources, based on the same principles as the modified Gadgil formula allocations, i.e., as if the external flows based on state sector expenditures were re-allocated, not to the states from which the expenditures originated, but to the divisible pool of plan resources. The fourth column shows the difference between the second and third one, while the last column represents the difference expressed as a proportion of the originally derived Gadgil allocations of 'normal' central assistance.

Table 5.12

**ACA Allocations and Gadgil Transfers for Major States,
1985-90**

(Rs. crore)

	<i>Allocations (Gadgil formula)</i>	<i>Actual ACA releases</i>	<i>Hypothetical ACA transfers</i>	<i>Difference</i>	<i>Difference as a proportion of transfers</i>
Andhra Pradesh	1483.47	110.34	276.58	-166.24	-11.2
Bihar	2134.74	122.88	397.94	-275.06	-12.9
Gujarat	607.63	354.97	113.27	241.70	39.8
Haryana	323.46	94.01	60.30	33.71	10.4
Karnataka	767.72	183.42	143.11	40.31	5.3
Kerala	923.57	123.37	172.16	-37.79	-4.1
Madhya Pradesh	1400.35	338.90	261.04	77.86	5.6
Maharashtra	1169.82	460.91	218.07	242.84	20.8
Orissa	910.43	266.59	169.72	96.87	10.6
Punjab	383.73	33.74	71.53	-37.79	-9.8
Rajasthan	1096.46	96.34	204.39	-108.05	-9.9
Tamil Nadu	1238.49	268.00	230.87	37.13	3.0
Uttar Pradesh	2944.85	457.55	548.96	-91.41	-3.1
West Bengal	1007.65	133.72	187.84	-54.12	-5.4
All Major States	23494.42	3124.36	3055.74		

Table 5.13

Sectoral Composition of ACA, 1980-90

(Rs. crore)

	Agriculture	Rural Deve- lopment	Irri- gation	Power	Indus- try	Trans- port	Social services	Total
1980-81	21.5	21.0	97.9	17.9	--	--	22.2	180.6
1981-82	24.6	9.8	123.3	14.4	0.1	4.3	41.6	210.7
1982-83	34.9	4.2	157.7	28.6	1.8	17.8	57.4	302.3
1983-84	46.9	1.6	227.1	57.9	2.7	12.1	75.6	423.9
1984-85	68.3	0.8	243.3	41.0	3.8	7.6	68.3	433.1
1985-86	72.6	2.1	239.2	47.5	3.7	4.5	92.6	462.3
1986-87	122.2	4.5	220.3	63.9	4.6	1.4	128.5	545.4
1987-88	90.7	--	254.5	94.1	5.0	1.8	157.1	603.2
1988-89	90.8	0.2	253.8	112.9	3.5	6.7	11.0	608.9
1989-90	161.9	1.0	285.1	206.2	0.5	12.6	271.8	939.1
VI Plan	196.2	37.4	849.3	159.8	9.1	59.1	260.0	1550.6
VII Plan	538.1	9.8	1253.0	524.6	17.3	27.1	790.1	3158.9

Table 5.14

Plan Outlays and ACA Transfers

(Rs. crore)

	Plan outlays (States, UTs)			ACA transfers		
	Sixth Plan	Seventh Plan	1989-90	Sixth Plan	Seventh Plan	1989-90
Agr. & Rural Dev.	7339.02	10223.1	4095.5	233.6	545.9	162.9
Irrigation	8301.46	15223.39	3666.7	849.3	125.0	285.1
Power	14293.56	22786.15	5955.1	159.8	524.6	206.2
Industry	2074.33	3464.48	1098.1	9.1	17.3	0.5
Transport	3604.78	5608.19	1557.0	59.1	27.1	12.7
Social Services	9495.44	17782.96	5766.8	260.0	790.1	271.8
Total	45108.59	75088.27	23151.6	1550.1	3158.8	939.1

Table 5.15

**ACA as a Resource for the State Plans
during the Seventh Plan**

(Rs. crore)

	Original Provisions			Revised Provisions			ACA actuals	Attainment of revised ACA target (percent)
	Plan outlay	Normal central assis- tance	ACA resource	Plan outlay	Normal central assis- tance	ACA reso- urce		
Andhra Pradesh	5200	1483	158	5560	1818	207	110	53
Bihar	5100	2135	170	6901	2677	345	123	36
Gujarat	6000	698	358	5589	865	528	35	67
Haryana	2900	323	71	2866	626	103	94	91
Karnataka	3575	768	114	4226	926	204	183	90
Kerala	2100	924	217	2211	1266	222	134	61
Madhya Pradesh	7000	1400	496	7663	1752	443	339	76
Maharashtra	10500	1170	620	11190	140	585	461	79
Orissa	2700	910	242	3560	1113	427	268	62
Punjab	3285	384	84	3314	2457	35	34	95
Rajasthan	3000	1096	58	3105	1363	74	96	130
Tamil Nadu	5750	1238	216	6180	1563	305	268	88
Uttar Pradesh	10447	2945	670	11512	3445	1461	458	31
West Bengal	4125	1008	215	4379	1215	177	134	76
All Major States	71682	16482	3689	78255	22621	5117	3090	60

Source: Seventh Five Year Plan and Mid-Term Review.

Annexure 1

Additional Central Assistance released to States (Sectorwise) during the year 1980-81

(Rs. in lakhs)

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Mines	Transport	Social services	Area development	Others	Total
1. Andhra Pradesh	63.1	--	1323.2	55.3	1240.3	--	--	132.4	--	--	2814.3
2. Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
3. Assam	79.6	--	--	--	--	--	--	--	--	--	79.6
4. Bihar	94.3	21.7	--	--	146.6	--	--	--	--	--	262.6
5. Goa	--	--	1239.0	--	--	--	--	--	--	--	1239.0
6. Gujarat	363.6	--	1411.5	--	137.2	--	--	--	--	--	1912.3
7. Haryana	69.2	--	--	--	--	--	--	--	--	--	69.2
8. Himachal Pradesh	60.4	--	--	--	--	--	--	--	--	--	60.4
9. Jammu & Kashmir	1.6	--	--	--	--	--	--	--	--	--	1.6
10. Karnataka	166.5	--	943.7	--	9.2	--	--	1.2	--	--	1120.6
11. Kerala	--	--	--	--	13.6	--	--	--	--	--	13.6

S. No.	State	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport services	Social services	Area development	Others	Total
12.	Madhya Pradesh	172.0	--	--	--	--	--	--	--	--	--	172.0
13.	Maharashtra	--	--	3311.1	--	188.2	--	--	987.7	--	--	4487.0
14.	Manipur	--	--	--	--	--	--	--	--	--	--	--
15.	Meghalaya	--	--	--	--	--	--	--	--	--	--	--
16.	Mizoram	--	--	--	--	--	--	--	--	--	--	--
17.	Nagaland	--	--	--	--	--	--	--	--	--	--	--
18.	Orissa	455.0	--	779.7	--	-0.5	--	--	--	--	--	1234.3
19.	Punjab	--	--	510.3	--	--	--	--	581.0	103.3	--	1194.6
20.	Rajasthan	205.8	--	--	--	--	--	--	64.3	--	--	270.1
21.	Sikkim	--	--	--	--	--	--	--	--	--	--	--
22.	Tamil Nadu	--	--	163.1	55.3	3.3	--	--	--	342.2	--	563.9
23.	Tripura	--	--	--	--	--	--	--	--	--	--	--
24.	Uttar Pradesh	304.5	--	--	--	--	--	--	454.2	137.2	--	895.9
25.	West Bengal	118.5	--	--	--	54.5	--	--	--	1498.7	--	1671.7
Total		2154.0	21.7	9681.6	110.6	1792.6	--	--	2220.9	2081.4	--	18062.6

Annexure 2

Additional Central Assistance released to States (Sectorwise) during the year 1981-82

(Rs. in lakhs)

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
1. Andhra Pradesh	181.1	--	1080.4	44.7	92.0	--	--	304.8	--	--	1703.1
2. Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
3. Assam	43.4	--	--	--	--	--	--	--	--	--	43.4
4. Bihar	25.9	--	--	--	334.9	--	28.7	--	--	--	389.4
5. Goa	--	--	--	--	--	--	--	--	--	--	--
6. Gujarat	515.0	--	2056.0	--	107.9	--	--	162.3	--	--	2841.2
7. Haryana	57.4	--	933.4	--	--	--	--	--	--	--	990.09
8. Himachal Pradesh	188.6	--	--	--	--	--	--	--	--	--	188.6
9. Jammu & Kashmir	13.2	--	--	--	--	--	--	--	--	--	13.2
10. Karnataka	160.4	--	781.1	--	6.0	77.4	--	--	--	--	1024.9
11. Kerala	--	--	--	--	--	--	--	--	--	1.6	1.6

S. State No.	Agriculture development	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
12. Madhya Pradesh	130.3	--	158.0	--	--	--	--	38.0	--	87.0	413.3
13. Maharashtra	--	--	3802.2	--	678.8	--	--	924.7	--	--	5405.7
14. Manipur	--	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--	--
18. Orissa	254.8	--	1291.0	18.9	0.0	--	--	--	--	--	1564.7
19. Punjab	--	--	859.8	--	--	--	--	525.7	118.3	--	1503.8
20. Rajasthan	314.7	--	270.0	--	--	--	--	429.8	--	--	1014.5
21. Sikkim	--	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	58.8	--	123.9	38.5	8.6	--	--	886.2	--	--	1116.0
23. Tripura	--	--	--	--	--	--	--	--	--	--	--
24. Uttar Pradesh	310.8	--	--	--	--	--	--	792.3	--	8.4	1111.5
25. West Bengal	202.9	--	--	59.9	215.8	--	406.0	--	861.7	--	1746.3
Total	2457.4	--	11355.7	162.0	1444.1	77.4	434.7	4063.8	980.0	97.0	21072.2

Annexure 3

Additional Central Assistance released to States (Sectorwise) during the year 1982-83

(Rs. in lakhs)

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
1. Andhra Pradesh	89.7	--	811.0	--	848.4	--	--	142.0	--	--	1891.2
2. Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
3. Assam	151.2	--	--	--	--	--	--	--	--	--	151.2
4. Bihar	67.9	--	347.9	--	22.0	--	456.4	--	--	--	894.2
5. Goa	--	--	--	--	--	--	--	--	--	--	--
6. Gujarat	783.3	--	3261.4	--	37.6	--	--	384.9	--	63.7	4530.9
7. Haryana	84.6	--	1177.3	--	--	--	--	--	--	--	1262.0
8. Himachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
9. Jammu & Kashmir	33.4	--	--	--	--	--	--	--	--	--	33.4
10. Karnataka	511.8	--	646.5	--	--	179.8	--	--	--	--	1338.0
11. Kerala	67.2	--	821.8	--	--	--	--	91.5	--	2.8	983.3

<i>S. State No.</i>	<i>Agriculture</i>	<i>Rural development</i>	<i>Irrigation</i>	<i>Flood Control & cyclone protection</i>	<i>Power</i>	<i>Industry & Minerals</i>	<i>Transport services</i>	<i>Social development</i>	<i>Others</i>	<i>Total</i>
12. Madhya Pradesh	350.4	--	1594.6	--	--	--	--	--	273.7	2218.7
13. Maharashtra	147.0	--	3794.1	--	145.3	--	--	1956.5	--	6042.9
14. Manipur	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--
18. Orissa	56.0	--	1428.9	3.6	--	--	--	--	--	1488.5
19. Punjab	--	--	700.2	--	--	--	--	382.2	172.2	1254.7
20. Rajasthan	247.5	--	1041.6	--	--	--	--	593.6	--	1882.7
21. Sikkim	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	423.5	--	141.4	--	--	--	--	697.2	--	1262.1
23. Tripura	--	--	--	--	--	--	--	--	--	--
24. Uttar Pradesh	291.2	--	--	--	1479.0	--	--	1121.5	--	2907.1
25. West Bengal	186.2	--	--	--	323.1	--	1322.3	--	246.4	2091.9
Total	3490.9	--	15766.8	3.6	2855.4	179.8	1778.7	5369.4	418.6	36932.7

Annexure 4

Additional Central Assistance released to States (Sectorwise) during the year 1983-84

(Rs. in lakhs)

S. No.	State	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport services	Social Area development	Others	Total
1.	Andhra Pradesh	170.7	--	1569.0	--	354.7	--	--	75.2	--	2169.6
2.	Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--
3.	Assam	73.1	--	--	--	397.6	--	--	--	--	470.7
4.	Bihar	43.4	--	319.9	--	99.4	--	376.6	--	--	839.3
5.	Goa	--	--	--	--	--	--	--	--	--	--
6.	Gujarat	626.5	--	4830.9	--	7.9	--	--	129.7	23.8	5618.9
7.	Haryana	261.8	--	1902.5	--	91.7	--	--	--	--	2256.0
8.	Himachal Pradesh	--	--	--	--	--	--	--	356.2	--	356.2
9.	Jammu & Kashmir	--	--	--	--	--	--	--	131.7	--	131.7
10.	Karnataka	630.5	--	1318.6	--	--	273.7	--	--	--	2222.9
11.	Kerala	88.2	--	676.2	204.3	982.5	--	--	174.4	--	2125.6

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport services	Social development	Others	Total
12. Madhya Pradesh	508.5	--	3211.4	--	--	--	194.0	--	--	3913.9
13. Maharashtra	472.2	--	4605.4	--	294.7	--	3239.5	--	--	8611.8
14. Manipur	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--
18. Orissa	140.7	--	1509.7	22.6	646.8	--	10.5	--	--	2330.2
19. Punjab	--	--	695.1	--	--	--	468.3	--	--	1163.4
20. Rajasthan	41.0	--	1263.9	--	--	--	539.7	--	--	1844.6
21. Sikkim	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	343.0	--	445.2	--	1153.6	--	706.3	--	--	2648.1
23. Tripura	--	--	--	--	--	--	--	--	--	--
24. Uttar Pradesh	811.2	--	--	--	1717.1	--	877.4	--	30.1	3435.9
25. West Bengal	477.8	--	--	135.0	41.5	--	828.8	606.9	159.7	2249.8
Total	4688.8	--	22347.6	361.9	5787.6	273.7	1205.4	7509.8	159.7	53.9 42388.6

Annexure 5

Additional Central Assistance released to States (Sectorwise) during the year 1984-85

(Rs. in lakhs)

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
1. Andhra Pradesh	185.6	--	1298.5	25.0	717.4	--	--	141.5	--	--	2368.0
2. Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
3. Assam	177.8	--	--	--	--	--	--	--	--	--	177.8
4. Bihar	35.7	--	593.6	--	--	--	434.0	--	--	--	1063.3
5. Goa	--	--	--	--	--	--	--	--	--	--	--
6. Gujarat	808.5	--	4789.2	--	--	--	--	519.9	--	--	6117.6
7. Haryana	347.9	--	1798.3	--	--	--	--	--	--	--	2146.2
8. Himachal Pradesh	--	--	--	--	--	--	--	584.2	--	--	584.2
9. Jammu & Kashmir	--	--	--	--	--	--	--	196.9	--	--	196.9
10. Karnataka	1363.6	--	2082.8	--	--	--	382.8	--	--	--	3809.2
11. Kerala	143.5	--	621.6	31.5	330.2	--	--	173.1	--	--	1299.8

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
12. Madhya Pradesh	633.2	--	4539.3	--	--	--	--	79.8	--	--	5252.2
13. Maharashtra	757.5	--	3602.4	--	30.1	--	--	3122.7	--	--	7512.6
14. Manipur	--	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--	--
18. Orissa	145.9	--	2057.3	49.6	685.3	--	--	--	--	--	2938.1
19. Punjab	--	--	1189.3	--	--	--	--	242.9	--	--	1432.2
20. Rajasthan	6.0	--	922.5	--	--	--	--	313.6	--	--	1242.1
21. Sikkim	--	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	1125.7	--	517.3	8.8	689.8	--	--	478.3	--	--	2819.8
23. Tripura	--	--	--	--	--	--	--	--	--	--	--
24. Uttar Pradesh	686.5	--	218.4	--	1645.0	--	--	456.3	--	--	3006.1
25. West Bengal	410.7	--	--	135.0	--	--	329.7	523.6	77.7	--	1341.7
Total	6828.1	--	24210.5	115.0	4097.8	382.8	763.7	6832.8	77.7	--	43308.4

Annexure 6

Additional Central Assistance released to States (Sectorwise) during the year 1985-86

(Rs. in lakhs)

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport services	Social Area development	Others	Total
1. Andhra Pradesh	152.2	--	394.8	--	106.4	--	--	101.8	--	755.2
2. Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--
3. Assam	--	--	--	--	454.3	--	--	--	--	454.3
4. Bihar	222.3	--	967.2	--	--	268.1	--	--	--	1457.6
5. Goa	--	--	--	--	--	--	--	--	--	--
6. Gujarat	736.7	--	2272.4	--	--	--	702.6	--	--	3711.6
7. Haryana	329.7	--	1726.9	--	17.6	--	--	--	--	2074.2
8. Himachal Pradesh	160.2	--	--	--	--	--	265.3	16.2	--	441.7
9. Jammu & Kashmir	203.3	--	--	--	--	--	--	--	--	203.3
10. Karnataka	1519.9	--	2548.0	--	--	374.9	--	26.9	--	4469.7
11. Kerala	442.4	--	1003.8	110.8	139.8	--	--	342.4	--	2099.1

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
12. Madhya Pradesh	701.0	4953.2	--	28.7	--	--	412.4	--	--	--	6095.2
13. Maharashtra	962.2	--	3122.4	--	1927.8	--	--	3841.1	--	--	9853.6
14. Manipur	--	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--	--
18. Orissa	179.2	--	2404.1	--	980.2	--	--	162.8	--	--	3726.3
19. Punjab	--	--	930.3	--	--	--	--	345.6	--	--	1275.9
20. Rajasthan	98.0	--	1297.8	--	--	--	--	533.4	--	--	1929.2
21. Sikkim	--	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	593.9	--	692.4	--	39.4	--	--	1045.9	--	--	2371.5
23. Tripura	--	--	--	--	426.6	--	--	--	--	--	426.6
24. Uttar Pradesh	605.1	--	1446.9	--	633.5	--	--	718.0	56.7	--	3460.2
25. West Bengal	349.6	--	--	52.7	--	--	184.8	761.6	135.6	--	1484.3
Total	7255.6	--	23760.2	163.5	4754.3	374.9	452.9	9259.7	208.5	--	46229.6

Annexure 7

Additional Central Assistance released to States (Sectorwise) during the year 1986-87

(Rs. in lakhs)

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
1. Andhra Pradesh	579.4	--	152.8	243.5	--	--	--	548.7	--	--	1524.3
2. Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
3. Assam	--	--	--	--	10.7	--	--	--	--	--	10.7
4. Bihar	--	--	--	--	3660.8	--	137.2	--	--	--	3798.0
5. Goa	--	--	--	--	--	--	--	--	--	--	--
6. Gujarat	698.0	--	2493.4	--	45.2	--	--	991.7	--	--	4228.3
7. Haryana	303.1	--	1768.9	--	44.6	--	--	--	--	--	2116.6
8. Himachal Pradesh	525.3	--	--	--	15.7	--	--	112.5	--	--	653.5
9. Jammu & Kashmir	414.7	--	--	--	--	--	--	--	--	--	414.7
10. Karnataka	1771.6	--	1626.1	--	--	460.9	--	91.3	--	--	3950.0
11. Kerala	1908.2	--	--	--	90.8	--	--	411.6	--	--	2410.6

<i>S. State No.</i>	<i>Agriculture</i>	<i>Rural development</i>	<i>Irrigation</i>	<i>Flood Control & cyclone protection</i>	<i>Power</i>	<i>Industry & Mines</i>	<i>Transport</i>	<i>Social services</i>	<i>Area development</i>	<i>Others</i>	<i>Total</i>
12. Madhya Pradesh	1062.1	--	4742.1	--	74.2	--	--	459.4	--	--	6337.7
13. Maharashtra	1065.8	--	3012.8	--	196.7	--	--	4691.4	--	--	8966.7
14. Manipur	--	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--	--
18. Orissa	403.6	--	3226.2	28.7	1751.6	--	--	283.2	--	--	5693.5
19. Punjab	--	--	557.2	--	--	--	--	871.8	--	--	1429.0
20. Rajasthan	631.0	--	664.6	--	--	--	--	1019.2	--	--	2314.8
21. Sikkim	--	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	1357.0	--	1128.6	7.9	33.0	--	--	1324.5	--	--	3851.0
23. Tripura	--	--	--	--	17.6	--	--	--	--	--	17.6
24. Uttar Pradesh	1089.5	--	2382.1	--	445.5	--	--	278.7	250.7	--	4446.5
25. West Bengal	416.7	--	--	--	--	--	--	1741.6	196.6	--	2354.9
Total	12226.0	--	21754.8	280.2	6386.4	460.9	137.2	12825.7	447.3	--	54518.4

Annexure 8

Additional Central Assistance released to States (Sectorwise) during the year 1987-88

(Rs. in lakhs)

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
1. Andhra Pradesh	139.3	--	260.3	--	--	--	--	967.8	--	--	1367.4
2. Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
3. Assam	--	--	--	--	1.8	--	--	--	--	--	1.8
4. Bihar	403.4	--	1284.2	--	497.9	--	285.6	63.0	--	--	2534.1
5. Goa	--	--	--	--	--	--	--	--	--	--	--
6. Gujarat	1137.9	--	2586.4	--	2063.7	--	53.2	1829.8	--	--	7671.0
7. Haryana	287.7	--	1374.1	--	17.5	--	--	--	--	--	1679.3
8. Himachal Pradesh	563.9	--	--	--	--	--	--	355.2	--	--	919.1
9. Jammu & Kashmir	244.6	--	--	--	--	--	--	--	--	--	244.6
10. Karnataka	1188.5	--	788.2	--	--	292.0	--	70.2	--	--	2338.9
11. Kerala	407.4	--	842.1	--	181.1	207.2	--	1328.2	--	--	2965.9

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
12. Madhya Pradesh	824.6	--	5944.1	--	286.7	--	--	130.6	--	--	7186.0
13. Maharashtra	387.3	--	2569.1	--	2094.2	--	--	3766.9	--	--	8817.6
14. Manipur	--	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--	--
18. Orissa	452.9	--	2509.8	--	1834.0	--	--	423.3	--	--	5219.9
19. Punjab	--	--	356.3	--	--	--	--	--	--	--	356.3
20. Rajasthan	532.3	--	516.1	--	--	--	--	593.6	--	--	1642.0
21. Sikkim	--	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	912.1	--	944.6	--	1810.4	--	--	2158.0	--	--	5825.1
23. Tripura	--	--	--	--	--	--	--	--	--	--	--
24. Uttar Pradesh	1143.3	--	5359.2	--	620.3	--	--	2532.1	--	--	9654.9
25. West Bengal	448.0	--	112.7	--	--	--	-154.7	1487.4	--	--	1893.4
Total	9073.1	--	25447.2	--	9407.5	499.2	184.1	15706.1	--	--	60317.3

Annexure 9

Additional Central Assistance released to States (Sectorwise) during the year 1988-89

(Rs. in lakhs)

S. No.	State	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Minerals	Transport	Social services	Area development	Others	Total
1.	Andhra Pradesh	1110.8	--	633.8	--	1076.2	--	--	757.2	--	--	3578.0
2.	Arunachal Pradesh	--	--	--	--	--	--	--	--	--	--	--
3.	Assam	110.4	--	--	--	--	--	--	--	--	--	110.4
4.	Bihar	--	--	2745.1	--	112.3	--	379.7	--	--	--	3237.1
5.	Goa	--	--	--	--	--	--	--	--	--	--	--
6.	Gujarat	1024.5	--	3950.8	--	514.5	--	289.6	507.9	--	--	6287.1
7.	Haryana	321.9	--	1033.9	--	20.1	--	--	--	--	--	1375.9
8.	Himachal Pradesh	859.3	--	--	--	--	--	--	11.5	--	--	870.9
9.	Jammu & Kashmir	400.8	--	--	--	--	--	--	--	--	--	400.8
10.	Karnataka	769.5	--	1464.4	--	516.0	297.4	--	56.0	--	--	3103.4
11.	Kerala	595.0	--	1480.2	--	528.6	--	--	931.3	--	--	3535.1

S. State No.	Agriculture	Rural development	Irrigation	Flood Control & cyclone protection	Power	Industry & Mines	Transport	Social services	Area development	Others	Total
12. Madhya Pradesh	679.0	--	4132.2	--	366.2	--	--	154.9	--	--	5332.4
13. Maharashtra	241.8	--	1296.3	--	4062.4	--	--	2544.4	--	--	8144.9
14. Manipur	--	--	--	--	--	--	--	--	--	--	--
15. Meghalaya	--	--	--	--	--	--	--	--	--	--	--
16. Mizoram	--	--	--	--	--	--	--	--	--	--	--
17. Nagaland	--	--	--	--	--	--	--	--	--	--	--
18. Orissa	78.7	--	2529.7	--	3025.0	--	--	533.9	19.4	--	6206.7
19. Punjab	--	--	247.4	--	--	--	--	65.8	--	--	313.2
20. Rajasthan	443.1	--	389.8	--	--	--	--	1980.1	--	--	2813.0
21. Sikkim	--	--	--	--	--	--	--	--	--	--	--
22. Tamil Nadu	311.4	--	1110.5	--	866.5	50.1	--	2865.7	--	--	5204.2
23. Tripura	--	--	--	--	--	--	--	--	--	--	--
24. Uttar Pradesh	1410.8	--	3693.6	--	--	--	--	2550.3	--	--	7654.7
25. West Bengal	725.6	--	675.3	--	204.0	--	--	1119.1	--	--	2724.0
Total	9082.6	--	25383.1	--	11291.8	347.6	669.2	14098.0	19.4	--	60891.8

PART II

**CASE STUDIES OF
INDIVIDUAL STATES**

Chapter 6

State Finances in Tamil Nadu, 1960-90

S. GUHAN

INTRODUCTION AND OVERVIEW

This chapter reviews state finances in Tamil Nadu during 1960-90, with particular reference to developments in the 1980s. In surveying the budgetary operations of the state government, the chapter looks at levels, structure, trends, issues, and interstate comparisons. It also examines the financial performance of the State Electricity Board and of state public enterprises. The primary data set relied upon is the annual issues of the Economic Classification of the Tamil Nadu Budget, available since 1960, supplemented with more disaggregated data from state budget documents. Annual RBI surveys of state finances and reports of Finance Commissions have been used for interstate comparisons. The Economic Classification and state budget time-series provide actuals for earlier years and Revised Estimates for 1989-90. In the RBI surveys, Revised Estimates for 1988-89 and Budget Estimates for 1989-90 have been used, since actuals are available only for earlier years.

After looking at revenue receipts, this chapter moves on to discuss expenditures and thereafter to examine the related issues of unrecovered costs and returns from public sector enterprises. The concluding section on debt and financing of capital formation completes the financial circuit. In the rest of this introductory section we shall bring out, in very broad brush, the main conclusions and the policy implications that follow.

Tables 6.1 and 6.2 present data on aggregate receipts and outlays in the budgetary operations of the Tamil Nadu Government for 1960-90, broken up in decadal intervals. Receipts and outlays have grown more than 13-fold in current prices between 1960-70 and 1980-90. As a share of net state domestic product (NSDP) at current prices, the increase has been from 13.5 percent in 1960-70 to 19.9 percent in 1980-85. Budgetary operations have reached a significant level in relation to NSDP in terms of their draft on, and their contribution to, the welfare and economy of the state. It is against this background that the sources and uses of funds and the related functions that Tamil Nadu has assumed have to be examined.

The state has taken upon itself diverse, important, and growing functions. On the investment side, it is concerned with irrigation and power, roads and transportation, industrial promotion and urban development. Adequate resources for these purposes can be secured only if current outlays are contained, but the demands on the latter are also large and growing on account of needs related to basic administration, merit goods, social infrastructure, and social welfare. The states, unlike the center, have to operate within a "hard budget constraint" in that they cannot resort to deficit financing, and their access to borrowing is strictly regulated. Under these circumstances, economically appropriate, politically acceptable, and administratively feasible balances have to be continually sought -- between consumption and capital formation; between priorities and purposes related to each of these broad categories; and, in raising resources, between taxation and direct recoveries from users or beneficiaries.

Tamil Nadu has had an outstanding record in mobilizing tax revenue, with a current (1984-87) tax-to-NSDP ratio of over 12 percent, the highest among all the states in India. Constraints on future revenue growth are clearly emerging, however. In the case of sales taxes, which have been the mainstay, commodity-wise rates are already high and will not bear further increases of any revenue significance without exacerbating regressive, inflationary, cascading and trade diversionary effects. Measures such as additional sales tax and local surcharges also have reached a plateau. In the case of state excise taxes, Tamil Nadu has gone through several vicissitudes in its prohibition policy, which remains vulnerable to changing currents of politics and public opinion.¹ Improvements are possible through

1. Most recently, the Tamil Nadu Government has once again banned the consumption and sale of country spirits (arrack) with effect from July 16, 1991.

checking evasion of stamps and registration fees; in the urban land tax through updating the reference year for base land values; and in motor vehicles taxes and entertainment taxes, which are wholly or largely specific, through providing for periodic rate increases. But these are not large revenue yielders. As is the case generally all over India, the incidence of taxation on agricultural incomes is very low in Tamil Nadu. An increase to any reasonably appropriate level will have unacceptable political and other costs. There is scope for feasible increases in agricultural taxation, however, mainly through taxation of remunerative commercial crops, a measure that would be progressive and would to some extent compensate for highly subsidized ground water irrigation used mostly in their cultivation.

Along with other states, Tamil Nadu obviously could benefit from a larger quantum of central revenue transfers of different kinds. The proportion of vertical tax-sharing has more-or-less plateaued since 1984 in the awards of the Eighth and Ninth Finance Commissions. To some degree this is an adjustment to the quantum jump in the share of the states in Union excise duties from 20 to 40 percent under the award of the Seventh Finance Commission (1979-84). Future increases in central transfers are bound to be quite gradual, even negligible, because of the serious structural disequilibrium in the center's own revenue account. The same constraint will also affect aggregate central plan assistance to states.

Tamil Nadu also cannot hope to improve its position in the zero-sum game of horizontal sharing among states, given the redistributive criteria favoring low-income states which have been increasingly adopted in the last decade by Finance Commissions and in modifications of the Gadgil formula. As a lower middle-income state, Tamil Nadu, despite a creditable tax effort, does not generate an adequate volume of own revenues to make do with low levels of central support, unlike the high-income states. As a prudent state, it has not qualified itself as did West Bengal, a higher middle-income state, to gap grants under Article 275 or to special treatment in plan assistance; and Tamil Nadu is not low-income enough to be favored on grounds of equity.

Turning to nontax revenues, Tamil Nadu does not benefit from significant forest or mineral royalty revenues. Growth in forest receipts may actually decline over the long term because of the emphasis on social forestry as opposed to commercial plantations. Mineral royalties, presently confined to a modest amount from low-calorific Neyveli lignite, could, however, increase on the basis of oil finds in the Cauvery basin.

Much more important issues related to nontax revenues concern cost recovery for services provided by the state government and returns from state public enterprises, notably the Electricity Board. The overall extent of directly unrecovered costs (DUC) depends not only on the recovery ratio in individual sectors but, quite importantly, on the sectoral distribution of outlays. Moreover, the pressure on revenue needs for financing current and capital outlays and the constraints on raising tax revenues or gaining access to higher central transfers underline the need for maximum feasible revenue mobilization through cost recovery and higher returns from PSEs.

The review of expenditures in Tamil Nadu in the third section of this paper will show that about 75 percent of total outlays are for current consumption and that the share of outlays for capital formation has decreased over time, particularly since the 1970s, for a number of reasons. First, in recent years there has been a considerable enlargement and extension of schemes and projects which, wholly or mainly, involve current outlays. Second, there has been a large increase in the 1980s in direct subsidies and in unrequited transfers. Third, apart from the "padding" that is a feature of bureaucracies, the sectoral distribution of outlays has itself been staff-intensive; at the same time, unit costs of staff have accelerated in the 1980s, culminating in parity with central pay scales in 1989. Fourth, chronic pressures for increasing current outlays have not, in Tamil Nadu, faced a countervailing demand for capital investments. In irrigation, for example, the state has already utilized a large part of its surface irrigation potential. This is not to say that there are no public investment needs or opportunities in power, industry, urban development, roads or the modernization of surface irrigation systems. But such needs have not been given adequate attention either in planning or in resource allocation, and the apparent lack of ready investment opportunities has encouraged a shift of incremental resources from capital to current outlays.

In this context it becomes necessary to examine possibilities for greater cost recovery, entailing the containment and rolling-back of subsidies and improving returns of public sector enterprises (PSEs). The overall direct cost recovery rate in the state budget is only 12 percent. The scope for reducing the quantum of DUC for pure public goods (basic administrative services such as police and administration of justice), merit goods (such as education, health and water supply), social infrastructure (such as urban development and housing), and welfare-oriented or redistributive transfers (IRDP and employment schemes, welfare of SC/ST and backward classes, nutrition, social

security and the food subsidy) would appear to be *prima facie* limited. Nevertheless, the thrust of policy could be three-fold: (1) contain the growth of these outlays which, incidentally, are also staff-intensive; (2) achieve higher cost-effectiveness and economy through better targeting and elimination of waste and leakages; and (3) attempt to increase recovery wherever appropriate, for example in secondary and higher education and through timely and adequate adjustments in issue prices for PDS.

It is a different matter when we turn to DUC in sectors that provide infrastructure or incentives to remunerative economic activities (such as irrigation, power, agriculture and industry), with the benefits accruing to relatively affluent sections of the population. Tamil Nadu is plagued by a very large subsidy on electric pumpset irrigation. Subsidies in surface irrigation have grown as well, because, while there has been no improvement in the recovery rate, a number of hydrologically undependable projects have been implemented in recent years on account of local pressures. In these areas, a radical reorientation of policy is called for, even if, operationally, it were to take the form of a gradual phasing out of subsidies.

There are several reasons for the poor financial performance of PSEs. Policy-induced subsidies affecting the State Electricity Board, State Road Transport Corporation, and Civil Supplies Corporation -- exacerbated by continual increases in the centrally-administered prices of inputs like coal, diesel, and rice -- are by far the most important factor. In recent years a number of welcome steps have been taken to improve returns from PSEs, to close down some, and to restructure others. Since 1989 there has also been a shift in industrial policy from a philosophy of direct public sector presence and control in manufacturing enterprises to promotional measures, such as growth centers, subsidies and joint ventures subject to disinvestment. The decision of the DMK government in 1989 not to appoint non-officials and politicians to head any of the PSEs in Tamil Nadu is noteworthy in this context. Needless to say, there is still much need and scope to achieve fair returns from PSEs and to dispose of dead wood.

This chapter closes by examining the debt position of Tamil Nadu and the relative contributions of current savings and of capital receipts to capital formation. Although the contribution of current receipts to capital formation declined in the late 1980s, it is still positive; moreover, the situation could improve, as the share of salary costs can be expected to plateau out (having crossed the Pay Commission hump in 1989-90), and if reasonable measures are taken to contain current outlays and to improve DUC on all fronts. At the same time, Tamil

Nadu is "under-borrowed" in comparison with other states. These factors taken together suggest that, apart from increasing current surpluses, Tamil Nadu should also seek greater access to debt financing for high-priority, relatively high-return capital investments, through institutional lending, private capital, provident funds, and small savings.

REVENUE RECEIPTS

Receipts on revenue account (or "revenue receipts") consist of Tamil Nadu's own tax and nontax revenues and central transfers to the revenue account (or "central revenue transfers"), the latter comprising shares in the shareable taxes and central grants for plan and nonplan purposes. Table 6.3 shows that the proportion of central revenue transfers in total revenue receipts has increased from 27 percent in 1965-70 to 29.2 percent in 1970-80 and 31.9 percent in 1980-90. The share of the state's own tax revenue has increased from 50.5 percent in 1965-70 to 58.4 percent in 1980-90, while correspondingly its own nontax revenues have declined quite steeply from 22.5 percent to 9.7 percent.

In 1985-90, compared to the all-states averages, Tamil Nadu relied more on its own tax and nontax revenues (67.8 percent versus 59.3 percent for all states) and less on central revenue transfers, mainly on account of smaller grants (32.2 percent in Tamil Nadu versus 40.7 percent for all states). The proportion of tax revenues in total own revenues was much higher in Tamil Nadu (59.5 percent versus 44.1 percent for all states), while the share of nontax revenues was much lower (8.3 percent versus 15.2 percent).

Own Tax Revenues

Tamil Nadu has maintained an outstanding performance in terms of tax effort. Tax revenues as a proportion of NSDP increased steadily from 5.8 percent in 1960-70 to 8.4 percent in 1970-80 and 11.5 percent in 1980-85. Tamil Nadu was the most heavily taxed state in terms of the tax-NSDP ratio among major states in 1980-85, as well as in the most recent triennium of 1984-87 for which comparable data are available (see Table 6.4). The relevant ratios were 11.5 percent in 1980-85 and 12.1 percent in 1984-87 for Tamil Nadu, as compared with averages for all major states of 7.5 percent and 8.2 percent respectively.

The structure of Tamil Nadu's own tax revenues is shown in Table 6.5. In 1985-90 major tax sources were sales taxes (67.4 percent), state

excise duties (11.3 percent), motor vehicle taxes (8.0 percent), stamp duties (6.6 percent) and entertainment tax (3.3 percent), which together accounted for 96.6 percent of total own tax revenues. Other indirect taxes (registration fees, electricity duty, betting tax, luxury tax, sugarcane cess) together contributed 2.0 percent. Direct taxes on income and property -- land revenue, agricultural income tax and urban land tax -- together accounted for only 1.4 percent. A comparison with the all-states tax structure in 1985-90 shows that taxes on commodities and services accounted for a little more in Tamil Nadu (90.8 percent) than in other states (89.8 percent); the share of taxes on property and transactions (8.6 percent) was slightly less than average (8.7 percent); and the share of taxes on income was noticeably lower (0.6 percent in Tamil Nadu versus the all-states average of 1.5 percent). The most important difference, however, is that in Tamil Nadu the weight of sales taxes (67.3 percent) was significantly higher than the average (58.3 percent).

Changes in the tax structure in 1960-90 reflect varying rates of growth in individual taxes, resulting from factors such as additional taxation, inflation, tax responsiveness to NSDP growth (or elasticity) and differences in the efficiency of tax collection. It can be seen from Table 6.5 that the relative importance of direct taxes has sharply declined from 12.6 percent in 1960-70 to 2.1 percent in 1980-90. Among indirect taxes, sales taxes have throughout remained the single most important source of revenue and have also registered the fastest rate of growth, their share in total tax revenues rising from 48 percent in 1960-70 to 66.1 percent in 1980-90. While changes in prohibition policy from time to time (which will be described later) have lent a great deal of volatility to state excise revenues, with a share of 11.3 percent they represented the second most important tax revenue source in 1985-90. The share of all other indirect taxes was only 19.9 percent during the same period.

We have estimated the contribution to the growth of tax revenues between 1980-81 and 1987-88 from (1) real NSDP growth, (2) additional tax measures, including the effect of price increases, and (3) inflation. Central sales taxes and state excise revenues have been excluded from the analysis, because the levy is by the central government in the case of the former and the latter has been subject to policy changes due to prohibition. NSDP deflators have been used to take inflation into account. The exercise indicates that additional taxation (along with inflation thereon) was responsible for 44.7 percent of the increase in tax revenues between 1980-81 and 1987-88; inflation contributed 28.3 percent; and the balance of 27 percent was

due to elasticity. The elasticity ratio was 0.84 overall and 0.77 for sales taxes. With this background, we can turn to a discussion of the major taxes.²

Direct agricultural taxation. Direct taxes on agriculture consist of land revenue and the agricultural income tax. In Tamil Nadu the consolidated land revenue assessment on irrigated land classified as "wet" (*nanjai*) includes an element of water charges which, being a cost-recovery item for water use, must be deducted in computing the incidence of land revenue proper. Local cess at 45 paise per rupee of land revenue and local cess surcharge up to a ceiling of Rs. 2.50 per rupee of land revenue are collected along with land revenue on behalf of Panchayat Unions and Panchayats. Inasmuch as they are based on land revenue, the cess and the surcharge can be viewed as a component of agricultural taxation. The agricultural income tax (AIT), introduced in 1955, initially covered only plantation crops (coffee, tea, rubber, cardamon and cinchona) but was extended to all agricultural crops in 1958. In principle, the AIT is progressive and responsive to increases in output, but these features have been eroded over the years through exemptions, compounding facilities, liberalization in the definition of standard acres, and avoidance through partitions.

Direct taxes on agriculture have all along accounted for less than two percent of NSDP in agriculture and allied activities. They actually declined from 1.9 percent in the early 1960s to about one percent in the early 1980s, during a period in which agricultural incomes rose on account of new technology and the spread of irrigation, especially from pumpsets, with particular benefit to larger farmers and cultivators of remunerative cash crops. Furthermore, the agricultural sector has benefited from substantial subsidies related to irrigation and inputs and debt reduction in the 1980s.

Agricultural taxes are thus very low, not progressive in relation to the incomes of the assesseees, and unresponsive to the growth of incomes in the sector. This is partly due to inherent features of land revenue, which is a per-acre levy that does not take into account either the extent of land ownership or the present value of output. Another reason is that state policy has over the years consistently diluted and de-emphasized the role of agricultural taxation. After initial settlements of land revenue in Tamil Nadu toward the end of the 19th century, there was only one revision in the 1930s, before

2. For basic information on individual taxes in Tamil Nadu see Guhan (1986).

resettlements were formally suspended in 1937. Assessments on "dry" lands were waived in 1967, and in 1971 the land revenue component of the consolidated wet assessment for holdings of less than five acres was waived. An attempt was made to increase agricultural taxation in 1976, when a special assessment was introduced on remunerative commercial crops (grapes, sugarcane, plantain, betelvine, turmeric, tobacco, chillies, irrigated cotton and irrigated groundnut). This measure was substantially eroded by concessions in 1977 and was completely repealed in 1981.

Sales taxes. Sales taxes have been by far the single most important and fastest growing source of revenue. Additional taxation measures relating to sales taxes have been the mainstay of Tamil Nadu's resource mobilization. In 1980-88 sales taxes contributed 85 percent of the yield from all additional tax measures (other than those relating to state excise revenues).

Sales taxes include the central sales tax (CST) and the general sales tax (GST), into which the motor spirits tax has been merged. Apart from the basic levy under GST, additional sales tax is levied on a turnover basis. The latter is meant to be a levy on trading margins and is not supposed to be passed on to consumers. Surcharges, applicable to notified local areas, are also levied as a percentage of the basic levy. In 1989-90 CST comprised about 17.3 percent of total sales tax revenues, while the various levies in the GST accounted for the balance.

Tamil Nadu had pioneered the introduction of the sales tax in 1939, starting as a low 0.5 percent levy on taxable turnover. The rates, coverage and features of the sales tax system were enhanced subsequently. From the late 1950s the trend has been away from multi-point levies and toward a single-point levy in the chain of sales. This culminated in 1990-91 with a complete shift to a single-point levy. The levy is on sales or purchases, generally at the point of first sale, with different rates on listed commodities and generally an eight percent levy on unlisted ones. Apart from exempted goods, and "declared goods", for which the maximum rate cannot exceed the CST rate (currently four percent), listed commodities are subject to levies at rates generally ranging from 2 to 18 percent, with some items (e.g. liquor and aviation fuel) attracting higher rates. In the aggregate, the ratio of revenue to taxable turnover works out to about seven percent.

Problematic aspects of sales taxes have been widely noted: regressiveness; inflationary effects; and the cascading effect related to central excises and also arising from taxation of both final goods and

intermediates and inputs. Reliable studies are not available for exploring these issues at the state level, however.³ All that is possible is to examine the yield-cum-rate structure for an indication of the incidence on different types of commodities. Fortunately, the Tamil Nadu sales tax administration compiles commodity-wise revenue statistics on a regular basis.

Table 6.6 shows the composition of GST revenue from major groups of commodities in 1988-89. Fuel items were the single most important source, accounting for 21.4 percent of total GST revenue. In descending order of importance thereafter come building materials (15.2), machinery, equipment and parts (12.9 percent), intermediates and chemicals (11.7 percent), general consumption goods (8.5 percent), agricultural and marine products (7.5 percent), durable consumer goods (7.4 percent), liquor (7.2 percent), food and food products (6.3 percent) and chemical fertilizers and pesticides (1.9 percent). The table also shows the share of revenue within each commodity group at different rates of levy, indicating the structure of incidence.

The fuel group comprises kerosene, diesel (highspeed and lowspeed), fuel gas, petrol, aviation fuel, furnace oil, crude oil and coal and coke. About 57 percent of the revenue comes from diesel (taxed at 14 percent), about 18 percent from kerosene (4 percent) and about 16 percent from petrol (18 percent). The levy being *ad valorem*, increases in the administered prices of petroleum products have been reflected in rising revenue receipts.

In the building and construction materials group, about 36 percent of revenue comes from cement (12 percent) and about 35 percent from iron and steel (4 percent). Other important commodities in this group, such as paints, plywoods, pipes and asbestos cement articles, bear a relatively high tax rate of nine percent.

Machinery, equipment (including transport equipment), parts (notably auto parts, for which Tamil Nadu has a significant manufacturing base), and accessories (notably tyres and tubes) carry a wide spectrum of rates clustered in the 8 to 12 percent range.

A large number of industrial raw materials, intermediates and chemicals are subject to tax at rates clustered around nine percent. Yarn, which bears the relatively low rate of three percent, accounts for 36 percent of total revenue in the group. The concentration of yield is at 9 per cent for the rest. Machinery, equipment (including

3. References to some of the available studies will be found in Guhan (1986).

transport equipment), parts (notably auto parts, for which Tamil Nadu has a significant manufacturing base), and accessories (notably tyres and tubes) carry a wide spectrum of rates with the yield clustered in the 8 to 12 per cent range.

More than 31 percent of the revenue from general consumption goods is contributed by drugs, which are taxed at a relatively high rate (considering their essentiality) of eight percent. Machine-made matches and paper carry a rate of four percent, hand-made matches being exempt. Other items of revenue significance are taxed mostly in the 6-9 percent range.

By far the most important revenue-yielder in the agricultural and marine products group is the 12 percent purchase tax on sugarcane, which accounts for about 55 percent of revenue in this category. The tax is on sugar mills (not on the cane grower) and is difficult to collect in bad years of the sugar cycle, especially because of continuous increases in notified or "announced" cane prices and variations in the quantum of levy sugar. Cotton, oilseeds, and groundnuts bear a preferential tax rate of three percent, while basic cereals such as paddy, wheat, and coarse grains are exempt. The rate for spices and condiments has been reduced from eight to six percent.

Durable consumer goods of various sorts are generally taxed in the higher brackets of 9-12 percent. Preferential rates have been extended to electronic items (two percent), as a promotional incentive and to safeguard against trade diversion, and to cycles (three percent), because they are a means of mass private transport and also an item in which Tamil Nadu has a strong manufacturing base.

Liquor (including country spirits), is taxable at 20 percent or above (50 percent for foreign liquor). Consistent with the relaxation of prohibition, sales taxes and state excise duties on liquor acquired importance under the DMK government. Subsequently moves have been made to return to tighter restrictions on liquor.

In the food and food products group, about 56 percent of the revenue comes from vegetable oils, oil cake and pulses (taxed at four percent). Higher rates apply to coffee and tea (six percent) and vanaspati and aerated drinks (eight percent). Finally, chemical fertilizers and pesticides carry a rate of 3.5 percent.

This review shows that tax rates in Tamil Nadu are already on the high side. They also appear to have achieved a certain degree of stability in the sense that changes in individual rates in recent years have been confined to marginal adjustments up or down, in response to changing rates in neighboring states. Any substantial removal of exemptions or significant increases in rates would accentuate regres-

siveness, inflation, trade diversion, and cascading effects. In fact, there is a case for reducing rates on agricultural products, food items, essential consumption goods (such as medicines) and industrial inputs and intermediates, but any comprehensive exercise along these lines would entail considerable revenue loss.

Additional tax effort with respect to the GST in recent years has for the most part involved increasing the rates of additional sales tax, expanding geographical coverage, and raising rates of surcharge. The additional sales tax, which is not permitted to be passed on directly to the consumer, goes up to two percent of taxable turnover when the latter exceeds Rs. 10 million. Since it affects manufacturing or trading profits, the levy faces considerable resistance, to the point of provoking capital flight from the state.

Tamil Nadu, unlike some other states (notably Maharashtra), does not have octroi. In principle, the surcharges on sales tax in notified local areas such as Municipalities and Corporations are a substitute for octroi and have definite administrative advantages, compared with octroi, in reducing evasion and harassment. The coverage of surcharges is, however, already extensive, with even non-municipal urban areas brought into the net. Rates are currently 20 percent in Madras City (including a special five percent surcharge for financing the Telugu Ganga Water Supply Project), 12 percent in the two other corporations (Madurai and Coimbatore) and in special grade municipalities, and eight percent elsewhere. No significant further increases would appear to be possible.

All in all, it is clear that additional resource mobilization from sales taxes, by far the most important component of tax effort in the 1980s, is likely to face severe constraints in the future. Given the less than unitary elasticity of sales taxes and their dominance in the tax structure, Tamil Nadu may find it difficult to maintain its high tax to NSDP ratio.

Liquor revenue. Tamil Nadu has had a checkered history of prohibition. Prohibition was introduced in one district (Salem) by the first Congress Ministry in 1937 and was withdrawn in 1945 with the dissolution of popular governments. The state went completely dry in 1948, after Independence, and remained so until 1971, when prohibition was suspended by the DMK government. The same government reintroduced prohibition in stages in 1973 and 1974. The AIADMK government relaxed prohibition in 1981 but banned the sale and consumption of country spirits (arrack) with effect from 1st January 1987. The DMK government took certain major steps in 1989 to mobilize additional revenue from this source and to plug leakages

and loopholes in excise administration. The excise duty on IMFS (Indian-made foreign spirits such as whisky, brandy, gin and rum) was sharply raised from Rs. 25 to Rs. 55 per proof litre. Liquor shops which had been given licenses by the previous administration for a modest fee of Rs. 25,000 were let out on auction, fetching substantial rental revenue. This was followed in 1990 by lifting the ban on arrack consumption. At the same time, a government monopoly was introduced in the blending and wholesale distribution of arrack, a reform of significant importance in curbing illicit manufacture and sale.⁴

At present, toddy continues to be banned, and the main sources of revenue consist of excise duties and vend fees on IMFS and on arrack, as well as revenue from the auction-sale of IMFS and arrack shops. With the relaxation of prohibition, excise revenues steadily increased from Rs. 110 crores in 1981-82 to Rs. 287 crores in 1986-87, but they dropped to Rs. 120 crores in 1987-88 with the ban on arrack. The duty increases and other reforms of 1989 nearly doubled revenue from Rs. 148 crores in 1988-89 to Rs. 282 crores in 1989-90. A further increase of Rs. 150 crores was expected in 1990-91 because of the reintroduction of arrack.

Excise revenues, which are the most important source of tax revenue next to sales taxes, have been volatile due to policy changes in the past and will continue to be unstable in the future. Public opinion in Tamil Nadu has not reconciled itself either to complete prohibition or to complete freedom in the matter of alcohol consumption. This uncertainty generates scope for political corruption at both local and higher levels. The banning of arrack, for instance, gives a fillip to illicit manufacture and sale and to interstate smuggling, providing a lucrative source of income for local political workers; at the same time, it results in a higher consumption of low price range IMFS, thereby increasing the profits of private manufacturers and distributors who can be tapped for political contributions. The same result can also be achieved, as was the case in the pre-1989 period, by relatively low excise duties and the letting out of retail shops for moderate license fees instead of on an auction basis. The reforms of 1989 and 1990 represent a major effort to plug these loopholes and to win back substantial revenues to the exchequer. But further revenue increases can be expected only from increases in consumption, since the levies are specific on a volume basis. Per-capita liquor consumption in Tamil Nadu appears to be already high in relation to that in most other

4. These reforms are very much along the lines considered optimal in the study of alcohol taxation in Karnataka by Musgrave and Stern (1985).

states, however. The AIADMK Government which came into office in June 1991 banned the consumption and sale of arrack, which will result in an estimated loss of revenue of Rs. 400 crore on a full-year basis, aside from encouraging illicit activities.

Motor Vehicles Tax (MVT). The MVT is a specific tax on vehicles of all kinds, related to the type and/or laden weight of the vehicle and to the number of seats in the case of buses. Growth of receipts accordingly depends on increases in the number of vehicles.⁵ The bulk of this levy falls on public transport, that is trucks and buses. With increases in the prices of diesel and petrol, profits in the public transport sector have been squeezed; increased taxation in the future would lead to rate increases likely to encounter resistance from traders and commuters. In as much as the levy is on vehicles, the MVT can be considered a recovery from road users rather than a tax; moreover, as we shall see later, this recovery already exceeds outlays on the roads sector. Thus both the scope and justification for sizable increases in the MVT are limited.

Stamps and registration fees. The bulk of revenue from stamps comes from non-judicial stamps, which along with registration fees are mainly tied to sales of immovable properties such as land and buildings. Determined as fixed percentages of the registered value, these levies are not progressive, but they are elastic with respect to increases in property values and growth of transactions. In Tamil Nadu, as elsewhere, there is considerable under-reporting of sale values and, consequently, substantial tax evasion. This has been sought to be tackled through the adoption of normative values and through coordination with valuations arrived at by the income tax authorities. These measures have resulted in good revenue growth during 1980-90. The current 13 percent stamp duty and one percent registration fee on property values are on the high side. Checking of evasion (if necessary through lowered rates) rather than rate increases would appear to be the feasible course for additional resource mobilization.

Entertainment taxes. Entertainment taxes are an important source of revenue in Tamil Nadu given the popularity of the cinema. Since 1989 the *ad valorem* levy on the price of cinema tickets and specific rates per show have been consolidated and modified into a "compounded" levy which is a percentage of the gross admission (i.e. seating) capacity in cinema theaters. This system is now applicable to

5. In 1989 there was an increase due to the levy of a "one-time" tax on new two-wheelers.

all areas other than Madras, Madurai, and Coimbatore, in which *ad valorem* taxes continue. The "compounding" system sacrifices elasticity arising from increases in ticket prices and from higher attendance in theaters but serves as a means of preventing evasion (as well as corruption and harassment). The implication, however, is that only in the three Corporations will this tax be elastic in the future.

The State's Own Nontax Revenue

We have already noted that Tamil Nadu's own nontax revenues constituted barely eight percent of total revenue receipts in 1985-90 and that their share has steadily declined over the years. The composition of own nontax revenues in Tamil Nadu for 1980-85 and 1985-90 and a comparison with the all-states averages are shown in Table 6.7. In 1985-90 Tamil Nadu derived about 30 percent of its own nontax revenues from interest receipts, 58 percent from recoveries on various state-provided services, 11 percent from forests, and less than one percent from profits and dividends of public enterprises. For all states, interest receipts and recoveries had a somewhat lower share, while the contribution of forest revenue was higher.

Table 6.7 also shows that recoveries covered only three percent of outlays for social and community services in Tamil Nadu in 1985-90, compared with about four percent in 1980-85. Recoveries as a proportion of outlays on economic services (including forests) were 12.8 percent in 1980-85 and 10.5 percent in 1985-90. In both quinquennia, the cost recovery rate for economic services was distinctly higher in other states (29.5 percent in 1980-85 and 25.5 percent in 1985-90), apparently mostly due to larger forest receipts.

Own nontax revenues, being a function of cost recoveries, interest receipts, and returns from departmental and nondepartmental public enterprise, are appropriately discussed in the overall context of indirect subsidies and returns from investments later in this chapter.

Central Revenue Transfers

As shown in Table 6.3, central transfers on the revenue account contributed about 32 percent of total revenue receipts in 1985-90, up from 27 percent in the late 1960s. Shared taxes constitute about two-thirds of all revenue transfers, with the balance being central grants for plan and nonplan purposes. Table 6.8 shows the detailed breakdown of central revenue transfers in 1980-85 and 1985-90.

Tamil Nadu shares in the two shareable taxes, income tax and union excise duties, according to the awards of successive Finance Commissions (Table 6.9). As far as income tax is concerned, there has

been a marginal drop from 8.4 percent in the award period of the Second Finance Commission (1957-62) to 7.9 percent under the award of the Ninth Finance Commission (NFC, 1990-95). This is due to a lower weight for the collection factor in income tax sharing in recent awards, combined with a decline in Tamil Nadu's share of the all-India population. Nevertheless, the NFC share of 7.9 percent is higher than Tamil Nadu's 1971 population share of 7.5 percent and its 1981 population share of 7.1 percent. As a state with low population growth, Tamil Nadu has benefited from the use of 1971 census figures for tax-sharing under criteria adopted by Finance Commissions.

Sharing in basic union excise duties is, however, much more important than sharing of income taxes, since this accounts for more than 70 percent of central tax transfers and is also more buoyant than income taxes. The share of Tamil Nadu reached a peak of 7.6 percent in the shareable pool of union excise duties under the Seventh Finance Commission (1979-84). Subsequently the Eighth and Ninth Finance Commissions segmented the pool into two parts, one component available to all states and another confined to post-devolution deficit states. Since Tamil Nadu is not such a "deficit" state, it benefits only from the component available to all states. This was 40 percent in 1984-89 (Eighth Commission) and in 1989-90 (First award of the NFC) but has been reduced to 37.575 percent in 1990-95 (Final award of the NFC). Table 6.9 shows that while Tamil Nadu's share in the component available to all states since 1984 has remained at about the level reached under the Seventh Finance Commission, its share in the overall divisible pool (including the component available only to deficit states) has dropped to 6.4 percent in 1990-95. This is a significant reduction from 7.6 percent in 1979-84.

Another major respect in which Tamil Nadu has been adversely affected in the dispensation of the NFC relates to the NFC's allocation of Rs. 9001 crores by way of so-called "plan deficit grants" based on criteria which are open to serious question (see Guhan, 1990). Tamil Nadu draws only Rs. 43.79 crores, or 0.5 percent, from this pool, while had it been distributed on the basis of excise-sharing or under the Gadgil formula applicable to plan grants, Tamil Nadu's share would have been over six percent.

Central grants include (1) grants for state plan schemes; (2) plan grants for central and centrally sponsored schemes; and (3) nonplan grants, which comprise (a) statutory grants under Article 275 of the Constitution, (b) grants for the relief of natural calamities and (c) other nonplan grants. About 85 percent of total central grants to Tamil Nadu in the 1980s have been plan grants, and about 60 percent

of the latter are accounted for by grants for central and centrally-sponsored plan schemes, the high proportion being mainly on account of increased allocations for centrally sponsored anti-poverty programs such as the IRDP, NREP, RLGP and the Jawahar Rozgar Yojana.

Assistance from the center for state plan schemes has been determined since 1980 on the basis of the "modified Gadgil formula", with 30 percent of such assistance being in the form of grants. The amount available is arrived at after setting apart allocations required for externally aided projects and for area programs (such as hill and tribal areas). Within this amount, 30 percent was allocated in the Seventh Plan to "special category" states, with the balance being available for other states. The latter sum was distributed on the basis of population (60 percent), tax effort (10 percent), per-capita income (20 percent, restricted to states with per-capita income below the national average) and 10 percent for "special problems".

Per-capita central plan assistance to Tamil Nadu has been below the average for major states (see Guhan, 1986, Table 36). In the Seventh Plan, allocations under "normal Gadgil assistance" amounted to 21.7 percent of Tamil Nadu's state plan outlay, which was less than the average of 23.5 percent for all non-special category states. Under the tax effort criterion, Tamil Nadu is estimated to have received Rs. 41 per capita in the Seventh Plan, compared to the all-states average of Rs. 32, but its relative benefit would have been higher if, as is logical, tax effort had been weighted by population. Tamil Nadu has not benefited at all from the 20 percent earmarked under the per-capita income criterion, since its per-capita income in the reference period has been just above the national average. It has received some compensation on this score, however, for "special problems", under which it is estimated to have received Rs. 67 per capita, compared to the all-states average of Rs. 31. Outside the normal Gadgil allocations, Tamil Nadu is estimated to have received Rs. 72 per capita for externally-aided projects in the Seventh Plan, compared to the all states average of Rs. 87. Its share under area programs is not appreciable, since hill areas in the state are not extensive and the tribal population comprises only about one percent of total population. Under grants for centrally sponsored schemes, Tamil Nadu is estimated to have received only Rs. 160 per capita, significantly less than the all-states average of Rs. 236.⁶

Turning to nonplan grants, Tamil Nadu, not being a post-

6. These figures are based on data to be found in Planning Commission (1990).

devolution deficit state, has not qualified for "gap" grants. The grants it has received under Article 275 represent some upgradation grants, the grant in lieu of the repealed railway passenger fare tax, and margin money grants. Table 6.8 shows that grants for the relief of natural calamities and other nonplan purposes have not been significant.

In sum, Tamil Nadu has been relatively disadvantaged with respect to central revenue transfers on both plan and nonplan accounts because it is a middle-income, non-deficit state. It does not benefit from the earmarked excise pool for deficit states, from Article 275 grants, or from allocations under the per-capita income criterion in the Gadgil formula. Constraints on the quantum of vertical sharing between the center and the states in Finance Commission awards and the trend of more progressive horizontal sharing among states in both Finance Commission and plan transfers will continue to affect central support for a state like Tamil Nadu.

EXPENDITURE

Expenditure patterns can be analyzed on the basis of different data formats. The Economic Classification gives final gross outlays on current expenditure, capital expenditure, and loans and advances, as well as net outlays (gross outlays net of loan repayments to the state government). Table 6.2 showed that final net outlays have steadily increased over time. Gross outlays as a proportion of NSDP (new series) went up from 13.5 percent in 1960-70 to 16.6 percent in 1970-80 and 19.9 percent in 1980-85.

Outlays on Consumption and Capital Formation

Consumption outlays include current expenditures and loans for current consumption in the Economic Classification format, while spending on capital formation includes capital expenditures and loans for capital formation. Consumption outlays comprised about two-thirds of gross outlays in 1960-70, went up to about 70 percent in 1970-80, declined slightly in 1980-85, and rose to about three-fourths in 1985-90 (Table 6.10). Capital formation has never accounted for more than about a third of gross outlays, declining to about one-fourth in the late 1980s. As a share of NSDP, consumption outlays have gone up from around 11 percent in the 1970s to around 16.5 percent in the 1980s; capital formation went up from 3.7 percent of NSDP in 1970-75 to 7.5 percent in 1980-85 but then fell to 5.8 percent in 1985-90. These fluctuations were due in part to increased

availability of receipts (for instance, from excise revenues in 1971-74 and again since 1982 and from Finance Commission awards, most notably in 1979-84), which encouraged larger consumption outlays (in the late 1980s) or enabled higher allocations to capital investment (in the 1970s and early 1980s). Another factor has been the availability and absorptive capacity of major projects, particularly in the power sector.

Sectoral Composition of Outlays

The Economic Classification time-series is also available in "functional" or major sectoral categories, from 1975 (Table 6.11). The sectoral pattern of outlays in 1975-90 has been more or less stable. General services claim about 20 percent of total outlays, social and community services about 40 percent, and economic services a little more than 35 percent. Education represents the single largest expenditure sector, with about 20 percent of total outlays and more than 25 percent of current outlays. Among social and community services, the share of health, water supply and sanitation has somewhat declined (from around 11 percent in 1975-85 to about eight percent in 1985-90), the share of housing and urban development has increased (from 2.5 percent in 1975-85 to 4.5 percent in 1985-90), and that of social welfare has risen (from around five percent in 1975-85 to eight percent in 1985-90).⁷ Under economic services, the important sectors are currently agriculture and allied activities (including rural development and employment programs) and water and power development, each with shares of 10-15 percent, while industry and minerals and transport and communication each account for only about three percent.

Budgetary Classification of Expenditure

We now turn to the format used in the annual RBI surveys of state finances, based on standard budget classifications of expenditures in terms of development/nondevelopment, plan/nonplan and revenue/capital/loans. The RBI surveys permit comparison of the expenditure pattern in Tamil Nadu with aggregated data for all states (see Table 6.12). The main observations that can be made on the basis of the table include the following:

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7. Social welfare expenditure growth mainly represents increased allocations for nutrition and for the welfare of SC/ST and backward classes.

- (1) The ratio of plan expenditure to total expenditure has remained distinctly lower in Tamil Nadu than the average for all states in 1980-85 and 1985-90 (about 28 percent versus an average of 36 percent for all states).
- (2) Within plan outlays, the proportion of plan revenue expenditure (broadly corresponding to current plan outlays) is higher in Tamil Nadu (64 percent in 1980-85 and 73 percent in 1985-90) than the average for all states (43 percent and 50 percent respectively).
- (3) Within revenue expenditure, the proportion of development spending (which predominantly represents outlays on maintenance or continuation of current outlays under the plan) is also higher in Tamil Nadu (74 percent in 1980-85 and 73 percent in 1985-90) compared to the all states average (71 percent and 69 percent respectively).
- (4) While the proportion of revenue expenditure in Tamil Nadu is somewhat higher than the average for all states, the share of capital expenditure is much lower. This implies that the share of loans and advances in Tamil Nadu is much higher than average.
- (5) Irrigation and roads in particular have lower shares in capital outlays in Tamil Nadu than in other states. These two sectors mainly account for the lower share of capital outlays as a whole. (Investment in power is discussed separately since it takes place through Electricity Boards and is not conducive to direct comparison in terms of the budgetary classification.)

Plan Outlays

The sectoral composition of plan outlays in Tamil Nadu is shown in Table 6.13. The main trends that emerge are:

- (1) The share of agriculture and allied activities in the past generally fluctuated between 15 and 25 percent of total plan outlays but has declined to about 12 percent in the Seventh Plan.
- (2) The share of social and community services, which was around 20 percent up to the end of the 1960s, increased to about 25 percent in the 1970s and more sharply to around 35 percent in the 1980s.
- (3) Irrigation had a share as high as 25 percent in the First Plan, which declined to nine percent in 1956-66 and subsequently to around five percent.

- (4) The power sector held on to a share of 35-40 percent until the 1980s. There was then a sharp decline to 26 percent in 1980-85 and a revival to 35 percent in 1985-90.
- (5) Industry and minerals have generally claimed a 5-6 percent share. Transport and communications peaked in the Fifth and Sixth Plans at 11.3 percent and 7.5 percent respectively, compared to 3-5 percent in earlier plan periods, but the share declined again to five percent in the Seventh Plan.

Table 6.14 compares the sectoral composition of plan outlays in Tamil Nadu with the average for all states in the Sixth and Seventh plan periods. There are no major differences in sectoral shares for agriculture and allied sectors. The share of power in Tamil Nadu improved over the all-states average in the Seventh plan, while that for transport and communications dipped lower. Most distinctively, for social and community services Tamil Nadu's proportion is about 15 percentage points higher and for irrigation it is about 15 percentage points lower than the all-states averages, indicating a drift in Tamil Nadu from capital investments on irrigation to current outlays on social and community services, when compared to all-states averages.

General Characteristics

Since the 1970s Tamil Nadu has opted for large current expenditures at the expense of capital outlays. The share of plan spending in total expenditure is low, and within the plan the proportion of revenue (or current) expenditure is high. The share of development expenditure in overall revenue expenditure also is high, however. These characteristics are interrelated and mutually reinforcing. Expenditures on continuation and maintenance of basic needs and welfare programs (education, health, welfare of SC/ST and backward classes, nutrition, etc.), initiated or enlarged in each successive plan period, become committed, nonplan, development-oriented revenue expenditures in subsequent plan periods, leaving fewer resources for incremental plan expenditures and thereby resulting in a lower proportion of plan to nonplan expenditure. Increasing current outlays within limited overall levels of plan spending have further constrained outlays for investment.

On the demand side, trends are related to the lack of ready investment potential in the irrigation sector. The ultimate irrigation potential in Tamil Nadu is itself very low, and the state has already utilized a very high proportion of its canal irrigation possibilities --

about 80 percent by the mid-1950s. This explains the sharp decline since then in outlays on irrigation. Apart from medium-sized irrigation projects of marginal viability, a few modernization projects in canal irrigation have been taken up in recent plan periods (e.g. the World Bank financed Periyar-Vaigai and National Water Management projects). But the major possibility in this category, irrigation modernization in the Cauvery delta, has been held up because of the water dispute with Karnataka. Nevertheless, investments could have been made to improve the efficiency of tank irrigation, which accounts for about 30 percent of total irrigation in Tamil Nadu and only recently has begun to receive the attention it deserves. The paucity of ready investment opportunities in irrigation could have permitted added investments in the power sector, but for several reasons this has not happened, with the consequence that Tamil Nadu has been subjected to severe power cuts in the last several years, with adverse effects on both industrial and agricultural production.⁸ The rapid growth of groundwater irrigation in the private sector through electrical pumpsets and additional generating capacity from the lignite-based Neyveli plants and the nuclear plant at Kalpakkam, both in the central sector, have to some extent alleviated the situation with respect to irrigation and power. Pumpset irrigation, however, is highly subsidized, as will be seen later in the chapter, with considerable impact on the availability of investible resources for the State Electricity Board.

Actual Versus Normative Levels of Expenditure

It is interesting to compare average per-capita expenditures in major sectors in Tamil Nadu with those in other states, based on the report of the Ninth Finance Commission (NFC), which provides information on actual per-capita expenditures in various sectors as well as corresponding "normative" levels. In the case of administrative and general services, normative levels have been estimated on the basis of the justifiable costs of providing average standards of such services already attained in the states. The data in the NFC report relate to 1986-87. Apart from methodological problems involved in the NFC's estimates, cost increases since 1986-87 render absolute figures for actual and normative expenditures out of date; nevertheless, some suggestive conclusions can be drawn (see Table 6.15). Per-capita

8. On irrigation and power development in Tamil Nadu, further information can be found in Chapters 6 and 8 of Madras Institute of Development Studies (1988).

spending on police in Tamil Nadu was below the average for major states, while that on general administrative services was only marginally higher. For both items, actual expenditures were less than normative levels. In primary and secondary education, medical, family welfare and public health services and social services, actual expenditures were less than normative levels, but in higher education and in agricultural services they were significantly above both normative levels and the averages for major states. In the aggregate, the NFC's trend estimates for nonplan revenue expenditures in Tamil Nadu for 1990-95 were slightly below (about 98 percent of) the normative estimates. These comparisons suggest that although the pattern of expenditure in Tamil Nadu is distinctly slanted toward current outlays, the unit costs of such outlays are not *prima facie* "unjustifiable" in terms of "normative" levels.

Main Components of Revenue Expenditure

The composition of current (or revenue) expenditures can be analyzed to identify possible sources of economy. In the 1990-91 Budget, salaries, wages, allowances and other establishment-related costs (such as travel, rent and motor vehicles) accounted for 38 percent of total revenue expenditure; current transfers in the form of grants-in-aid, subsidies, scholarships, assignments to local bodies and so on accounted for about 30 percent; and committed liabilities, such as interest payments and pensions and gratuities, comprised about 18 percent. Direct non-salary expenditures of the government, such as maintenance and repair of works, purchase of materials and supplies, diet and drug expenditures, equipment for schools and so on, accounted for about 15 percent. In other words, leaving out current transfers and committed liabilities, salaries and other establishment-related expenditures took up more than 72 percent of the remaining direct revenue expenditures of the state government.

Table 6.16, based on the Economic Classification of the budget, brings out quite forcefully the escalation in expenditures on compensation of employees (including pensions) since 1960-70 and especially in the 1980s. In relation to final (net) outlays, the share of such expenditures rose from 23 percent in the 1960s to about 28 percent in the 1970s and early 1980s and thereafter to 34 percent in 1985-90 and 38 percent in 1990-91. The share of employee compensation in total current expenditure rose from 33 percent in the 1960s to 41 percent in the 1970s, 68 percent in 1980-85, and 76 percent in 1985-90. With the implementation of the Fifth Pay Commission's recommendations in 1989, the ratio went up further to over 78 percent in 1990-91

(Budget Estimates). These figures are actually underestimates, since a substantial proportion of grants-in-aid to local bodies and to government-supported educational institutions also cover salary costs.

Establishment Levels and Costs

Salary expenditures being a function of staff strength and emolument levels, it is necessary to look at these two parameters separately. According to the Report of the Fifth Tamil Nadu Pay Commission (1989) there were 1,113,000 employees in the state government, local bodies and government-aided institutions on 31 March 1988. This included 282,000 people on consolidated pay (mainly those engaged for the noon-meals scheme) and about 18,000 college teachers on UGC scales. Table 6.17, based on NFC data, shows that as of the beginning of 1989 the number of government, local body and aided employees per 1000 population in Tamil Nadu (18.05) was 20 percent higher than the average for all major states (15.06). The much wider differential with respect to staff per 100,000 sq. km. of area -- 67.23 for Tamil Nadu versus 35.24 for all major states -- is partly to be expected given the higher density of population. Staff strength in Tamil Nadu appears to have grown at a faster pace than the average for all 14 major states (42.6 percent in 1972-82 for Tamil Nadu as opposed to 33.4 percent for all major states and 39.9 percent and 22.6 percent respectively in 1982-88).

In terms of emolument levels, Tamil Nadu traditionally tended to lag behind many of the major states, but the gap began to narrow in the 1980s. While there was an interval of 10 years between the First (1960) and Second Pay Commissions (1970) in Tamil Nadu, the Third (1978), Fourth (1985) and particularly the Fifth (1988) were constituted at shorter intervals in response to strong union demands and agitations of public employees, including teachers. The culmination of the process was the adoption in 1989 of central government pay rates and indices for Dearness Allowance revisions. Some of the other allowances, notably house rent allowance, are still below central levels, however. On the basis of figures available in the Budget documents, it can be estimated that the average cost per employee for salary and basic allowances has gone up four-fold in the 1980s, from about Rs. 5,000 in 1980-81 to nearly Rs. 20,000 in the Budget of 1990-91.

The distribution of staff among broad sectors of services provided by the state government, local bodies, and aided institutions is shown in Table 6.18. About 25 percent are in general services (mainly police and revenue administration), 35 percent in education (mainly school

teachers) and 25 percent in other social services, mainly health, social welfare and nutrition. This does not include over 200,000 employees on consolidated pay engaged in the noon meals scheme. Among economic services, agricultural and allied activities is the largest, with a weight of about 10 percent.

The employment profile is tilted toward the lower rungs: about 80 percent of employees are on scales where basic pay is less than Rs. 1,600 per month and about 33 percent below Rs. 900. The latter are generally unskilled employees, the most numerous single category of whom are office assistants ("peons" in colonial and common terminology). The Fifth Pay Commission drew attention to the fact that the number of office assistants increased from about 20,000 in 1970 to 30,000 in 1978 and 48,000 in 1988.

In sum, the level of government staffing in Tamil Nadu is noticeably on the high side. Its rate of growth has been higher than average among major states in the 1970s and particularly in the 1980s. In part this is related to the sectoral shift of expenditures toward social services (e.g. nutrition), which are employment-intensive. Despite high levels of staffing, the wage bill was contained to some extent until the late 1980s, because emoluments in Tamil Nadu were held below the all-states average. With the extension of central government pay scales and Dearness Allowance since 1989, salary costs have increased sharply. At the beginning of the 1990s, the cost per government employee was about four times what it had been a decade ago. Increased expenditures on staff are crowding out both capital outlays and high priority non-salary current outlays such as maintenance of assets, food and drugs, equipment, materials for schools, etc. In this context, it will be important to pursue all avenues to contain and reduce the growth in staff strength through higher productivity, reducing surplus employees to meet incremental staffing requirements, discouraging staff-intensive and staff-perpetuating programs, and the like.

Apart from salaries, grants to aided institutions (largely for educational expenditures), tax assignments to local bodies, and subsidies of various kinds account for the bulk of revenue expenditures other than committed liabilities such as interest payments and retirement benefits. Assignment of taxes and grants (both statutory and specific grants for entrusted functions) to local bodies currently accounts for two percent of revenue expenditures. Of total assignments and grants, the local share of entertainment tax accounted for 38 percent, the local cess matching grant to Panchayat Unions for 27 percent, and other important statutory grants (like the house tax matching grant,

local irrigation grant and local roads grant) for 12 percent. Specific grants, mostly for education, health, family welfare and water supply, make up the balance of 23 percent. The low level of fiscal support to local bodies is related to the fact that in Tamil Nadu, teachers in local body schools have been "provincialized", with their salaries being directly met by the state government. Besides, basic needs and rural infrastructure programs are being mostly implemented through state government departments rather than through local bodies and hence are directly funded from the state exchequer.

UNRECOVERED COSTS AND SUBSIDIES

In the earlier discussion of Tamil Nadu's nontax revenues, attention was drawn to the fact their share in the state's total revenue receipts has significantly declined over the years (from 22.5 percent in 1965-70 to 9.7 percent in 1980-90). The ratio of nontax revenues to total own revenue receipts is low (13 percent in 1985-90), and as noted earlier, the ratio of nontax recoveries to outlays in 1985-90 was only 3 percent for social and community services and no more than 10.5 percent for economic services.

Costs of services provided by the state can be recovered either directly from beneficiaries and users or via taxation. The choice between these alternatives is based on ideology, political aspects, feasibility and optimality considerations, and other rational or irrational factors. The pattern of expenditure and the recovery rate for each item of expenditure together determine the share of uncovered costs in total outlays. Given the constraints on additional taxation, especially in an already highly taxed state like Tamil Nadu, it is clearly necessary to contain the growth of unrecovered costs and to improve recoveries from services provided by the state government.

This study attempts to quantify as best as possible the directly unrecovered costs (DUC) in the revenue account and to investigate certain key relationships that can be derived from such quantification. The approach in principle is the same as that in Govinda Rao and Mundle (1991), but the methodology followed here is in some respects more refined. Having ascertained the magnitude and distribution of DUC, we proceed to comment on the issues that they raise. The section that follows complements the picture by specifically taking into account returns from public enterprises, actual and normative, so as to ascertain the DUC involved in their operations.

Detailed Analysis of DUC

Table 6.19 presents sector-wise data on the revenue account for total state expenditures, expenditures net of central grants, internal recoveries, DUC and cost recovery for 1988-89. The methodology based on which these computations were made is explained in Annex 6.1. The various expenditure sectors have been categorized for analytical purposes under seven groups. Group A includes basic administrative services relating to law and order (police, jails and administration of justice), enforcement of property relations (registration, survey and settlements) and relief of natural calamities. These functions relate broadly to what would be expected of the "minimal" (or "night watchman") state. Group B (basic social services) includes education, medical, public health and family welfare services and water supply and sanitation. These can be broadly viewed as primary "merit goods". Group C (social infrastructure) includes housing and urban development and rural development and employment. Group D (social welfare) includes a large component of pure transfers, the main component of which is for the welfare of SC, ST and Backward Classes, social security (e.g. old age pensions), child and school nutrition and the subsidy involved in the Public Distribution System (PDS). Group E (economic infrastructure) includes irrigation, power, roads and transport. Group F (production services) covers agriculture and allied sectors, forests and industry and minerals. Group G includes a number of miscellaneous expenditure items. The proportion of DUC in total expenditures is a function of the pattern of expenditure and the recovery rates for the items in each category (see Table 6.19).

In the aggregate, recoveries come to about 12 percent of net state expenditure, or in other words, DUC comprises 88 percent of total net expenditures. The cost recovery rate varies from 2/3 percent in Group B (basic social services) to 32.2 percent in Group F (production services). We now discuss each group and major items therein.

Group A (basic administrative services). Recoveries in this category are in the form of fines (under police), jail manufactures, judicial stamps (under administration of justice) and registration fees. The costs of the registration department are more than covered by fees. Recovery is also quite high (62.7 percent) in the judiciary. The overall group recovery ratio is only 17.9 percent, however, due not surprisingly to very low cost recovery by police and zero recoveries for survey and settlement and for relief.

Group B (basic social services). Items in this category account for 37 percent of total net state expenditure but contribute only about

seven percent to total recoveries. The cost recovery rate for the group as a whole is as low as 2.3 percent. It is 1.5 percent in education, which claims over 26 percent of aggregate net state expenditure while contributing only about three percent to total recoveries.

The structure of expenditures, recoveries and DUC in the three levels of general education (elementary, secondary and higher-level) is shown in Table 6.20. The recovery rate is marginal (0.3 percent) in elementary education and only around 2.4 percent in secondary and higher education. In Tamil Nadu schooling is free, in terms of basic tuition fees, up to the higher secondary (12th standard) level.⁹ Table 6.20 also provides information on unrecovered costs per student per annum at each tier in 1988-89, based on enrollment figures. This figure was Rs. 449 per student at the elementary education stage; Rs. 800 at the secondary level; and Rs. 3,764 for university and higher education, that is, more than eight times the DUC per student at the primary level. As noted earlier, per-capita secondary education expenditures are below the normative level in Tamil Nadu. With increasing future enrollment at the secondary level (100 percent enrollment has been achieved at the elementary state) and rising per-capita costs, unrecovered costs will burgeon at this level if recovery levels are not improved. As far as higher education is concerned, actual per-capita expenditures are already on the high side relative to normative levels; hence there is need and scope to increase cost recovery.

Group C (social infrastructure). Outlays on housing and urban development mainly reflect support to local bodies and the Slum Clearance Board for slum improvement and clearance and for urban infrastructure development, transfers to the urban development fund and subsidies for rural housing. The main outlays under rural development and rural employment are for the IRDP (Rs. 24 crores) and for the NREP/RLEGP (Rs. 125 crores). These amount to pure transfers, with no recoveries intended.

Group D (social welfare). Outlays on the welfare of SC, ST and Backward classes do not involve any cost recovery. Under social security and nutrition the major items are old-age pensions (Rs. 19 crores) and the noon-meals scheme (Rs. 162 crores). The latter provides a meal every day of the year for more than 8.5 million pre-school and school children between the ages of 2 and 15. This

9. Higher education is also free, based on means criteria, for girl students and for students belonging to SC, ST, most backward classes and denotified communities.

single program accounts for about 35 percent all social welfare expenditures and six percent of total DUC. The food subsidy, apart from the noon-meals scheme, is related to the PDS. It varies from year to year depending on the procurement cost of paddy (the main foodgrain consumed), the issue price fixed by the central government for allotments from the central pool, the cost of open market purchases (if any), storage and distribution costs and the issue price for consumers under the PDS. These parameters also vary according to the variety of rice (ordinary, fine and superfine). The food subsidy can fluctuate widely from year to year depending on the amounts purchased and sold, the extent to which the issue price to consumers is adjusted to reflect costs, and the outlay on the noon-meals scheme, for which foodgrains are the main cost item. In 1990-91 (Budget Estimates), the outlay on the noon-meals scheme was Rs. 195 crores, and the food subsidy had risen to about Rs. 250 crores. Since 1989-90, several new social security schemes also have been initiated, along with the liberalization of old-age and other pensions such as pensions for widows and the physically handicapped (see Guhan, 1991).

Group E (economic infrastructure). Irrigation, power, roads and transport are included in this group. In the roads and transport sector, full recovery has been shown in Table 6.19 because the Motor Vehicles Tax is a levy on road-users in its incidence and hence can appropriately be considered as a recovery from them. The overall cost recovery rate in this group reaches 18 percent only because of full recovery under roads. In irrigation and power taken together the cost recovery rate is only 0.6 percent.

Public irrigation works in Tamil Nadu are classified as (1) "commercial" works, mainly canal irrigation, in which recoveries are expected to cover operation and maintenance (O & M) expenses and interest and (2) "non-commercial" works, mainly tank and minor works, where only O & M expenses are expected to be recovered (since they are treated as "protective" works). Proforma accounts are maintained for both types of works. Using the data in the proforma accounts, the expenses (actual on O & M and imputed on interest and depreciation), recoveries, and DUC on commercial and non-commercial works can be calculated and related to the net acreage irrigated under each category in 1980-85 and in 1985-90 (see Table 6.21). DUC in commercial works nearly doubled from Rs. 358 to Rs. 700 per hectare between the two quinquennia. This is not so much because of the increase in O & M expenses but because of substantial increases in interest and depreciation on account of additions to capital outlays for high-cost, marginal projects with dubious

hydrological viability, that have not resulted in commensurate increases in receipts or in the area covered. In the case of non-commercial works, DUC per hectare has increased from Rs. 180 in 1980-85 to Rs. 225 in 1985-90. The subsidies in surface irrigation are patently regressive, since beneficiaries from relatively more assured canal irrigation reap unit subsidies more than three times as high as beneficiaries from largely rain-fed tank sources.

DUC in power consists of a subsidy of Rs. 293 crores in 1988-89 to the Tamil Nadu Electricity Board (TNEB) to meet the losses incurred on supply of power to farmers using electric pumpsets and the interest due, but not paid, on loans from the state government (about Rs. 150 crores). The large loss on agricultural power consumption in TNEB's finances (which are reviewed in detail in the following section) is due to the relatively high share of the agricultural load in overall electricity consumption in Tamil Nadu (about 27 percent) and the heavy subsidy in the per unit agricultural tariff. Tamil Nadu is a leading state in India in agricultural pumpsets, with more than 1.2 million pumpsets in operation in 1988-89. TNEB has estimated the cost of supplying one unit of electricity at the pumpset to be 102.17 paise, while the average sales realization is only 11.2 paise, resulting in DUC of 90.97 paise per unit. Given consumption of 3,524 million units in 1988-89, DUC for TNEB was Rs. 321 crores on account of agricultural consumption, or Rs. 2,650 for an average pumpset (see TNEB, 1990). At 1988-89 tariff levels, the cost of operating an electric pumpset was only about one-fifth of that of using a diesel pump. Besides, pumpset owners often "lease" out water, for which they usually levy a charge equal to one-third of gross output. Translated into per unit realization, this can be estimated at about 66 paise, or six times the tariff paid to TNEB. Another indicator of the value of pumpset irrigation is the waiting list of 400,000 applicants (Sankar and Hema, 1990).

The regressive nature of the agricultural power subsidy also needs to be highlighted. On average, a pumpset in Tamil Nadu is estimated to irrigate 0.62 hectare, which means that the irrigation subsidy via the agricultural power tariff was Rs. 4,274 per hectare for ground-water irrigation using pumpsets, compared with Rs. 700 for users of canal and Rs. 225 for users of tank irrigation (in 1988-89). This is particularly anomalous since, according to TNEB statistics, about 91 percent of pumpset owners are "large farmers" (above 2.5 irrigated acres) who extensively deploy well irrigation to grow remunerative cash crops. Moreover, cheap electricity has a high social cost: it provides a disincentive to economy in the use of water and has led to

overexploitation of groundwater resources in many parts of Tamil Nadu.

Successive tariff revisions have tended to increase rather than reduce the power subsidy. The agricultural power tariff was reduced from 16 paise per unit to 13.84 paise for small farmers and 15.84 paise for large farmers in 1979 and to 12 paise and 15 paise respectively in 1982. In 1984 small farmers came to be supplied power entirely free of cost, while the tariff was fixed at Rs. 75 per horsepower for large farmers (which worked out to an average yield of 11.49 paise per unit of electricity). The levy per horsepower was reduced to Rs. 50 in 1989 and was altogether removed a year later, with the result that all agricultural pumpset users in Tamil Nadu are now being provided with free electricity. The loss to TNEB on this account is on the order of Rs. 400 crores per annum. As we shall see later, the agricultural subsidy has a serious impact on the financial viability of TNEB.

Group F (production services). In agriculture and allied sectors (animal husbandry, fisheries, cooperation) DUC pertains to costs of various promotional schemes and includes some direct subsidies, the most important of which are input subsidies, grants to cooperative banks for the waiver of interest and/or loan dues (Rs. 30 crores in 1988-89) and other subsidies in the cooperative sector. Since forest resources more than meet outlays on forests, recovery is 100 percent under this item. In industry and minerals, which includes village and small industries and handlooms, DUC relates to outlays on several promotional schemes and certain direct subsidies such as handloom and khadi rebates (Rs. 44 crores in 1988-89) and capital subsidies for setting up industries in backward areas (Rs. 3 crores). Interest subsidies implicit in interest-free sales tax loans form another component.

Direct Subsidies

The analysis of DUC presented above can be supplemented by figures on the sector-wise breakdown of "subsidies" in the Economic Classification of the state budget. The identification of subsidies in the Economic Classification is neither uniform nor comprehensive, however, especially since it does not fully take into account indirect subsidies implicit in under-recovery of costs. Table 6.22 shows that direct subsidies have risen from an annual average of Rs. 9.56 crores in 1973-80 to Rs. 165.43 crores in 1980-88, with wide year-to-year fluctuations. The breakdown in Table 6.23, showing direct subsidies in 1980-88 for major sectors, also is of interest. Food and nutrition, accounting for nearly 35 percent of total direct subsidies, comprise by

far the largest category. The electric power subsidy through TNEB is a distant second at 16 percent of the total. Agriculture and related areas account for 14 percent of total direct subsidies, rural development for another nine percent.

DUC by Broad Expenditure Purposes

The data on DUC in Table 6.19 have been recast in Table 6.24 to show the composition of total DUC as between what could be broadly considered as public goods (Group A), merit goods (Group B), mainly pure transfers (Group D and rural development and employment in Group C), economic and social infrastructure (Group E and housing and urban development from Group C), production services (Group F) and others (Group G). Public goods, merit goods and pure transfers together account for about 68 percent of DUC, of which 41 percent is accounted for by merit goods. It may not be feasible to significantly increase the cost recovery rate for these categories, although there is a strong case for doing so in university and higher education and, to some extent, in secondary education. Economic and social infrastructure and production services together account for about 30 percent of DUC. The scope for enhanced cost recovery is much greater in this category, particularly in irrigation. Over the longer run it is clear that the pattern of government expenditure -- the extent to which it continues to be oriented toward merit goods and welfare transfers -- will influence the quantum of aggregate DUC and overall cost recovery rate.

DUC According to Broad Target Groups

The targeting of DUC is also of interest (see Table 6.25). About seven percent of total DUC is claimed by public goods of universal benefit (police, jails, administration of justice). As much as 54 percent is accounted for by expenditures on merit goods (education, health, water supply) and welfare (mostly nutrition and PDS), which are either not targeted at all (except to a small extent in social security expenditures) or do not differentiate between the poor and nonpoor within large beneficiary groups (education, medical care, child and school nutrition). If anything, the poor may benefit less in relative terms because of restricted access to these facilities (for instance higher education or non-school going children who do not benefit from noon meals). Thirteen percent of DUC is related to beneficiaries who are in some sense vulnerable or disadvantaged, such as the rural and urban poor, SC, ST and backward classes, and handloom and khadi weavers. About 26 percent of DUC is claimed by landowning

agriculturists, namely DUC related to land administration, agricultural input subsidies, loan and interest write-offs and, most of all, the massive underrecovery of irrigation costs. Their share is twice that of DUC attributable to groups that can be considered economically or socially disadvantaged.

PUBLIC ENTERPRISES

The financial performance of the Tamil Nadu Electricity Board (TNEB) is examined first, followed by a discussion of state public sector enterprises (PSEs) more generally. There are also statutory boards in Tamil Nadu engaged in pollution control, housing, water supply and drainage (in Madras city and outside), metropolitan development, khadi and village industries and slum clearance. These are not covered for lack of suitable data.

The Tamil Nadu Electricity Board

Established in 1957 under the Electricity Supply Act (1948), TNEB took over the functions of the electricity department of the state government. At the end of 1988-89, TNEB's capital and current assets were of the order of Rs. 5,427 crores, of which gross capital assets (including work-in-progress and capital stores) amounted to Rs. 3,191 crores. Investments in TNEB have been largely financed by loans, ways and means advances, grants and subventions and subsidies from the government; TNEB has been the largest single recipient of government loans. The latter (including ways and means advances) totalled Rs. 1,975 crores at the end of 1988-89. Under the provisions of the Electricity Supply Act, government loans to TNEB (as distinct from ways and means advances) are "permanent", that is, the principal does not have to be repaid, even though interest is payable.

Table 6.26 reviews the financial performance of TNEB. In 1960-70 its operating surplus was adequate to meet all interest payments and depreciation provisions, with a surplus left over. In 1970-80 the operating surplus became insufficient to meet interest and depreciation, so there was a net deficit. The total subsidy extended by the state government during this decade was Rs. 181 crores. Moreover, at the end of 1979-80, accumulated interest arrears to the government amounted to about Rs. 50 crores. Since 1980-81 there has been a sharp deterioration in TNEB's finances. Gross income (excluding government subsidies) has not been adequate even to cover operating expenses. Government subsidies in 1980-85 amounted to Rs. 867 crores, and interest arrears had accumulated to Rs. 278 crores at the

end of that period. The situation further worsened in 1985-90. TNEB's operating deficit rose to Rs. 214 crores in 1989-90, and the final deficit after interest and depreciation came to Rs. 386 crores. Government subsidies in 1985-90 totalled Rs. 1,607 crores, Rs. 523 crores in 1989-90 alone. Accumulated interest arrears reached Rs. 592 crores.

The Electricity Supply Act requires State Electricity Boards to achieve a return of three percent on net fixed assets, after meeting all expenses chargeable to revenue, i.e. operating and maintenance expenses, interest payments and depreciation. Table 6.27 shows that as compared to the normative return of Rs. 201 crores prescribed by statute, the actual position was a total loss of Rs. 1,415 crores during 1985-90. The loss computed on a normative basis in this period was, therefore, Rs. 1,616 crores, or an annual average of Rs. 323 crores, with the figure reaching Rs. 527 crores in 1989-90.

TNEB's massive losses are related to costs, inefficiency and tariff policy. The share of thermal generation in TNEB's own capacity, which was 31 percent in 1975-76, had risen to 46 percent in 1981-82 and has remained at about that level since then. In the 1980s TNEB has had to depend on purchases of power (mainly from central projects in Neyveli, Kalpakkam and Ramagundam) to cover about one-third of its total energy availability. There have been continual increases in the costs of inputs to thermal generation -- coal, oil, railway and ocean freight -- which have especially affected TNEB since Tamil Nadu is distant from coal sources. Similarly, there have been continual increases in the price of purchased electric power. Expenses on wages and salaries also have increased. Interest charges are another important cost item. In the absence of internal funds, TNEB has had to resort heavily to borrowings to finance its capital investments, the costs of which also have been steadily rising. Overall, the average basic cost per unit (generated and purchased) has risen from 23 paise in 1980-81 to 55 paise in 1988-89, or by nearly 140 percent.

Efficiency parameters of TNEB, such as the availability factor, plant load factor and coal and oil consumption, compare favorably with all-India averages, although the employee ratio is higher than the all-India average by 27 percent, which could be explained to some extent by the extensive rural network in Tamil Nadu. Transmission and distribution losses (18.5 percent in 1988-89) are below the all-India average, but they have stayed at about that level for a number of years and are still above the normative level of 15 percent (see Table 6.28).

In a context in which exogenous cost increases have to be borne and the scope for efficiency improvements is limited, tariff increases become inevitable to avert large and increasing losses. TNEB, or rather the Tamil Nadu government (which has to approve tariff revisions), has lagged in revising tariffs to keep pace with escalating costs. According to TNEB's estimates, the cost of supply of one unit for High Tension (HT) consumers in 1988-89 was 78.93 paise and for Low Tension (LT) consumers 102.17 paise. The effective rates charged were 100 to 109 paise for HT, 95 to 115 for LT industrial, 115 to 135 paise for LT commercial, 55 paise for LT domestic and 11.49 paise for LT agricultural consumers. Industrial and commercial consumers were thus being charged tariffs well above costs; domestic consumers were being heavily subsidized; large farmers among agricultural consumers were being provided with electricity at barely 10 percent of cost; and electricity was being given free to small farmers.

The extent of cross-subsidization has increased over time. Between 1980-81 and 1988-89, average realizations per unit from industrial consumers went up from 31 to 78 paise (by 152 percent); the increase in the case of commercial consumers was from 67 to 98 paise (46 percent); that for domestic consumers was from 46 to 67 paise (also 46 percent); and average realization from agricultural consumers decreased from 15 to 10 paise (Sankar and Hema, 1990). Despite this significant and widening cross-subsidization, TNEB has suffered heavy overall losses, which shows that the extent to which agriculture is being subsidized has gone much beyond the point at which it can be covered by a reasonable burden on industry and commerce. As noted earlier, this trend continued with the further reduction of the agricultural tariff in 1989 and culminated with its total elimination in 1990. TNEB's financial viability and autonomy can be restored only if there is a radical reversal in the government's policy of wholesale subsidization of agricultural consumers.

Other Public Sector Enterprises

The state government's annual review of state public enterprises in Tamil Nadu listed 62 PSEs in 1988-89, grouped in 10 categories. Table 6.29 presents group-wise data on paid-up share capital, long-term borrowings and internal resources for 1988-89. Out of the total equity base, the share of the state government (Rs. 369 crores) accounted for 86.5 percent. In addition, capital grants from the government to PSEs came to Rs. 28 crores. The government also accounted for 12.6 percent of long-term borrowings or Rs. 131 crores.

Thus the total exposure of the government (excluding loan guarantees) was Rs. 528 crores by way of equity, loans and capital grants. Government share capital was concentrated in the development finance (42 percent of total) and manufacturing groups (22 percent), while government loans were concentrated in the development finance (34 percent), passenger transport (30 percent) and manufacturing groups (20 percent). The ratio of long-term borrowings from all sources to total equity was 2.4 for all the PSEs taken together. Internal resources (reserves and depreciation) came to about 35 percent of share capital and long term loans.

Table 6.30 shows group-wise financial data in 1986-89. The gross operating surplus (prior to depreciation, interest and tax) was Rs. 150 crores in 1986-89 (annual average), and the net operating surplus (after depreciation) was Rs. 27 crores. Interest payments amounted to Rs. 93 crores and taxes to Rs. 2 crores. The net loss (after depreciation, interest and taxes) came to Rs. 68 crores. In terms of return to the gross block (of capital employed), gross operating surplus was 15.9 percent and net operating surplus (after depreciation) was 2.8 percent. Interest payments came to 9.8 percent of gross block and taxes to 0.2 percent. The resulting net loss (after depreciation, interest and taxes) was -7.2 percent. In 1988-89 only two PSEs (Tamil Nadu Minerals and Tamil Nadu Warehousing) paid dividends, which totalled only Rs. 45 lakhs.

The overall loss of Rs. 88 crores in 1988-89 was the result of an aggregate loss of Rs. 95 crores in 33 loss-making PSEs and total profits of Rs. 8 crores in 29 profitable PSEs. Table 6.31 shows the position in different sectors. PSEs in the "trading" group accounted for 45.3 percent of the overall loss. The balance was mainly due to manufacturing (16.0 percent), development finance (13.8 percent), passenger transport (12.9 percent), other transport (8.3 percent) and agriculture (2.8 percent). The main aspects of financial performance in each group are now discussed.

Passenger transport corporations. The Tamil Nadu government has a strong presence in public transport, both urban and long distance, accounting for 70 percent of the bus fleet strength in the state. There are 15 passenger transport corporations, the largest of which is the PTC (Pallavan Transport Corporation) operating in Madras city. Eleven out of 15 of these corporations made a total loss of Rs. 12.34 crores in 1988-89, while the remaining four made aggregate profits of Rs. 0.67 crores. The PTC with a loss of Rs. 3.11 crores was the poorest performer. Efficiency norms in state road transport undertakings in Tamil Nadu are basically satisfactory according to

data available in the Report of the Ninth Finance Commission (1989, Annexure III.7, p. 68). The overall loss is mainly due to high debt-equity ratios; the large weight of urban transport operations; inadequacy of fare revisions to keep pace with increasing operating and maintenance expenses particularly on fuel; operation of uneconomic routes; and concessional fares to students and certain other categories of passengers.

Other transport corporations. This category includes the goods transport corporation and the Poompuhar Shipping Corporation, which is wholly involved in transporting coal for TNEB and in chartering vessels for the purpose. The losses of the Shipping Corporation represent in part underrecovery of true costs from TNEB. The goods transport corporation, which was always unviable in the face of stiff competition from the private sector, has since been wound up.

Mining. This includes Tamil Nadu Minerals (engaged in the mining, processing and export of granite, of which Tamil Nadu has extensive resources) and the Tamil Nadu Magnesite Corporation. Both enterprises have been making profits. Since 1989-90 special steps have been taken to improve the financial performance of Tamil Nadu Minerals.

Manufacturing. The most important PSE in this group is Tamil Nadu Newsprint (TNPL). In 1988-89 TNPL made a loss of Rs. 9.7 crores due to a number of factors like over-capitalization, under-utilization of capacity and low output prices. Since 1989-90 there has been some improvement. Other significant loss-making PSEs were TANSI and Tamil Nadu Ceramics (both of which inherited obsolete machinery and a host of other problems from old departmental units) and Southern Structural (a taken-over sick concern). In 1988-89, TANSI and TACEL each made a loss of Rs. 2.3 crores. In recent years attempts have been made to restructure these two PSEs by closing down some uneconomic units. Five other PSEs in this group, engaged in sugar, salt, electronics, zari and engineering, made marginal profits or losses.

Trading. This sector is dominated by the Tamil Nadu Civil Supplies Corporation (TNCSC), which is engaged in the procurement and distribution of foodgrains and other essential commodities under the PDS. The trading loss made by TNCSC, mostly due to interest charges, was Rs. 42.7 crores in 1988-89, accounting for about 45 percent of the aggregate losses of loss-making PSEs. The other trading concern is TASMAL, engaged in the wholesale distribution of liquor. It made a marginal loss in 1988-89 but has shown promise of

improved performance since then.

Development finance. Major industrial finance and industrial promotion corporations are in this category, including TIDCO (which has promoted a number of joint sector companies and also has as its subsidiaries three public sector units producing steel, cement and industrial explosives), SIDCO (small industries development), SIPCOT (infrastructure development), TIIC (the main state industrial finance corporation) and four other corporations engaged in transport finance, handloom finance, textiles and a defunct theater finance corporation. Large losses in 1988-89 were incurred by TIIC (Rs. 6.95 crores) and SIPCOT (Rs. 4.57 crores). In both cases, revised accounting methods have worsened the financial picture. TIDCO made a loss of Rs. 1.58 crores in 1988-89. The five other PSEs in the group made marginal profits or losses. As compared to the overall loss of Rs. 12.71 crores for this group in 1988-89, a profit of Rs. 1.66 crores was recorded in 1987-88 and a marginal loss of Rs. 0.3 crores in 1986-87, suggesting that the accounting changes in TIIC and SIPCOT distorted the results in 1988-89.

Other development corporations. This group includes a diverse set of nine small promotional and welfare-oriented PSEs engaged in tourism, handicrafts, poultry, meat (since wound up), fisheries, district development in Dharamपुरi, backward classes economic development, leather and womens' development. Taken together, they made a marginal profit in 1988-89.

Agriculture and allied activities. The six PSEs in this group include the agro-industries corporation, sugarcane farm corporation (since wound up) and four plantation corporations dealing with commercial forests, tea, rubber and medicinal plants. Together they incurred a loss of Rs. 2.3 crores in 1988-89, with the agro-industries, sugarcane farm and tea corporations being the major loss makers. The rubber corporation made a profit.

Construction and miscellaneous. These two categories include nine PSEs engaged in construction, warehousing and diverse miscellaneous activities. Three of them (Chit, Police Housing and Tubewells) have now been wound up. Taken together they contributed a marginal profit in 1988-89.

The financial performance of Tamil Nadu PSEs is clearly unsatisfactory in terms of actual results and much more so with reference to the Ninth Finance Commission's reasonable norms of one percent return on investment for road transport undertakings in 1990-91, going up to 6.5 percent in 1994-95, and returns of three and five percent respectively in financial and commercial enterprises, with

promotional companies expected at least to cover all expenses. While detailed enterprise-wise analysis is necessary to identify the various factors responsible for poor performance, this brief overview has drawn attention to major generic problems, including (1) policy-induced subsidies reflected in under-recovery of economic costs (e.g. civil supplies, road transport and shipping), exacerbated by continual increases in administered prices of inputs (e.g. fuel); (2) inheritance or takeover of sick units (e.g. TANSI, TACEL, SSL, textiles); (3) promotional considerations involving implicit subsidies (e.g. SIPCOT, SIDCO); and (4) overextension into fields in which there is no prima facie rationale or comparative advantage for the public sector (steel, cement, sugar, salt, ceramics, industrial explosives, leather, plantations, construction).

DEBT AND FINANCING OF CAPITAL FORMATION

This concluding section examines the debt position of Tamil Nadu and the sources of financing for capital formation.

Sources of Debt

Table 6.32 shows the composition of outstanding borrowings in Tamil Nadu at the end of 1988-89. The central government has been the main source of borrowings, accounting for 65 percent of outstanding debt, while open market loans account for 21 percent, institutional sources (such as LIC, NABARD, HUDCO, NCDC) for three percent and the state's Provident Funds and reserve funds 11 percent. The comparison in Table 6.32 indicates that Tamil Nadu's debt portfolio has historically relied significantly more on open market loans and relatively less on GOI and internal funds.

Growth of Debt

Table 6.33 shows the growth in borrowings -- gross and net -- in different periods. With reference to the level in 1960-70, gross borrowings were nearly seven times as high and net borrowings nearly nine times as high in 1980-90. Growth in borrowings was much faster in 1980-90 over 1970-80, compared to the growth in 1970-80 over the previous decade. Borrowings have increased much more slowly than current revenue receipts, however, which in 1980-90 were more than 14 times their 1960-70 level.

There has been an appreciable shift from the Government of India (GOI) to "other" sources of borrowings (mostly internal funds), while market loans have more or less maintained their share (See Table

6.34). GOI and "other" sources accounted respectively for about 70 percent and 12 percent of gross as well as net borrowings in 1970-80. The GOI share dropped to 56 percent in gross and 49 percent in net borrowings in 1980-90, while the share of other sources increased to 26 percent of gross and 33 percent of net borrowings. Repayment ratios for all three sources of funds declined between 1970-80 and 1980-90 -- from 41 to 28 percent for market loans, from 47 percent to 38 percent for GOI loans and, most sharply, from 53 to 10 percent for other loans. In the case of market and GOI loans, the decline in the repayment ratio represents in part a softening of maturities and in part a reflection of the profile of past borrowings. The larger yield and lower outgo in 1980-90 under other loans, which are mostly accounted for by state provident funds, are the result of larger accretions due to salary increases in the 1980s and the impounding of a part of the arrears payments related to the Pay Commission increases in 1989. Overall, the repayment ratio for state government debt has gone down significantly from about 47 percent in 1970-80 to about 29 percent in 1980-90. While this is welcome, there is no assurance that the repayment rate will remain at this level. It should also be noted that in the case of GOI loans, the major source of borrowings, about 40 percent of fresh loans are used to repay past borrowings.

Level of Indebtedness

Tamil Nadu stands out among the major states as the one with the lowest ratio of outstanding debt to GDP, 20.5 percent as compared with the all-states average of 29.2 percent (see Table 6.35). A variety of reasons could explain this, among them availability of current account surpluses resulting in lesser reliance on borrowings and lack of major capital projects (especially in irrigation) to absorb lending and the relative absence of frequent or major natural calamities necessitating nonplan loans from the center.

Assets and Liabilities

At the end of 1988-89, as compared to the outstanding debt from all sources of Rs. 3933 crores (Table 6.32), assets including outstanding loans advanced by the state government, capital expenditures and cash balance and investments amounted to Rs. 5579 crores, well in excess of liabilities. Cumulative capital expenditure of Rs. 2210 crores at the end of 1988-89 was financed only to the extent of Rs. 564 crores (or 26 percent) through borrowings, implying that revenue surpluses were able to finance as much as 74 percent of capital outlays. The excess of assets over liabilities could, however, give a misleadingly

comfortable impression. The "assets" of the government, whether loans to TNEB or irrigation investments or share capital investments in PSEs, do not generate cash for amortization. As we have seen, loans to TNEB are not repayable, and TNEB has not been able to meet even interest dues to government. In irrigation, receipts do not cover even operation and maintenance costs, while dividend income from PSEs is negligible. Under these circumstances, debt servicing needs to be viewed as a charge on revenue receipts. The ratio of debt servicing to total revenue receipts was 14 percent in 1980-90, providing an indication of the revenue surplus required for viable debt management at current repayment levels.

Financing of Capital Formation

Levels of capital formation and financing from current savings and capital resources in 1960-70, 1970-80, 1980-85 and 1985-90 are shown in Table 6.36. Outlays on capital formation were of the order of 30-33 percent of total gross outlays in 1960-70; the ratio of current savings to current revenues was about nine percent; and the contribution of current savings to capital formation was about 16 percent. There was a marked improvement in these ratios in 1970-80 and 1980-85, when the ratio of current savings to current revenues went up to 18-19 percent and current savings were able to contribute 32-35 percent of capital formation. Against this background, the steep decline in 1985-90 both in the ratio of capital formation to total gross outlays (25.4 percent) and in the contribution of current savings to capital formation (14.1 percent) is striking.

The signs are unmistakable that increases in current outlays reflected in establishment costs, subsidies, and welfare schemes are crowding out capital formation, and that capital formation is being financed to a much smaller extent than in the past from current savings. The situation is likely to worsen considerably in the near future because of the decision of the state government to ban arrack in mid-1991, which will cost Rs. 400 crores annually in terms of forgone revenue.

Annex 6.1

Reclassification of the Tamil Nadu Revenue Account in 1988-89 to Estimate Directly Unrecovered Costs

The objective of this exercise is to estimate direct cost recoveries for each sector of expenditure, with the sectors themselves being classified in a form that might be useful from the viewpoint of public policy. This involves adjustments to both receipt and expenditure figures to distinguish, in terms of economic logic, between taxes (net of collection costs) and direct recoveries; allocations of certain overhead expenditures (such as those on general administrative services) and of receipts and expenditures shown in bulk in the standard budgetary classification (interest receipts and payments, block grants from GOI, pensions and gratuities, and so on); elimination of expenditures shown in the revenue account that do not reflect final outflows (contribution to sinking fund, interest on irrigation etc.); and estimation of certain costs not shown in the budget (like depreciation). The adjustments made and the assumptions on which they are based are explained below. Annex Table 6.1 shows the reconciliation between the revenue accounts as reclassified here and the figures in the Budget documents.

Adjustments in Receipt Items

- (1) *Share of central taxes*: No adjustments.
- (2) *Government of India grants*: Specific purpose grants have been shown as recoveries against the concerned sectors. Block grants, which are mainly for the state plan, have been netted out against individual sectors in proportion to sector-wise plan revenue outlay in 1988-89.
- (3) *State taxes*: (a) Assignments to local bodies of entertainment tax, terminal tax, and taxes on vehicles have been netted out. (b) Revenue from judicial stamps (net of the amount turned over to local bodies) has been shown as nontax revenue against administration of justice. (c) Revenue from registration fees has been shown as nontax revenue against "registration". The excess of such revenue over expenditures under "registration" is treated as a tax. (d) Revenue from taxes on vehicles (net of collection costs) has been shown as nontax recovery against roads and transport, with the excess over expenditure treated as a tax. (e) The estimated cost of collection of land revenue has been netted out as collection

charges under land revenue.¹⁰ (f) Expenditures on collection of agricultural income tax, non-judicial stamps (net of the amount deducted for local bodies), state excise duties, sales taxes and other taxes and duties have been netted out.

- (4) *Nontax revenue*: (a) Revenue from judicial stamps, registration fees, and taxes on vehicles to the extent transferred from state taxes have been shown as recoveries against the relevant sectors. (b) Recoveries related to "general overheads", such as stationery and printing, public works, pensions, miscellaneous general services, other general services, state legislature, Council of Ministers, general administration (less estimated cost of collection of land revenue) and elections have been netted out of expenditures on these items. Net expenditures so arrived at have been subsequently allocated to expenditure heads along with interest and pension payments related to them. (c) Interest receipts from irrigation have been eliminated from nontax revenue as well as on the expenditure side, since this is an internal transfer. (d) Interest receipts have been shown against individual sectors in proportion to loans outstanding and on the basis of the average interest yield on loans outstanding in the budget as a whole.

Adjustments in Expenditure Items

- (1) *Collection of Taxes*: Expenditures on survey and settlement have been shown under a separate head under basic administrative services. Other expenditures for collection of taxes have been treated as indicated under state taxes and nontax revenues.
- (2) *Debt service*: (a) Appropriation for reduction of debt has been eliminated since it is a contribution to the sinking fund and not a final expenditure. (b) Interest payments on irrigation have been eliminated as stated above. (c) Other interest payments have been allocated to individual sectors.¹¹

10. Collection costs for land revenue have been estimated as being equivalent to 75% of the expenditure on village revenue establishment, 50% on *taluk* establishment, 33-1/3% on subdivisional establishment, and 25% on district establishment.

11. This has been done on the basis of loans outstanding and capital outlays for each sector financed by outstanding borrowings of the government and based on the average interest cost on such borrowings.

- (3) *Other general services, social services and economic services:*
 (a) Pensions have been allocated to individual sectors.¹² (d) Depreciation at two percent of capital outlay (on the same basis as in Govinda Rao and Mundle, 1991) has been added as an imputed cost sector-wise.
- (4) *Assignments and compensation to local bodies:* (a) Assignments of taxes have been netted out from the relevant state taxes. (b) Contribution to the urban development fund has been shown under "urban development".

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12. Pensions to teachers of aided educational institutions, which are separately identified in the Budget documents, have been classified under education. For lack of a better procedure, the balance of expenditure under pensions has been allocated in proportion to expenditures on wages and salaries in each sector.

Table 6.1

Structure of Aggregate Receipts in Tamil Nadu, 1960-90

(Rs crores)

	1960-70	1970-80	1980-85	1985-90	1980-90
Current Revenues	1562.61	5071.29	7963.95	14589.69	22553.64
Tax Revenues	1051.79	4270.92	6741.90	12905.25	19647.15
Share of					
Central taxes	248.21	1189.27	1817.92	3421.42	5239.34
State taxes	803.58	3081.65	4923.98	9483.83	14407.81
Non-tax revenues	510.82	800.37	1222.05	1684.44	2906.49
Capital Receipts	30.76	55.62	36.37	405.48	441.85
Net Borrowings	454.60	768.14	1361.33	2581.25	3942.58
Market loans (net)	78.84	142.99	92.66	612.00	704.66
GOI Loans (net)	216.25	537.70	702.97	1228.24	1931.21
Other Loans (net)	159.51	87.45	565.70	741.01	1306.71
Drawals from					
Cash Balances	5.37	24.08	-11.12	164.04	152.92
Total Receipts	2053.34	5919.13	9350.53	17740.46	27090.99
Percentage of NSDP	13.5	16.6	19.9	NA	NA

NA = Not available.

Source: Economic Classification of the Tamil Nadu Budget.

Table 6.2

Structure of Final Outlays in Tamil Nadu, 1960-90

	(Rs crores)				
	1960-70	1970-80	1980-85	1985-90	1980-90
Current Expenditures	1398.64	4083.25	6061.63	13304.53	19366.16
Compensation of Employees	464.21	1660.73	2531.92	5989.68	8521.60
Purchase of goods and services (net)	293.73	577.35	1191.17	1913.62	3104.79
Interest	135.61	341.36	448.97	1076.22	1525.19
Grants and other current transfers	471.64	1395.06	1396.36	2343.13	3739.49
Subsidies	33.45	108.75	493.21	1981.88	2475.09
Capital Expenditures	426.95	1216.88	2125.56	3082.11	5207.67
Net capital formation	391.08	1028.06	1807.99	2629.45	4437.44
Renewals and replacements	27.73	176.47	316.90	451.23	768.13
Other capital transfers	8.14	12.35	0.67	1.43	2.10
Loans & Advances (net)	227.75	619.00	1163.34	1353.82	2517.16
For capital formation (gross)	284.36	711.58	1092.17	1654.81	2746.98
For current consumption (gross)	47.23	315.79	861.13	615.27	1476.40
Repayments	-103.84	-408.37	-789.96	-916.26	-1706.22
Final Outlay (net)	2053.34	5919.13	9350.53	17740.46	27090.99
Percentage of NSDP	13.5	16.6	19.9	NA	NA

NA = Not available.

Source: Economic Classification of Tamil Nadu Budget.

Table 6.3

Structure of Revenue Receipts in Tamil Nadu, 1965-90

(Rs crores and percent of total)

	1965-70	1970-80	1980-90	1985-90 (percent)	
	<i>Tamil Nadu All States</i>				
Central Revenue					
Transfers	312.88 (27.0)	1687.48 (29.2)	7894.33 (31.9)	32.2	40.7
Shares in central taxes	169.39 (14.6)	1193.19 (20.6)	5250.18 (21.2)	21.1	21.7
Central grants	143.49 (12.4)	494.29 (8.6)	2644.15 (10.7)	11.1	19.0
State's own revenues	846.69 (73.0)	4092.14 (70.8)	16837.76 (68.1)	67.8	59.3
Own tax revenues	585.91 (50.5)	3242.78 (56.1)	14437.83 (58.4)	59.5	44.1
Own non-tax revenues	260.78 (22.5)	849.36 (14.7)	2399.93 (9.7)	8.3	15.2
Total Revenue Receipts	1559.57 (100.0)	5779.62 (100.0)	24732.09 (100.0)	100.0	100.0

Note: Figures in brackets are percentages to column total.

Source: Tamil Nadu Budget documents and RBI Annual Surveys of State Finances.

Table 6.4

**Tax Revenue to NSDP ratios in major States
1980-85 and 1984-87**

<i>States</i>	<i>1980-85</i>	<i>1984-87</i>
Andhra Pradesh	8.7	10.8
Assam	3.5	4.6
Bihar	4.4	4.4
Gujarat	8.3	9.2
Haryana	8.5	9.2
Karnataka	9.9	11.0
Kerala	10.2	11.8
Madhya Pradesh	7.0	7.6
Maharashtra	9.0	9.8
Orissa	4.5	5.2
Punjab	8.1	8.1
Rajasthan	6.3	7.2
Tamil Nadu	11.5	12.1
Uttar Pradesh	5.2	5.5
W. Bengal	6.1	6.7
All Major States	7.5	8.2

Source: RBI Annual Surveys of State finances for tax revenues and CSO: *Estimates of State Domestic Product* (1989) for NSDP (current price) comparable estimates.

Table 6.5

Own Tax Revenues in Tamil Nadu, 1960-90

	(Rs crores)						
	1960-70	1970-80	Index ^a (1960-70 = 100)	1980-85	1985-90	1980-90 ^b	Index ^a (1960-70 = 100)
Land Revenue ^c	90.53 (10.7)	121.92 (3.9)	135	72.22	122.01	194.23 (1.3)	215
Agricultural Income tax	14.86 (1.8)	37.45 (1.2)	252	28.95	53.23	82.18 (0.6)	553
Urban Land tax	1.26 (0.1)	17.12 (0.5)	1359	14.66	7.59	22.26 (0.2)	1766
Sales tax	406.96 (48.0)	1913.39 (60.5)	470	3179.90	6406.38	9586.28 (66.1)	2356
State Excise duties	5.54 (0.6)	164.92 (5.2)		695.49	1078.58	1774.07 (12.2)	
Stamps (net)	82.00 (9.7)	212.42 (6.7)	259	262.02	626.02	888.04 (6.1)	1083
Registration fees	18.07 (2.1)	40.66 (1.3)	225	48.55	103.88	152.43 (1.1)	844

	1960-70	1970-80	Index ^c (1960-70=100)	1980-85	1985-90	1980-90 ^b	Index ^c (1960-70=100)
Motor vehicle taxes	131.83 (15.6)	405.42 (12.8)	308	415.41	757.76	1173.17 (8.1)	890
Entertainment tax	48.70 (5.7)	168.62 (5.3)	346	181.88	312.11	493.99 (3.4)	1014
Other taxes ^d	47.54 (5.7)	78.82 (2.6)	166	61.20	80.83	142.03 (0.9)	299
Total tax revenue	847.29 (100.0)	3160.74 (100.0)	373	4960.28	9548.39	14508.67 (100.0)	1712

Note: Figures in brackets are percentages to column totals.

^aNot given for excise because of discontinuities in prohibition policy.

^bBased on Revised Estimate for 1989-90.

^cNet of irrigation component of land revenue and including assignments to local bodies.

^dElectricity duties, betting tax, luxury tax, sugarcane cess.

Source: Tamil Nadu Budget documents.

Table 6.6

**Revenue and Rate Structure for General Sales Tax
in Tamil Nadu, 1989-89**

Group	Percent in total revenue	Tax rates (percent of revenue from product category)																		
		1	2	3	4	5	6	8	9	12	14	15	18	20						
Fuel Items	21.42			1.0	17.6			4.4	1.7			56.7		15.7	2.9					
Building Materials	15.21			34.9	2.4			6.8	17.2			36.2		2.5						
Industrial raw materials, intermediaries, chemicals	11.69	0.1	2.9	35.8	8.4	0.6	3.4	10.0	38.8											
Machinery, equipment parts and accessories	12.86				4.2	0.3	3.1	25.8	32.1	20.4				14.1						
Consumer items (including drugs)	8.53		0.6	4.1	10.1	0.2	14.7	40.5	20.2	7.4				2.2						
Agricultural and marine products	7.52		2.3	27.0		4.1		11.8		54.8										
Durable consumer goods (including office equipment)	7.37		5.7	5.4		0.7		5.9	53.4					28.9						
Liquor and intoxicants	7.23																			
Food, food products, beverages	6.25		5.4					27.3	10.9											
Chemicals, fertilizers and pesticides	1.92																			

Note: Figures in the rates columns are percentages of revenue subject to the concerned rate in total group revenue.
Source: Tamil Nadu sales tax administration.

Table 6.7

**Structure of Non-Tax Revenues
Tamil Nadu and all States, 1980-85 and 1985-90**

(percent)

Items	1980-85		1985-90	
	Tamil Nadu	All States	Tamil Nadu	All States
Interest receipts	35.95	26.92	29.35	28.91
Profits and dividends	0.70	0.56	0.80	0.49
Receipts from general services	12.37	14.37	15.67	11.95
Receipts from social and community services	14.73	9.04	15.64	7.61
Receipts from economic services	36.25	49.11	38.54	51.04
Of which: receipts from forests	9.99	18.28	11.38	14.99
Total	100.00	100.00	100.00	100.00
<i>Percentage of receipts to total outlays in:</i>				
Social and Community Services	4.12	4.00	2.87	2.89
Economic Services	12.80	29.48	10.48	25.52

Source: Derived from RBI, Annual Surveys of State Finances.

Table 6.8

**Central Revenue Transfers to Tamil Nadu
1980-85 and 1985-90**

(Rs crores and percent of total)

	1980-85	1985-90
Share in Central Taxes	1824.26 (67.5)	3425.92 (66.0)
Income tax	447.07	1005.04
Union excise duties	1370.79	2416.36
Estate duties	6.40	4.52
Plan grants	750.62 (27.8)	1492.38 (28.7)
State plan	293.44	576.21
Central plan	159.15	348.40
Centrally sponsored	298.03	567.77
Non-plan grants	127.89 (4.7)	273.25 (5.3)
Under Article 275	9.66	55.79
For natural calamities	39.84	45.57
Others	78.39	171.89
Total	2702.77 (100.0)	5191.55 (100.0)

Note: Figures in brackets are percentages to column total.

Source: Tamil Nadu Budget documents.

Table 6.9

Share of Tamil Nadu in Shareable Central Taxes: 1957-95

(percent)

<i>Finance Commission</i>	<i>Income tax</i>	<i>Union Excise Total Divisible pool</i>	<i>Union Excise Divisible pool for non-deficit states</i>
Second (1957-62)	8.40	7.56	7.56
Third (1962-66)	8.13	6.08	6.08
Fourth (1966-69)	8.34	7.18	7.18
Fifth (1969-74)	8.18	6.50	6.50
Sixth (1974-79)	7.94	7.43	7.43
Seventh (1979-84)	8.05	7.64	7.64
Eighth (1984-89)	7.57	6.51	7.32 ^a
Ninth (1989-90)	7.61	6.92	7.79 ^a
Ninth (1990-95)	7.93	6.38	7.64 ^b

Note: ^a40 percent^b37.575 per cent

Source: Finance Commission reports.

Table 6.10

Current and Capital Outlays in Tamil Nadu: 1960-90

(Rs crores)

<i>Type of Outlays</i>	<i>1960-70</i>	<i>1970-80</i>	<i>1980-85</i>	<i>1985-90</i>	<i>1980-90</i>
Consumption outlays ^a	1446 (67.0)	4399 (69.5)	6922 (68.3)	13920 (74.6)	20842 (72.4)
Capital formation outlays ^b	712 (33.0)	1928 (30.5)	3218 (31.7)	4737 (25.4)	7955 (27.6)
Total gross outlays	2158 (100.0)	6327 (100.0)	10140 (100.0)	18657 (100.0)	28797 (100.0)

Note: Figures in brackets are percentages to column total.

^aCurrent expenditures plus Loans for consumption.^bCapital expenditures plus Loans for capital formation.

Source: Economic Classification of the Tamil Nadu Budget.

Table 6.11

Sectoral Composition of Current and Capital Outlays in Tamil Nadu: 1975-90*

Sector	1975-80			1980-85			1985-90		
	Current	Capital	Total	Current	Capital	Total	Current	Capital	Total
General Services	29.9	7.3	21.0	26.0	8.0	18.8	28.7	7.3	22.6
Social & Community Services	52.0	22.9	40.7	47.6	21.3	37.0	47.1	22.8	40.2
Education	31.2	1.1	19.7	26.0	2.3	16.5	26.6	1.2	19.3
Medical, Health, Family Welfare, Water Supply, Sanitation	12.7	9.6	11.4	11.0	10.4	10.7	8.6	4.9	7.6
Housing & Urban Development	0.2	6.1	2.5	0.5	5.0	2.3	0.9	13.4	4.5
Social Welfare	5.6	3.7	4.9	7.8	2.2	5.5	10.0	2.2	7.8
Others	2.3	1.8	2.2	2.3	1.4	2.0	1.0	1.1	1.0
Economic Services	15.5	69.1	36.4	24.5	70.1	42.9	22.7	69.2	36.0
Agriculture & allied	10.3	20.3	14.2	16.1	22.2	18.6	11.9	21.2	14.5
Industry & Minerals	2.1	5.3	3.3	2.7	5.1	3.7	2.7	5.0	3.4
Water and Power development	0.1	16.8	6.6	1.7	22.9	10.2	3.6	30.8	11.4
Transport and Communication	1.2	13.5	6.0	0.9	12.3	5.5	0.6	10.1	3.3
Others	1.9	13.2	6.3	3.0	7.7	4.9	3.9	2.1	3.4
Other purposes	2.6	0.7	1.9	1.9	0.6	1.3	1.5	0.7	1.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*In total outlays net of loan repayment.

Source: Derived from the Economic Classification of the Tamil Nadu Budget.

Table 6.12

**Key Expenditure Ratios for Tamil Nadu
and All States, 1980-85 and 1985-90**

(percent)

Ratios	1980-85		1985-90 ^a	
	Tamil Nadu	All States	Tamil Nadu	All States
Plan expenditure to total expenditure	28.71	35.89	27.59	35.59
Plan revenue expenditure to total plan expenditure	64.23	42.90	73.02	50.16
Development revenue expenditure to total revenue expenditure	74.20	70.87	72.62	68.52
Revenue expenditure to total expenditure	75.38	75.44	84.27	80.38
Capital expenditure to total expenditure	6.68	14.25	4.32	11.98
Of which:				
Irrigation expenditure to total expenditure	1.5	5.2	1.2	5.2
Industry and minerals to total expenditure	1.1	0.8	0.4	0.8
Transport and Communication to total expenditure	1.0	2.2	0.8	1.7
Loans to total expenditure	17.94	10.31	11.41	7.64

^aRevised Estimates for 1988-89 and Budget Estimates for 1989-90.

Source: Derived from RBI Annual Surveys of State Finances.

Table 6.13

Sectoral Composition of Plan Outlays in Tamil Nadu: 1951-90

Sector	First Plan Plan (1951-56)	Second Plan Plan (1956-61)	Third Plan Plan (1961-66)	Annual Plan Plan (1966-69)	Fourth Plan Plan (1969-74)	Fifth Plan Plan (1974-80)	Sixth Plan Plan (1980-85)	Seventh Plan Plan (1985-90)
Agriculture and allied	12.0	17.3	23.1	26.1	20.0	15.0	21.2	12.2
Social and community services	20.0	20.2	23.1	19.7	25.6	25.2	33.5	36.0
Irrigation	25.0	9.3	9.0	4.8	4.4	6.4	4.0	5.7
Power	37.7	42.2	34.4	39.1	38.2	35.0	26.3	35.0
Industry and minerals	1.9	7.5	6.8	6.2	5.9	6.3	6.6	5.0
Transport and communication	3.4	2.9	3.4	3.9	5.5	11.3	7.5	4.8
Others	--	0.6	0.2	0.2	0.4	0.8	0.9	1.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Tamil Nadu Economic Appraisal.

Table 6.14

**Pattern of Plan Outlays in Tamil Nadu and all States in
Sixth and Seventh Plan Periods**

(percent)

<i>Sector</i>	<i>Sixth Plan (1980-85)</i>		<i>Seventh Plan (1985-90)</i>	
	<i>Tamil Nadu</i>	<i>All States</i>	<i>Tamil Nadu</i>	<i>All States</i>
Agriculture and allied	21.2	15.6	12.2	16.7
Social and Community Services	33.5	18.2	36.0	21.3
Irrigation	4.0	23.4	5.7	19.8
Power	26.3	29.4	35.0	28.2
Industry and Minerals	6.6	4.5	5.0	4.7
Transport and Communication	7.5	7.7	4.8	7.3
Others	0.9	1.2	1.3	2.0
Total	100.0	100.0	100.0	100.0

Source: Tamil Nadu Economic Appraisal, Sixth and Seventh Plan documents.

Table 6.15

Actual and 'Normative' Levels of Non-Plan Revenue Expenditure, Tamil Nadu and Major States, 1986-87

Item	Per capita actual expenditure (Rs.)		Per capita normative expenditure in Tamil Nadu (Rs.)	Per capita actual to normative expenditure in Tamil Nadu	Per capita actual expenditure in Tamil Nadu to actual expenditure in major States
	Tamil Nadu	Major States			
Police	21.17	24.40	25.46	0.83	0.87
General administrative services	57.32	53.89	58.99	0.97	1.06
Primary education	50.82	44.89	61.08	0.83	1.13
Secondary education	29.43	30.98	40.19	0.73	0.95
Higher education	20.81	14.38	12.53	1.66	1.45
Medical, family welfare and public health	30.23	35.08	33.88	0.89	0.86
Social services	138.57	124.42	155.92	0.88	1.11
Agriculture and allied and community development	24.78	18.39	21.21	1.17	1.35

Source: Report of the Ninth Finance Commission (1989, Table B 5.2).

Table 6.16

**Proportion of Compensation to Employees in Current
and Total (Net) Outlays in Tamil Nadu, 1960-90**

	<i>Compensation to employees^a</i>	
	<i>In current outlays (percent)</i>	<i>In total (net) outlays (percent)</i>
1960-70	33.2	22.6
1970-80	40.7	28.1
1980-85	68.0	27.1
1985-90	75.9	33.8
1990-91 ^b	78.4	37.6

^aIncluding pensions.

^bBudget Estimates.

Source: Economic Classification of the Tamil Nadu Budget.

Table 6.17

**Employees in Relation to Population and Area
in Major States on 1 January 1989^a**

<i>State</i>	<i>Employees per 1000 population</i>	<i>Employees per 100000 sq. km.</i>
Andhra Pradesh	13.70	26.67
Assam	18.00	45.91
Bihar	13.38	53.76
Gujarat	7.49	13.02
Haryana	20.60	60.51
Karnataka	16.31	31.55
Kerala	19.26	125.70
Madhya Pradesh	14.98	17.64
Maharashtra	13.33	27.17
Orissa	17.68	29.88
Punjab	21.15	71.02
Rajasthan	15.32	15.35
Tamil Nadu	18.05	67.23
Uttar Pradesh	14.44	54.45
West Bengal	15.52	95.15
All Major States	15.06	35.34

^aIncluding employees of government, local bodies and aided institutions.

Source: Derived from *Report of Ninth Finance Commission* (1989, Annexure III.17, Table 2).

Table 6.18

**Sector-wise Distribution of Employees
in Tamil Nadu, 1990-91**

<i>Sector</i>	<i>No. of employees (laks)</i>	<i>Percent to total</i>
General Services	2.12	25.2
Social and Community Services	5.10	60.6
Education	2.96	35.2
Medical, health, water supply and sanitation, housing and urban development	0.87	10.3
Social welfare	1.14	13.5
Others	0.13	1.6
Economic Services	1.19	14.1
Agriculture and allied	0.81	9.6
Industry and minerals	0.05	0.6
Water and power development	0.07	0.8
Transport and communication	0.11	1.3
Others	0.15	1.8
Other Purposes	0.01	0.1
Total	8.42	100.1

Source: Compiled from *Statement of Posts and Scales of Pay 1990-91*
(Tamil Nadu Budget documents).

Table 6.19

Unrecovered Costs and Cost Recovery Rates in Tamil Nadu 1988-89^a

(Rs. crores)

Sector	Total Expenditure	Net State Expenditure	Recovery	Unre- covered costs ^b	Cost reco- very rate (percent) ^c
A. Basic Adminis- trative Services	264.28 (7.36)	261.37 (8.28)	46.79 (12.36)	214.58 (7.71)	17.90
Police	173.05 (4.81)	172.16 (5.45)	13.06 (3.45)	159.10 (5.72)	7.59
Jails	16.62 (0.46)	16.62 (0.53)	4.53 (1.20)	12.09 (0.43)	27.26
Administration of Justice	28.96 (0.81)	28.96 (0.92)	18.17 (4.80)	10.79 (0.39)	62.74
Registration	11.03 (0.31)	11.03 (0.35)	11.03 (2.91)	--	100.00
Survey and settlement	25.38 (0.71)	25.38 (0.80)	-- --	25.38 (0.91)	--
Relief of natural calamities	9.24 (0.26)	7.22 (0.23)	--	7.22 (0.26)	--
B. Basic Social Services	1319.42 (36.70)	1169.25 (37.02)	27.16 (7.17)	1142.09 (41.09)	2.32
Education	902.90 (25.09)	833.42 (26.39)	12.83 (3.39)	820.55 (29.52)	1.54
Medical, Public Health and Family Welfare	294.76 (8.20)	247.93 (7.85)	11.52 (3.04)	236.41 (8.51)	4.65
Water Supply and Sanitation	122.57 (3.41)	87.90 (2.78)	2.81 (0.74)	85.0 (3.06)	93.20
C. Social Infrastructure	361.30 (10.05)	221.20 (7.00)	19.04 (5.04)	202.16 (7.27)	8.61
Housing & Urban Development	113.22 (3.15)	107.82 (3.41)	14.10 (3.73)	93.72 (3.37)	13.08
Rural Development and Employment	248.08 (6.90)	113.38 (3.59)	4.94 (1.31)	108.44 (3.90)	4.36
D. Social Welfare	513.29 (14.27)	463.25 (14.66)	52.65 (13.91)	410.60 (14.77)	11.37

<i>Sector</i>	<i>Total Expenditure</i>	<i>Net State Expenditure</i>	<i>Recovery</i>	<i>Unrecovered costs^b</i>	<i>Cost recovery rate (percent)^c</i>
Welfare of SC, ST & BC	93.92 (2.61)	71.70 (2.27)	--	71.70 (2.58)	--
Labour and Employment	29.39 (0.82)	28.87 (0.91)	2.34 (0.62)	26.53 (0.95)	8.11
Social Security and Welfare and Nutrition	278.06 (7.73)	250.76 (7.94)	50.31 (13.29)	200.45 (7.21)	20.06
Civil Supplies	111.92 (3.11)	111.92 (3.54)	--	111.92 (4.03)	--
E. Economic Infrastructure	650.45 (18.09)	642.00 (20.33)	116.24 (30.71)	525.76 (18.92)	18.11
Irrigation	75.61 (2.10)	69.02 (2.19)	3.18 (0.84)	65.84 (2.37)	4.61
Power	459.92 (12.79)	459.92 (14.56)	--	459.92 (16.55)	--
Roads and Transport	114.92 (2.20)	113.06 (3.58)	113.06 (29.87)	--	100.00
F. Production Services	404.27 (11.25)	320.81 (10.16)	163.30 (27.36)	217.51 (7.82)	32.20
Agriculture and allied	266.41 (7.41)	224.45 (7.11)	61.47 (16.24)	162.98 (5.85)	23.07
Forests	26.81 (0.75)	23.03 (0.73)	23.03 (6.09)	--	100.00
Industry and minerals	111.05 (3.09)	73.33 (2.32)	18.80 (4.97)	54.53 (1.96)	25.64
G. Others	82.05 (2.28)	80.05 (2.55)	13.27 (3.51)	66.78 (2.42)	16.58
Total	3595.06 (100.0)	3157.93 (100.0)	378.45 (100.0)	2779.48 (100.0)	11.98

^aFigures in parentheses are percentages of column totals.

^bNet state expenditure less recovery.

^cRecovery divided by net state expenditure.

Source: Reclassified revenue account for Tamil Nadu, as explained in Annex 6.1.

Table 6.20

Recoveries in General Education in Tamil Nadu, 1988-89^a

<i>(Rs. crores)</i>					
<i>Levels of General Education</i>	<i>Expenditure</i>	<i>Recovery</i>	<i>DUC</i>	<i>Percentage of recovery</i>	<i>DUC per student</i>
Elementary Education	373.71 (51.3)	1.30 (13.0)	372.41 (51.9)	0.34	449
Secondary Education	277.04 (38.1)	6.91 (69.0)	270.13 (37.6)	2.49	800
University and Higher Education	77.08 (10.6)	1.81 (18.0)	75.27 (10.5)	2.35	3764
Total	727.83 (100.0)	10.2 (100.0)	717.81 (100.0)	1.38	

^aFigures in brackets are percentages to column totals.

Source: Tamil Nadu Revenue Account (1988-89) and Tamil Nadu Economic Appraisal (for enrollment data).

Table 6.21

Unrecovered Costs in Surface Irrigation in Tamil Nadu, 1980-85 and 1985-90

	<i>Commercial</i>		<i>Non-commercial</i>	
	<i>1980-85</i>	<i>1985-90</i>	<i>1980-85</i>	<i>1985-90</i>
Expenses	169.92	284.80	64.90	80.21
O & M	26.85	31.30	20.91	30.15
Interest	115.29	204.42	35.47	40.37
Depreciation	27.68	49.08	8.52	9.69
Receipts	15.41	13.76	4.68	4.48
Water rates	5.66	4.01	0.83	0.63
Irrigation component in land revenue (estimated)	9.75	9.75	3.85	3.85
Unrecovered costs (Annual average)	30.90	54.21	12.04	15.15
Unrecovered costs per Net hectare (Rs.)	358.0	700.0	180.0	225.0

Source: Information furnished to NFC by the government of Tamil Nadu.

Table 6.22

Direct Subsidies in the Economic Classification of the Tamil Nadu Budget, 1973-88

<i>Year</i>	<i>Direct Subsidies (Rs. crores)</i>	<i>Percent to total current expenditure</i>
1973-74	11.28	3.27
1974-75	1.26	0.34
1975-76	5.02	1.24
1976-77	5.80	1.25
1977-78	11.30	2.29
1978-79	13.30	2.39
1979-80	18.99	3.13
1973-80	66.95	2.07
1980-81	24.43	2.74
1981-82	114.34	11.32
1982-83	44.75	3.84
1983-84	103.18	7.61
1984-85	206.58	12.60
1985-86	146.21	7.94
1986-87	182.60	8.76
1987-88	501.34	19.09
1980-88	1323.43	10.49

Source: Economic Classification of the Tamil Nadu Budget.

Table 6.23

**Composition of Direct Subsidies in the Economic
Classification of the Tamil Nadu Budget, 1980-88**

	<i>Direct Subsidies</i> (Rs. crores)	<i>Percent to Total</i>
<i>Social Services and Social Welfare</i>	79.16	5.98
Education	4.17	0.32
Welfare of SC, ST & BC	74.99	5.66
<i>Food and Nutrition</i>	472.84	35.73
Public distribution system	214.10	16.18
Procurement bonus	101.16	7.64
Noon meals scheme	157.58	11.91
<i>Agriculture etc.</i>	183.34	13.85
Agriculture & allied, inputs, etc	36.79	2.78
Loan write-off	114.11	8.62
Interest waiver	23.63	1.79
Cooperation	8.81	0.66
<i>Rural Development</i>	114.91	8.68
IRD	58.52	4.42
Minimum needs programme	22.68	1.71
Rural Housing	33.71	2.55
<i>Industry</i>	61.77	4.67
Sugar Mills	43.63	3.30
Backward areas	13.50	1.02
Sericulture	2.85	0.21
Miscellaneous	1.79	0.14
<i>Handloom and Khadi</i>		
Controlled cloth rebate	29.08	2.20
Handloom rebate	128.81	9.73
Khadi rebate	9.34	0.71
Other subsidies for weavers	13.15	0.99
<i>Electricity Board</i>	210.80	15.93
<i>Others</i>	20.23	1.53
Police	18.74	1.42
Miscellaneous	1.49	0.11
<i>Total</i>	1323.43	100.0

Source: Economic Classification of the Tamil Nadu Budget.

Table 6.24

Purposewise Composition of DUC in Tamil Nadu, 1988-89

<i>Expenditure purposes^a</i>	<i>DUC in 1988-89 (Rs. crores)</i>	<i>Percent of Total</i>
Public goods	214.58	7.72
Merit goods	1142.09	41.09
Pure transfers	519.04	18.67
of which:		
Rural development and employment	108.44	3.90
Social Welfare	410.60	14.77
Economic and Social Infrastructure	619.48	22.29
Production Services	217.51	7.83
Other	66.78	2.40
Total	2779.48	100.0

^aSee text for explanation.

Source: Derived from Table 6.19.

Table 6.25

Broad Beneficiary-wise Breakdown of DUC in Tamil Nadu 1988-89

<i>Broad Beneficiary Categories</i>	<i>DUC in 1988-89 (Rs. crores)</i>	<i>Percent to total</i>
Universal population	189.20	6.97
Universal in population as a whole or in beneficiary groups	1454.46	53.62
Economically or socially disadvantaged groups	354.92	13.08
Land-owning agriculturists	714.12	26.33
Total	2712.70^a	100.00

^a“Other DUC” in Table 6.19 of Rs. 66.78 crores has been ignored.

Source: Based on Table 6.19.

Table 6.26

Financial Results of TNEB, 1960-90

(Rs. crores)

<i>Period</i>	<i>Gross Revenue^a</i>	<i>O & M Expenses</i>	<i>Operating surplus or deficit</i>	<i>Surplus after interest payments and depreciation provision^b</i>	<i>Subsidy from government</i>
1960-70					
Annual Average	33.19	17.02	16.17	14.10	--
1970-80					
Annual Average	147.16	115.51	31.65	-11.36	18.11
1980-85					
Annual Average	131.48	423.00	-61.52	-169.57	173.50
1985-86	611.04	641.41	-30.37	-126.18	210.74
1986-87	712.24	715.63	-3.39	-95.51	145.47
1987-88	792.52	848.30	-55.78	-167.04	287.10
1988-89	876.53	1047.96	-171.43	-328.94	437.49
1989-90 ^c	1033.37	1247.59	-214.22	-386.50	525.80
1985-90					
Annual Average	805.14	900.18	-95.04	-220.83	321.32

^aExcluding government subsidies.^bExcluding interest due and unpaid to Government.^cProvisional.

Source: Annual Accounts of TNEB.

Table 6.27

Normative Losses in TNEB, 1985-90

(Rs. crores)

	<i>Net fixed assets^a</i>	<i>Normative return^b</i>	<i>Real surplus^c</i>	<i>Normative loss</i>
1985-86	990.92	29.73	-182.86	212.59
1986-87	1071.77	32.15	-145.47	177.62
1987-88	1265.50	37.97	-223.42	261.39
1988-89	1404.37	42.13	-396.16	438.29
1989-90	1974.31	59.13	-467.57	526.80
1985-90		201.21	-1415.48	-1616.69

^aAt end of the year.^bOn basis prescribed in Electricity (Supply) Act.^cAfter depreciation and interest, including interest payable on government loans and without taking into account government subsidy.

Source: Based on TNEB Annual Accounts.

Table 6.28

Efficiency Norms in Selected SEBs, 1987-88

<i>SEB</i>	<i>Thermal Plants</i>				<i>Employee per Million Kwh sold</i>
	<i>Availability Factor</i>	<i>PLF</i>	<i>Coal Kg/Kwh</i>	<i>Oil Me/Kwh</i>	
Andhra Pradesh	88.6	76.2	0.78	1.9	5.1
Gujarat	75.3	60.0	0.60	16.8	3.1
Karnataka	78.6	64.5	0.64	5.3	5.5
Madhya Pradesh	73.9	53.3	0.83	10.6	6.5
Maharashtra	74.9	57.0	0.75	9.0	4.1
Punjab	83.4	71.5	0.69	7.5	6.7
Tamil Nadu	79.7	68.7	0.68	7.0	7.9
Uttar Pradesh	64.1	47.1	0.80	8.2	7.3
All India	74.1	56.5	0.73	11.2	6.2

Source: Annual Report on the working of SEBs, 1989.

Table 6.29

Capital Resources of PSEs in Tamil Nadu, 1988-89

(Rs. crores)

Group	Share capital			Long-term borrowings			Internal resources ^a
	Government (including share advance)	Others	Total	Government	Others	Total	
I Passenger Transport	32.10 (8.7)	--	32.10	39.88 (30.4)	126.37	166.25	336.41
II Goods Transport and shipping	11.07 (3.0)	0.06	11.13	6.17 (4.7)	0.59	6.76	42.46
III Mining	13.27 (3.6)	--	13.27	0.16 (0.1)	9.39	9.55	24.34
IV Manufacturing	81.77 (22.1)	36.34	118.11	25.57 (19.5)	149.49	175.06	36.98
V Trading	22.74 (6.2)	--	22.74	0.01 (--)	--	0.01	11.90
VI Development finance	163.54 (44.3)	18.44	181.98	44.80 (34.2)	604.58	649.38	27.17

Group	Share capital			Long-term borrowings			Internal resources ^a
	Government (including share advance)	Others	Total	Government	Others	Total	
VII Development (other)	12.34 (3.3)	0.06	12.40	7.66 (5.8)	0.60	8.26	11.96
VIII Agriculture and allied	8.34 (2.3)	--	8.34	4.88 (3.8)	11.05	15.93	11.70
IX Construction	19.82 (5.4)	--	19.82	1.95 (1.5)	1.51	3.46	1.03
X Miscellaneous	4.28 (1.1)	2.71	6.99	--	4.17	4.17	12.03
All PSEs	369.27 (100.0)	57.61	426.88	131.08 (100.0)	907.75	1038.83	515.98

^aExcluding deferred liabilities.

Source: Review of State Public Sector Enterprises in Tamil Nadu 1988-89.

Table 6.30

**Financial Performance Indicators for Tamil Nadu PSEs,
1986-89**

<i>Group</i>	<i>(percent)</i>				
	<i>Group surplus^a to GB</i>	<i>Operating surplus^b to GB</i>	<i>Interest to GB</i>	<i>Tax to GB</i>	<i>Net Profit^c to GB</i>
I Passenger Transport	21.56	2.06	5.73	0.01	-3.68
II Goods Transport and shipping	10.85	1.25	5.12	--	-3.87
III Mining	26.36	13.30	5.46	0.61	7.23
V Trading	12.32	5.46	120.93	0.13	-115.60
VI Development finance	-17.42	-22.09	--	10.12	-32.21
VII Development (Other)	7.86	1.44	3.92	0.02	-2.50
VIII Agriculture and allied	10.22	5.21	5.59	0.11	-0.49
IX Construction	11.31	0.94	19.47	0.03	-18.56
X Miscellaneous	12.51	10.47	2.36	0.25	7.86
<i>All PSEs</i>	<i>15.88</i>	<i>2.81</i>	<i>9.81</i>	<i>0.17</i>	<i>-7.17</i>
Memo					
All PSEs (Rs. crores) (annual average)	150.49	26.59	92.99	1.63	-68.03
All PSEs 1988-89 (Rs. crores)	155.21	16.24	102.82	0.95	-87.53

^a Prior to depreciation, interest and tax; GB is Gross Block.

^b After depreciation alone.

^c After depreciation, interest and tax.

Source: Derived from *Review of State Public Sector Enterprises in Tamil Nadu*.

Table 6.31

Profits and Losses of Tamil Nadu PSEs, 1988-89

(Rs. crores)

<i>Group</i>	<i>Number of PSEs</i>	<i>Number of loss-making PSEs</i>	<i>Total loss</i>	<i>Number of profit-making PSEs</i>	<i>Total profit</i>	<i>Aggregate profit or loss</i>
I Passenger Transport	15	11	-12.34 (12.9)	4	0.67	-11.67
II Goods Tpt. & Shipping	2	2	-7.91 (8.3)	-		-7.91
III Mining	2	-	-	2	3.92	3.92
IV Manufacturing	9	6	-15.27 (16.0)	3	0.24	-15.03
V Trading	2	2	-43.19 (45.3)	-	-	-43.19
VI Development Finance	8	4	-13.11 (13.8)	4	0.40	-12.71
VII Development (other)	9	2	-0.19 (0.2)	7	0.78	0.59
VIII Agriculture and allied	6	4	-2.75 (2.9)	2	0.45	-2.30
IX Construction	4	2	-0.54 (0.6)	2	0.53	-0.01
X Miscellaneous	5	-	-	5	0.77	0.77
Total	62	33	-95.30 (100.0)	29	7.76	-87.54

Source: Derived from *Review of State Public Sector Enterprises in Tamil Nadu in 1988-89*.

Table 6.32

Outstanding Debt as on 31st March 1989

(Rs. crores)

	Tamil Nadu		All States	
	Amount	Percent to total	Amount	Percent to total
1. GOI	2563.31 ^a	65.2	55828	70.1
2. Open Market Loans	825.66	21.0	10589	13.1
3. Other Loans (Mainly from institutions)	125.79	3.2	2320	2.9
3. State Provident Funds	418.21	10.6	10865	13.7
Total	3932.97	100.0	79602	100.0

^aIncludes Rs. 0.83 crores by way of ways and means advances.

Sources: Appendix XII to the Tamil Nadu Budget Memorandum 1990-91 and RBI Currency and Finance Report for 1988-89 (Revised Estimates).

Table 6.33

Growth in Gross and Net Borrowings in Tamil Nadu 1960-90

(Rs. crores)

	1960-70	1970-80	1980-90
Gross Borrowings	838 (100)	1439 (192)	5575 (665)
Net Borrowings	455 (100)	769 (169)	3942 (866)
Current Revenues	1563 (100)	5071 (324)	22554 (1443)

Note: Figures in brackets are indices with 1960-70 = 100.

Source: Economic Classification of the Tamil Nadu Budget.

Table 6.34

**Gross and Net Borrowings and Repayments
1970-80 and 1980-90**

(Rs. crores)

	<i>Market</i>	<i>GOI</i>	<i>Other</i>	<i>Total</i>
1970-80				
Gross Borrowings	243 (16.9)	1010 (70.2)	186 (12.9)	1439 (100.0)
Repayments	100	472	99	671
Net Borrowings	143 (18.6)	538 (70.1)	87 (11.3)	768 (100.0)
Repayment Ratio (percent)	41.2	46.7	53.2	46.6
1980-90				
Gross Borrowings	985 (17.7)	3135 (56.2)	1455 (26.1)	5575 (100.0)
Repayment	280	1204	148	1632
Net Borrowings	705 (17.9)	1931 (49.0)	1307 (33.1)	3943 (100.0)
Repayment Ratio (percent)	28.4	38.4	10.2	29.3

Note: Figures in brackets are percentages to row totals.

Source: Derived from Economic Classification of the Tamil Nadu Budget.

Table 6.35

**Outstanding Debt/NSDP Ratios for
Major States in 1986-87**

(percent)

<i>State</i>	<i>Outstanding debt to NSDP in 1986-87</i>
1. Andhra Pradesh	28.7
2. Assam	44.8
3. Bihar	36.1
4. Gujarat	24.2
5. Haryana	27.7
6. Karnataka	26.1
7. Kerala	37.2
8. Madhya Pradesh	31.3
9. Maharashtra	22.0
10. Orissa	43.5
11. Punjab	30.0
12. Rajasthan	40.1
13. Tamil Nadu	20.5
14. Uttar Pradesh	30.1
15. West Bengal	27.4
All Major States	29.2

Source: RBI Currency and Finance Report 1987-88 for outstanding debt and CSO comparable estimates of NSDP.

Table 6.36

Financing of Capital Formation in Tamil Nadu 1960-90*(Rs. crores)*

	1960-70	1970-80	1980-85	1985-90	1980-90
Outlays on capital formation ^a	711.31	1928.46	3217.73	4736.92	7954.65
Financed by:					
Current surplus ^b	116.74	672.25	1041.19	669.89	1711.08
Capital resources ^c	594.57	1256.21	2176.54	4067.03	6243.57
Memorandum items					
Current surplus to current revenues (percent)	8.9	18.1	19.5	6.6	11.1
Current surplus to capital formation outlays (percent)	16.4	34.9	32.4	14.1	21.5
Outlays on capital formation to total gross outlay (percent)	33.0	30.5	31.7	25.4	27.6

^aCapital expenditures and loans for capital formation.

^bCurrent revenues minus current expenditures and loans for consumption.

^cNet borrowings, loan repayments, capital receipts and draws from cash balance.

Source: Based on the economic classification of the Tamil Nadu budget.

Annex Table 6.1

Reconciliation Statement

(Rs. crores)		
<i>Sources/Uses</i>	<i>Budget figure</i>	<i>Figure in Revised Classification</i>
Sources of Funds		
1. Share in central taxes	722.92	722.92
2. Grants from GOI	437.13	437.13
3. State taxes	1994.23	1760.10
Adjustments		
(i) Deduct assignments to local bodies	-41.70	
(ii) Deduct recoveries shown under judicial stamps	-13.31	
(iii) Deduct recoveries shown under registration	-11.03	
(iv) Deduct recoveries shown under roads and transport	-113.06	
(v) Deduct estimated cost of collection of land revenue	-36.51	
(vi) Deduct cost of collection of other taxes	-30.48	
(vii) Add excess over full recovery under forests	11.96	
4. Nontax revenues	334.58	384.20
Adjustments		
(i) Add recovery from judicial stamps	13.31	
(ii) Add recovery from registration fee	11.03	
(iii) Add recovery from motor vehicle tax	113.06	
(iv) Deduct cost of collection of MVT	-3.56	
(v) Deduct interest on irrigation	-45.75	
(vi) Deduct recoveries in general overheads allotted to sectors	-26.51	
(vii) Deduct excess recovery in forests	-11.96	
5. Total sources (1+2+3+4)	3488.86	3304.35

<i>Sources/Uses</i>	<i>Budget figure</i>	<i>Figure in Revised Classification</i>
Uses		
1. Revenue expenditure	3763.04	3578.53
Adjustments		
(i) Deduct assignments to local bodies	-41.70	
(ii) Deduct estimated cost of collection of land revenue	-36.51	
(iii) Deduct cost of collection of MVT	-3.56	
(iv) Deduct cost of collection of other taxes	-30.48	
(v) Deduct interest on irrigation	-45.75	
(vi) Deduct recoveries netted out under general overheads	-26.51	
Revenue Deficit		
1. Revenue Receipts	3488.86	3304.35
2. Revenue Expenditure	3763.04	3578.53
3. Revenue Deficit	274.18	274.18
Further adjustments to Revenue Expenses in Revised Classification		
1. Base figure	3578.53	
2. Deduct sinking fund contribution	-27.67	
3. Add imputed depreciation cost	44.20	
4. Gross outlay shown in Table 6.19	3595.06	

Chapter 7

State Finances in Uttar Pradesh, 1965-90

J.L. BAJAJ and O.P. AGARWAL

In post-Independence India there has been a continuous expansion in the scale and scope of governmental budgetary operations, reflecting the expanding dimensions of state activity, particularly administrative and developmental functions. This chapter seeks to review the budgetary operations of the Government of Uttar Pradesh (UP) in the period 1965-1990, i.e. from the beginning of the Third Five Year Plan to the end of the Seventh Five Year Plan. This period witnessed accelerated growth in the aggregate budgetary transactions of the central government and in those of the states. Its inception also coincides with the introduction of the new economic classification of the Budget in UP in 1965-66. The first section of the chapter examines the structure and growth of receipts of the state government from tax revenue, nontax revenue (including the operations of the public sector) and central assistance for plan expenditure. Then the level and pattern of government expenditure and trends over time are analyzed. In order to even out annual fluctuations, the data have been presented in terms of five quinquennial periods. For the purpose of interstate comparisons, data from the annual surveys of state finances compiled by the Reserve Bank of India and the reports of successive Finance Commissions have been utilized.

BUDGETARY RECEIPTS

The receipts of the UP state government may be classified in four

broad categories: (1) current revenue, (2) capital receipts, (3) borrowings and (4) drawals from cash balances. Current revenue is derived from both tax and nontax sources. The former consists of taxes collected and retained by the state as well as taxes shared in by the state through transfers from the central government. Nontax revenues include interest receipts, royalties, fees and recoveries of fines and dividends from public enterprises, among others. An important component of nontax revenues is grants, of which central transfers are the main source. Capital receipts consist of the internal resources of departmental undertakings and grants received for investment purposes. Borrowings comprise loans raised through public issues in the open market, loans from the central government, the state's share of small savings receipts and provident fund contributions of state government employees.

Receipts can be divided into two broader categories: (1) revenues that are appropriated, earned or received and (2) borrowings of the state from the rest of the economy (including the central government). Unlike the Government of India (GOI), the states are not in a position to resort to deficit financing by borrowing from Reserve Bank of India (RBI). State governments may borrow from RBI only within pre-defined limits, essentially to bridge temporary excesses of expenditure over receipts. Deficits over a financial year are ordinarily made up by drawing down accumulated cash reserves. Alternatively, RBI can extend ways and means advances or temporary overdraft accommodation. In case of a persistent excess of disbursements over cash balances, RBI can and often does stop further payments to the state through agent banks and the Treasuries.

Trends in Receipts

Table 7.1 presents, in summary fashion, the state government's receipts during the period 1965-90. Aggregate receipts increased from Rs. 321 crores in 1965-66 to Rs. 9,213 crores in 1989-90, that is by over 28 times in 25 years, for an average annual increase of about 15 percent at current prices. The most significant component of receipts has been current revenue, whose contribution varied in the range of 73-75 percent in 1965-80 and declined to about 67 percent in the subsequent decade. Taxes constituted almost 56 percent of overall receipts in 1965-80 and about 54 percent in 1980-90. UP's share in central taxes accounted for 20.5 percent of total receipts in 1965-70, a figure that increased to 26.9 percent in 1970-75 and has since remained at about this level. On the other hand, the contribution of

state taxes in total revenue receipts declined from 35.5 percent in 1965-70 to 26.6 percent in 1985-90. Reflecting a similar trend, nontax revenue declined from 17 percent of total revenues in 1965-66 to 14 percent in 1980-85 and then fell further to approximately 11 percent in 1985-90. The state's dependence on borrowings rose markedly in the Seventh Plan. Net borrowings as a proportion of total receipts actually declined from 21 percent in 1965-70 to 17 percent in 1970-75, but subsequently the figure increased to around 22 percent in 1975-85. In the Seventh Plan (1985-90), net borrowings represented almost 27 percent of total receipts.

Table 7.2 provides information on the growth of average annual aggregate receipts in nominal and real terms and changes in their share of net state domestic product (NSDP) in 1965-85. Aggregate receipts showed an increasing trend, both in constant prices and in relation to NSDP.

Transfers from the Center on Current Account

Central revenue transfers include shared central taxes; statutory grants recommended by Finance Commissions; and other grants (plan and nonplan), including those for relief on account of natural calamities. Central transfers have consistently increased their share in total receipts, from about a third in 1965-70 to 45 percent in 1975-80 and 52 percent in 1985-90. UP's own revenues have correspondingly declined as a share of total revenue from 67 percent in 1965-70 to 48 percent in 1985-90. Table 7.3 provides details of central revenue transfers to UP.

Growth of Tax Revenues

Uttar Pradesh's own revenues consist of tax revenues (other than the state's share in central taxes) and nontax revenues (not including grants from the central government). Among the state's own revenues, tax revenue has been the predominant source of income. In 1965-70 tax revenue accounted for 68 percent of own revenues, increasing to 71 percent in 1985-90. The state's revenue effort in the period 1965-90 is summarized in Table 7.4. UP's annual tax revenue at current prices has registered impressive increases from Rs. 119.21 crores in 1965-70 to Rs. 1,510 crores in 1985-90, a fifteen-fold increase. Allowing for inflation, annual tax revenue at constant prices of 1970-71 increased from Rs. 133.59 crores in 1965-70 to Rs. 249 crores in 1980-85. The index of annual per-capita tax revenue at current prices increased about ten times, while per-capita tax revenue at constant prices increased by only 1.8 times in the period 1965-70 to

1980-85. Tax revenue as a proportion of NSDP increased from 3.21 percent to 5.66 percent between 1965-70 and 1985-90.

There is evidence that UP's tax effort was not as great as that of other states. The index of tax effort of all major states increased from 100 in 1960-61 to 3,167 in 1986, whereas UP's index rose only to 2,661. Per-capita annual tax revenue in UP in 1982-85 was Rs. 98, as compared to the all-states average of Rs. 172. The ratio of state taxes to NSDP in Uttar Pradesh was 5.7 percent in 1986-87. This was higher than the figures for Bihar and Orissa but lower than those in other states. Most of the richer states, including Tamil Nadu, Karnataka, Kerala, Gujarat, Maharashtra, Haryana, Andhra Pradesh and Punjab, were able to raise a higher proportion of taxes to NSDP than UP. Significantly, however, comparably backward states like Madhya Pradesh and Rajasthan also were able to do better than UP (Table 7.5).

Changing Taxation Structure

The overall growth of taxes has been accompanied by important changes in the structure of taxation in UP (Table 7.6). The relative importance of direct taxes on income and wealth (i.e. land revenue and agricultural income) has declined, even as indirect taxation has come to play a more important role. The share of these direct taxes in total tax revenue, 20.7 percent in 1965-70, declined to about 1.7 percent in 1985-90. The growth of indirect taxes between 1965-70 and 1985-90 was 19-fold, while direct taxes increased by only 74 percent. Since 1960, sales taxes (including taxes on motor spirit and sugarcane sales) have been the most important source of tax revenue for the state. Sales tax receipts increased by nearly 21 times between 1965-70 and 1985-90. Their contribution to total tax revenue increased from 38.4 percent in 1965-70 to 52.7 percent in 1985-90. The next most important source of state budget revenue has been excise duties. Their share in tax revenue was 16.7 percent in 1965-70 but declined to 14 percent in 1980-85 before subsequently rising to 19 percent in 1985-90. Other direct taxes increased 16 times between 1965-70 and 1985-90.

These trends appear to be similar to those in other states. In almost all major states, the share of direct taxes on agricultural income has significantly diminished in the last three decades. Only in Assam and West Bengal are direct taxes still an important source of state revenue, largely due to taxes levied on the plantation sector (tea estates). The share of direct taxes in total own tax revenues of all major states was 3.9 percent in 1982-87, somewhat higher than the corresponding figure for UP (2.5 percent). But this difference appears

to be mainly attributable to West Bengal and Assam.

Taxes on Agriculture

In UP the only significant direct tax on agriculture is land revenue. This is assessed on holdings of a minimum size of 3.125 acres and ranges between Rs. 10 and Rs. 20 per acre for irrigated land (Rs. 5-10 per acre for unirrigated land). A land development tax was introduced in 1972, also on holdings above 3.125 acres, but it was abolished in 1977. Receipts from direct taxation of agriculture constituted 1.05 percent of NSDP in 1965-70 but declined to only 0.40 percent in 1980-85 (Table 7.7). An important feature of land revenue collections is their high cost. The total expenditure incurred by the state Department of Revenue on district revenue administration was Rs. 49.31 crores in 1989-90. If only half of this cost is attributed to assessment, collection and accounting of land revenue, the costs are equivalent to around 80 percent of the yield from the land revenue.

The agricultural income tax was introduced in UP in 1948, payable by persons holding more than 30 acres of land and with income exceeding Rs. 3,000 (raised to Rs. 4,200 in 1954). This tax was levied on a graduated scale, ranging from one anna in a rupee on the lowest slab to 10 annas in a rupee on agricultural income exceeding Rs. 35,000 per annum. Agricultural income tax was replaced by a Large Land Holdings (LLH) tax in 1957. An additional direct tax on agriculture, the *Vrihat Jot Kar* (VJK) was introduced in 1963. The maximum collections from LLH were in the year of its inception (1956-57). From a level of Rs. 1.32 crores, receipts declined to Rs. 2,56,000 in 1979, when the tax was abolished. Collections from VJK continue but at insignificant levels.

In addition to land revenue, various other levies are collected from the agricultural sector, including purchase taxes on foodgrains and sugarcane and *mandi* (agricultural market) fees. Taking these levies into account, the contribution of the agricultural sector to state revenues increased from Rs. 77.66 crores in 1980-81 to Rs. 250.08 crores in 1990-91. The contribution of land revenue to this increase was marginal. Receipts from the purchase tax on sugarcane increased from Rs. 15.75 crores in 1980-81 to Rs. 41.75 crores in 1990-91. During the same period, fees collected from agricultural markets increased from Rs. 16.18 crores to Rs. 89.08 crores, while the sales/purchase tax on foodgrains increased from Rs. 23 crores to Rs. 90 crores. Nevertheless, the share of taxes on agriculture in the state's net domestic agricultural product remained at less than 1.5 percent (Table 7.8).

Sales Taxes

Sales taxes are by far the most important as well as the fastest growing source of state revenue. They include a General Sales Tax, Central Sales Tax (CST), purchase tax on sugarcane and tax on motor spirits. The general sales tax and motor spirit tax are levied and collected by the state. CST is levied by the Union Government (on commodities entering interstate trade) but is retained by the state. GST was introduced in 1948, initially as a multi-point levy. Subsequently, 30 commodities were subjected to a single-point levy at a lower rate. A number of commodities, including foodgrains, fertilizers and kerosene were exempted from the purview of GST. As the need for resources increased, the rates, coverage and features of the sales tax system have undergone many changes. By 1975, a complete shift to a single-point tax had been achieved, and tax rates on consumer durables had been increased to 12 percent of the price charged. Presently 104 commodities are subject to single point levies ranging from two percent to 26 percent. An additional tax on sales has also been introduced, primarily to compensate local bodies for the abolition of octroi, previously one of their primary sources of income.

Under the Constitution, the tax jurisdictions of the central government and the states are mutually exclusive in the legal sense. Nevertheless, there is considerable overlap between Union excise duties and state sales taxes. Both are indirect taxes and are important sources of revenue. The relatively high incidence of central excise duties inhibits the ability of states to raise sales tax rates. It is also essential for a state to harmonize its tax rates in order to avoid diversion of trade to other states. For these reasons the maximum rates of sales tax cannot be very high, and the scope for variation across commodities is limited.

A state taxation review committee in 1984-85 sought to estimate the burden of sales taxes in UP on the basis of a household consumption expenditure survey covering ten expenditure groups of households in rural and urban areas. The results of the study are shown in Table 7.9. According to the survey, the share of indirect taxes in household consumption expenditure was 4.4 percent, of which sales tax accounted for 2.58 percent. In the two highest expenditure groups, the overall impact of all indirect taxes was in the range of 5.30-7.71 percent and that of state sales tax 2.9-3.96 percent. The data also indicate that sales and indirect taxes have been less progressive in rural areas than in urban areas.

Excise Duties and Other Taxes

Excise duties on liquor are next only to sales tax as a source of revenue in Uttar Pradesh. Collections have varied according to the prevalent state policy on prohibition. In years when prohibition on sale of liquor was either relaxed or lifted, excise receipts have shown considerable growth. In 1977, as a consequence of the introduction of prohibition in 21 districts, receipts from this source declined sharply. In 1978-79 excise receipts were Rs. 51.45 crores. After a relaxation of prohibition policy in 1980, excise receipts increased sharply to Rs. 119.26 crores in 1981-82 and to Rs. 130.78 crores in 1982-83. By 1987-88 revenue from state excise duties had increased to Rs. 500 crores.

Other important taxes in the state are stamps and registration fees, motor vehicles taxes (MVT) and entertainment tax. These accounted for 11.9 percent, 9.3 percent and 3.2 percent respectively of total tax receipts in 1985-90. MVT is a specific tax, related to the type of vehicle and in the case of buses to the number of seats per vehicle. The major impact of this tax falls on public transport vehicles. Revenues from stamp duties and registration fees are derived from the sale of immovable property. Rates are a percentage of the registered sale value of properties concerned. There is considerable evasion owing to underreporting of property values. This not only directly reduces state revenues (stamp duties and municipal property taxes) but also offers opportunities for evasion of taxes on income, wealth and capital gains. The entertainment tax is mainly a levy on the exhibition of films in cinema halls, charged ad valorem on the price of cinema tickets. Outside the major towns, however, it has been compounded with reference to the size of the town and the number of seats in a cinema house. With the growth of alternative, often unregulated, entertainment, revenues from this source have declined in relative terms, from 5.24 percent of total tax receipts in 1970-75 to 3.2 percent in 1985-90. The professions tax was introduced in UP in 1966 but was abolished in 1971. Successive state taxation enquiry committees have recommended the reimposition of this tax. Although the tax ceiling of Rs. 250 per taxpayer per annum has been raised to Rs. 2500 per annum by an amendment to Article 274 of the Constitution, UP has not yet restored this tax.

Buoyancy and Elasticity¹

The UP taxation enquiry committee in 1984-85 sought to assess the

1. Buoyancy measures the responsiveness of taxes to changes in aggregate economic activity. Elasticity, on the other hand, is the measure of responsiveness of the tax revenue at constant rates to changes in aggregate economic activity.

buoyancy and elasticity of state taxes for the period 1971-72 to 1982-83. Buoyancy measures the ratio between the percentage increase in tax revenue and that of NSDP at current prices, whereas elasticity excludes that part of the increase in tax revenue which is due to changes in tax rates. Estimates of buoyancy and elasticity of various UP taxes for the period from 1971-72 to 1982-83 are given in Table 7.10. Sales tax was the most buoyant and elastic major category of taxes, whereas land revenue and electricity duty had slightly lower than unitary buoyancy.

Comparative data show that the buoyancy coefficients of tax revenue in UP were higher than in most neighbouring states, except for Madhya Pradesh (Table 7.11).² The elasticity of total tax revenue in UP was the highest of any neighboring state by a considerable margin, implying that rate increases have played a relatively insignificant role in contributing to revenue growth, as compared to the situation in other states. Of the individual taxes, the performance in terms of buoyancy of sales tax, stamp duties and registration fees was satisfactory. The buoyancy of sales tax in UP was 1.56, compared with 1.72 in Bihar, 1.65 in West Bengal and 1.61 in Madhya Pradesh. In the case of state excise duties, UP had the lowest buoyancy except Rajasthan.

We have computed buoyancy and elasticity coefficients for various state taxes levied in UP for the period 1981-89 (shown in Table 7.10), using the new state domestic products series introduced from 1981-82. The estimates indicate that state excise and electricity duties have shown the highest responsiveness to the increase in NSDP in this period (1.5 and 1.52 respectively).³ Stamp duties and registration fees also were buoyant. The buoyancy of state sales taxes was 1.19. Excepting land revenue and entertainment tax, all taxes had greater than unitary buoyancy. However, the elasticity of all taxes declined from 1.34 in the 1970s to 0.97 in the 1980s, which means that high buoyancy coefficients resulted from upward revisions in tax rates (unlike in the earlier period). Moreover, the buoyancy of sales taxes taken as a whole declined from 1.56 to 1.19.

Transfers from the Center on Current Account

Revenue transfers from the central government consist of (1) the

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2. West Bengal also had a somewhat higher buoyancy coefficient for total tax revenue than UP.
 3. Both excise duties and electricity duty were much less buoyant in the 1970s.

state's share of central taxes, (2) statutory grants awarded by successive Finance Commissions, and (3) other grants for plan or nonplan purposes, the latter being principally on account of natural calamities such as floods and droughts. Central transfers comprised about one third of total state revenue in 1965-70. Their contribution increased to about 45 percent in 1975-80 and further to 52 percent in 1985-90. UP's share in income tax and union excise duties (including additional duties in lieu of sales tax on certain commodities) have become the dominant form of central transfers, contributing about eight percent and 11 percent respectively in 1965-70. In subsequent years, the contribution of income tax in total revenue transfers remained at about same level but that of union excise duties increased significantly on account of greater buoyancy of tax collection. This trend was accentuated when the Seventh Finance Commission (1979-84) doubled the share of states in Union excise duties from 20 to 40 percent. The share of the states was increased further to 45 percent by the Eighth Finance Commission. Central transfers currently are equivalent to 109 percent of UP's own revenues.

The share of Uttar Pradesh in central taxes is determined by the criteria for distribution adopted by successive Finance Commissions. In the case of income tax, population was given the dominant weight by the first seven Finance Commissions (1952-84). The formulae adopted for the sharing of excise duties have included economic backwardness, measured in terms of specified indicators or with reference to state per-capita income. Up to the Seventh Finance Commission, the share of income tax distribution to Uttar Pradesh was lower than the state's share of India's total population. Up to the Fourth Finance Commission, the share of excise duties also was lower than the proportion of population residing in the state. This trend changed from the award of Fifth Finance Commission, however.

Per-capita transfers of central taxes have not been less in UP than the all-India average. The situation changes, however, if grants recommended by Finance Commissions under Article 275 of the Constitution are included. These grants (also known as gap grants) are intended to cover estimated deficits in the nonplan revenue accounts of states, to the extent that these gaps are not covered by tax sharing. Transfers to Uttar Pradesh from this source were less than one third of the average for all major states. This is attributable to the fact that UP was able to a greater extent than other states to meet its nonplan revenue gap on the basis of its own revenue performance, supplemented by tax sharing.

NONTAX REVENUES AND PUBLIC ENTERPRISES

Nontax revenues of states consist of grants from the central government and the states' own nontax revenues. The latter include interest receipts, loan advances, forest and irrigation receipts, fees from educational and medical institutions and dividends from public sector enterprises. We have seen that the relative contribution of nontax revenue to total receipts has sharply declined. The structure of nontax revenue in UP during the past decade is shown in Table 7.12. The major source of nontax revenue is interest receipts, followed by departmental receipts. The latter include charges for services rendered, sale proceeds, fees and fines. Dividends of public enterprises contribute an insignificant amount, less than one percent of total nontax revenue. Since UP does not possess large mineral resources, royalties do not contribute significant revenue, unlike in Assam, Bihar, Orissa and Madhya Pradesh.

UP's total outstanding borrowings were Rs. 11,617.12 crores at the end of 1989-90. Interest payments during the year on these borrowings were Rs. 1,095.50 crores, or 9.43 percent of debt outstanding. On the other hand, interest payments received by the state in 1989-90 amounted to only Rs. 306.43 crores. Rs. 284.02 crores of this represented a purely accounting adjustment from departmental undertakings (mainly irrigation projects). Cash interest receipts were only Rs. 22.41 crores, representing 0.37 percent of the total value of loans advanced by the state as of March 31, 1990 (Rs. 5,995.47 crores). The difference between the unit cost of borrowing and of lending is substantial and is not likely to be sustainable in the long run.

UP State Electricity Board

The poor performance in recovery of interest on loans is largely attributable to the Uttar Pradesh State Electricity Board (UPSEB), the largest public sector undertaking in the state. At the end of 1987-88 its capital and current assets were about Rs. 5,000 crores. Investments in UPSEB have largely been financed by loans, grants, subventions and subsidies from the state government. It has been the largest single recipient of loans from the state government (approximately Rs. 3,900 crores outstanding at the end of the 1987-88).

The financial performance of UPSEB is shown in Table 7.13. UPSEB had operating surpluses from 1959-60 to 1986-87. These were not, however, adequate to cover interest payments and depreciation

provisions. In 1987-88 it incurred operating losses of over Rs. 32 crores. The losses after interest payment and depreciation increased nearly four times in the period 1980-81 to 1987-88, reaching Rs. 400 crores annually. Among the factors responsible for losses at UPSEB are the following:

- (1) The share of thermal generation has been steadily increasing at UPSEB, from 52 percent in 1961-62 to 72 percent in 1987-88; the share of power purchased from NTPC and other sources also has increased, from about 7.4 percent in 1970-71 to 23.1 percent in 1987-88.
- (2) Cost escalation on account of increases in prices of coal, oil, and freight have increased operating expenditures.
- (3) Efficiency parameters are low and in need of considerable improvement; the plant load factor (a measure of the capacity utilization of power stations) ranged between 33.5 percent and 45.9 percent in 1980-88.
- (4) High transmission and distribution losses further contribute to loss of revenue; such losses reached about 27 percent in 1987-88.
- (5) Overstaffing and low productivity have contributed further to the deterioration in the finances of UPSEB.

Table 7.14 shows the average per-unit cost of generation and distribution and the average tariff rate and average sales realization of UPSEB for 1987-88. As against an average cost of 95.56 paise per unit, the average rate charged per unit of electricity consumption was 63.32 paise. Clearly, tariff revisions have not kept pace with cost increases. Moreover, the gap between the average realization and average cost has widened. In 1989-90 the average tariff is estimated to have increased to 71.61 paise per unit, against an estimated per unit cost of 107 paise. The per-unit gap between cost and realized revenue, which was 21.45 paise per kwh in 1980-81, increased to 32.24 paise per kwh in 1987-88, and it is estimated to have reached about 35.39 paise in 1989-90. In the period 1980-87, the increase in the average tariff rate for all consumers was 87 percent. It was 175 percent for industrial consumption and 80 percent for low-tension industrial consumption, but only 31 percent for consumers in the agriculture sector. Subsidized power to agriculture has had a severe adverse impact on the revenues of UPSEB. Almost 40 percent of total power consumption is in rural areas, which contribute only 14.5 percent of total revenue. Table 7.15 shows estimates of losses incurred due to

low tariffs charged for agricultural operations. The yearly loss was about Rs. 103 crores in 1980-81 and increased to Rs. 430 crores in 1987-88. The average annual loss per pumpset amounted to Rs. 3,952 in 1980-88.

UP State Road Transport Corporation (UPSRTC)

UPSRTC was established in 1972 under the Road Transport Corporation Act of 1950. It was intended to provide efficient, economic and organized road transport services in the state. The number of buses owned by UPSRTC increased to nearly 8,000 by March 1990. The number of nationalized routes rose from 1,123 in 1971-72 to 2,380 in 1988-89. The route length covered by UPSRTC buses rose from 1,22,000 km in 1971-72 to 4,56,000 km in 1988-89, and the distance covered by these buses increased from 22.89 crores km to 44.65 crores km. The number of passengers carried by state-owned buses increased from 25.13 crores in 1971-72 to about 43 crores in 1987-88.

The total capital of UPSRTC, which was Rs. 142 crores in 1984-85, increased to Rs. 352 crores in 1989-90. The contribution of the state government was Rs. 180 crores, Railways Rs. 59 crores and Financial Institutions Rs. 113 crores. UPSRTC has been incurring substantial losses in its operations. Accumulated losses reached Rs. 144.31 crores by the end of 1989-90, of which Rs. 68 crores was incurred in the Seventh Plan period alone. There was, however, some improvement in the operational efficiency of UPSRTC during the Seventh Plan. Fleet utilization increased from 72 percent in 1984-85 to 89 percent in 1989-90; vehicle utilization, 158 km per bus per day in 1984-85, increased to 222 km per bus per day in 1989-90. However, trends in the occupancy ratio of the transport fleet have been uneven; it was 66 percent in 1984-85, rose to 74 percent in 1986-87, and fell to 66 percent in 1989-90. Productivity per worker per day improved from 24.06 km in 1984-85 to 30.45 kms in 1989-90. The financial performance of UPSRTC in the Seventh Plan period is shown in Table 7.16.

Other Public Sector Corporations

Despite the proliferation of corporations and public sector enterprises in UP in the last two decades, their contribution to state revenues has been almost negligible. In 1970, there were 11 state public sector undertakings (PSUs). In the next five years 28 additional PSUs were created, raising their number to 39 by the end of 1975. By 1990, their number had increased to 63 (excluding UPSEB). The total paid-up share capital of UP's PSUs (excluding UPSEB) on March 31,

1990 was Rs. 1,182.06 crores. Of this, the state government had contributed Rs. 1,069.75 crores or 90.4 percent. In addition, the state government advanced loans amounting to Rs. 1,076.64 crores. State government funds employed accounted for 44.4 percent of total investment in enterprises other than UPSEB at the end of 1989-90. The financial performance of state PSUs in the period 1987-90 is given in table 7.17. Of the 63 enterprises, 19 regularly earned profits during the three years ending in 1987-88, 15 in 1988-89 and the same number in 1989-90. Regularly loss making enterprises during the previous three years numbered 24 in 1987-88, 23 in 1988-89 and 26 in 1989-90. The cumulative loss of the 63 PSUs reached Rs. 905.61 crores in 1989-90. Of the eight manufacturing enterprises, seven incurred losses in 1987-88 and 1988-89 and six in 1989-90. The state government had contributed Rs. 496.92 crores to these PSUs' capital stock. By 1989-90 their entire equity had been lost, as cumulative losses that year reached Rs. 512.58 crores.

Of the 15 PSUs in the industrial sector, seven are of a promotional nature. The rest are engaged in manufacturing cement, textiles, sugar, electronic goods and brassware. Manufacturing enterprises account for most of the accumulated and current losses of industrial PSUs. There are 12 public enterprises in agriculture and allied sectors, covering a wide range of activities including agroprocessing, horticulture, animal husbandry/fisheries, forests and irrigation. As many as eight of these corporations continuously incurred losses in the period 1980-83. The welfare sector comprises 20 corporations, including 12 area development corporations, the *Jal Nigam*, *Panchayati Raj*, *Anusuchit Jati Vitta*, *Anusuchit Janjati* and Employees Welfare Corporations. The financial performance of these entities and their returns on investment have also been poor. The major losses in this category are accounted for by the *Jal Nigam*, which incurred average annual losses of Rs. 1.43 crores in 1980-83 and had accumulated losses of Rs. 10.23 crores at the end of 1982-83.

State PSUs, which were set up with the objective of manufacturing essential goods or promoting sectoral or area development, have by and large failed to attain desired objectives. Barring the promotional enterprises, they were reasonably expected to function on commercial lines and to provide a minimum return on state government investments. Instead, they are incurring losses and have accumulated large, generally unwarranted deficits. The negative contribution of state PSUs, in the context of the current precarious resource environment, has further eroded the resource base of the state government. Among the key problems are overstaffing and poor

managerial capabilities. Specific reasons for poor financial performance include policies of deliberate underpricing or subsidized pricing, obsolete equipment and outdated technologies, and a lack of clarity in institutional objectives. In particular, the non-economic objectives of PSUs are not explicitly articulated, and no attempt is made to reconcile these with the issue of institutional viability.

State Irrigation Works

Irrigation has been an important area of public investment in Uttar Pradesh. Considerable expenditure has been incurred on surface irrigation and on the construction of public tubewells. The state also has a wide network of private tubewells that use diesel or electric power. Excluding private tubewells, almost all forms of irrigation works are exclusively constructed and maintained by the state government. Public irrigation works in UP are classified in two categories:

- (1) Commercial works, mainly canal irrigation including pumped canals and state public tubewells. For these, water charges are expected to yield a return on investment after covering maintenance expenses.
- (2) Noncommercial works consisting largely of drainage works, where no such return is expected.

Water charges are levied in the state on a per-acre basis according to the nature of crops grown and the number of waterings required. For public tubewells, water rates are fixed on a volumetric basis irrespective of the crop grown by the farmer. No betterment levy is charged from the beneficiaries of irrigation.

Table 7.18 shows the financial flows related to irrigation in the period 1983-88, for commercial and noncommercial projects. The total receipts from state canals and state tubewells contributed only 17.4 percent of the actual maintenance expenses (including interest). Receipts from noncommercial irrigation works were negligible. The aggregate subsidy for commercial irrigation, i.e. canals and tubewells, amounted to Rs. 256 crores annually, or Rs. 455.67 per hectare of irrigated land. The subsidy on state tubewells was Rs. 122.47 crores annually, which was equivalent to Rs. 1,144.57 per net hectare. The subsidy per hectare is substantially higher for state tubewells because of the higher cost of maintenance than in the case of canal irrigation. Successive committees and commissions have noted that the actual maintenance expenditure on canals and state tubewells falls far short of what is required for their proper upkeep. If allowances are made for

this, the additional expenditure required for the maintenance of the existing state irrigation system would be significantly higher.

In addition to the financial losses involved, the irrigation potential created in the state through canals and tubewells has not been utilized adequately. In the period 1980-89, an additional irrigation potential of 18 lakh hectares was created, of which only five lakh hectares have been utilized. As against the increase of 21 percent in irrigation potential in the period 1980-89, the actual irrigated area registered an increase of only nine percent. In addition, the utilization rate of irrigation potential declined from 64 percent in 1980-81 to 57 percent in 1988-89.

BUDGETARY OUTLAYS

Governmental outlays may be classified in the following broad categories: (1) current expenditures on wages and salaries of employees, purchase of goods and transfer payments (including interest payments, grants and subsidies); (2) capital expenditure, including net capital formation and renewals and replacements; and (3) loans, for capital formation, working capital or consumption. Table 7.19 shows the pattern of net outlays for UP in 1965-90, i.e. gross outlays less receipts of repayments of loans advanced by the state government.

Consumption outlays include current expenditures and loans for consumption, while capital outlays comprise capital expenditures and loans for capital formation. The ability to finance the latter depends on the availability of current savings and of capital resources, the latter including capital receipts, net borrowings, loan repayments and withdrawals from accumulated cash balances. In recent years, particularly in the Seventh Plan period, consumption outlays have shown a rising trend at the expense of capital outlays. This is brought out in Table 7.20, which shows the breakdown of gross outlays as between consumption and capital formation.

Almost 21 percent of current outlays in the period 1980-90 went into general services, such as general administration, police and judicial establishments (Table 7.21). Spending on education accounted for almost 30 percent of total current outlays, and those on agriculture and allied activities for 16 percent. On the other hand, economic services accounted for over 75 percent of capital outlays, largely on irrigation and power (23 percent), agriculture and allied activities (27 percent) and transport and communication (15 percent). These figures need to be interpreted with some caution, however. They understate capital investments, for instance in education, where grants-in-aid to

autonomous bodies may be utilized partly for capital formation.

Average annual per-capita budgetary outlays in UP were lower than the average for all major states in 1982-87, which was Rs. 489. In fact, at Rs. 378 per capita, expenditures in UP were lower than in all of the major States except Bihar. On the other hand, the share of direct capital expenditures in total expenditures of UP was 15.5 percent, that of loans 15.5 percent, both higher than the averages for major states of 12.7 percent and 9.6 percent respectively. Consequently, the revenue component of expenditure in UP (72.9 percent), was lower than the average for major states (77.7 percent).

Establishment Costs

The single most important component of current outlays has been compensation of employees, in the form of salaries, wages and pensions. State budgetary data show a decline in the share of compensation to employees, from 41 percent of total current outlays in the period 1965-70 to about 33 percent during 1985-90. Budgetary outlays, however, increasingly present only a partial picture, since a substantial part of government grants-in-aid are spent on salaries and wages. For instance, grants-in-aid to local bodies in the urban and rural sectors and in the education sector are largely spent on salaries and maintenance of establishments. If these are taken into account, the establishment component of current outlays is estimated at around 65 percent in 1985-90.

In fact, the number of employees per 100 sq. km. in UP (544.5) is significantly higher than the major-states average of 358.15 in 1985-90. The UP figure of 12 employees per thousand of population is marginally lower than the average for major states of 13 employees per thousand. Emoluments of state government employees in UP have been recently revised and are presently comparable to and in some respects better than those of central government employees. In 1987-88, 69 percent of nonplan expenditure in the health sector was on pay and allowances, whereas in 1989-90 the figure stood at 78 percent. Of the total value of grants-in-aid to educational institutions, it is estimated that over 80 percent is spent on salaries and allowances.

Direct Subsidies

These are an important element of current expenditure and in fact comprise its fastest growing component. From Rs. 64 crores in 1965-70, direct subsidies increased to Rs. 2,596 crores in 1985-90. They are most significant in economic services, where subsidies for agriculture

and allied activities predominate. (Of the direct subsidies for economic services, almost 92 percent were utilised in this sector.) Direct subsidies in social and community services amounted to less than one percent of current outlay.

Other Subsidies

The state government has been playing an important role in providing various public services, including education, medical and health services, water supply, sanitation and housing. The difference between the receipts earned from providing such services and the resources expended in their delivery can broadly be classified as subsidy. The total revenue expenditure on the provision of general, social and economic services in 1989-90 in UP was Rs. 8,641.39 crores. Of this, about Rs. 4,500 crores was incurred for providing general services, Rs. 2,167 crores on social services, Rs. 1,960 crores on economic services, and Rs. 42.65 crores as compensation and assignment to local bodies. The total nontax revenue of the state government was only about Rs. 746 crores -- less than nine percent of the total expenditure on these services (Table 7.22).

It would not be reasonable to expect all revenue expenditure to be recovered through fees and other charges. Activities like provision of general administrative services, expenditures on law and order and relief for natural calamities are part of the normal activities of the state, the cost of which has to be recovered from tax revenues. Expenditures on direct subsidies according to the economic and functional classification (discussed above) are estimated at about Rs. 2,600 crores in 1985-90. This is an underestimate of total subsidies, as it covers only direct subsidies, of which losses on account of irrigation works constitute the most important component.

Table 7.23 shows estimates of subsidies for education and cost recovery per student per year. The state government is spending about Rs. 440 per student in primary schools. At the pre-university and university levels the cost increases to Rs. 1,815 per student. As hardly any recovery is made from students, almost the entire expenditure is a subsidy.

Plan Outlays

The five year plans provide a framework for reviewing capital formation, in the context of incremental development expenditures undertaken in successive plan periods. Per-capita plan expenditure in UP has increased from Rs. 25 in the First Five Year Plan (1951-56) to Rs. 822 in the Seventh Plan (1985-90). The average per-capita plan

expenditure for the major states increased from Rs. 39 in the First Plan to Rs. 980 in the Seventh Plan, indicating that UP Plan expenditures have risen in relative terms to more closely approximate the average for major states.

The main determinants of the level of plan outlays in a state are the state's own resources and plan assistance extended by the central government. Per-capita plan assistance from the center to UP has increased from Rs. 13 in the First Plan to Rs. 58 in the Fourth Plan and to Rs. 284 in the Seventh Plan. Prior to the Fourth Plan, plan assistance to UP was consistently below the average for all major states, but it subsequently moved above the average and remained there. This is largely attributable to the operation of the "Gadgil formula" since 1968 for determination of interstate allocations of plan assistance. The Gadgil formula is weighted in favor of states with per-capita incomes below the national average.

The primary constraint to large plan outlays in UP has been the limitations of its own resources. Table 7.24 shows the pattern of plan financing for the major states from the Fourth to the Seventh Five Year Plans. UP's contribution of its own resources to plan outlays has been consistently lower than average in per-capita terms. Gujarat, Haryana, Maharashtra and Punjab have contributed significantly to their own plans, enabling them support higher plan outlays. This is also true of Andhra Pradesh, Karnataka and Madhya Pradesh from the Fifth Plan onwards.

Plan spending presently accounts for over a third of UP's total expenditures (38 percent in the Sixth Five Year Plan). Of total plan expenditures, over two-fifths are revenue expenditures (42 percent in the Sixth Plan). UP's plan expenditures comprise a higher proportion of overall expenditures than in most major states, the average being 32 percent. On the other hand, the revenue component of the UP Plan is somewhat lower than the average for major states (44 percent).

Table 7.25 shows the sectoral composition of plan outlays from the First Plan onwards. Expenditures on agriculture and allied activities rose from an initial level of 25 percent in the First Plan to around 30 percent in the Second and Third Plans. Thereafter, this category registered a continuous decline, to 14 percent in the Sixth Plan. This trend was reversed in the Seventh Plan, when the share of agriculture and allied activities rose to 19 percent. Expenditure on social and community services declined from an initial figure of 29 percent in the First Plan to around 23 percent in the Fourth and Fifth Plans. This category has since shown a rising trend. Spending on transport and communications has risen consistently and in fact more than doubled

from four percent in the First Plan to 10 percent in the Seventh Plan. These increases, particularly in the 1980s, have been partly at the expense of power sector outlays, which dropped from 38 percent in the Fourth Plan to 25 percent in the Seventh Plan.

Centrally Sponsored Schemes

Centrally Sponsored Schemes (CSS) play an important role in central transfers as well as in plan expenditures. The states as a group have favored their reduction, partly on the assumption that an increase in allocations through the divisible pool of plan resources would result. Individually, however, states and their departments have sought to maximise their access to such schemes. An important issue in this context is the longer-term impact of CSS on states' current expenditures. Most schemes are sponsored for a specified period of time, normally the duration of a Plan. After that the states are expected to meet the full costs of the maintenance of these schemes. It is politically difficult for states to refuse centrally sponsored schemes, and even more difficult to terminate them at the end of the period of central sponsorship. This places a sizable burden on state finances.

This problem was of much lesser magnitude prior to the Sixth Plan. In the last three years of the Fifth Plan, CSS outlays (including central sector scheme outlays) averaged around Rs. 150 crores annually, with the central government meeting over 80 percent of the cost. In the Sixth Plan (1980-85) expenditures on CSS doubled, to an annual average of Rs. 330 crores. In the Seventh Plan (1985-90), annual CSS expenditures have exceeded Rs. 825 crores. Table 7.26 provides information on centrally sponsored (including central sector) schemes in the Seventh Plan. It is clear that in the Eighth Plan, UP will need to meet large nonplan liabilities on this account, in addition to the continuing legacy of CSS of preceding Plans. This is likely to further constrain the budgetary resources of the state government and to limit its ability to finance additional developmental expenditures.

FINANCING AND BALANCE SHEET

Debt and Financing of Capital Formation

The sources of borrowing for the state government are (1) loans from GOI; (2) loans raised through bond issues in the open market; (3) loans negotiated with public financial institutions; (4) state provident funds and other deposits; (5) floating loans such as ways

and means advances; and (6) overdrafts from RBI. GOI loans provided the main source of borrowing and represented 52.2 percent of UP's debt at the end of 1987-88. Next in order of importance were market loans (17 percent) and small savings loans (15 percent). Provident fund and other deposits represented 13.3 percent of the total state debt, while institutional loans accounted for only two percent. GOI borrowings (including small savings loans) have declined in relative importance, from 88 percent of gross borrowings in 1965-70 to 77 percent in 1985-90. On the other hand, market loans have increased their share from 10 percent in 1965-70 to 19 percent in 1985-90. Indebtedness in UP was relatively low in comparison with that of many other states. The Ninth Finance Commission (Second Report) estimated the outstanding debt per capita for UP in 1988-89 to be Rs. 754, and debt as a proportion of State Domestic Product to be 48.7 percent. Among the major states, UP's per-capita debt was almost the same as that of Andhra Pradesh and higher than only Bihar, Karnataka, Madhya Pradesh and Tamil Nadu. This is partly explained by the relatively low levels of per-capita central plan assistance, and also by limited access to market borrowing. The average level of per-capita debt in the major states was Rs. 824.

Assets and Liabilities

Net borrowings may be utilized for a variety of purposes: (1) to bridge current account deficits, (2) for direct capital expenditures and (3) for loans for capital formation, working capital or consumption. In the period 1965-85, UP had a current account surplus (including tax transfers from GOI in current receipts) and did not need to cover current deficits with borrowings. Debt financing was therefore wholly deployed for capital expenditures and for relending to enterprises and others. At the end of 1989-90, such "assets", in the form of cumulative capital expenditures, loans advanced by government, and other investments, amounted to Rs. 15,737 crores. This was far in excess of the "liabilities", measured in terms of outstanding debt, of Rs. 11,617 crores. This comparison, however, is misleading, for a number of reasons. First, not all loans have resulted in productive assets. A large proportion of the loans have been extended either specifically for consumption or to cover losses of public undertakings. Second, the "assets" of the state government have rarely generated cash flows to amortize the capital invested in them. As a result, "assets" have not generated surpluses to offset "liabilities" incurred by the government in their creation.

Capital formation (capital expenditures and loans for capital

formation) is financed from (1) current savings and (2) capital resources, i.e. net borrowings, loan repayments to the state government, capital receipts, and drawals from cash balances. Current savings represent the excess of current revenues over current outlays (current expenditures and loans for consumption). Table 7.27 shows the pattern of financing of capital formation in 1965-90. Current revenues excluding tax transfers from GOI have consistently been inadequate to finance current outlays. In fact the deficit on this account has shown an increasing trend in the period 1965-90. At the same time, tax transfers from GOI have steadily increased; in each successive five-year period they more than doubled. The ratio of current savings to current revenues increased from 15.5 percent to 19.5 percent in the period 1965-80, but dropped sharply to 9 percent in 1980-85 and to negative levels in 1985-90. Table 7.28 shows the incremental availability and use of resources in different five year periods. In 1975-80, the current deficit was partly contained and increases in tax shares and capital resources helped to achieve a significant step-up in capital formation. In the 1980s, however, the current deficit increased sharply. Despite the substantial increases in tax shares and capital resources, the increment to capital formation was more or less stagnant in 1980-90.

In the longer term, capital formation is likely to depend to a greater extent, in comparison with earlier periods, on the level of current savings. As repayment burdens accumulate, the rate of growth of net borrowings will tend to decelerate. It is also unlikely that revenue transfers from GOI will continue to grow at the rates at which they have increased in the preceding two decades. Under these circumstances, the task of increasing current savings will have to depend mainly on (1) increases in the state's own tax and nontax revenues and (2) containment of current outlays. Otherwise a decline in real capital formation will be likely.

SUMMARY AND FUTURE PERSPECTIVES

In the period 1965-90, there has been an unprecedented expansion in the scope and scale of budgetary operations in UP. In nominal terms, there has been manifold growth of net final outlays (from about Rs. 320 crores in 1965-66 to over Rs. 4,000 crores in 1989-90) and in receipts to finance them. A significant part of this increase is undoubtedly accounted for by inflation. But government spending, on developmental activities, in support of its regulatory functions, and on itself, has vastly increased.

It is in this context that the sustainability of a path of continued expansion and the efficiency of the investments made assume particular significance. In the face of mounting expenditures and the need to maintain the momentum of development, the UP state government made considerable efforts to mobilize and secure additional resources. Overall resources have risen from about 10 percent of NSDP in 1965-70 to over 16 percent in 1980-85. The state's efforts have been facilitated by impressive increases in central revenue transfers. Further real growth of the latter is, however, likely to be constrained by the center's own growing resource limitations and by budgetary pressures, as well as by competing demands from other states.

In the absence of recourse to deficit financing, the state will perforce have to concentrate its efforts on its own current (tax and nontax) revenue and on its access to borrowings. Current revenues have grown much faster than borrowings. Most of the growth in the former is attributable to increases in tax revenues. The tax structure is dominated by indirect taxes; the contribution of direct taxes to the state's total tax revenue is marginal. In fact, the share of direct taxes on agriculture has declined to insignificance from initially low levels. Among indirect taxes, sales taxes and excise duties on liquor currently contribute about 73 percent of revenues. The prospects for continued increases in receipts from these sources are limited, partly on account of the high level of central impositions. An additional inhibiting factor is the need to harmonize rates with those prevailing in neighbouring states to prevent trade and revenue diversion. A further widening of the tax base, particularly with respect to sales taxes, would also need to be weighed against the need to mitigate the regressive characteristics of the present tax structure. It is likely, however, that in addition to structural changes, there would be benefits from rationalization of rules and procedures and from increases in the efficiency of tax collection.

As in many other states, the quest for rapid industrial development has led to the adoption of incentive-based industrial policies. One of the key elements of the package offered to entrepreneurs is sales tax exemption for up to seven years and options for sales tax deferment. This is beginning to adversely affect the growth of tax revenues; an objective assessment of the benefits vis-a-vis revenue foregone is imperative. Tax deferment in addition tends to strain the capacity of tax administration systems. It is unlikely that a single state would now be able to rationalize its approach to tax-based industrial incentives. This would need a coordinated approach at least among

neighbouring states.

Indirect taxes other than sales taxes and state excise duties have exhibited only moderate rates of growth. It should be possible to increase yields particularly from stamp duties and registration fees. It is estimated that considerable evasion occurs as a result of the underreporting of property values in sales transactions.

In the field of direct taxes, a promising course of action, from many viewpoints, would appear to be to increase direct taxation of agriculture and of rural and urban wealth. This may not be easy, even given the requisite level of political fortitude. Rates, structures and exemptions would need to be in conformity with central direct taxation. There is little evidence to show that the central government is prepared for any substantive initiatives in this respect; in fact, recent signals have been to the contrary. In addition, long practised and well-established methods of evasion may hamper attempts to achieve progressivity in direct taxes at the state level. The UP state government's Taxation Review Committee (1985) recognized the desirability of increasing direct taxes on agriculture, however. It recommended that land revenue be revised through simplified and quick settlement operations. It suggested that the circle rate of basic land revenue for each of the soil classes in an assessment circle be computed at 1.5 percent of the gross value of output. The land revenue payable on individual holdings would be 50 percent of basic land revenue for holdings below 3.125 acres, rising to 150 percent on holdings above 12.5 acres. Interim hikes in the ceilings on land revenue payable and withdrawal of exemptions for land revenue also were recommended. Such measures are likely to be feasible and possible to implement, given the outreach and organization of the land revenue administration in the state.

Even as tax revenues have shown relative buoyancy (partly supported by successive changes in prohibition policy), nontax revenues have remained sluggish. Among the major reasons for this are significant indirect subsidies, including those which are reflected in low recovery rates on investments. Irrigation charges have stagnated and now cover only part of operating and maintenance costs. Interest collected on loans extended by the state government covers only a small fraction of the interest payments due. User charges and fees for many community and welfare services have been lowered or even waived in the 1980s. Collections on reduced rates have not been encouraging. Other major contributory factors are related to the inadequate performance of public sector enterprises, where returns have been low, even negative.

It is evident that the costs of subsidies in different sectors go far beyond the budgetary statistics. Undoubtedly, in an environment characterized by social and economic inequity, there will need to be some subsidization. Many of the subsidies, however, are not targeted. Some are even unintended but have established themselves over the years. Most of them have been inadequately conceived, partly because the resource perspective is insufficiently factored into the planning, implementation, and subsequent maintenance of investments. With respect to targeted subsidies, concerns relate to the actual extent of coverage of the target group and of diversions outside the target group. Subsidy overlap is another issue, particularly where incentives or grants are provided for the same purpose by different departments and agencies. Such areas include education, social welfare and industry. The burden of inadequately targeted and administered subsidies falls on the general taxation and revenues of the state. The combined overall effect of the present framework of taxes-cum-subsidies needs to be carefully evaluated. In several critical social service sectors like education, health and water supply, the quality of subsidized services and the delivery mechanisms are poor. In these areas it may be desirable to increase cost recovery to provide resources for upgradation of quality.

There is sufficient evidence to suggest that a significant proportion of subsidies may actually represent transfers to the nonpoor. Agricultural subsidies, which comprise a major part of overall subsidies, tend to benefit affluent farmers. These subsidies include non-recovery of water charges, below-cost pricing of power, procurement premia and subsidised provision of fertilizers and seeds. The benefits on this account accrue to relatively well-off farmers, since they have better access to land, water and pumpsets and produce a larger marketable surplus. In the industrial sector, major subsidies are related to the incentives for investment in backward areas, handloom rebates and fiscal exemptions. These incentives mainly benefit large and medium entrepreneurs, not small entrepreneurs. Similarly, handloom rebates tend to benefit traders and master weavers, not artisans and consumers.

The second major area for increasing nontax revenues lies in raising returns from the public sector. The present financial malaise of many state PSUs can be ascribed in part to initial uneconomic investment decisions, relating to location, product scale and technology. Some PSUs would require capital and managerial resources for their revival which are not presently available. A partial beginning was made, however, with decisions by the previous state

government to close down or sell two such enterprises (subsequently called into question by the new state government). It would require much more along these lines, including a decision to restrict state public enterprises to activities which are either catalytic or demonstrably add to infrastructure, in an efficient manner. Several specific areas need attention, including augmentation of management and professional capacities, reduction in overstaffing, an appropriate product and input pricing policy, and a reduction in working capital and general purpose subsidies.

On expenditure priorities, there has been a substantial shift from capital outlays, notably on irrigation and power, to current outlays, in agriculture and social services. Outlays for capital formation have shown a declining trend, and this should be a cause of concern. At the same time, the committed liabilities of the state have increased dramatically, to the point where they have seriously constrained allocative flexibility. There has been a noticeable "crowding out" effect on capital expenditures, particularly in the Seventh Plan. Continual accretions to nonplan expenditures are one of the major reasons for UP's relatively low balances from current revenues. As a result of growing nonplan expenditures, smaller amounts of funds have been available for project completion (resulting in higher costs and delayed benefits) and for initiating new programmes.

An area which has tended to be neglected is local body finances and capabilities. Both in urban and rural areas, local bodies have grown increasingly dependent on state government transfers. Without an adequate resource base of their own, and dependent on irregularly sequenced flows of funds, their contribution to development has faltered. These bodies can play an important role, particularly in the provision of basic services such as education, health, nutrition and water supply. The provision of incentives, in the form of an assured system of devolution, and enhanced powers of resource mobilization, could facilitate the emergence of a grassroots framework for developmental activities in these sectors.

Escalating salary and establishment costs, most of them effectively indexed against inflation, will need to be reviewed. Emoluments of government employees are already at relatively high levels in comparison with those in many other major states. The expansion in the numbers of employees and the growth of their remuneration has not been accompanied by commensurate increases in productivity. Even as it is necessary to contain further growth in the numbers of employees, their deployment, the pattern of governmental organization, training and professional skills would need to be attended to.

One other aspect of the phenomenal growth of budgetary operations has received insufficient attention. There has been little effort to incorporate systematic improvements in the management of a vastly increased scale of funds and transactions. This has adversely affected the efficiency of the system and its ability to deliver on assigned tasks in several ways. In the first place, planning and evaluation capabilities have lagged. This has resulted in an emphasis on the aggregate and on allocation without prioritization and without an objective assessment of costs and benefits. Secondly, financial, budgetary and accounting processes and procedures have remained largely unchanged. At different operational levels, from field directorates to expending entities, transaction volumes, intersectoral linkages and sectoral complexity have increased, without significant enhancement of capabilities. The combined effect on system accountability and on the quality of delivery has been adverse. In the longer term, the efficiency of state investments will in part rest on the ability to enhance planning and management capabilities, at the state and operational levels.

Table 7.1

Structure of Receipts, 1965-90

	(Rs. crores)				
	1965-70	1970-75	1975-80	1980-85	1985-90
Current revenues	1367.70 (72.6)	2482.06 (73.7)	5325.32 (75.3)	10324.92 (67.4)	20630.13 (62.1)
Of which:					
Tax revenues	1054.31	1892.27	4049.95	8254.45	204.64
Share of central taxes	385.72	904.99	1717.59	3934.48	8759.17
State direct taxes	108.70	216.21	175.82	112.94	138.71
State indirect taxes	559.89	771.07	2156.54	4207.03	8306.76
Nontax revenues	313.39	589.79	1275.37	2070.47	3433.49
Profits and dividends	85.82	90.51	162.20	159.89	161.66
Interest receipts	125.98	165.21	115.00	135.33	191.59
Other nontax revenue	101.59	334.07	998.17	1775.25	3080.24
Capital receipts	115.55 (6.1)	225.92 (6.7)	409.55 (5.8)	1257.65 (8.2)	2515.62 (7.9)
Internal resources of departmental undertakings	19.52	27.89	27.30	53.69	101.74
Capital transfers	96.03	198.03	382.25	1203.96	2413.88
Borrowings (net)	394.67 (21.0)	556.44 (16.5)	1583.50 (22.4)	3517.82 (23.0)	8451.01 (26.6)
Of which:					
Market loans (net)	17.46	71.82	151.64	527.04	1453.58
Loans from GOI (net)	265.77	354.74	1248.75	1691.93	5083.36
Other loans (net)	111.44	129.88	183.11	1298.85	1914.07
Drawals from cash	5.29 (0.3)	105.75 (3.1)	-247.99 (-3.5)	224.18 (1.5)	117.15 (0.4)
Total receipts	1883.21 (100.0)	3370.17 (100.0)	7070.38 (100.0)	15324.57 (100.0)	31721.91 (100.0)

Note: Figures in brackets represent percentages of total receipts.

Source: Economic and Functional Classification of the UP Budget.

Table 7.2

Growth of Receipts, 1965-85

	<i>(annual averages)</i>			
	1965-70	1970-75	1975-80	1980-85
1. Total receipts in current prices (Rs. crores)	376.64 (100)	674.03 (179)	1414.08 (375)	3064.91 (814)
2. Total receipts in constant prices of 1970-71 (Rs. crores)	423.67 (100)	576.32 (136)	866.46 (205)	1119.26 (264)
3. Per capita receipts in current prices (Rs.)	45.38 (100)	73.99 (163)	138.91 (306)	266.98 (588)
4. Per capita receipts in constant prices of 1970-71 (Rs.)	51.06 (100)	63.26 (124)	85.11 (167)	97.52 (91)
5. Receipts (as percent of NSDP)	10.14 (100)	12.23 (121)	15.82 (156)	16.90 (167)

Note: Figures in parentheses are index numbers with 1965-70 = 100.
NSDP = net state domestic product.

Source: Economic and Functional Classification of the UP Budget.

Table 7.3

Central Revenue Transfers and UP's Own Revenues, 1965-90

	<i>(Rs. crores)</i>				
<i>Source</i>	<i>1965-70</i>	<i>1970-75</i>	<i>1975-80</i>	<i>1980-85</i>	<i>1985-90</i>
Share in central taxes	331.55 (19.1)	852.45 (28.7)	1708.29 (27.3)	3763.29 (30.1)	8239.91 (32.9)
Of which,					
Share in income tax	138.57 (8.0)	367.14 (12.4)	555.06 (8.9)	857.50 (6.9)	2199.34 (8.8)
Share in Union excise duties	188.97 (10.9)	479.62 (16.1)	1146.27 (18.3)	2902.03 (23.2)	6037.74 (24.2)
Share in estate duties	4.01 (0.2)	5.69 (0.2)	6.96 (0.1)	3.76 (0.0)	2.83 (0.0)
Central grants	236.88 (13.7)	379.75 (12.7)	1130.44 (18.0)	2521.04 (20.1)	4802.78 (19.2)
Total central revenue transfers	568.43 (32.8)	1232.20 (41.4)	2838.73 (45.3)	6284.33 (50.2)	13042.69 (52.1)
State's own revenues	1162.70 (67.2)	1741.84 (58.6)	3428.06 (54.7)	6230.52 (49.8)	11973.27 (47.9)
Total revenues	1731.13 (100.0)	2974.04 (100.0)	6266.79 (100.0)	12514.85 (100.0)	25015.96 (100.0)
Central transfers per-capita (Rs.)	68	135	279	547	1026

Note: Figures in brackets represent percentages of total revenues.

Source: UP State Budget documents.

Table 7.4

UP's Own Tax Revenues: 1965-90

(Rs. crores)					
Taxes	1965-70	1970-75	1975-80	1980-85	1985-90
Direct Taxes	123.61	96.91	175.39	145.79	153.29
Land Revenue	116.72	95.77	173.43	145.68	153.14
Agricultural Income Tax ^a					
Urban Land Tax	6.89	1.14	1.96	0.11	0.15
Indirect Taxes	472.44	912.54	2210.35	4383.72	8844.54
Sales Taxes	229.06	462.40	1272.24	2473.23	4745.86
State Excise Duties	99.67	168.36	308.23	650.91	1714.63
Stamp Duties (Gross) and Registration fees	51.53	95.93	239.83	494.82	1067.71
Motor Vehicles Tax	57.89	110.40	238.84	479.49	836.62
Entertainment Taxes	23.56	52.90	113.62	222.28	287.93
Other Indirect Taxes	10.73	22.55	37.59	62.99	191.79
All Taxes	596.05	1009.45	2385.74	4529.51	8997.83
Index	100	169	400	760	1510
Index in constant prices	100	128	238	NA	NA
Memorandum Items					
Per-capita tax revenues	71.81	110.81	234.36	394.55	NA
Index	100	154	326	549	NA
Index in constant prices	100	117	194	NA	NA
Tax revenue to NSDP (percent)	3.21	3.66	5.34	5.23	NA

^aNominal annual receipts are about Rs. 20 lakh, which is shown under the head Land Revenues.

Source: UP State Budget documents.

Table 7.5

Interstate Comparisons relating to Own Tax Revenues

State	Index of own tax revenue in 1986-87 (1960-61 = 100)	Average per capita own tax revenue in 1982-87 (Rs.)	Tax to NSDP ratio (percent)			
			1976-81	1980-81	1984-85	1986-87
Andhra Pradesh	3881	206.15	7.8	8.1	10.0	11.2
Assam	1997	83.61	3.9	2.7	4.2	4.9
Bihar	2109	66.47	4.4	4.2	4.1	4.6
Gujarat	5997	269.42	7.5	8.0	9.0	9.4
Haryana	1630	302.98	7.6	7.8	8.8	9.6
Karnataka	4938	229.09	8.4	8.9	10.3	10.9
Kerala	4035	226.35	8.9	9.6	10.9	12.2
Madhya Pradesh	3580	131.16	6.5	6.3	7.4	8.1
Maharashtra	4345	311.59	7.9	8.1	9.1	10.5
Orissa	3956	86.72	4.5	4.3	4.8	5.7
Punjab	NA	339.27	7.2	8.0	7.7	9.0
Rajasthan	3619	133.68	5.5	5.6	6.3	7.5
Tamil Nadu	4415	262.14	8.6	10.0	11.6	12.1
Uttar Pradesh	2661	97.92	5.1	4.6	5.3	5.7
West Bengal	2365	159.00	5.7	5.8	6.2	6.7
All major states	3167	172.37	6.7	6.8	7.7	8.5

Source: RBI Bulletin; SDP estimates as published by various states.

Table 7.6

Structure of UP's Own Tax Revenue, 1965-90

Tax	(percent)				
	1965-70	1970-75	1975-80	1980-85	1985-90
Direct Taxes	20.74	9.60	7.35	3.22	1.70
Land Revenue and agricultural income tax	19.58	9.49	7.27	3.22	1.70
Urban land tax	1.16	0.11	0.08	0.0	0.0
Indirect Taxes	79.26	90.40	92.65	96.78	98.30
Sales taxes	38.43	45.81	53.33	54.60	52.74
State excise duties	16.72	16.68	12.92	14.37	19.06
Stamp duties (gross) and registration fees	8.65	9.50	10.05	10.92	11.87
Motor vehicles tax	9.71	10.94	10.01	10.59	9.30
Entertainment taxes	3.95	5.24	4.76	4.91	3.20
Other indirect taxes	1.80	2.23	1.58	1.39	2.13
All Taxes	100.00	100.00	100.00	100.00	100.00

Source: UP State Budget documents.

Table 7.7

Agricultural Taxation in UP, 1965-85

(Rs. crores)

Quinquennium	Agricultural	Land revenue (annual average) ^a	Total direct	NSDP in agriculture (annual average)	Direct Taxes
	income tax (annual average)		taxes on agriculture (annual average)		on agricul- ture to NSDP in agri- culture (percent)
1965-70	-	23.34	23.34	2226.60	1.05
1970-75	-	19.15	19.15	3266.14	0.59
1975-80	-	34.69	34.69	4419.88	0.78
1980-85	-	29.14	29.14	7320.67	0.40

^aReceipts of "Vrihat Jot Kar" are nominal and are included under Land Revenue.

Source: UP State Budget documents; Department of Economics and Statistics publications for NSDP in Agriculture.

Table 7.8

Incidence of Agricultural Taxation

(Rs. crores)

Year	Land revenue	Purchase tax on sugarcane	Mandi tax	Sales tax/ purchase tax on foodgrain	Total taxes	NSDP in agriculture (current prices)	Ratio to NSDP in agriculture	
							Land revenue	Total taxes on agriculture
1980-81	2273	1575	1618	2300	7766	686013	0.33	1.13
1981-82	3556	2127	1732	2980	10395	683937	0.52	1.52
1982-83	2843	2132	1799	3215	9989	783492	0.36	1.27
1983-84	3485	2773	2176	3403	11837	850801	0.41	1.39
1984-85	2411	3045	2428	4117	12001	906672	0.27	1.32
1985-86	2791	2379	2826	4243	12239	1047020	0.27	1.17
1986-87	2948	3851	3166	3888	13853	1097065 ^a	0.27	1.17
1987-88	3575	3738	3363	5005	15681	1211188 ^a	0.30	1.29
1988-89	3000	2718	3779	5990	15487	1463346 ^b	0.21	1.06
1989-90 ^c	3000	3550	4454	8075	19079	169177 ^d	0.18	1.13
1990-91 ^c	3000	4175	8908 ^d	9000 ^d	25083	1955860 ^d	0.15	1.28

^aProvisional.^cRevised Estimates.^eBudget Estimates.^bQuick estimates.^dEstimated.Source: UP State Budget documents; *Bulletin No. 235*, Economics and Statistics Department of UP.

Table 7.9

Incidence of Indirect Taxation 1983-84
(as percent of consumer expenditure)

Expenditure Group (monthly per capita expenditure in Rs.)	Rural		Urban		Rural and Urban	
	State Indirect Taxes	State Sales Taxes	State Indirect Taxes	State Sales Taxes	State Indirect Taxes	State Sales Taxes
0-50	1.95	1.34	5.71	4.08	2.22	1.54
50-60	2.10	1.38	5.85	4.13	2.50	1.68
60-70	2.19	1.45	5.65	4.16	2.62	1.78
70-80	2.44	1.49	6.24	4.49	2.99	1.93
80-100	2.73	1.62	6.58	4.67	3.42	2.16
100-125	2.97	1.72	6.86	4.62	3.84	2.37
125-150	3.80	1.84	7.20	4.71	4.55	2.48
150-200	3.89	1.99	7.27	4.66	4.74	2.66
200-250	4.17	2.20	8.11	4.72	5.30	2.92
250 and above	4.80	2.79	12.93	6.10	7.71	3.96
All Groups	3.32	1.87	8.33	4.95	4.47	2.58

Source: UP Taxation Review Committee Report, 1985.

Table 7.10

Buoyancy and Elasticity of UP Taxes

	1971-72 to 1982-83		1981-89	
	Buoyancy	Elasticity	Buoyancy	Elasticity
Land revenue	0.99	NA	0.24	NA
Stamps and registration fees	1.56	1.22	1.40	1.13
State excise taxes	1.16	0.83	1.59	0.81
Taxes on vehicles, passenger, goods	1.29	1.00	1.08	0.63
General sales tax (including motor spirit sales tax)	1.59	1.36	1.21	1.04
Total sales tax	1.56	1.38	1.19	1.03
Entertainment tax	1.31	1.06	0.72	0.59
Electricity duty	0.93	0.27	1.52	1.07
Total taxes ^a	1.40	1.34	1.24	0.97

^aIncluding land revenue for the earlier period but not for the later period.

Source: UP Taxation Review Committee Report 1985, pp. 278-279.

Table 7.11

Buoyancy and Elasticity of Major Taxes in UP and Neighbouring States, 1971-72 to 1982-83

State	Agricultural tax		State tax		Taxes on Vehicles ^a		General Sales Tax including motor spirit sales tax		Total Sales Tax	
	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity
Bihar	0.4571	-0.7536	0.1356	-1.6229	1.3715	1.2312	1.8364	1.6108	1.7222	1.5384
Delhi ^b	0.1379		1.7282	0.8777	1.0879	1.4000	1.31025	1.1422	1.4403	1.3181
Haryana	0.8785	0.3870	1.2375	1.2076	1.4490	1.3751	1.7596	1.4763	1.5054	1.3623
Madhya Pradesh	0.3097	0.1835	1.3386	1.1470	1.9417	1.5812	1.6325	1.5619	1.6155	1.3538
Punjab	0.4351	-0.0122	1.1813	1.0390	1.0390	1.0159	1.2903	0.9315	1.3099	1.0329
Rajasthan	0.4234	0.4234	0.7921	0.2901	0.2901	1.2882	1.5630	1.3668	1.5626	1.3983
Uttar Pradesh			1.1606	0.8342	0.8342	1.0043	1.5892	1.3630	1.5634	1.3822
West Bengal	0.9133	-0.7536	1.2279	0.8385	0.8385	1.1575	1.6568	1.3093	1.6512	1.3542

Table 7.11 (Contd.)

State	Entertainment Tax		Electricity duty		Stamps and registration fees		Total tax revenue	
	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity
Bihar	0.3201	0.1986	0.5010	0.4633	0.7330	0.3555	1.2385	0.9013
Delhi ^b	0.5515	0.5515			0.6216	0.6381	1.2713	1.1344
Haryana	0.9805	0.9269	1.7596	1.4763	1.1035	0.9869	1.3660	1.2533
Madhya Pradesh	1.3559	0.9675	1.7366	0.8900	1.4045	1.0716	1.5141	1.2580
Punjab	1.1391	0.7372	1.4688	1.3987	1.1923	0.8144	1.2441	1.1259
Rajasthan	1.4792	0.9894	1.4966	1.4966	1.3186	0.6331	1.3463	0.9338
Uttar Pradesh	1.3106	1.0653	0.9269	0.2792	1.5575	1.2239	1.3974	1.3425
West Bengal	1.1611	1.1004	0.6520	0.4592	1.1849	0.7331	1.4794	1.1199

^aMotor vehicles tax and passengers and goods tax.

^bElasticity estimates for Delhi pertain to the period 1973-74 to 1981-82.

Source: *UP Taxation Review Committee Report, 1985, page 278-279.*

Table 7.12

Structure of Nontax Revenues in Uttar Pradesh

	<i>Annual average in 1980-85 (Rs. crores)</i>	<i>Percentage of total</i>	<i>Annual Average in 1985-90 (Rs. crores)</i>	<i>Percentage of total</i>
Interest receipts	122.04	35.9	243.11	40.8
Dividends from public enterprises	1.75	0.5	5.25	0.9
Others	2.46	0.7	2.71	0.4
Receipts from general services	40.76	12.0	113.39	19.1
Receipts from Social and community service	43.16	12.7	41.98	7.1
Receipts from Economic Services	130.03	38.2	188.65	31.7
Of which:				
Agricultural receipts	5.85	1.7	8.22	1.4
Forest receipts	56.17	16.5	76.46	12.8
Others	68.01	20.0	103.97	17.5
Total	340.20	100.0	595.09	100.0

Source: UP State Budget documents.

Table 7.13

Financial Performance of UPSEB, 1959-88*(Rs. crores)*

<i>Year</i>	<i>Gross revenue^a</i>	<i>Operating expenditure</i>	<i>Operating surplus</i>	<i>Surplus after interest payments and depreciation provision</i>	<i>Subsidy from government</i>
1959-60	6.76	3.61	+3.15	-0.59	-
1960-61	7.36	4.17	+3.19	-0.78	-
1961-62	8.75	4.43	+4.32	-0.22	-
1962-63	11.75	5.73	+6.02	+0.96	-
1963-64	13.15	7.35	+5.80	-0.23	-
1964-65	16.30	9.35	+6.95	+0.95	-
1965-66	22.67	12.20	+10.47	-1.83	-
1966-67	29.63	15.88	+13.75	-3.86	-
1967-68	34.39	19.48	+14.91	-7.97	-
1968-69	46.67	24.52	+22.15	-6.34	-
1969-70	54.69	31.66	+23.03	-10.13	3.30
1970-71	61.86	36.66	+25.20	-15.52	-
1971-72	67.44	38.13	+29.31	-8.55	-
1972-73	83.98	48.65	+35.33	-9.71	-
1973-74	79.98	55.16	+24.82	-30.63	-
1974-75	110.39	86.36	+24.03	-9.24	-
1975-76	166.08	120.19	+45.89	-12.03	-
1976-77	192.41	129.58	+62.83	-0.25	-
1977-78	176.27	145.59	+30.68	-18.53	-
1978-79	224.82	175.47	+49.35	-6.43	-
1979-80	256.70	216.58	+40.12	-83.50	101.00
1980-81	284.11	263.53	+20.58	-118.49	144.57
1981-82	347.85	319.43	+28.42	-124.97	159.40
1982-83	456.05	419.45	+36.60	-134.99	175.13
1983-84	558.57	499.22	+59.35	747.48	204.80
1984-85	613.87	549.20	+64.67	-264.56	222.50
1985-86	674.11	661.24	+12.87	-359.48	254.90
1986-87	891.10	661.24	+12.87	-359.48	254.90
1987-88	977.52	1009.79	-32.27	-383.87	424.70

^aExcluding subsidy for rural electrification.

Source: UPSEB accounts; UP Plan documents.

Table 7.14

Costs, Tariffs and Sales Realization in 1987-88*(Paise per kwh)*

<i>Consumer Category</i>	<i>Cost of generation and distribution</i>	<i>Average charges for electricity</i>	<i>Average sales realization^a</i>
Domestic	NA	65.80	83.87
Commercial	NA	83.42	104.50
Industry: Low tension	NA	96.34	101.40
Industry: High tension	NA	102.75	101.40
Agriculture			
Small Farmers	NA	23.99	22.32
Other Farmers	NA	23.99	22.32
All consumers	95.56	63.32	68.76

^aRevenue from sale of power plus electricity duty and other state levies divided by the number of units sold.

Source: *Annual Plan 1990-91*, page 25; Schedule-3 of *Statement of Accounts 1987-88*.

Table 7.15

Impact of the Agricultural Power Tariff, 1980-88

Year	Agricultural consumption (Million units)	Cost of supply to agriculture (paise ^a)	Total cost of supply to agriculture (Rs. crores)	Sales realisation from agriculture (Rs. crores)	Difference between cost and realisation (Rs. crores)	Number of electrified pump sets (Lakhs)	Shortfall in realisation per pumpset (Rs.)
1980-81	2773	55.30	153.35	50.65	-102.70	4.03	2548
1981-82	2818	63.44	178.77	61.98	116.79	4.35	2685
1982-83	3398	66.15	224.78	76.37	-148.41	4.61	3219
1983-84	3506	73.47	257.58	96.51	-161.07	4.85	3321
1984-85	3611	78.71	284.22	100.62	-183.60	5.09	3607
1985-86	3723	85.05	316.64	103.68	-212.96	5.38	3958
1986-87	4938	85.38	421.61	135.05	-286.56	5.70	5027
1987-88	5869	95.56	560.84	130.99	-429.85	5.93	7249
1980-88 (Average)					-205.24		3952

^aAs the category-wise cost of electricity is not available, the average cost for all consumer has been applied to agriculture category also.

Source: UPSEB accounts.

Table 7.16

Financial Performance of UPSRTC, 1985-90

	(Rs. crores)					
	1985-86	1986-87	1987-88	1988-89	1989-90	VII Plan Total
Net Profit/loss	-17.52	-8.23	0.04	-17.57	-24.75	-68.03
Depreciation						
Reserve Fund	18.29	23.76	34.23	40.49	42.20	158.97
Internal Resources	0.77	15.53	34.27	22.92	17.45	90.94
Repayment of term loans	8.45	31.04	17.43	22.88	25.34	105.14
Contribution to the Plan	-7.68	-15.51	16.84	-0.04	-7.89	-14.20

Source: UP Plan documents.

Table 7.17

UP State Enterprises other than UPSEB

	<i>(Rs. lakh)</i>		
<i>Particulars</i>	<i>1987-88</i>	<i>1988-89</i>	<i>1989-90</i>
INVESTMENT	356,050.06	422,056.68	483,590.43
State government funds:	156,884.32	180,195.46	214,635.86
Equity	69,690.17	95,144.50	106,975.12
Loans	87,194.15	85,050.96	107,660.74
External Resources:	115,292.02	144,385.91	159,266.56
Equity	5,907.86	8,734.41	11,231.14
Loans	109,384.16	135,561.50	148,035.42
Grants/Subsidy	83,873.72	97,475.31	109,688.01
CAPITAL EMPLOYED	171,171.07	201,527.12	293,530.45
Net fixed assets	42,927.40	48,582.35	113,182.50
Net working capital	128,243.67	152,944.77	180,347.95
TURNOVER	131,606.86	156,489.20	174,428.31
GROSS PROFIT/LOSS	9,130.74	4,804.13	6,495.90
DEPRECIATION	6,985.57	8,198.78	13,078.93
PROFIT/LOSS AFTER TAX	-6711.04	-13,520.65	-15,009.86
Profit earned	2,890.52	1,910.56	6,065.51
Number of enterprises	23	25	31
Loss incurred	-9,601.56	-15,431.21	-21,075.37
Number of enterprises	37	35	31
CASH PROFIT/LOSS	274.53	-5,321.87	-1,930.93
INTEREST ON			
GOVERNMENT LOANS	4,169.49	3,912.63	6,970.36
CUMULATIVE DEFICIT	55,723.34	70,220.53	90,561.66
INTERNAL RESOURCES	51,286.18	60,600.47	77,607.65
Reserves and surplus	16,791.01	18,421.97	23,654.50
Depreciation (cumulative)	34,495.17	42,178.50	53,953.15
Number of Enterprises:			
a. Regularly profit making during the last 3 years	19	15	15
b. Regularly loss making	24	23	26
c. Making either profit or loss during last 3 years	17	22	21
Number of Employees	145,736	149,003	156,810

Table 7.18

**Receipts and Expenditure for State Irrigation
Works, 1983-88**

<i>(Rs. crores)</i>			
<i>Receipts</i>	<i>1983-88 Annual Average</i>	<i>Expenditure</i>	<i>1983-88 Annual Average</i>
Commercial canals		Commercial canals	
Irrigation component in land revenue		Maintenance	58.12
Water charges	48.40	Interest	124.10
Other receipts			
Total	48.40	Total	182.22
Commercial state tube wells	5.74	Commercial state tubewells	
		Maintenance	95.24
		Interest	32.97
		Total	128.21
Noncommercial drainage		Noncommercial drainage	
Irrigation component in land revenue	0.02	Maintenance	0.27
Other receipts			
Total	0.02	Total	0.27
Total of commercial and Non-commercial irrigation	54.16	Total of commercial and non commercial irrigation	310.70

Source: UP State Budget documents.

Table 7.19

UP Final Net Outlays, 1965-90

<i>(Rs. crores)</i>					
<i>Item</i>	<i>1965-70</i>	<i>1970-75</i>	<i>1975-80</i>	<i>1980-85</i>	<i>1985-90</i>
Current expenditure	1124.41	2063.79	4274.63	9356.11	22415.70
Compensation of Employees	460.76	804.38	1477.47	3005.61	7357.02
Purchase of goods and services	192.57	314.92	677.20	1432.93	2086.55
Interest	124.77	184.71	301.06	653.79	2456.23
Grants	248.53	568.76	1246.00	2765.32	7248.25
Subsidies	64.03	130.50	420.00	984.46	2595.73
Other transfers	33.75	60.52	152.90	514.00	671.92
Capital expenditure	366.80	825.25	1708.18	4063.80	7359.24
Net capital formation	308.70	731.99	1430.81	3347.25	6125.12
Renewals and replacements	15.14	30.62	46.09	203.22	401.42
Other capital transfers	42.96	62.64	231.28	513.33	832.70
Loans and advances (net)	392.00	481.13	1087.57	1904.66	1946.97
For capital formation (gross)	466.33	635.60	1194.00	2206.22	2253.24
For current consumption (gross)	31.78	28.06	9.78	24.52	276.17
Deduct repayments	106.11	182.53	116.21	326.08	572.44
Final outlay (net)	1883.21	3370.17	7070.38	15324.57	31721.91

Source: Economic and Functional Classification of the State Budget of UP.

Table 7.20

Outlays on Consumption and Capital Formation (Gross), 1965-90

(Rs. crores)

<i>Outlays</i>	<i>1965-70</i>	<i>1970-75</i>	<i>1975-80</i>	<i>1980-85</i>	<i>1985-90</i>
Consumption outlays^a					
In current prices	1156 (58.12)	2092 (58.88)	4284 (59.62)	9381 (59.94)	22692 (70.28)
In constant prices of 1970-71	1261 (56.09)	1821 (60.60)	2859 (66.32)	N.A.	N.A.
Outlays on capital formation^b					
In current prices	833 (41.88)	1461 (41.12)	2902 (40.38)	6270 (40.06)	9602 (29.73)
In constant prices of 1970-71	987 (43.91)	1184 (39.40)	1452 (33.68)	N.A.	N.A.
Total gross outlays					
In current prices	1989 (100.00)	3553 (100.00)	7186 (100.00)	15651 (100.00)	32294 (100.00)
In constant prices of 1970-71	2248 (100.00)	3005 (100.00)	4311 (100.00)	N.A.	N.A.

^aCurrent expenditure plus loans for consumption.

^bCapital expenditure plus loans for Capital formation.

Note: Figures in parentheses are percentages to respective Column totals.

Source: Table 7.19 and price deflators.

Table 7.21

Functional Classification of UP Outlays, 1980-90

(Rs. crores)^a

Sector	Current Outlays	Capital Expenditure including loans ^b	Total
General Services	6697.96 (21.08)	412.18 (2.55)	7110.14 (14.83)
Social and Community services	14201.94 (21.08)	3408.51 (36.73)	17610.45 (44.70)
Education	9453.28 (29.75)	369.59 (2.29)	9822.87 (20.49)
Medical, health and sanitation	1868.48 (5.88)	247.70 (1.53)	2116.18 (4.41)
Housing, urban and community development	946.49 (2.98)	2548.40 (15.76)	3494.89 (7.29)
Social welfare	1746.70 (5.50)	172.92 (1.07)	1919.62 (4.00)
Others	186.99 (0.59)	69.90 (0.43)	256.89 (0.54)
Economic services	7529.32 (76.02)	12295.58 (41.35)	19824.90 (23.70)
Agricultural and allied	5119.25 (16.11)	4410.72 (27.27)	9529.97 (19.88)
Industry and minerals	475.56 (1.50)	1422.30 (8.79)	1907.86 (3.96)
Water, power development and water supply	689.81 (2.17)	3699.89 (22.88)	4389.70 (9.15)
Transport and communication	875.35 (2.76)	2368.79 (14.65)	3244.14 (6.77)
Others	369.35 (1.16)	393.88 (2.43)	763.23 (1.59)
Other purposes	3342.59 (10.52)	56.92 (0.35)	3399.51 (7.09)
Total	31771.81 (100.00)	16173.19 (100.00)	47945.00 (100.00)

^aFigures in parentheses represent percentages of total outlays of the relevant category (current, capital, total).

^bExcluding repayment of debt.

Source: Economic and Functional Classification of the UP Government Budget.

Table 7.22

**Cost Recovery for Services provided by the UP Government
(1989-90^a)**

(Rs. crores and percent)

<i>Services</i>	<i>Revenue expenditure</i>	<i>Nontax revenue</i>	<i>Unrecovered cost</i>	<i>Cost recovery rate</i>
General Services	4472.64	215.02	4257.62	4.81
Social Services	2166.49	48.53	2117.96	2.24
Education (including technical education, sports and youth welfare and art and culture)	1325.02	30.16	1294.86	2.28
Medical and public health	307.12	11.00	296.12	3.58
Family planning	73.51	0.13	73.38	0.18
Water supply and sanitation	129.90		129.90	-
Housing	5.77	2.45	3.32	42.46
Social security and welfare	101.24	1.16	100.08	1.15
Other social services	223.93	3.63	220.30	1.62
Economic Services	1960.11	482.29	1477.82	24.61
Agriculture and allied services	363.25	93.17	270.08	25.61
Industries and minerals	76.23	11.76	64.47	15.43
Other economic services	1520.63	377.36 ^b	1143.27	24.82
Compensation and assignment to local bodies and Panchayat Raj institutions	42.65		42.65	
Total	8641.89	745.84	7896.05	8.63

^aBudget estimates.^bThis includes receipts from irrigation also.

Sources: UP Budget, 1989-90, Volume-II.

Table 7.23

Per-Unit Subsidies at Different Educational Levels**(Rs. crores and Rs. per student)*

<i>Level of education</i>	<i>Total Outlay^b</i>	<i>Nontax revenue^c</i>	<i>Enrol-ment (Lakhs)^d</i>	<i>Outlay per student</i>	<i>Recovery per student</i>	<i>Subsidy per student</i>
Primary Education	690.24	3.50	156.66	440.60	2.23	438.37
Secondary Education	447.38	23.79	46.36	965.01	51.32	913.69
Pre-University and Higher Education	107.97	0.95	5.95	1814.62	15.97	1798.65

*Based on 1989-90 Budget Estimates.

^bThis does not include expenditures on adult education, technical education, training and research.

^cThis does not include receipts of special education, technical education and general receipts.

^dIn respect of recognised educational institutions only.

Source: *Budget in Brief-1989-90*; Budget 1989-90 Volume 4; and Education Directorate figure for 1988-89 increased by five percent.

Table 7.24

Plan Financing in Different States, 1969-90

(Rs. per capita)^a

State	Fourth Plan		Fifth Plan		Sixth Plan		Seventh Plan	
	Plan Expenditure	Own Resources	Plan Expenditure	Own Resources	Plan Expenditure	Own Resources	Plan Expenditure	Own Resources
Andhra Pradesh	98	45	338	200	740	508	1195	822
Bihar	85	27	210	92	523	268	905	499
Gujarat	204	146	516	402	1453	1212	2247	1854
Haryana	357	281	675	498	1563	1272	2889	2502
Karnataka	128	71	369	255	910	717	1195	896
Kerala	156	76	313	168	771	544	984	452
Madhya Pradesh	114	53	345	266	928	668	1681	1230
Maharashtra	199	152	527	434	1294	1082	2083	1731
Orissa	114	43	291	122	712	367	1230	708
Punjab	316	244	694	547	1396	1146	2424	2080
Rajasthan	120	37	336	186	829	548	1164	722
Tamil Nadu	134	86	279	156	870	686	1396	1047
Uttar Pradesh	132	74	329	185	738	488	1183	775
West Bengal	82	34	283	176	549	377	931	657
All States	137	79	356	229	864	628	1392	1002

^aPopulation of 1971 was used in calculating per-capita outlays and own resources.

Source: *Statistical Statements on Finances and Plans*, Ministry of Finance, July-1988 Issue.

Table 7.25

Sectoral Composition of Plan Expenditures in Uttar Pradesh, 1951-90

(Rs. crores)^a

	1st Plan (51-56)	2nd Plan (56-61)	3rd Plan (61-66)	Annual Plans (66-69)	4th Plan (69-74)	5th Plan (74-80)	6th Plan (80-85)	7th Antici- pated (85-90)
Agriculture and allied activities	3918 (25.5)	7156 (30.7)	16414 (29.3)	13370 (29.4)	24193 (20.8)	57208 (15.3)	90107 (13.6)	229151 (19.0)
Social and community services	4474 (29.2)	4601 (19.7)	10335 (18.4)	4922 (10.8)	14846 (12.7)	49051 (13.2)	125871 (19.2)	24438 (20.3)
Irrigation	3291 (21.5)	2543 (10.9)	6168 (11.0)	5200 (11.4)	18476 (1.59)	73806 (19.7)	139582 (21.2)	209672 (17.4)
Power	2331 (15.2)	5675 (24.3)	15701 (28.0)	17536 (38.5)	44651 (38.2)	137425 (36.8)	186217 (28.2)	302444 (25.1)
Industry and minerals	637 (4.2)	1292 (5.5)	2084 (3.7)	1824 (4.0)	4177 (3.6)	22165 (5.9)	43077 (6.5)	66980 (5.6)
Transport and communication	686 (4.4)	1537 (6.6)	2814 (5.0)	1689 (3.7)	7796 (6.7)	33234 (8.9)	67790 (10.3)	124216 (10.4)
Others	--	532 (2.3)	2547 (4.6)	991 (2.2)	2418 (2.1)	921 (0.2)	6785 (1.0)	26113 (2.2)
Total	15337	23336	56063	45532	116557	373810	659429	1202894

^aFigures in parentheses represent percent of total plan spending in the period concerned.

Source: *Plan Expenditure in Uttar Pradesh* (Published by State Planning Commission, Uttar Pradesh) and draft Annual Plan, 1986-87, Vol. II.

Table 7.26

Centrally Sponsored Schemes in UP (1985-90)*(Rs. crores)*

<i>Sector</i>	<i>Total outlays</i>	<i>Central share</i>	<i>as percent of total outlay</i>
Agriculture and allied activities	819	479	58.5
Rural and area development	1492	1133	75.7
Irrigation	12	7	58.3
Power	45	45	100.0
Industry	122	81	66.4
Transport and communications	86	66	76.7
Social and community Services	1553	1429	92.0
Others	5	3	60.0
Total	4134	3243	78.5

Source: UP Plan documents, 1985-86 to 1989-90.

Table 7.27

Financing of Capital Formation 1965-90

Item	(Rs. crores)				
	1965-70	1970-75	1975-80	1980-85	1985-90
Current revenues net of shared taxes	1036.15	1577.07	3607.73	6390.44	11878.96
Current outlays ^a	1156.19	2091.85	4284.41	9380.63	22691.87
Current deficit	-120.04	-514.78	-676.68	-2990.19	-10812.91
Share of central taxes	331.55	904.99	1717.59	3934.48	8759.17
Current surplus after taking into account shared taxes	211.51	390.21	1040.91	944.29	-2053.74
Capital resources ^b	621.62	1070.64	1861.27	5325.73	11656.22
Outlays on capital formation ^c	833.13	1460.85	2902.18	6270.02	9602.48
Ratio of:					
Current savings to current revenues (percent)	15.5	15.7	19.5	9.1	-10.0
Contribution of current savings to capital formation (percent)	25.4	26.7	35.9	15.1	-21.4

^aCurrent expenditure and loans for consumption.

^bNet borrowings, loan repayments, capital receipts and drawals from cash balances.

^cCapital expenditure and loans for capital formation.

Source: Economic and Functional classification of the UP Government Budget; UP State Budget documents.

Table 7.28

Incremental Financing of Capital formation, 1970-90

<i>Item</i>	<i>Increase over previous quinquennium in Rs. crores</i>			
	<i>1970-75</i>	<i>1975-80</i>	<i>1980-85</i>	<i>1985-90</i>
Current revenue net of shared taxes	540.92	2030.66	2782.71	5488.52
Current outlays	935.66	2192.56	5096.22	13311.24
Deficit	-394.74	-161.90	-2313.51	-7822.72
Shared central tax	573.44	812.60	2216.89	4824.69
Current surplus after taking into account shared taxes	178.70	650.70	-96.62	-2998.03
Capital resources	449.02	790.63	3464.46	6330.49
Outlays on capital formation	627.72	1441.33	3367.84	3332.46

Source: Derived from Table 7.27.

Chapter 8

Gujarat State Finances

NIZAR JETHA

While Gujarat, one of India's most developed states, cannot be characterized as typical, the main issues of its public finances are of general concern. The primary purpose of this study is to review the structure of and trends in Gujarat's state finances, with a view to identifying some of the main issues of state finances. The first section of this chapter examines the structure of Gujarat's state finances, while the second explains the different types of central transfers to Gujarat. Trends in Gujarat's state finances are reviewed in the following section. The fourth and fifth sections then discuss the structure of the state's taxes. The final section draws together the earlier analysis and discusses some of the major issues of state finances in India. These include rapidly rising expenditures; growing indebtedness of the states, particularly to the center; increasing difficulties in identifying new sources of revenues; widespread taxation of inputs under sales tax; inadequate resource mobilization through public enterprises; and underutilization of user charges.

THE STRUCTURE OF GUJARAT'S FINANCES

This section, following a brief description of the Gujarat economy, describes the main features of Gujarat's expenditures and their financing. The discussion is based on the state's revised budget estimates for 1986-87.

The Gujarat Economy¹

The State of Gujarat (1981 census population 34.1 million)

1. For a good introduction to the Gujarat economy see Lakdawala (1983).

accounts for about five percent of India's population and six percent of its area. With a literacy rate of 43.7 percent, Gujarat ranks fourth among the states in terms of this indicator. About 31 percent of the population resides in urban areas, making Gujarat the country's third most urbanized state. Other vital statistics are less favorable: the state has among the highest infant and general mortality and crude birth rates. Gujarat ranks fifth in terms of per-capita income. Its per-capita state domestic product (SDP) of Rs. 2,985 (1985/86) is about 10 percent higher than the average for India as a whole.

Agriculture dominates the economy, accounting for about 35-40 percent of SDP and providing livelihood to more than 60 percent of the population. The principal crops are rice, wheat, jowar, bajra, pulses, groundnut and cotton. Low and highly variable rainfall is a major constraint to agricultural development. With only 20 percent of the cultivable area under irrigation, the state is vulnerable to the vagaries of monsoons. Gujarat's ultimate irrigation potential, allowing for completion of the World Bank assisted Sardar Sarovar (Narmada) Project, is estimated at about one-half of the cultivable area.

Gujarat is the second most industrialized state in India; value added in manufacturing accounts for over 20 percent of SDP. The state's long-established industries produce goods such as textiles, dairy products, edible oils, leather products and cement. The industrial structure has been gradually diversifying with the development of industries such as petrochemicals, pharmaceuticals, fertilizers, engineering goods and electronics. However, Gujarat's largest organized industry, the textile industry, has been passing through a severe crisis.

Gujarat's growth slowed in the 1970s -- from 4.5 percent annually in the 1960s to 3.3 percent per year -- largely because of the poor performance of agriculture, which recorded growth of value added of under one percent p.a. By contrast, manufacturing value added achieved growth of five percent p.a. during the decade. The early 1980s saw considerable improvement in growth performance. Between 1980-81 and 1984-85, reflecting the better performance of agriculture (growth rate of three percent p.a.) and more rapid growth of manufacturing (7.6 percent p.a.), SDP increased by an estimated 4.5 percent p.a.² Persistence of drought or near-drought conditions from 1985-86 to 1987-88 seriously retarded growth, reducing per-capita income in these years below the 1984-85 level.

2. Growth rates given here are derived from estimates of SDP issued by the Central Statistical Organization (Government of India).

The state's Seventh Five-Year Plan (1985-90) provided for outlays of Rs. 60 billion. The largest allocations were for agriculture and irrigation (33.4 percent of the total), power (24.4 percent), social and community services (15 percent), and the mid-day meals program (9.2 percent). Since the introduction of Decentralized District Planning in 1980, District Planning Boards have been playing a growing role in the formulation and implementation of projects.

Overview of Gujarat's Finances

Gujarat's current expenditures and revenues in 1986-87 were estimated at Rs. 25.2 billion and Rs. 23.3 billion, respectively, giving a current account deficit of Rs. 1.9 billion (Table 8.1). The state used to achieve current budget surpluses, often sizable, until the emergence of a modest deficit (of Rs. 699.1 million) in 1985-86, which was expected to persist in 1987-88. The budget proposals for that year implied a deficit of Rs. 1.9 billion before taking account of new revenue proposals. The budget proposed to raise Rs. 1.25 billion in additional taxes (through higher sales taxes, an increase in the rate of surcharge on sales taxes from 10 to 20 percent, and the substitution of the annual tax on some vehicles by a one-time lump-sum tax) and to introduce economies in current expenditures of Rs. 232.5 million. Taking account of these measures, the budgeted deficit amounted to about Rs. 425 million (Table 8.1).³

The state's capital disbursements reflect all capital outlays undertaken by the Government of Gujarat, including budgetary support in the form of share capital contributions and grants and loans to state enterprises. Capital outlays by non-departmental enterprises are not part of the state budget, except those financed through transfers from the state government. A significant proportion of capital disbursements by the state takes the form of loans and advances. These go mostly to state enterprises, which play an important role in the provision of goods and services. There are about fifty statutory undertakings and government companies in Gujarat.⁴

With capital disbursements expected to amount to Rs. 5.9 billion, the overall budgetary deficit for 1986-87 worked out to Rs. 7.8 billion. The financing pattern for current expenditures and for the overall

3. More recent data show actual current account budget deficits of Rs. 3.1 billion in 1986-87 and Rs. 2.9 billion in 1987-88. There has been some improvement since then.
4. Details of their activities and financial performance can be found in annual reports of Bureau of Public Enterprises, Finance Department, Government of Gujarat.

deficit has several interesting features.

Nearly three-quarters of current receipts are derived from taxes and nontax levies imposed by the state government, with the rest coming from tax revenues transferred by the central government and central grants. The state's own taxes account for about four-fifths of total tax receipts (receipts from own taxes and from central taxes received under revenue sharing).⁵ The state government's reliance on the central government for financing capital disbursements is greater. Nearly 50 percent of the overall deficit is financed through central loans. Domestic borrowing, the next main source of financing, was expected to meet about 20 percent of the 1986-87 deficit (a much higher proportion than in a normal year). Recoveries of past loans and advances are also a significant source of financing, as are net contributions from the various state provident funds. The remaining resources come mainly from reserve funds, use of cash balances, and borrowing from the Reserve Bank of India (RBI). External resources pass through the Union budget and are then passed on to the states through central loans and grants.

The State's Own Taxes

Gujarat, like other states, levies about ten different taxes. Indirect taxes provide most of the revenues, mainly the sales tax, electricity duties, taxes on goods and passengers, taxes on motor vehicles, stamp and registration fees, and the entertainment tax. State excise duties on alcoholic beverages play a lesser role in Gujarat than in most other states. Income and capital are each taxed through a single tax, the former through the tax on trades, professions, callings and employment, the latter through a land tax. The sales tax dominates the state's tax structure, providing two-thirds of total revenue from the state's taxes (Table 8.2). The next major tax -- electricity duties -- accounts for just over 10 percent of revenue.

Current Nontax Receipts

The state's nontax revenues are derived mainly from interest receipts, dividends, sale of goods, and user charges (Table 8.3). Major commercial services are provided by autonomous corporations and do

5. The states in India have greater independent sources of revenue (taxes and other levies they can impose and vary) than the states/provinces in most developing countries. In Pakistan, for example, the position is reversed: the provinces' own tax receipts account for only one-fifth of their total tax receipts, and own current receipts only one-quarter of total current receipts. See Jetha and Akhtar (1986, p.10).

not contribute directly to the state's budget. However, taxes levied on services provided by corporations such as the State Electricity Board (electricity duties) and the State Road Transport Corporation⁶ (the passenger tax) make a sizable contribution to state revenues.

Most dividend and interest receipts come from state public enterprises. A large proportion of interest receipts are notional (imputed), arising in connection with irrigation expenditures. Although irrigation is a departmental service, accounts are kept on a commercial basis, requiring that interest charges be imputed for capital investment in irrigation. So as not to distort the overall state budget (which is kept on a cash basis), the imputed interest payments of the irrigation department are also shown as the state government's interest receipts.

As is the case in other states, Gujarat has not relied extensively on user charges. Such charges make only a limited contribution in social and community services. In education, receipts come from fees for university and other higher education and to a lesser extent for secondary and technical education; dispensary and hospital charges and medical college fees account for most health receipts. In economic services, most nontax revenues are derived from mining (royalties)⁷ and forests (from sale of timber), but the user charge for irrigation water also is a significant revenue source. The various state levies on the transport sector (motor vehicle taxes, taxes on goods and passengers, and sales tax on motor spirits), some of which could be regarded as user charges, bring in substantial revenues (not shown in Table 8.3). In addition, revenues from tolls for bridges on national highways levied by the central government accrue to the state.

Current Expenditures

Education is the single most important current expenditure at the state level, absorbing about one-fifth of total current expenditures (Table 8.4). Health, which absorbs about 3.5 percent, and other services such as social security and welfare, bring the total share of social

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6. Passenger road transport has been nationalized in Gujarat.
 7. Rates of royalties for major minerals are fixed under central government legislation -- Mines and Minerals (Regulation and Development) Act, 1957 and Oil Fields (Regulation and Development) Amendment Act, 1984 -- which also provides for their revision at least every three years. Some states have levied cesses and surcharges on the royalties determined by the central government. The rate of royalty on crude oil, Gujarat's main mineral resource, in the late 1980s was Rs. 192 per ton until 1989/90, when an interim increase of Rs. 100 per ton took place.

and community services to 41.8 percent. Economic services account for 35 percent of current expenditures. These mainly comprise irrigation (10.5 percent including imputed interest payments), roads and bridges (6.5 percent), agriculture (6.1 percent), water and power development services (4.1 percent) and community development (3.6 percent). Miscellaneous expenditures such as debt servicing and general administration account for the remaining 23.2 percent of the total. Interest payments (nearly two-thirds of which represent payments to the central government) claim 9.5 percent of the budget.

Capital Expenditures

Since the bulk of spending on social and community services consists of current expenditures, economic services have a greater weight in capital expenditures (Table 8.5). The relative shares of economic and social (including community) services are about 80 and 20 percent respectively. Significant proportions of capital expenditures are devoted to irrigation (45.7 percent of total capital expenditures), industry and minerals (12.4 percent), forests (8.3 percent), and road and water transport services (eight percent). Agriculture, on the other hand, claims only 0.7 percent of the total, due in part to the importance of public corporations and other autonomous bodies like Gujarat Agriculture University, whose capital spending is not fully reflected in state budget statistics. About half of the allocation for social services is absorbed by water supply and sanitation. The relatively low share of education -- under one percent of total capital expenditures -- reflects, *inter alia*, the major role played by the private sector in the provision of secondary education and the autonomous nature of the universities.⁸

Because of the importance of the loans and advances made by the state government to public enterprises for capital investment, direct budgetary capital expenditures give only a partial picture of the state's total capital spending. Even the concept of capital disbursements, which includes loans and advances in addition to the state's direct

8. Another reason is that a large proportion of current expenditure takes the form of transfers to local bodies and private secondary schools, which may be used for both current and capital purposes. This tends to overstate current expenditures and understate capital expenditures. In 1984-85 grants to local bodies for primary education accounted for about 80 percent of the state's current expenditures on primary education, and grants to private secondary schools about 90 percent of its current expenditures on secondary education. See Finance Accounts, Government of Gujarat (1986).

capital expenditures, has a limitation: it does not reflect capital expenditure of non-departmental state public enterprises and other autonomous institutions that are financed from internally generated resources and from borrowing (from sources other than the state government). For a more complete picture of the development program, one must look at the state's annual plan.

Gujarat's Annual Plan for 1987-88

Gujarat's five-year development program, which is part of the national five-year plan, is implemented through annual plans. The annual plan includes most capital disbursements, since the bulk of such expenditures are for plan schemes. For example, it includes all capital expenditures of the Gujarat Electricity Board and the Gujarat State Road Transport Corporation. The plan also includes all recurrent expenditures on plan projects during the plan period. The state's annual plan does not, however, reflect central assistance for centrally sponsored plan schemes. This convention has probably been adopted to avoid double counting, since the central government's annual plan does include its contribution to centrally sponsored plan schemes. The state's annual plan can therefore be thought of as consisting of outlays on all state plan schemes and the state's contribution (but not the center's) to centrally sponsored schemes.

Gujarat's annual plan for 1987-88 proposed outlays of Rs. 11.6 billion, including Rs. 8.4 billion of capital outlays and Rs. 3.2 billion of current outlays (Table 8.6). The total development program amounted to Rs. 13.1 billion if account is taken of the expected central assistance of Rs. 1.5 billion for centrally sponsored plan schemes. The major claimants for the annual plan's resources were irrigation (27.3 percent of the total), energy (26.7 percent), and social and community services (21.6 percent).

The implementation of Gujarat's total Seventh Plan outlays of Rs. 60 billion (excluding central assistance for centrally sponsored plan schemes) was satisfactory. Gujarat is likely to have spent Rs. 54 billion, or 90 percent of the proposed plan outlays.⁹ Strictly speaking, the pace of progress is somewhat less, since planned outlays are in 1984-85 prices.

9. The annual plan outlays (in million rupees) were as follows:

1985/86	8,250 Actual
1986/87	9,650 Actual
1987/88	11,020 Revised Outlay
1988/89	10,750 Approved Outlay
1989/90	14,000 Approved Outlay

CENTRAL TRANSFERS TO GUJARAT

While central assistance takes many forms, most central resources come to Gujarat in the form of plan assistance, revenue sharing and small savings loans. This section discusses the different types of transfers received by Gujarat and outlines the present arrangements based on the recommendations of the Ninth Finance Commission.

Gujarat's budget for 1987-88 envisaged central transfers of Rs. 11.9 billion (Table 8.7), of which plan assistance amounted to Rs. 4.8 billion (40 percent of the total) and nonplan assistance Rs. 7.1 billion (60 percent). Transfers of tax revenues have tended to account for about one-half of nonplan transfers and just under one-third of total transfers. Small savings loans have greatly increased in significance in recent years.

In broad terms, nonplan assistance (with the major exception of small savings loans, which the central government has provided on its own initiative) is based on the recommendations of Finance Commissions, whereas plan assistance is determined by the Planning Commission. Finance Commissions not only make recommendations on the total amounts of tax revenues and grants that should be transferred but also on their distribution among the states. Plan assistance, by contrast, is provided under Article 282 of the Constitution, which permits both the central and state governments to make grants for any public purpose. This has meant that the center has greater discretionary powers over plan assistance -- both its volume and distribution -- than over nonplan assistance. The inauguration of five year plans in 1951-52 and the setting up of the Planning Commission therefore added a new dimension to center-state financial relations.

Shared Taxes

The revenue from Union excise duties and income tax is shared with the states. Although additional excise duties are not strictly a shared tax, it is convenient to discuss them here as well. The revenue from estate duties, until their recent abolition, was wholly assigned to the states.

Union excise duties. The states have been assigned 45 percent of the net proceeds from Union excise duties. The distribution of 83.5 percent of this amount among the states is based on population, the inverse of per-capita income, an index of backwardness,¹⁰ and the

10. The index of backwardness is based on the relative shares of a state in the total populations of Scheduled Castes and Scheduled Tribes and of agricultural labourers, with both elements receiving equal weight.

difference between a state's per-capita income and the highest per-capita state income (that of Punjab).¹¹ The first factor received a weight of 0.25, the next two factors a weight of 12.5 each and the last one 0.50. Gujarat's share worked out to 3.186 percent of the proceeds. The remaining 16.5 percent of the net proceeds from excise duties are distributed to the deficit states in a specified manner. Gujarat does not qualify for any such transfer.

Income tax. The states have been assigned 85 percent of the net proceeds from income tax (but not corporation tax). Ten percent was distributed among the states on the basis of their contribution to income tax revenues, defined as the income assessed for income tax in a state as a proportion of the total income assessed (for all states). The remaining 90 percent of the proceeds were distributed in the same manner as shared Union excise duties. This formula gave Gujarat a share of 4.55 percent in the income tax revenues distributed to all states.

Additional excise duties. Under an agreement between the central and state governments in 1956, the latter agreed to avoid levying sales taxes on certain commodities, in return for which they received the revenues from additional excise duties levied on those commodities by the center. The agreement applies to textile fabrics, sugar and tobacco, including manufactured tobacco. This can be regarded as a tax-rental arrangement between the central and state governments, since the states retain the right to reimpose sales taxes on these commodities.¹² The distribution of receipts from additional excise duties among the states was based on population and SDP, with both factors receiving equal weight. Gujarat's share worked out at 5.941 percent of the total.

Other Nonplan Assistance

Aside from shared taxes, the main forms of nonplan assistance received by Gujarat are grants in lieu of tax on railway passenger fares, grants from the Central Road Fund, grants and loans for the relief of natural calamities (when needed) and the small savings loans. Of these, the small savings loans are by far the most significant.

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11. Punjab's per capita SDP was retained in the formula, although Goa has the highest per capita SDP.
 12. In practice, it will not be in the interests of a state to tax these commodities because, as "declared goods" under the Central Sales Tax Act they cannot be subjected to sales taxes at rates higher than four percent.

Gujarat does not qualify for nonplan revenue gap grants-in-aid, (under Article 275 of the Constitution) paid to the states expected to have current budget deficits after taking account of Finance Commission recommendations.

Grant in lieu of tax on railway passenger fares. A tax on railway passenger fares is leviable by the central government, but the entire proceeds accrue to the states. The tax, introduced in 1957, was merged with basic fares in April 1961. To compensate the states for the loss of revenue, a grant has been payable to them since 1961-62. An annual grant of Rs. 1500 million was distributed among the states on the basis of their relative shares in the railways' total non-suburban passenger earnings. Based on its relative share of 5.72 percent, Gujarat received Rs. 86 million annually.

Grants from the Central Road Fund. At present, five percent of the revenues from the Union excise duty on diesel and petrol, which are earmarked for road development, are credited to the Central Road Fund. About 64 percent of this sum is earmarked for state roads and 35.5 percent for national highways, with the balance being used for administering the fund.

Relief for natural calamities. Under the present arrangements for financing relief expenditures, the central and state governments contribute annually to a calamity relief fund set up in each state. The central government contribution for Gujarat amounts to Rs. 638 million p.a.

Small savings loans. Small savings schemes are operated by the central government, but proceeds are shared with the states. These consist of deposits and other savings instruments provided by the Post Office Savings Bank. Since 1952 the central government has provided loans on concessional terms to the states based on net collections of small savings. The loan provided to each state amounts to three-quarters of net receipts from small savings in that state. Such loans carry an interest rate of 12 percent and are repayable over 25 years, including a five-year grace period when only interest is payable. This arrangement seems to be aimed at securing the cooperation of the states in mobilizing domestic savings.

Plan Assistance

Plan assistance is provided in the form of block loans and grants, assistance for specific centrally sponsored schemes, and transfers related to external assistance for state projects. While the overall level of plan assistance is determined by the Planning Commission, assistance for centrally sponsored schemes is administered by central

ministries.

Block loans and grants. General purpose assistance for state plan schemes has been provided under the so-called modified Gadgil formula. The formula, first adopted in 1969, was modified in 1980 for the Sixth Plan; the modified formula continued to be used during the Seventh Plan. The needs of the special category states (the five northeastern states of Assam, Meghalaya, Nagaland, Manipur and Tripura together with Sikkim, Jammu and Kashmir and Himachal Pradesh) had first claim on central allocations for state plan schemes. The balance of the allocation was distributed to the other states as follows: (1) 60 percent on the basis of population; (2) 20 percent on the basis of per-capita income, only to those states below the national average; (3) 10 percent on the basis of tax effort in relation to state income; and (4) 10 percent for tackling special problems such as droughts, floods and relatively underdeveloped tribal areas. Block assistance, thus determined, is provided in the form of 30 percent grants and 70 percent loans.¹³ The loan finance is provided for 15 years at an interest rate of nine percent per annum.¹⁴

Further modifications in the Gadgil formula were adopted by the National Development Council in October 1990. Briefly, the weighting pattern was changed, "fiscal management" replaced "tax effort" in the formula, and special problems were more broadly defined. The new weights (in percentages) were: population-55, per capita SDP-25, fiscal management-5, and special development problems-15.

Assistance for centrally sponsored plan schemes. Block grants and loans are supplemented by assistance for specific schemes and programs regarded to be of national importance by the central government -- ranging from malaria eradication to the Rural Landless Employment Guarantee Program (RLEGP). While most assistance is for schemes that are fully funded by the center, a significant proportion of schemes receive assistance on a matching basis. For these latter schemes, most commonly the central government finances one-half of the cost of a project. The bulk of the assistance for centrally sponsored plan schemes is provided as grants.

The conditions that a state must satisfy to be eligible for assistance under a centrally sponsored scheme vary widely from scheme to scheme. The assistance to a state for a particular service often

13. The special category states receive 90 percent of the assistance as grants and 10 percent as loans.

14. The gross rate of interest is 9.25 percent p.a., but a rebate of 0.25 percent is granted for timely payments of principal and interest.

depends on the level at which the service is provided in the state in relation to the plan target for its national development. The likely level of assistance for centrally sponsored schemes (for a five-year period) for each state is determined during the preparation of the national and state five-year plans. The assistance for each state in a particular year is then decided during the extensive consultations that take place between the state and central governments on state annual plans. In recent years, central assistance for centrally sponsored plan schemes has accounted for 25-30 percent of total plan central assistance to the states.

External assistance for state projects. Transfers related to external assistance for state projects do not form part of block transfers or of those related to centrally sponsored schemes; hence they are often referred to as "additionality." Until recently, however, only a portion of external assistance for state projects was transmitted to the states. Seventy percent of the proceeds from external assistance for a state project were passed on to the relevant state (for financing the project concerned), with the central government retaining the balance. The proceeds so transferred are subject to the same lending terms as block assistance, irrespective of the terms on which external assistance was obtained (30 percent of such transfers in the form of grants and 70 percent as loans, with the latter repayable over 15 years at the rate of interest of nine percent p.a. net of rebate).

Partial additionality was probably meant to moderate the effect of aid resources on the pattern of inter-state allocations secured through the Gadgil formula and transfers for centrally sponsored schemes. The adoption of full additionality was certainly intended to increase the incentive for the states to mobilize external resources.

TRENDS IN GUJARAT'S FINANCES

There has been great expansion in Gujarat's expenditures. Total state expenditures in 1984-85 were about five times higher than in 1973-74 (Table 8.8). Even with the population growing by nearly 30 percent during the period and prices rising rapidly, per-capita real expenditures rose by two-thirds.¹⁵ Greater resource mobilization

15. In this paper, where data have been given in real terms, current expenditures (and revenues) have been deflated by consumer price index for industrial workers (all India), and capital expenditures by the price index for gross domestic capital formation (all India). Suitable state-level price indices are not available. The implicit SDP deflator seems to behave erratically and cannot be used.

efforts contributed to the expansion of the state's activities. The share of the state's own current revenues (from state taxes and own nontax sources) in total current receipts (including central transfers) has remained stable at about three-quarters despite the rapid growth in current expenditures. There was, however, much greater reliance, in relative terms, on central loans for financing capital expenditures. Overall, central transfers (net) came to finance about one-third of the state's total expenditures, compared to one-quarter in the mid-1970s. These trends are examined in further detail below.

Expenditures

Between 1973-74 and 1984-85 Gujarat's total expenditure rose from 14 percent to 22 percent of state domestic product (SDP). Capital expenditure, which amounted to 3.4 percent of SDP in 1973-74, rose to about six percent of SDP (Table 8.9). Current expenditures increased from 10.6 percent to 16 percent of SDP. Capital expenditure, following its strong expansion in the 1970s, seems to have stabilized both in relation to SDP and in real terms. The main reason for the slowdown seems to be the resource constraints faced by the state. Current expenditure, by contrast, has grown rapidly throughout the period. Real per-capita current expenditures in 1984-85 were about 70 percent higher than in 1973-74. The growth of current spending has been accompanied by a large measure of stability in the relative share of social and community services and a sizable increase in the share of economic services (Tables 8.10 and 8.11).

In Gujarat, as in most other states, rapid growth of current expenditure seems to have been the result of adoption of ambitious development plans; salary revisions and automatic adjustments in cost of living ("dearness") allowances (based on movements in the consumer price index for industrial workers);¹⁶ rising interest payments (which came to absorb nearly 10 percent of Gujarat's current expenditures); and increased emphasis on programs aimed at poverty alleviation and employment generation. With the states supplementing the centrally sponsored anti-poverty programs (such as Integrated Rural Development Program and National Rural Employment Program) with their own schemes, welfare programs have been making growing claims on state budgets. For example, Gujarat's mid-day meal scheme (under

16. Gujarat has roughly the same salary scale as the central government (though similar positions may be graded differently), and it pursues a similar policy with respect to cost of living allowances.

which children in standards 1-7 of primary schools are provided cooked meals) and the food-for-all scheme (which provides wheat and other grains to households below the poverty line at subsidized prices) alone involve annual expenditures of Rs. 1.2 billion (equivalent to five percent of total current expenditures).

The State's Own Taxes

Receipts from taxes levied by the state government have grown substantially (Table 8.12). Their share of the state's total tax revenues rose from 72 percent in 1973-74 to 76 percent in 1984-85; the increase in the share of own taxes in current receipts was from about 45 percent to 55 percent. The share of SDP captured by the state's taxes rose from 4.8 percent to 9.2 percent. Per-capita receipts from the state's taxes also grew significantly in real terms. There are indications, however, that the growth of own tax receipts has slackened somewhat in the 1980s.

The structure of revenue from the state's taxes underwent only limited changes between 1973-74 and 1986-87. This was due largely to the fact that the sales tax -- the mainstay of the state's tax structure -- maintained its share at over 60 percent (Table 8.13). Aside from the sales tax, the only major tax that gained ground was the electricity duty (which accounted for about 11 percent of total own tax revenue in the 1980s); revenue from most remaining taxes declined in importance.

Buoyancy coefficients are in line with these trends. The buoyancy coefficient for revenues from the state's own taxes was found to be 1.37 -- that is, for every one percent increase in SDP, the corresponding increase in revenue from the state's taxes was 1.37 percent (Table 8.14). This impressive overall buoyancy reflected buoyancy coefficients of substantially above unity for most taxes. The buoyancy coefficient for the sales tax was identical to the overall buoyancy of the state's taxes. Electricity duties recorded the highest buoyancy coefficient (1.81), land revenue the lowest (0.74). The relatively low buoyancy of revenue from motor vehicle taxes (1.11) was due to virtually unchanged specific rates of tax (with a consequent decline in average tax rates in ad valorem terms).¹⁷

Current Budget Balance

Gujarat managed to achieve current budget surpluses amounting

17. This problem was acknowledged and the rates of tax raised in the 1986-87 budget.

to 1-2 percent of GDP until the emergence of a moderate deficit in 1985-86. The deficit widened considerably in the following year when, budgeted at Rs. 1.9 billion, it was equivalent to about 10 percent of the state's own current receipts. The budget for 1987-88 proposed to reduce the deficit to a modest Rs. 425 million. Actual outcomes were much worse, however: budget deficits (actual figures) of Rs. 3.1 billion and Rs. 2.9 billion were realized in 1986-87 and 1987-88, respectively. Preliminary data show deficits of Rs. 2.9 billion (Revised Estimates) for 1988-89 and Rs. 2.3 billion (Budget Estimate) for 1989-90.

The difficulties experienced by Gujarat in financing its expenditure are symptomatic of the deterioration in state finances generally in recent years. The substantial combined current budget surplus for all states of Rs. 15.5 billion in 1979-80 dwindled to Rs. 2.1 billion in 1983-84; in 1984-85, for the first time in many years, there was a current budget deficit of Rs. 9.2 billion. There were modest surpluses in the next two years, but deficits re-emerged from 1987-88 onward.

Central Transfers

Gujarat's relative dependence on central transfers increased moderately over the past decade (Table 8.15). As indicated above, the share of central transfers (net) in total state expenditures increased from about one-quarter in 1974-75 to about one-third in 1986-87, reflecting the growth of central loans for the state's capital expenditures. The share of central tax revenues and grants in the state's current receipts (and expenditures) has remained relatively stable at one-quarter.

The increase in the central government's relative contribution to financing the state's expenditures appears to have been due more to the large expansion in central transfers than to a slackening in resource mobilization by the state. The state's resource contribution to its total expenditures in 1978-79, for instance, was 125 percent higher than in 1973-74, and a similar percentage higher in 1983-84 compared to that in 1978-79. By contrast, central transfers expanded rather slowly until 1978-79, when they were only 35 percent above their level in 1973-74, but they gained momentum thereafter, with their level in 1983-84 reaching 170 percent above that in 1978-79. The more rapid growth in central transfers coincided roughly with the inauguration of the Sixth Plan and the implementation of the recommendations of the Seventh Finance Commission.

Certain trends in central transfers are worth noting (Table 8.16). The most striking development was the spectacular growth of loans against Gujarat's share of small savings, which expanded twenty-fold

between 1973-74 and 1987-88. On a per-capita basis, small savings in Gujarat are among the highest in the country,¹⁸ greatly benefiting the state. The impact of the growth of small savings on loans to states was reinforced by the central government's adoption of progressively higher loans/small savings collection ratios.¹⁹ Second, there has been considerable stability in the relative shares of transfers within the jurisdiction of Finance Commissions and those determined by the Planning Commission. At the national level, transfers determined by Finance and Planning Commissions each accounted for about 40 percent of total central transfers between 1974-75 and 1983-84 (the periods covered by recommendations of the Sixth and Seventh Finance Commissions). The proportions for Gujarat changed, but not appreciably. Overall, the Planning Commission is as important in the determination of central transfers to the states as the Finance Commission. Another feature worth noting is that although the proportion of plan assistance received by Gujarat in the form of assistance for centrally sponsored schemes has remained constant at about one-third of the total, such assistance has expanded greatly in absolute terms. Despite the importance of matching grants in state finances, hardly any empirical work has been done on their possible effects on the structure and growth of state expenditures. Such work as has been done on assistance for centrally sponsored schemes has concentrated on its equity aspects.²⁰

Financing of Capital Expenditure

The increasing contribution of central loans to financing Gujarat's capital disbursements, especially over the last three to four years, has been a most significant development. Central loans now finance three-quarters of capital disbursements, compared to one-fifth in 1974-75 and two-fifths as recently as 1983-84. While the increasing role of central loans is due in part to the growth of plan loans, a more important factor has been the growth of central loans related to small savings collections in the state. More resources now come to Gujarat through small savings loans than as plan loans.

The contribution of the current budget surplus -- the next main source of finance for capital outlays -- has varied widely from year to

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18. They were the fourth highest in the country at the end of 1983/84. See *Report of the Eighth Finance Commission*, p. 103.
 19. The steady extension of incentives for savings under Sections 10, 80C and 80L of the Income Tax Act, 1961 also contributed to the growing popularity of national savings instruments.
 20. See, for example, Gulati and George (1985) and George (1986).

year. Its ratio to total capital outlays declined from an average of about one-third in the 1970s to one-fifth in 1979-84. The situation worsened in 1985-86 and 1986-87, when a total (combined) budget deficit equivalent to nearly one-quarter of capital outlays was realized. The relative importance of other sources of finance -- net contributions to the state provident funds, recoveries of loans and advance, and market borrowing -- also decreased.

Since 1975-76 each state has been permitted to increase its net market borrowing by 10 percent per year.²¹ Additional borrowing powers have been provided to the relatively less developed states. The limited scope for borrowing allowed to the states accounts for the sharp decline in net market borrowing as a source of financing for Gujarat's capital outlays -- from nine percent in 1973-74 to a mere four percent in 1984-85. The past policy with respect to market borrowings by the states was continued during the Seventh Plan period.

The central government's new policy on unauthorized overdrafts by state governments from the Reserve Bank of India (RBI) seems to have brought under control a longstanding problem. Unauthorized overdrafts arise when state governments' short-term borrowings from RBI exceed their agreed borrowing limits for ways and means advances. On October 1, 1985, the central government extended to the state governments medium-term loans of Rs. 16.28 billion, an amount equal to 90 percent of their unauthorized overdrafts as on January 28, 1985. These loans, supplemented by their own resources, enabled the states to repay all unauthorized borrowings. Henceforth RBI was to stop payments whenever unauthorized overdrafts remained beyond seven consecutive working days. The new Overdraft Regulation Scheme seems to have been effective; during 1988-89, for instance, no state government was in an overdraft position beyond the prescribed limit.

Concluding Remarks

Recent trends in Gujarat's state finances pose many difficult questions concerning state expenditures, the state's own resources and intergovernmental transfers. For example, are there significant possibilities for raising revenues from existing taxes? Can sufficient resources be mobilized in support of reasonable levels of expenditures without greater reliance on user charges and surpluses of state

21. Exceptions were made in 1983-84 and 1984-85, when increases of 20 percent and 15 percent, respectively, were permitted.

enterprises? A look at major revenue sources in the next two sections should assist in an assessment of such issues.

SALES TAX

This section describes the three main components of the sales tax -- the general (or state) sales tax, the central sales tax (on interstate sales), and the sales tax on motor spirits. The state's other main taxes are discussed in the next chapter. The recommendations of a major taxation commission (Government of Gujarat, 1980) will be noted where appropriate.

The State Sales Tax

Main features. The sales tax is primarily levied at a single stage (at the manufacturer, importer or wholesale level), though some commodities are taxed at two stages. The commodities subject to tax at a single stage are mostly taxed at the point of first sale (on sale by a manufacturer or by an importer) rather than at the point of last sale (that is, in the Indian context, on sale by a wholesaler). The tax is collected from registered dealers (manufacturers, importers and resellers). All dealers above a prescribed turnover are required to register. A registered dealer satisfying certain conditions may apply to be licensed. Licensing has been introduced, *inter alia*, to avoid the collection of tax from a large number of small producers, especially farmers.

The state sales tax imposed under the Gujarat Sales Tax Act, 1969 had four components: (1) a sales tax levied at the first point of sale on a large number of commodities; (2) a general sales tax levied at the last point of sale (that is, when a licensed dealer, generally a wholesaler, sells to an unlicensed dealer) on a limited number of commodities; (3) both sales tax and general sales tax levied on the remaining commodities; and (4) a purchase tax to supplement the sales tax and general sales tax. The 1988-89 budget introduced a 1.5 percent turnover tax on dealers whose turnover exceeded Rs. 2.5 million per annum, excluding turnover relating to goods exempt from sales tax, interstate and export sales and "declared goods" (see below). The tax is payable on net turnover exclusive of the sales tax and surcharge.

The *sales tax* or the first-point levy applies to a wide range of goods, from industrial raw materials and inputs to consumer durables. It accounts for an estimated three-quarters of the total revenue from the sales tax. The tax is imposed on sales by manufacturers, importers

and resellers of goods purchased from unregistered dealers. All subsequent sales of a good subject only to the sales tax and for which tax has been paid are exempt. This exemption is ensured by permitting resellers of tax-paid goods to claim deduction of the sale value of all goods purchased from registered dealers.

The *general sales tax* is levied on agricultural products such as cotton, hides and skins, oilseeds and butter, many of which are produced by a large number of producers but marketed by a few dealers. The tax is normally payable at the last point of sale -- that is, when licensed dealers sell to unlicensed dealers (or consumers). No tax is levied when producers sell goods subject to the general sales tax to licensed dealers, because such dealers are entitled to purchase goods free of tax. Since licensed dealers are generally wholesalers, the tax can be thought of as being levied at the wholesale stage. However, the tax is also payable when producers sell directly to unlicensed dealers, so that in this instance it becomes, in effect, a first stage levy.

The *two-point levy* arises when "goods which by and large do not pass through controlled and identifiable channels of trade and/or on which a high tax rate at single stage is considered undesirable, are subject to both the sales tax and the general sales tax". (Government of Gujarat, 1980, p. 63). Goods subject to the two-point levy include articles of gold, foodstuffs, toilet articles, perfumes, lamps, pressure cookers, hair oils, suitcases and cutlery. Goods not otherwise specified also are subject to tax at two points. The first-stage tax is levied on sales by a manufacturer, importer or a reseller (on sale of goods purchased from unregistered dealers), whereas the last point tax is levied on the last licensed dealer. If the purchaser at the first stage is an unlicensed dealer, both the sales tax and the general sales tax become payable. If, on the other hand, the purchaser is a licensed dealer, only the sales tax is payable; the general sales tax becomes payable later, when the licensed dealer sells to an unlicensed dealer.

The *purchase tax* is payable at the appropriate rate for the sales tax or the general sales tax or both when taxable goods are bought from unregistered dealers and are not resold in the state.

Exemptions. All goods are taxable unless specifically exempted. Exempted goods can be classified into the following broad categories: necessities (e.g. bread, cereals, salt); perishable goods (e.g. eggs, milk, meat); goods of educational or cultural merit (e.g. books and periodicals); and goods used by low-income households (e.g. cheap footwear). In addition, exemptions have been granted to provide fiscal incentives to certain industries or activities (e.g. handlooms, bullock carts).

Tax rates. There are about 15 different rates of tax. The tax rates for most goods subject to the sales tax vary from four to 15 percent. The rate of general sales tax for most goods is four percent. For goods subject to the two-point levy, the rate of sales tax for most commodities varies in the range of 3-12 percent; the rate of general sales tax for these goods is four percent. Broadly, luxury goods such as consumer durables are taxed at relatively high rates, while nonluxury consumer goods and raw materials are taxed at low rates (Table 8.17). Taxable goods for which tax rates are not specified are subject to a two-point levy consisting of a sales tax of eight percent and a general sales tax of three percent.

For selected goods, some states, including Gujarat, had at one point adopted the practice of levying higher sales taxes on goods imported into the state than on similar goods manufactured in the state, a practice subsequently discontinued. For example, electronic goods manufactured in Gujarat carried a sales tax rate of one percent, compared to 10 percent for comparable goods imported into the state; similarly, scooters manufactured in the state were exempt from the sales tax, whereas imported scooters were subject to a tax of four percent. Such higher tax rates on "imports" were clearly equivalent to import duties (at the state level).

A surcharge at the rate of 10 percent has been levied on all prevailing rates of sales tax. Forty percent of the proceeds are transferred to the Narmada Development Fund for support of the Narmada project; the remaining 60 percent of the proceeds are allocated to a natural calamities fund. The 1987-88 budget raised the surcharge to 20 percent, earmarking receipts from the increment in the surcharge for expenditures on natural calamities. The 1988-89 budget raised the surcharge further to 25 percent.

Tax treatment of inputs. For the purpose of tax relief, inputs are divided into two categories -- "prohibited" goods and other goods (which will be referred to as "non-prohibited" goods).²² The latter receive partial relief, whereas the former do not. Purchases of non-prohibited goods by manufacturers receive relief in one of two ways. The goods may be purchased free of tax and the tax liability discharged later at the concessional rate of two percent. Or alternatively, the tax paid on inputs in excess of two percent may be set off against the tax payable on the output. The extent of relief for

22. The expression "prohibited goods" is somewhat confusing; in the context of the Gujarat Sales Tax Act, it simply denotes goods that do not qualify for tax relief.

input taxation has been reduced in recent years. Until a few years ago there was complete relief for taxes paid on non-prohibited inputs. In 1983-84 a one percent tax was imposed on such goods, increased to two percent in 1985-86. Input tax relief does not apply when inputs are used in the manufacture of exempt commodities. Nor does it apply to taxes paid on capital goods used in the process of production and on petroleum products (which are classified as "prohibited" goods).

Treatment of exports. Goods exported outside India are exempt from the sales tax. (The exemption also applies when an exporter does not export directly but through an intermediary.) In every other respect they are treated in the same manner as other goods produced in the state. No tax relief is available for taxes paid on "prohibited" inputs used in export production, and the relief for taxes paid on non-prohibited inputs is available only with respect to tax rates in excess of two percent. Thus for all goods produced in the state, including exports, only partial relief is available for input taxation.²³

Sales tax incentives for industries. In 1986, the Government of Gujarat introduced comprehensive incentives for industrial development of the state, particularly in the less developed areas, including investment subsidies and sales tax concessions. Under the latter, an eligible firm is exempt from sales taxes on both inputs and outputs. Alternatively, the firm may opt for sales tax deferment, under which the sales tax liability must be discharged over six years following the expiry of the deferment period. The extent of concessions (timing, magnitude, etc.) for both types of sales tax incentives depends on the size and location of a firm and the amount of fixed investment.

Recommendations of the Gujarat Taxation Commission. Of the many recommendations made by the Taxation Enquiry Commission on the sales tax (see Government of Gujarat, 1980), the following were the most significant:

- (1) There should be a tax at the first stage on almost all commodities subject to the sales tax.
- (2) Relief for taxes paid on inputs should be greatly expanded.
- (3) A two-point levy should be imposed on certain goods where there is evidence of evasion at the first stage or where the value-added after the first point is substantial. The object

23. It is worth mentioning, in passing, that inputs and machinery imported directly by a manufacturer will not come within the purview of sales taxation unless they are resold.

should be to levy the tax at the same rate at both stages and to permit set-off of the tax paid at the first point against that payable at the second point.²⁴

The Central Sales Tax

Sales taxation of interstate trade is governed by the Central Sales Tax Act, 1956, which limits states' powers to levy sales taxes on interstate sales. Only the Central Sales Tax (CST) may be levied on the first interstate sale of all goods other than newspapers, actionable claims, stocks, shares and securities and electrical energy.²⁵ The CST is administered by the states, which also retain the revenues from it. The revenue from the CST benefits the relatively developed and industrialized states like Gujarat more than other states -- CST revenues account for about 20 percent of total sales tax revenues in Gujarat, compared to 10 percent for all states.

Certain goods considered to be of special importance in interstate trade have been designated as "declared" goods. Aside from the three commodities subject to additional excise duties (textile fabrics, sugar and tobacco and tobacco products), the "declared" goods consist of coal (excluding charcoal), iron and steel, crude oil, cotton and cotton yarn, jute, hides and skins, cereals, oilseeds and pulses.²⁶ "Declared" goods are treated somewhat differently from other goods under CST.

The rate of CST, currently four percent,²⁷ applies to all interstate sales (of both "declared" and undeclared goods) to governments and registered dealers (unless the rates of sales taxes in the exporting state are lower than four percent, in which case these lower rates apply). For all internal sales of "declared" goods as well as their interstate sales to governments and registered dealers, the CST rate is the *maximum* rate. This means that domestic sales of "declared" goods cannot be subjected to sales taxes in excess of four percent.

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24. Two members of the Commission, including the chairman of the 1977 study team on sales tax, did not see the need for the continuance of the two-point levy. They favored exclusive reliance on a single-point levy at the first stage of sale for administrative reasons.
 25. In other words, goods exported in the course of interstate trade cannot be taxed more than once in the exporting state. If goods that have borne a state sales tax are subsequently sold in interstate trade (without undergoing further manufacturing), the state sales tax is refundable.
 26. All "declared" goods are also "prohibited" goods under the Gujarat Sales Tax Act.
 27. The initial rate of 1% was raised to 2% in 1963, 3% in 1966 and 4% in 1975.

Moreover, interstate sales of "declared" goods that have already borne CST at four percent in the exporting state cannot be taxed further through sales taxes in the importing state.

The CST system can be summarized²⁸ as follows:

- (1) where a good, whether "declared" or undeclared, is sold to a government or a registered dealer, the rate of CST is four percent or the rate applicable to internal sales within the exporting state of the good concerned, whichever is lower;
- (2) where a "declared" good is sold to other entities, the rate of CST is twice the rate applicable to the internal sales of the good concerned (i.e. the tax rate can rise up to eight percent);
- (3) where an undeclared good is sold to other entities, the rate of CST is 10 percent or the rate applicable to the internal sales of the good concerned, whichever is higher; and
- (4) where a good is generally and unconditionally exempt from the sales tax within a state, it is also exempt from the CST.

In Gujarat, relief for sales taxes paid on inputs embodied in interstate sales is no different from that for other sales. "Prohibited" inputs used in interstate sales do not qualify for tax relief, and the relief for taxes paid on nonprohibited inputs is available only for tax rates exceeding two percent.²⁹ Furthermore, no tax relief is provided to manufacturers within the state for CST paid on inputs.

Evasion has been a longstanding problem in the operation of the CST. There has been a growing tendency for firms to transfer goods to their branches and commission agents in other states to take advantage of interstate differences in tax rates. Until recently such consignment transfers did not constitute a "sale" for the purposes of the CST and no tax was payable on such transactions.³⁰ This anomaly was rectified by the Forty-Sixth Amendment to the Constitution, which extended the definition of a "sale" to include, *inter alia*, consignment transfers. This wider definition was adopted by the state

28. For details of the evolution and structure of CST, see Government of India, (1954, pp. 1-76) and Government of India (1978, Part II).

29. Many other states do not provide any input tax relief with respect to interstate sales.

30. More precisely, in the absence of a definition of the expression "sale of goods" in the Constitution, the Supreme Court had consistently held that the expression had the same meaning as in Section 4 of the Sale of Goods Act, 1930, under which consignment transfers do not constitute a sale.

through the Gujarat Sales Tax (Amendment) Act, 1985. The 46th Amendment has not yet become effective because further legislation needed to operationalize it remains to be enacted by the central government.³¹

Some states withdraw input relief when goods are consigned. In Gujarat, a manufacturer can only set off that part of the tax paid on inputs which is in excess of four percent of the sale price of the goods consigned. The rationale for this is that had the goods been sold in the course of interstate trade instead of being consigned, CST at the rate of four percent would have been payable. To improve the enforcement of this provision, the state has recently imposed a purchase tax of two percent (in addition to other state taxes that are payable) on all inputs (other than "declared" goods) utilized in the manufacture of taxable goods which are dispatched outside the state (but within India) by way of transfers to branches or commission agents.

Sales Tax on Motor Spirits

This tax is levied on aviation fuel, gasoline and diesel. The tax rate for gasoline and diesel is 20 percent of the sale price. A surcharge of 10 percent is levied on these rates with, as in the case of the sales tax, the proceeds allocated to the Narmada and famine relief funds.

Concluding Remarks

Both state and central sales taxes in India affect the allocation of resources by changing relative prices of intermediate goods (thereby inducing changes in factor proportions in production) and by modifying levels of protection. Input taxation not only changes relative prices of inputs but also affects costs of production (or effective protection) of industries using taxable inputs. The protective effects of the CST become obvious as soon as it is recognized that the CST can be viewed as an export tax levied by states on interstate sales. Possible reforms with a view to reducing the distortionary effects of sales taxes are discussed in the last section.³²

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31. Consignment transfers are to be taxed at the same rate as the CST. Fifty percent of the proceeds are to be distributed to the states on the basis of the origin of goods and the other 50 percent according to the formula governing the distribution of Union excise duties.
 32. Comments will be confined to distortions in production. Good discussions of distortions in consumption will be found in Ahmad and Stern (1984) and Ray (1986).

THE STATE'S OTHER MAIN TAXES

Land Revenue (Tax)

Powers to tax agricultural income and property have been conferred upon the states under the Constitution. The income tax levied by the central government consequently excludes agricultural incomes from its scope. Neither agricultural income nor property has been adequately taxed at the state level, though some states levy an unsophisticated agricultural income tax (frequently confined to plantations) and most states tax agricultural property through a land tax.

The land tax is probably the oldest tax in India. In Gujarat it is levied at a fixed rate per acre, with the rate of tax varying with the class of land (rainfed, irrigated, rice land, gardens, etc.). The rates of tax vary widely, from 37.5 paise to Rs. 13 per acre. Holdings of agricultural land up to 3.5-8.25 acres in size (depending on the class of land) are exempt.

The Taxation Enquiry Commission found two major defects in the land tax. First, the impact of the tax on lands of comparable productivity was dissimilar because assessments were carried out in different areas using different methods and at different times. Second, the assessments, which were guaranteed to remain in effect for thirty years to encourage farmers to make improvements on their lands, have not been revised for decades. To overcome these problems, the Commission recommended the replacement of the land tax by a graduated agricultural holdings tax, similar to that proposed by the Committee on the Taxation of Agricultural Wealth and Income (Raj Committee).³³ In Gujarat, as in other states, an agricultural holdings tax has not found acceptance.³⁴

The Professions Tax

Article 276 of the Constitution permits the states to levy a tax on "professions, trades, callings and employments", provided that the maximum rate of tax does not exceed Rs 250 per annum. Gujarat has levied the tax since April 1976, and the ceiling has recently been raised to Rs. 2,500 by a Constitutional amendment. The tax is broad-based but has not been applied to agriculturalists for administrative reasons. Employers have the responsibility for collecting the tax from

33. The Taxation Enquiry Commission's recommendations were based on a modified agricultural holdings tax suggested by Bagchi (1978).

34. A farm holdings tax is levied in West Bengal but has not yielded much revenue.

wage and salary earners.

The tax applies to (1) salary and wage earners whose monthly emoluments are above Rs. 1,000; (2) doctors, lawyers, accountants and other professionals with annual incomes above Rs. 10,000; (3) employers employing an average of more than five employees per day during a year; (4) partners of registered firms with annual incomes above Rs. 10,000; (5) dealers (as defined for the purposes of the Gujarat sales tax) with annual gross turnover of above Rs. 50,000; and (6) companies, hotels, theatres, gas stations, banks, moneylenders, estate agents and building contractors.

Tax rates ranged from Rs. 50 to Rs. 250 per year. Employees' rates varied with their salaries, those for professionals with their "standing in the profession" (those with less than five years of working experience being exempt), and those for dealers with their turnover. The rates for employers under (3), moneylenders and professionals varied with the size of the urban area; those in localities with populations of under 20,000 were exempt.

Stamp Duties

Stamp duties are levied by both the center and the states. The central government sets uniform national rates for stamp duties under its jurisdiction.³⁵ All duties levied within a state are, however, collected by the state, which also retains all revenues. In Gujarat, stamp duties are levied at specific or ad valorem rates depending on whether or not the assets to which documents refer are amenable to valuation. Instruments relating to conveyances, mortgages, gifts and sales transactions account for most of the revenue.

The Taxation Enquiry Commission found that undervaluation of properties was widely resorted to with a view to evading the proper payment of stamp duties.³⁶ The Commission recommended that stamp duties for conveyances should be based on the market values of the properties concerned, and suggested the setting up of valuation machinery for this purpose. The Gujarat state government implemented this proposal during 1982-83, replacing at the same time the various duties on conveyances, which varied between six and 12 percent, with a single rate of eight percent. The amendment in

35. It determines stamp duties for bills of exchange, checks, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

36. Undervaluation of property sales helps both the seller and the buyer to evade several other taxes as well. See Acharya and associates, (1985).

legislation permitting the levy of stamp duties with reference to market values of properties has been challenged in the courts, however.

State Excise Duties

State excise duties (not to be confused with Union excise duties) are confined to alcoholic beverages and medicinal and toilet preparations containing alcohol. They are a minor source of revenue in Gujarat because of prohibition.

Taxes on Vehicles

All owners of motor vehicles were until recently subject to an annual tax. The 1987-88 budget replaced the annual levy with a single lumpsum payment for all vehicles except commercial vehicles engaged in the transport of goods and passengers and the heaviest category of private cars. Exemptions from the tax include motor vehicles designed and used solely for agricultural purposes, tractors, ambulances, school buses and government vehicles used for non-commercial purposes.

The tax base consists of registered laden weight for trucks, seating capacity for buses and other vehicles plying for hire and used for the transport of passengers, and unladen weight for private cars (except the heaviest category of cars, which are taxed on the basis of permissible seating and standing capacity), motorcycles and tricycles. A surcharge of 50 percent on the normal rates -- both annual and lumpsum -- is levied on diesel vehicles. Imported vehicles are subject to twice the rates applicable to other vehicles.

The introduction of one-time payment of the motor vehicle tax on private vehicles was meant to simplify administration. The lump-sum tax for new motor vehicles varies from Rs. 1,500 (for vehicles with unladen weight not exceeding 750 kg) to Rs. 3,250 (for vehicles with unladen weight exceeding 1,500 kg, but not exceeding 2,250 kg). The annual tax continues to apply for motor vehicles with unladen weight above 2,250 kg. The lump-sum tax for new motorcycles varies from Rs. 160 to Rs. 600, depending on weight, while that for new three wheelers is fixed at Rs. 600. For previously registered vehicles, the lump-sum tax is lower, varying inversely with their age. These rates apply to individuals, local authorities, public trusts, and educational and social welfare institutions; other taxpayers are liable at twice the rates indicated above. This scheme is expected to lighten the administrative burden by removing 700,000 two-wheelers and 100,000 four-wheelers from the purview of annual (or quarterly) tax collection.

Taxes on Goods and Passengers

Road travel by passengers (except by taxis) in most areas is taxed at the rate of 25 percent of the gross-of-tax fare payable. Travel in certain areas (e.g. within the state capital of Gandhinagar and municipalities) is taxed at the rate of one percent of the fare. All goods transported by road are subject to tax. The basis of taxation for goods carried by public and private goods vehicles is different, the former being taxed on the freight charged and the latter on tons carried per kilometer. However, all transport operators have the option to pay a lump-sum amount in lieu of the goods tax.

The Taxation Enquiry Commission's recommendations included a lump sum levy on contract vehicles (vehicles that carry passengers under a contract). Such vehicles tended to evade the passenger tax by not correctly disclosing the number of passengers carried, the fares charged, and the number of trips undertaken. The state government implemented the recommendation during 1981-82 by taxing contract vehicles on the basis of weight.

Electricity Duties

Electricity duties are levied on the consumption of electrical energy. Some uses of electricity are either exempt or taxed at concessional rates. A major concession applies to new industrial undertakings, which are exempt from the payment of duties for five years. The duties are collected by the Gujarat Electricity Board and other licensees. The rates of duty applicable to purchases of electricity are shown in Table 8.18. The rates, mostly ad valorem in nature, vary according to the type of consumption, with residential consumers generally subject to higher rates than other consumers. Electricity for irrigation purposes is taxed at the relatively low rate of five percent of power charges. Electricity generated for own use is taxed at lower rates than that purchased from power companies. The Taxation Enquiry Commission was broadly in agreement with the structure of electricity duties but suggested that the number of different rates might be reduced to two (10 percent and 20 percent).

Entertainment Tax

This tax applies to any exhibition, performance, amusement, game or sport to which persons are admitted on payment. Certain types of entertainment are, however, exempt (e.g. Indian dramatic performances and dancing). Screenings of Gujarati films produced in the state bear a concessional rate of 30 percent of the rates applicable to other films. Screenings of films through video cassette recorders

became taxable in 1984-85. The tax, which is levied on gross-of-tax admission charges, varies progressively with admission charges; it also varies with the size of the locality (Table 8.19).

User Charges

User charges play a minor role in state finances in India. Table 8.20 shows Gujarat's receipts from user charges in the four main sectors (agriculture, irrigation, education and health) in which user charges could be expected to be levied.³⁷ The smallest contributions in 1987-88 came from agriculture and education. The budgeted contribution of health was higher, with the bulk of receipts taking the form of payments by the state government's Employees' Insurance Scheme for use of government medical facilities by its contributors. Receipts from irrigation met only a small fraction of current expenditures on irrigation as defined in the budget. However, if interest payments (which form most of current expenditures on irrigation) are excluded, current expenditures on irrigation equalled irrigation receipts. In other words, if no account whatsoever is taken of capital costs, receipts from irrigation (mainly from water charges) covered expenditures on operation and maintenance of the irrigation system.

In Gujarat's 1987-88 budget, receipts from user charges from the above sectors were budgeted at Rs. 357 million, compared with corresponding current outlays of about Rs. 9.3 billion, giving a ratio of user charge receipts to current outlays of about four percent. This ratio rises to five percent if current outlays on irrigation are taken net of interest payments.

SELECTED ISSUES

The durability of fiscal federalism and its responsiveness to rapidly changing needs in a populous and heterogeneous country constitute one of the major accomplishments of independent India. The retention by the states of greater fiscal independence than in most countries is an important aspect of this achievement. However, the assumption of growing expenditure obligations by the states, though accompanied by notable tax effort, has tended to increase their dependence on the central government in recent years. Containing this trend will be difficult under the present division of functions and resources between the center and the states, unless greater reliance is

37. As already indicated, user charges levied by autonomous state enterprises are not reflected in state budgets.

placed on sources of revenues inadequately utilized in the past.

The overriding issues of public finance in Gujarat include (1) high growth of current expenditures; (2) growing claims on resources by poverty alleviation, employment generation, and other welfare-type programs; (3) increasing constraints on the use of tax policy for revenue purposes, given the present intensive use of major taxes; (4) widespread taxation of inputs under sales tax; (5) inadequate resource generation by public enterprises; and (6) underutilization of user charges.³⁸

State Expenditures

The most critical fiscal issue in Gujarat, as in most other states, is the rapid growth of current expenditures. The estimated buoyancy coefficient for Gujarat's current expenditures for the period from 1973-74 to 1984-85 was 1.30. This compares with a buoyancy coefficient of 1.28 for total current revenue. Given that current expenditures presently exceed current revenues, persistence of these coefficients would mean growing current budget deficits. Achievement of moderate surpluses would require both restraint in the growth of current expenditures and greater resource mobilization. The growth of current expenditures in recent years of about 20 percent annually cannot be sustained over the long term.

Though still comprising a modest portion of Gujarat's expenditures, outlays on programs for poverty alleviation and employment generation have increasingly contributed to the growth of current expenditures. Not only have the states enthusiastically adopted centrally sponsored schemes in these areas but they have also supplemented these with a wide range of welfare measures of their own. The major state-sponsored welfare programs in Gujarat include mid-day meal and food-for-all programs, an old-age pension scheme and a scheme for financial assistance to destitute widows. Unless the growth of welfare-type expenditures can be restrained, serious inroads into the resources available for basic infrastructure and services will be difficult to avoid. In this connection, better targeting of beneficiaries and more cost-effective ways of assisting them need to be explored.

Little or no detailed quantitative work has been done on the main factors underlying the growth of state expenditures. The state expenditure data published by RBI, though valuable, are too

38. The issue of state transfers to local authorities, though very important in Gujarat, will not be addressed.

aggregated. Consequently, detailed analyses of expenditures have to rely on state budget documents; the fact that the annual budget documents of each state consist of nearly twenty volumes gives some idea of the magnitude of the task. To make matters worse, only a few states undertake an economic classification of expenditures. The growing use of microcomputers and the change in the classification of government budgets from 1987-88, which gives a clearer picture of some of the more rapidly growing expenditure categories such as rural development and nutrition, should make the task more manageable. Detailed work on state expenditures is needed both at an aggregate level and at the level of individual states.

The State's Own Taxes

The maintenance of the share of receipts from the state's own taxes in total tax receipts in Gujarat constitutes a remarkable achievement. It implies that the rate of growth of revenues from state-controlled taxes was comparable to that of tax revenues received from the central government under revenue sharing. The high buoyancy of own tax receipts that made this possible could only have been achieved through substantial increases in tax rates, since the elasticity of tax revenues (i.e. the automatic response of tax receipts to changes in GDP) of Indian states is thought to be low.³⁹ There are indications, however, that sustaining the high rate of growth of revenues from own taxes will be difficult.

A major reason why tax revenues may not be as buoyant as in the past is the concentration on a narrow range of taxes. The rapid growth in receipts from the state's own taxes since the early 1970s stemmed largely from the four main taxes (sales tax, electricity duties, taxes on vehicles and taxes on goods and passengers), which contribute over four-fifths of own tax receipts. In the process, most of the revenue potential of these taxes appears to have been utilized.

There are major limitations on the flexibility of even the sales tax. The large overlap between the tax bases of state sales taxes and Union excise duties has already been mentioned. The prevailing rates of sales tax in Gujarat are high relative to Union excise duties, so trends in rates of excise duties significantly affect revenue potential from the state's sales tax.⁴⁰ This was less of a problem in the past, when sales

39. Further work on elasticities of state taxes is needed. Estimates of elasticities per se are of lesser interest than analysis of possible causes of their relatively low magnitudes.

40. The use by the central government of administered prices instead of excise duties has been a source of irritation to the states.

tax rates were generally low and could be regarded as minor supplements to excise duties. Tax rates in neighboring states also circumscribe a state's independence with respect to tax rates. A state that levies higher tax rates than nearby states will encourage consumers to make direct purchases from other states and dealers to transfer goods on a consignment basis to other states, especially high-value goods. It was to combat these related problems of evasion and trade diversion that Gujarat reduced tax rates for items such as utensils, television sets, air conditioners, refrigerators and motor vehicles in the 1986-87 budget. Another constraint on the revenue potential of sales tax is the heavy reliance on revenues from taxation of intermediate goods and machinery, which provide an estimated one-third of sales tax receipts.

The proposals for new taxation in the 1985-86, 1986-87 and 1987-88 budgets illustrate the growing difficulties of raising additional tax revenues within the prevailing tax structure. All three budgets raised new revenues from sales tax, while the 1987-88 budget raised substantial revenues from the motor vehicle tax as well. Sales tax changes during this period included an increase in the rate of general sales tax from three to four percent, increases in tax rates for individual commodities, an increase in the rate of surcharge on sales taxes from 10 to 20 percent, and an increase in the rate of tax on non-prohibited inputs from one to two percent. The additional revenues from the motor vehicle tax came mainly from the substitution of a lifetime tax for annual license fees. These measures all reflect increasing difficulties in obtaining more revenue from an already well-utilized tax base.

Identification of desirable directions of tax reform is a complex matter requiring much more detailed analysis than can be undertaken in a general review of this kind. Fortunately such an analysis is already available in the report of the Gujarat Taxation Enquiry Commission (Government of Gujarat, 1980), some of the main conclusions of which were mentioned in the previous two sections. The brief comments on taxation that follow are meant to supplement the discussion in that report.

The single most important measure Gujarat could take to improve the efficiency of the tax system would be to relieve raw materials and intermediate goods from sales taxation.⁴¹ The objective should be to

41. This issue is discussed in the national context in Government of India (1978), and in Chelliah (1980). A more recent discussion of this and other issues of state and inter-state sales taxes can be found in Govinda Rao and Tulasidhar (1986).

abolish the distinction between "prohibited" and non-prohibited inputs and to permit the set-off of all sales taxes paid on inputs against tax payable on outputs. This would free inputs from sales taxes, thereby converting the sales tax into a form of value added tax. The adverse revenue impact of this measure could be moderated by suitably increasing tax rates on final goods.⁴² Now that Union excise duties are being converted into a value added tax (MODVAT), the continued taxation of inputs under state sales taxes seems anomalous.

Extensive taxation of intermediate goods together with only partial relief for input taxation has several undesirable features. First and foremost, the relative prices of intermediate products are distorted. Second, the task of determining tax incidence is greatly complicated, thereby making it difficult to spread the burden of the tax in the desired manner. For the same reason, the tax element in exports is difficult to calculate for the purpose of rebate. Furthermore, vertical integration of production processes is encouraged even when economic considerations do not justify integration.

The increasingly common practice of differentiating between state-produced and other goods for sales tax purposes is highly undesirable.⁴³ Protective policies by states distort the national allocation of resources. At present taxation of inputs is the main source of protection in state sales taxes. As relief for taxes paid on inputs is expanded, the protective element would decline. To take an extreme case, transformation of state sales taxes into value added taxes, which would in effect free inputs from taxation, would divest sales taxes of protective elements, transforming them into purely revenue taxes. This desirable development will not be realized if differential sales taxes based on origin are utilized.

Turning to the Central Sales Tax (CST), there does not seem to be a consensus on the desirability of a consignment tax. The protagonists of the tax, prominent among which are the states, argue that since the purpose of the CST was to tax all interstate trade, albeit lightly, the loophole created by consignment transfers should be closed. Others believe that consignment transfers have helped to attenuate the CST's distortionary effects on the allocation of resources and should not be made taxable. This lack of consensus may well be the reason behind

42. It is not intended to suggest that this would be easy to do; constraints imposed by tax rates in neighboring states have already been noted.

43. Since this was written, the Supreme Court has ruled, in the *Weston Electronics* case, that this practice is *ultra vires* under provisions of Articles 301 and 303(1) of the Constitution.

the delay by the central government in making the consignment tax effective. Irrespective of how this matter is resolved, there is a need to consider how the adverse effects of the CST might be minimized.

Probably the best way of coordinating state sales taxes would be to abolish the CST and to adopt the destination principle of taxation (instead of the prevailing mixed origin/destination system) for interstate trade. Under the destination principle, goods would be taxed in the state in which they are consumed, irrespective of where they are produced. The operation of this arrangement would require a comprehensive system of tax credits that cuts across state boundaries.⁴⁴ In other words, the existence at the state level of broadly similar value added taxes (though not necessarily levied at the same rates) is a precondition for this solution.⁴⁵ Given that at present the states allow partial and widely varying levels of relief for taxes paid on inputs, imposition of the destination principle can only be viewed as a long-term possibility. For the immediate future, the frequently made proposal that the ceiling rate of CST should be reduced, perhaps to the original level of one percent, is the most relevant. A phased reduction in the rate of CST, combined with enforcement of the consignment tax, would help to minimize the adverse revenue impact of the measure. A lower CST would significantly reduce tax-induced distortions in the location of production and the pattern of trade.

The profession tax is capable of yielding much higher revenues, now that the ceiling of Rs. 250 per annum prescribed in the Constitution has been raised to Rs. 2,500. The steady increase in the personal exemption from income tax in recent years has reduced tax liability at all income levels, as well as excluding many taxpayers from the scope of income tax. This provides an opportunity to capture part of the gains accruing to taxpayers through higher rates of tax on professions and trades. These should be accompanied by greater efforts to expand coverage of the self-employed, who are much more difficult to tax than employees.

The structure of motor vehicle taxes appears to be broadly

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44. Such an arrangement has been proposed in the context of the EEC. See Sijbren Cnossen, "Harmonization of Indirect Taxes in the EEC", in Charles E. McLure, Jr. (ed.), *Tax Assignment in Federal Countries* (The Australian National University, Canberra, 1983), pp. 150-168.
 45. In the absence of full relief for taxes paid on inputs, exporting states, prevented from taxing exports, will tend to extract as much revenue as possible from taxes on inputs utilized in export production. This is probably among the main reasons why the previous attempt to introduce the destination principle was unsuccessful.

satisfactory, but the introduction of a one-time lump-sum motor vehicle tax for most private vehicles, notwithstanding its administrative convenience, seems to be a step in the wrong direction.⁴⁶ Such measures bring sizable immediate gains, but often at the expense of future revenues. The appropriate levels of motor vehicle taxes in a given year depend presumably on revenue requirements, the cost of road maintenance, the expected rate of inflation, the tax rates prevailing in neighboring states and other considerations, most of which cannot be predicted with confidence. The main shortcoming of the measure is therefore that it reduces control over a major tax. The conversion of the annual tax for commercial vehicles into a one-time tax would not be advisable.

Three aspects of tax administration are worth noting. First, the problem of arrears in tax collections seems to be manageable in Gujarat.⁴⁷ The Taxation Enquiry Commission found that recovery proceedings (ranging from preliminary investigations to court actions) were underway for the bulk of arrears. Second, there is considerable evasion, especially of the sales tax, but there is no evidence to suggest that the problem is more serious than in other states. Third, information necessary for making proper assessments of the working of the state tax system as well as tax administration is lacking. Compilation of basic tax statistics requires early attention in all states.

Neither the analysis of the Taxation Enquiry Commission nor the description of state taxation in the previous two sections indicates major possibilities for broadening the tax bases of individual taxes or for effecting significant changes in their structures for revenue purposes.⁴⁸ Most additional tax revenues would have to come from the normal growth of receipts in response to economic growth, improvements in tax administration and higher tax rates.

Own Nontax (Current) Receipts

The assignment of most major taxes to the central government and of most economic and social functions to the state governments makes user charges a highly suitable form of revenue mobilization at the state level. Nevertheless, user charges have not been adequately

46. Fortunately, passenger vehicles accounted for no more than 20 percent of receipts from motor vehicle taxes at the time of the reform.

47. Arrears of tax collections in Gujarat amounted to Rs 353 million at the end of March 1985.

48. Nonetheless, a careful review of exemptions under the sales tax could be worthwhile. Consideration might also be given to reducing the number of sales tax rates (from the present 15 to 5-8) to simplify administration.

utilized. It is the Government of Gujarat's policy to seek full cost recovery from all services except for those subsidized for social reasons. But, as in the rest of India, the gap between policy objectives and practice is wide. Additional resource mobilization in support of plan expenditures will be increasingly difficult unless user charges play a larger role.

The problems of the two main state enterprises -- the State Electricity Boards (SEBs) and State Road Transport Corporations (SRTC's) -- have been so frequently studied and the problems faced by these enterprises in different states are so similar that only a few general comments need be made.⁴⁹ The low or negative returns realized by SEBs have been the subject of two official enquiries. The Venkatraman Committee (1964) proposed that SEBs should achieve a return of 11 percent, made up of six percent interest on capital, 0.5 percent for appropriation to reserves, a notional 1.5 percent for electricity duty and net profit of three percent. The Rajadhyaksha Committee (1980) suggested a gross return of 15 percent, including an average composite rate of interest of seven percent to be paid by SEBs on state government loans. Adoption of these guidelines was not mandatory.

Concerned by the continued unsatisfactory performance of SEBs, the Union Government amended Section 59 of the Electricity (Supply) Act of 1948 in 1983. It now requires SEBs to adjust their tariffs "so as to ensure that the total revenues in any year of account shall, after meeting all expenses properly chargeable to revenues, including operating, maintenance and management expenses, taxes (if any) on income and profits, depreciation and interest payable on all debentures, bonds and loans, leave such surplus as is not less than three percent....." This corresponds roughly to the 11 percent return envisaged by the Venkatraman Committee. There has been very little progress toward achieving this legislated objective, however.

The Eighth Finance Commission assumed, for the purposes of projections, that the SEBs would pay interest on loans from state governments (at the average of the applicable rates, which worked out to seven percent), but no net profits would be realized.⁵⁰ The

49. Other enterprises will not be discussed because policy information is not readily available. On the SEBs and SRTC's, see, especially, reports of various Finance Commissions and periodic reports by the Planning Commission on SEBs and SRTC's. A recent discussion of problems of SEBs is Thapar and Nanjudiah (1987).

50. The "norms" adopted by Finance Commissions form the basis of their projections of outlays for the maintenance of different types of assets (e.g., irrigation works, roads); the states are not obliged to adopt them.

calculations disregarded loans and subsidies provided by state governments for rural electrification, and electricity duties payable by SEBs to state governments were netted out against their projected interest payments.⁵¹ The Ninth Finance Commission proposed that the rate of return should rise from three percent in 1990-91 to seven percent in 1990-95; interest payments on loans outstanding for rural electrification were disregarded for this purpose.

The Eighth Finance Commission was even more cautious in its projections for SRTCs. Its belief that there was considerable scope for improvement in the performance of SRTCs was tempered by the knowledge that most SRTCs were not able to achieve the modest norms assumed by the Seventh Finance Commission. It assumed that the SRTCs would yield a return of three percent to the state governments after providing for depreciation. The Ninth Finance Commission recommended that a return of 6.5 percent should be achieved by 1994-95.

On irrigation, noting the losses incurred by irrigation projects, the Eighth Finance Commission did not propose any rate of return target, recommending instead that the states should, as a minimum, ensure that receipts from water charges cover the cost of maintaining irrigation systems. For the purposes of projecting the states' receipts from and expenditures on irrigation (major and medium irrigation works), the Commission decided on the figure of Rs. 100 per hectare of gross irrigated area for the maintenance of irrigation works (including normal repairs, special repairs and regular establishment); the cost of maintaining unutilized irrigation potential was taken as Rs. 30 per hectare. Noting that the situation had worsened since the review by the previous Finance Commission, the Ninth Finance Commission adopted that Commission's recommendation. Gujarat's irrigation receipts, as already explained, roughly cover the cost of operating and maintaining (O&M) its irrigation system. States that are recovering the O&M costs need to begin to recover capital costs of irrigation systems.

Detailed information on user charges in the social sectors is not readily available. Broadly, the situation in Gujarat is similar to that in most states, where education up to secondary level (up to standard 10) is free,⁵² basic health services are provided at nominal charges,

51. For Gujarat, the projection implied that the SEB would not pay interest to the state government, since payments of electricity duties were likely to exceed projected interest payments.

52. Girls' education is free throughout the secondary level in Gujarat.

and higher education and medical facilities at government hospitals are heavily subsidized. Early attention is needed to securing more realistic pricing, especially of higher education and specialized medical services.

Studies on state finances have increasingly come to the conclusion that greater reliance on nontax receipts is necessary for adequate resource mobilization. For example, a major taxation review commission appointed by the Government of Karnataka recommended that (1) a rate of return of at least 10 percent should be earned on investments made in public enterprises; (2) the pricing policy for irrigation works should provide for a return of at least 5% on investments made in irrigation projects; (3) bus fares should be adjusted to improve the financial position of the State Road Transport Corporation; and (4) higher education should not be heavily subsidized. (Karnataka Taxation Review Committee, 1983). Similarly, a study on Tamil Nadu stressed the need for increasing nontax revenues by reducing indirect subsidies and improving cost recovery (especially in irrigation) and for increasing the efficiency of and returns from public sector enterprises, including the SEB (see Guhan, 1986).

A critical question of a long-term nature is whether the states will be able to raise adequate revenues if they continue to neglect user charges and the taxation of agricultural incomes? Gujarat's experience seems to suggest that unless the revenue base is substantially expanded, the states will be forced to rely increasingly on revenue measures with serious adverse economic effects. Greater use of revenue sources underutilized in the past is needed to reduce the cost, in terms of tax-induced distortions, of raising revenue.

Concluding Remarks

The main problems of Gujarat's public finances -- rapidly rising expenditure obligations; increasing difficulties in identifying new sources of tax revenue; substantial reliance on sales taxes on raw materials and intermediate and capital goods; meager or negative contributions by public enterprises to resource mobilization; and underutilization of user charges -- are common to most states. Because the Finance Commission and the Planning Commission must necessarily confine themselves to the areas of their respective responsibilities, many critical issues of state finances do not receive sufficient attention. Hence it may be desirable to set up a joint state/central commission to look comprehensively at state finances. A national commission, by contributing to the development of consensus

on major issues of state finances, could help hasten the adoption of desirable policies at the state level.

Examples of issues where broad agreements between state governments and the central government would be beneficial are the desirable directions of change for state sales taxes and user charges. Increasing input taxation under state sales taxes, unless checked, could greatly attenuate the benefits of MODVAT. There is now clearly a greater need for coordination of state sales taxes and Union excise duties than in the past. National guidelines of some form are equally important for user charges, since it will be politically difficult for a state to institute higher charges for services if similar services are more heavily subsidized in other states. National committees and commissions that have studied the question of appropriate levels of user charges for individual services have tended to prescribe certain rates of return without, for example, reviewing the feasibility and implications of marginal cost pricing. A comprehensive examination of user charges in the broader context of efficient pricing would be useful.

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Table 8.1

Summary of Gujarat's Public Finances, 1986-87 and 1987-88*(million rupees)*

	<i>Revised Estimates 1986-87</i>	<i>Budget Estimates 1987-88^a</i>
1. Current Revenue	23,367.7	26,120.4
Tax receipts	15,358.3	17,933.5
State's own taxes	(12,051.4)	(14,415.1)
Share in central taxes	(3,306.9)	(3,516.4)
Non-tax receipts	8,009.4	8,186.9
Grants from the Centre	(2,958.7)	(2,675.5)
Own non-tax receipts	(5,050.7)	(5,511.4)
2. Current Expenditure	25,244.3	26,544.8
3. Current Account Surplus (1 minus 2)	-1,876.6	-434.4
4. Capital Disbursements	5,914.5	6,622.7
Capital expenditure	2,952.7	4,025.6
Loans and advances	2,961.8	2,597.1
5. Financing (4 minus 3)	7,791.1	7,047.1
Loans from the Centre	3,815.6	4,362.3
Domestic loans	1,498.0	566.8
Recoveries of loans and advances	684.5	615.0
Provident Funds	370.0	400.0
Other	1,423.0	1,103.0

^aIncluding effects of new budget proposals.

Source: Gujarat State Budget documents.

Table 8.2

Receipts from the State's Own Taxes

	<i>(percent of total)</i>
Tax on professions, trades, etc.	1.7
Land Revenue	1.8
Stamp and Registration fees	4.1
State Excise	0.5
Sales Tax	66.4
General sales tax (including tax on motor spirits)	(53.5)
Central sales tax	(12.9)
Taxes on vehicles	3.7
Taxes on goods and passengers	5.5
Electricity duties	10.8
Entertainment tax	3.1
Other	2.4

Source: Gujarat State Budget documents.

Table 8.3

Current Nontax Revenues, 1986-87

	<i>(percent of total)</i>
Interest Receipts	40.5
Dividends	6.9
Social and Community Services	5.6
of which: Education	(1.9)
Health	(2.1)
Economic Services	42.4
of which: Irrigation	(1.9)
Forests	(3.8)
Mines and Minerals	(31.3)
Other	4.6

Source: Gujarat State Budget documents.

Table 8.4

Current Expenditures by Function, 1986-87

	<i>(percent of total)</i>
<i>Social and Community Services</i>	41.8
of which: Education	(20.5)
Health	(3.5)
Water Supply and Sanitation	(5.0)
Social Security and Welfare	(5.0)
<i>Economic Services</i>	35.0
of which: Agriculture and Allied services ^a	(6.1)
Community Development	(3.6)
Water and Power Development Services	(4.1)
Irrigation	(10.5)
Roads and Bridges	(6.5)
<i>Interest Payments</i>	9.5
<i>Other</i>	13.7

^aExcluding forests, community development and irrigation.

Source: Gujarat State Budget Documents.

Table 8.5

Capital Expenditures by Function, 1986-87

	<i>(percent of total)</i>
<i>Social and Community Services</i>	19.4
of which: Education	(0.8)
Health	(1.0)
Water Supply and Sanitation	(9.8)
Social Security and Welfare	(1.2)
Housing	(3.3)
Urban Development	(1.9)
<i>Economic Services</i>	79.5
of which: Agriculture and Allied services ^a	(0.7)
Irrigation	(45.7)
Forests	(8.3)
Industry and Minerals	(12.4)
Roads and water transport services	(8.0)
<i>Other</i>	1.1

^aExcluding forests, community development and irrigation.

Source: Gujarat State Budget Documents.

Table 8.6

Annual Plan, 1987-88*(million rupees)*

	<i>Capital Disbursements</i>	<i>Current Expenditures</i>	<i>Total</i>
Agriculture and Allied Services	376.8	355.7	732.5
Rural Development	--	294.4	294.4
Irrigation and Flood Control	2,943.0	222.0	3,165.0
Energy	3,058.0	42.0	3,100.0
Industries and Minerals	383.3	233.7	617.0
Transport	691.1	50.5	741.6
Science, Technology and Environment	1.6	2.9	4.5
General and Economic Services	56.2	385.2	441.4
Social Services	851.2	1,652.4	2,503.6
of which: General Education			(182.2)
Technical Education			(48.6)
Health			(205.0)
Water Supply and Sanitation			(520.0)
Housing			(290.0)
Urban Development			(120.0)
Welfare of Scheduled Tribes, etc.			(240.0)
Mid-day Meals Program			(600.0)
<i>Total Annual Plan</i>	8,361.2	3,238.8	11,600.0
<i>Central Assistance for Centrally Sponsored Plan Schemes</i>			1,530.0
<i>Total Development Program</i>			13,130.0

Source: Government of Gujarat (1987).

Table 8.7

Central Transfers to Gujarat 1987-88^a

	<i>(million rupees)</i>
<i>Shared Taxes</i>	3,518.4
Union Excise Duties ^b	2,371.4
Income Tax	1,147.0
<i>Other Nonplan Assistance</i>	3,566.1
Grant in lieu of railway passenger fares	63.4
Grants from the Central Road Fund	9.0
Relief for natural calamities	--
Small Savings Loans	3,300.0
Other (Grants and Loans)	193.7
<i>Plan Assistance</i>	4,845.4
State Plan Schemes	3,203.3
Loans	(2,022.7)
Grants	(1,180.6)
Centrally sponsored schemes	1,642.1
Loans	(243.1)
Grants	(1,399.0)
<i>Total</i>	11,929.9

^aBudget Estimates.

^bIncluding additional excise duties.

Source: Gujarat State Budget Documents.

Table 8.8

Summary of Gujarat's Public Finances, Selected years

(million rupees)

	1973-74	1978-79	1984-85	1986-87 ^a
<i>Current Receipts</i>	3,363.9	6,743.9	17,694.6	23,367.7
Tax receipts	2,098.6	4,696.6	12,862.1	15,358.3
State's' Taxes	(1,511.9)	(3,726.2)	(9,800.2)	(12,051.4)
Share in central taxes	(586.7)	(970.4)	(3,061.9)	(3,306.9)
Own non-tax receipts	699.4	1,241.3	3,319.5	5,050.7
Grants from the Centre	565.9	806.0	1,513.0	2,958.7
<i>Expenditures</i>	4,439.0	8,406.6	23,414.6	31,158.8
Current	3,366.8	6,033.6	17,012.0	25,244.3
Capital ^b	1,072.2	2,373.0	6,402.6	5,914.5
<i>Current Budget Surplus/Deficit^c as percentage of SDP</i>	-2.9	710.3	682.6	-1,876.6
<i>Current Receipts</i>	10.6	13.5	16.6	
Tax receipts	6.6	9.4	12.1	
State's taxes	(4.8)	(7.5)	(9.2)	
Share in central taxes	(1.8)	(1.9)	(2.9)	
Own non-tax receipts	2.2	2.5	3.1	
Grants from the Centre	1.8	1.6	1.4	
<i>Expenditures</i>	14.0	16.9	22.0	
Current	10.6	12.1	16.0	
Capital ^b	3.4	4.8	6.0	
Current Budget Surplus ^c	--	1.4	0.6	

^aRevised Estimates.^bIncluding loans and advances.^cCurrent receipts less current expenditures.

Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table 8.9

Trends in the Gujarat's Expenditures

	Capital Expenditure ^a		Current Expenditure		
	As percent of GDP	In 1973-74 Prices (Rs. million)	As percent of GDP	In 1973-74 Prices (Rs. million)	Per capita in 1973-74 prices (Rs.)
1973-74	3.4	1,072.2	10.6	3,366.8	118.1
1974-75	5.4	1,299.4	11.6	2,772.0	95.3
1975-76	3.3	903.0	10.3	3,044.5	102.2
1976-77	4.4	1,377.1	11.2	3,971.1	130.2
1977-78	4.9	1,652.3	10.3	3,800.1	121.4
1978-79	4.8	1,563.2	12.1	4,557.1	142.4
1979-80	6.0	1,947.8	13.1	5,168.5	157.6
1980-81	6.1	2,049.4	13.6	5,631.3	167.6
1981-82	5.3	1,924.0	12.9	5,760.3	167.0
1982-83	6.0	2,101.2	15.0	6,599.9	187.0
1983-84	5.9	2,209.5	14.3	6,517.9	180.1
1984-85	6.0	2,197.9	16.0	7,307.6	197.5
1985-86	N.A	1,529.8	N.A	7,953.2	N.A

^aIncluding loans and advances.

Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table 8.10

Composition of Current Expenditures, Selected Years*(percent of total current expenditures)*

	1973-74	1978-79	1984-85	1986-87 ^d
<i>General Services</i>	30.4	30.2	23.3	22.6
of which: Interest payments	(7.3)	(7.8)	(8.6)	(9.5)
<i>Social and Community Services</i>	43.9	40.6	43.9	41.8
of which: Education, Research, etc.	(17.8)	(24.0)	(24.5)	(20.6)
Health, Water Supply, etc.	(8.0)	(9.7)	(8.8)	(10.0)
Social Security and Welfare	(3.1)	(3.7)	(4.7)	(5.0)
<i>Economic Services</i>	24.2	28.5	32.3	35.0
of which: Agriculture and allied services ^b	(3.9)	(8.3)	(5.8)	(6.1)
Irrigation	(8.1)	(5.3)	(7.1)	(10.5)
Transport and Communications	(5.9)	(2.5)	(5.9)	(6.5)
<i>Other</i>	1.5	0.7	0.5	0.6
<i>Per capita Expenditures in 1973-74 prices (Rs.)</i>				
Education, Research, etc.	21.0	34.2	48.4	
Health, Water Supply, etc.	9.5	13.9	17.3	
Agriculture	4.6	11.9	11.4	
Irrigation	9.6	7.5	13.9	
Transport and Communications	7.0	3.5	11.7	

^aRevised Estimates.^bExcluding forests, community development and irrigation.

Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table 8.11

Growth of Current Expenditures, 1984-85 to 1986-87

	(million rupees)		
	1984-85	1986-87 ^a	Annual rate of increase (%)
<i>General Services</i>	3,961.2	5,711.7	20.1
Administration of Justice	118.0	147.8	11.9
Tax collection	245.0	282.1	7.3
Police	989.0	1,363.0	17.4
Interest Payments	1,463.5	2,388.8	27.7
Other	1,145.7	1,530.0	15.6
<i>Social and Community Services</i>	7,470.2	10,551.9	18.8
Education	4,147.2	5,179.5	11.8
Public Health (Medical)	692.6	888.7	13.3
Family Welfare	295.8	389.0	14.7
Sanitation and Water Supply	502.7	1,259.6	58.3
Housing and Urban Development	331.3	358.1	4.0
Labor and Employment	395.8	544.8	17.3
Social Security and Welfare	801.8	1,264.9	25.6
Relief of Natural Calamities	202.3	528.5	61.6
Other	100.7	138.8	17.4
<i>Economic Services</i>	5,491.2	8,834.3	26.8
Agriculture and allied services	2,459.6	3,938.3	26.5
of which: Minor Irrigation	(241.9)	(1,303.8)	132.2
Industry	120.5	421.3	87.0
Water and Power Development	1,604.1	2,395.6	22.2
of which: Multipurpose River projects	(133.2)	(207.8)	24.9
Irrigation, drainage, etc.	(843.6)	(1,137.2)	16.1
Transport and Communications	1,010.3	1,648.9	27.8
of which: Roads and Bridges	(998.1)	(1,631.5)	27.1
Other	296.7	429.7	20.3
<i>Other</i>	89.4	146.3	27.9
TOTAL	17,012.0	25,244.3	21.8

^aRevised Estimates.

Source: Gujarat State Budget documents.

Table 8.12

Trends in Receipts from the State's Own Taxes

	1973-74	1978-79	1984-85	1986-87
Receipts from the state's own taxes:				
Percent of tax receipts	72.0	79.3	76.2	78.5
Percent of current receipts	44.9	55.3	55.4	51.6
Percent of SDP	4.8	7.5	9.2	N.A
Receipts in current prices (Annual rate of growth)	--	19.8	17.5	10.9
Receipts in 1973-74 prices (Rs. million)	1,511.9	2,814.4	4,209.7	N.A
Per-capita receipts in 1973-74 prices (Rs.)	53.0	87.9	113.8	N.A

Source: Reserve Bank of India Bulletin.

Table 8.13

Composition of Gujarat's Tax Revenues, Selected Years

	<i>(percent of total)</i>			
	1973-74	1978-79	1984-85	1986-87 ^a
Major Direct Taxes	5.2	3.6	3.3	3.5
Land Revenue	5.2	1.9	1.7	1.8
Profession tax	-	1.7	1.6	1.7
Major Indirect Taxes	93.7	94.4	93.3	94.1
Stamps and Registration fees	5.6	5.8	4.5	4.1
Sales Tax	62.2	63.1	62.2	66.4
State Excise Duties	0.6	0.7	0.5	0.5
Taxes on Vehicles	5.9	4.7	4.0	3.7
Taxes on goods and passengers	8.5	7.6	6.9	5.5
Electricity duties	6.4	8.0	11.0	10.8
Entertainment tax	4.5	4.5	4.2	3.1
Other	1.1	2.0	3.4	2.4

^aRevised Estimates.

Source: Reserve Bank of India Bulletin and Gujarat State Budget documents.

Table 8.14

Buoyancy of the State's Taxes and Other Current Receipts

	<i>Buoyancy Coefficient</i>	<i>t Value</i>	<i>R²</i>
State's own taxes	1.37	22.11	0.98
Share in central taxes	1.25	13.05	0.94
<i>Total tax revenue</i>	1.34	23.05	0.98
Own non-tax revenues	1.17	21.88	0.98
Grants from the Centre	1.12	8.26	0.86
<i>Total non-tax revenue</i>	1.15	20.12	0.97
<i>Total current revenues</i>	1.28	33.67	0.99
Own current revenues	1.32	25.33	0.98
<i>Different state taxes</i>			
Stamps and registration fees	1.31	14.27	0.95
Land Revenue	0.74	7.45	0.83
Sales Tax	1.37	18.01	0.97
General (state) sales tax	(1.31)	(18.63)	(0.97)
Central sales tax	(1.38)	(11.78)	(0.93)
Sales tax on motor spirits	(1.83)	(13.19)	(0.94)
State excise duties	1.33	8.85	0.88
Taxes on vehicles	1.11	23.72	0.98
Taxes on goods and passengers	1.09	4.38	0.62
Electricity duties	1.81	21.05	0.98
Profession tax ^a	1.40	10.50	0.93
Entertainment tax	1.34	23.83	0.98

^aBased on data for 1976-77 to 1984-85.

Note: Buoyancy coefficients were estimated from the double-log function $\log x = \log a + b \log y$, where x represents receipts, y represents SDP, and b is the buoyancy coefficient. Unless otherwise stated, data for 1973-74 to 1984-85 were used.

Table 8.15

Trends in Central Transfers to Gujarat

(percentages)

	1974-75 ^a	1978-79	1984-85	1986-87 ^b
<i>As a percentage of the State's current receipts</i>				
Receipts of central tax revenues	16.9	14.4	17.3	14.1
Central grants	9.3	12.0	8.6	12.7
Total	26.2	26.2	25.8	26.8
<i>As a percentage of the state's capital disbursements</i>				
Central Loans (gross) as % of the state's capital disbursements ^c	35.2	41.5	50.0	97.9
Central Loans (net) as % of the state's capital disbursements ^c	19.5	20.5	38.2	75.9
<i>As a percentage of the state's total expenditures</i>				
All central transfers (gross)	30.3	32.9	33.2	38.7
All central transfers (net)	25.3	26.9	30.0	34.5

^a1974-75 has been used as the base year because central transfers were unusually high in 1973-74.

^bRevised Estimates.

^cCapital disbursements include loans and advances.

Source: Reserve Bank of India Bulletin.

Table 8.16

Composition of Central Transfers to Gujarat, Selected Years*(million rupees)*

	1973-74	1978-79	1984-85	1987-88 ^a
<i>Share in Central Taxes</i>	586.7	970.4	3,061.9	3,518.4
Income Tax	272.0	392.2	736.9	1,147.0
Estate Duty	8.7	50.0	18.5	--
Union Excise Duty	306.0	573.2	2,306.5	2,371.4
<i>Nonplan Assistance</i>	758.3	413.5	1,994.3	3,566.1
Grants	265.0	73.6	43.7	95.9
Grants for Natural Calamities	(227.5)	(--)	(--)	(--)
Other	(37.5)	(73.6)	(43.7)	(95.9)
Loans (gross)	493.3	339.9	1,950.6	3,470.2
Loans for Natural Calamities	(335.0)	(--)	(--)	(--)
Share of Small Savings	(153.4)	(283.8)	(1,843.2)	(3,300.0)
Other	(4.9)	(56.1)	(107.4)	(170.2)
<i>Plan Assistance</i>	710.8	1,278.2	2,718.4	4,845.4
Grants	300.9	732.4	1,469.3	2,579.6
State Plan Schemes	(118.4)	(284.1)	(515.1)	(1,180.6)
Central Plan Schemes	(32.8)	(130.3)	(294.9)	(--)
Centrally Sponsored Schemes	(149.7)	(318.0)	(659.3)	(1,399.0)
Loans (gross)	409.9	545.8	1,249.1	2,265.8
State Plan Schemes	(330.4)	(513.6)	(1,192.0)	(2,022.7)
Central Plan Schemes	(11.7)	(18.9)	(43.5)	(--)
Centrally Sponsored Schemes	(67.8)	(13.3)	(13.6)	(243.1)
<i>Ways and Means Advances</i>	--	100.0	-	-
Total	2,055.8	2,762.1	7,774.6	11,929.9

^aBudget Estimates.

Source: Reserve Bank of India Bulletin and budget documents.

Table 8.17

Rates of Sales Tax on Selected Commodities*(percentage of price)*

Coal	4
Cotton yarn	6
Iron and steel and products	4
Crude petroleum oil	4
Agricultural machinery	6
Chemical fertilizers	4
Kerosene	3
Ready-made garments	3
Sweets and sweetmeats	10
Sheets, bars, rods, etc. of non-ferrous metals and alloys	6
Betel nuts	5
Sewing machines	4
Soap	8
Bicycles	6
Jewellery	10
Machinery used in the manufacture of goods	6
Domestic electrical appliances	15
Hydrogenated vegetable oils	8
Coffee and tea	10, 15
Paints and varnishes	15
Footwear (with price of above Rs. 40 per pair)	10
Non-alcoholic beverages	12
Furniture	6
Motor vehicles	10
Cameras	15
Refrigerators	12
Radios and gramophones	15
Duplicating machines and tape recorders	15
Television sets	3
Tractors	2
Cement	12

Source: Gujarat Finance Department; Janab (1985); and the Budget Speech for 1991-92.

Table 8.18

Rates of Electricity Duty

1. Residential premises	
(a) rural areas	20% of charges
(b) urban areas	25% to 40% of charges depending on consumption
2. Specified commercial undertakings	25% of charges
3. Cinema or theatre	45% of charges
4. Undertaking engaged in manufacturing food or drinks (for consumption on the premises of the undertaking)	10 paise per unit
5. Industrial undertaking, and an undertaking engaged in construction of factory buildings and installation of plant and machinery	
(a) high tension energy	20% of charges
(b) low tension energy	10% of charges depending on the load
6. Pumping of water for irrigation	5% of charges
7. Other	60% of charges

Source: Gujarat State Finance Department.

Table 8.19

Rates of Entertainment Tax

(percent of admission charge)

Admission charge	Localities with population under 100,000	Localities with population over 100,000
First Re 1 or any part thereof	35	40
Next Re 1 or any part thereof	45	50
Next Re 1 or any part thereof	55	60
Next Re 1 or any part thereof	55	60
Remainder	60	65

Source: Gujarat Finance Department.

Table 8.20

Receipts from User Charges in Relation to Current Expenditures, 1987-88^a

(million rupees)

	Receipts from user charges	Current expendi- ture	Receipts as per cent of current expenditure
<i>Education</i>	97.1	5,032.0	1.9
Elementary	10.2		
Secondary	7.6		
University and other higher	40.0		
Technical	12.5		
Other	26.8		
<i>Medical and Public Health</i>	127.9	1,235.9	10.3
Hospital and dispensary charges	3.0		
Receipts from Employees' Insurance Scheme	103.3		
Tuition and fees for medical education	2.3		
Other	19.3		
<i>Agriculture^b</i>	41.6	822.4	5.1
Crop Husbandry	7.5		
Animal Husbandry	8.2		
Fisheries	5.0		
Other	14.0		
<i>Irrigation</i>	90.4	2,179.9 ^c	4.1
Major and medium irrigation	80.8		
Minor Irrigation	9.6		
TOTAL	57.0	9,270.2	3.9

^aBased on Budget Estimates.^bIncluding receipts from sale of goods. Forestry has been excluded because the bulk of the receipts are from the sale of timber.^cIncluding interest payments of Rs. 2,089.1 million. Excluding these payments, current expenditures on irrigation amount to Rs. 90.8 million.

Source: Gujarat State Budget documents.

Chapter 9

State Finances in Kerala

R. RAMALINGOM AIYAR AND K. N. KURUP

The state of Kerala, situated at the southernmost tip of the Indian subcontinent, occupies a unique position in many respects. With 1.19 percent of the total land area in India, the state has to support 3.7 percent of the country's population. It was the most densely populated state in India according to the 1981 census and second after West Bengal in the 1991 census. The state's population density was 747 persons per sq km in 1991. Kerala had the highest economic growth rate in the country until 1971, but it has fallen behind the national average since then. The state's population as per the 1991 census provisional figures was 290.11 lakhs, with a sex ratio of 1040 women for every 1000 men, indeed a unique feature in India.

Life expectancy at birth in Kerala was 67 years for men and 70 years for women in 1988, as against the all-India levels of 55 and 54 years respectively. The infant mortality rate in Kerala dropped to 24 per 1000 live births in 1988, whereas the all-India rate was as high as 94. The state achieved a 50 percent reduction in its birth rate and a 65 percent reduction in the death rate during the last three decades. The birth rate was 19.9 per thousand and the death rate 6.0 per thousand in 1988.

Kerala has the highest literacy rate of any state, 81.56 percent in 1981 and 90.59 percent in 1991, as against 52.11 percent for the country as a whole in the latter year. Out of the 14 districts in the state, four have the distinction of having achieved total literacy in 1991.

Table 9.1 shows selected indicators of development. The state's

achievements are quite good under electrification of villages, road length per 100 sq km area, school enrollment of children in the age groups 6-11 and 11-14, hospital beds per lakh of population, bank offices per lakh of population, population below the poverty line, etc.

This chapter is divided into nine parts, covering the following topics: (1) an overview, (2) the overall revenue budget, (3) revenue receipts, (4) the state's own tax revenue, (5) nontax revenue, (6) revenue expenditure, (7) wage bill, (8) revenue transfers from the central government, and (9) externally aided projects. A comparative analysis of certain important aspects of Kerala's state finances with that of the other southern states and with the all-states average also is attempted, depending on the availability of data.

AN OVERVIEW

The development experience of Kerala presents certain paradoxical features. Kerala's per-capita income growth has been rather poor and persistently below the national average. At the same time the physical quality of life, as indicated by lower infant mortality, low death rates, high life expectancy, and the higher literacy rate attained by the state, is way ahead of all other regions in the country. Thus a state with relatively low per-capita income has levels of some social indicators that are in line with the performance of developed countries. An inevitable consequence of the high literacy rate is high incidence of unemployment, which curiously is accompanied by relatively high wage rates. The dependence of its population to a very great extent on small agriculture (more than 80 percent of the holdings are less than 0.2 hectare in size) and the absence of a well developed industrial sector have made Kerala a problem state, however, especially on the fiscal side.

At the core of this development paradox is the structural profile of the state's economy, with its fragile base and low growth of commodity producing sectors. The average annual rate of growth of state income from the primary sector was -0.43 percent, compared to the all-India rate of growth of 4.5 percent during the period from 1961-62 to 1988-89. Similarly, the annual rate of growth of state income in the secondary sector was only 3.5 percent, compared with the all-India figure of 6.9 percent. Growth in the secondary sector was largely accounted for by construction and power rather than by manufacturing, the share of which in state domestic product (SDP) is only 15.4 percent at present. As against an annual growth rate of 10.6 percent for all manufacturing in India as a whole (at 1980-81 prices),

the growth rate achieved by Kerala was only a meager 1.7 percent p.a. between 1980-81 and 1987-88. The slow and lopsided growth of SDP has been a major factor limiting the expansion of productive employment opportunities, leading to a rise in the incidence of unemployment. The state's capacity to generate adequate budgetary resources for accelerating economic development also has been adversely affected by the pattern of growth. The share of the tertiary sector in state income has risen significantly during the past three decades, which is somewhat in line with the all-India pattern. But the fact is that such a sectoral transformation is not based on industrialization acting as a springboard to stimulate growth in the tertiary sector. Clearly the process of development that has taken place is not conducive to sustaining Kerala's achievements in the social aspects of development.

The sluggish growth of the economy has created a vicious circle, as it coincided with a marked slowdown in plan activities, with per-capita plan investment remaining much below the national average. The growth in plan outlays, both in absolute terms and in per-capita terms, has been grossly inadequate to support the required level of economic growth. This disparity has been more pronounced in the past two decades. The comparative position of per-capita plan outlays is shown in Table 9.2. Lately, however, the state has shown a remarkable recovery in plan investment and particularly a change in its direction, with a view to narrowing the gap between the state's per-capita plan investment and the national average on the one hand and accelerating the pace of economic growth on the other, largely through prudent management of the finances of the State.

Kerala's inability to raise its per-capita plan outlay squarely rests on its failure to generate adequate budgetary saving. Kerala's overall budgetary position for selected years is shown below:

	1957-58	1974-75	1975-76	1976-77	1980-81	1985-86	1986-87	1987-88	1988-89	1989-90
Budgetary surplus (+) or deficit (-)	+8.4	+12.0	-15.0	-14.0	-67.0	+122.0	-169.0	-6.0	+14.0	-55.0
Ratio to SDP (percent)	+2.6	+0.6	-0.7	-0.6	-1.9	+1.8	-2.3	-0.1	+0.0	-0.1

The state's budgetary deficit as a share of SDP reached a peak of -2.3 percent in 1986-87. The magnitude of this deficit was especially

serious, as that financial year had commenced with a large opening surplus primarily due to large transfers during the previous year to cover the deficit carried over from 1984-85. The overall budgetary position from 1974-75 to 1989-90 is presented in Table 9.3. The revenue account of Kerala showed a deficit for ten years out of 16 years during this period, as against five years each for Karnataka and Tamil Nadu and six years for all states taken together. The revenue account positions of the southern states, Maharashtra, and the average for all states are shown in Table 9.4. In 1989-90, Kerala accounted for 2.1 percent of the total revenue deficit of Rs. 2,633 crores in 18 states. During 1990-91 and 1991-92, however, the revenue account of Kerala is expected to show larger deficits of Rs. 321 crores and Rs. 400 crores respectively.

Kerala's capital budget, on the other hand, showed a surplus in a number of years (see Table 9.5). During the period from 1974-75 to 1989-90, Kerala had a capital surplus in eight years and a deficit in an equal number of years. But since 1980-81, there has been a deficit on capital account only in four years and a surplus in six years. In contrast, Karnataka had a deficit on capital account in 14 years, Tamil Nadu in seven years, Andhra Pradesh in 12 years, and the all-states average in 12 years of the 16-year period from 1974-75. Thus Kerala and Tamil Nadu financed their revenue deficits partly or fully from surpluses on capital account in a larger number of years than the other two southern states and also all states together. Kerala's failure to achieve surpluses on revenue account had an adverse impact on the growth of per-capita plan outlay. This was above the all-states average during the Third and Fourth Five Year Plans, but since then Kerala has fallen behind, and the gap compared with the all-states average has steadily widened (see Table 9.6), reaching Rs. 299 in the Seventh Plan (29.1 percent).

REVENUE ACCOUNT

The fact that the revenue budget of Kerala was in the red for most of the years covered by this study shows the inherent weakness of the state's finances. The magnitude of the revenue deficit grew in size during the Seventh Five Year Plan period and in the subsequent two years, largely as a result of rapid growth of revenue expenditure. While the trend growth of revenue receipts in Kerala, including the yield from additional resources raised during the 16-year period 1974-90, has been estimated at 14.0 percent, growth of revenue expenditure was 15.1 percent. During 1980-90 the gap between

expenditure and revenue growth was more striking (15.5 percent versus 13.7 percent). Such a trend, however, was also evident, though to a lesser degree, in the other southern states, Maharashtra, West Bengal, and the all-states average. Though conceptually, a surplus was expected to be generated within the nonplan revenue account, Kerala resorted to heavy doses of deficit financing to meet its nonplan revenue expenditures, more than other states.

Revenue deficits emerged in Kerala and Tamil Nadu for two years during the Fifth Plan period. While Tamil Nadu ceased to have a revenue deficit from 1978-79 until 1987-88, Kerala had deficits during three years of the Sixth Plan and all five years of the Seventh Plan. Except for one year, there has been a continuous revenue deficit from 1983-84 to 1989-90 in the case of Andhra Pradesh, and in Karnataka except for two years. Revenue deficits emerged for all states taken as a group for the first time in 1987-88, and they continued in 1988-89 and 1989-90.

Among the southern states, the revenue deficit has been more serious for Kerala, as can be seen from the ratios of revenue deficits to total revenue expenditure (in percentage terms):

	1985-86	1986-77	1987-88	1988-89	1989-90
Kerala	-5.05	-9.12	-10.89	-7.96	-10.88
Karnataka	-4.00	+3.58	-4.12	-0.96	-3.44
Tamil Nadu	+7.71	+3.75	-8.39	-8.47	-6.97
Andhra Pradesh	-2.16	+5.76	+1.08	-1.65	-3.13

Except in 1988-89, the ratio of the revenue deficit to total revenue expenditure during the Seventh Plan period was highest in Kerala. In 1987-88 and 1989-90, revenue deficits financed as much as 11 percent of revenue expenditure. In 1990-91 the ratio of revenue deficit was expected to increase further to 11.4 percent.

Revenue deficits in Kerala were compounded by deficits on capital account in eight out of the 16 years covered in this paper. Deficits on both revenue and capital account occurred in five years; deficits on revenue account and surpluses on capital account in another five years, surpluses on revenue account and deficits on capital account during three years. The position in Kerala along with that of other states is shown in Tables 9.4 and 9.5. Clearly, a major part of the revenue deficit was financed by surpluses generated on capital account, and in three years surpluses on revenue account could be

generated to finance capital expenditure. The other southern states generated revenue account surpluses in most years to finance the deficit on capital account. Given the fundamental fiscal situation faced by the state, Kerala has perforce had to adopt the unhealthy practice of meeting revenue expenditure needs with borrowed funds. The increasing reliance on borrowed funds will further complicate the future debt servicing liability of the state, thereby leading to greater strain on the budget.

Thus Kerala has been facing a sort of fiscal crisis in most years, especially during the 1980s. The reasons for such a situation can be understood only by a detailed examination of the receipts and expenditure patterns of the Government.

REVENUE RECEIPTS

Receipts on revenue account comprise (1) the state's own tax and nontax revenue, and (2) central government transfers on revenue account through shared taxes and grants for plan and nonplan purposes. Time series data for Kerala's total revenue receipts as well as for all states during the period from 1974-75 to 1989-90 are presented in Table 9.7.

Kerala's aggregate revenue receipts rose from Rs. 288 crores in 1974-75 to Rs. 2077 crores in 1989-90, that is, by about 7.2 times, while revenue receipts for all states rose by 8.5 times. The index of Kerala's revenue receipts, which remained more or less at the same level as that of the all-states average until the early 1980s, started to fall behind from 1982-83 onward, and the gap has further widened since then. It is interesting to note that the index suffered a steep fall in 1982-83 but recovered in subsequent years, except perhaps in 1987-88. (These two years were affected by severe droughts.) Tamil Nadu has recorded more or less the same rate of increase in revenue receipts as Kerala, but in other states growth was more rapid.

The pattern of growth in revenue receipts is better understood by examining the trend growth rate, with the help of an exponential model of the following type:

$$Y_t = a b^t,$$

where $b = (1+r)$, Y represents revenue receipts, and t represents the time period which varies from 1 to 16. The growth rate r represents the percentage increase per annum. By applying this model, the values shown below are obtained.

States	Estimated values of the coefficient		Growth rate per annum (b-1)
	Log a	Log b	
Kerala	4.4232	0.0569	13.99
Andhra Pradesh	4.6583	0.0645	16.01
Karnataka	4.5563	0.0614	15.19
Tamil Nadu	4.6315	0.0624	15.45
Maharashtra	4.8872	0.0610	15.07
West Bengal	4.6111	0.0603	14.90
All States	5.7613	0.0624	15.45

The trend rate of growth in revenue receipts at current prices was the lowest in Kerala when compared to the other five states or to the all-states average.

The trend growth rate of Kerala's revenue receipts varied as between the 1970s and the 1980s. It was 15.12 percent p.a. in 1974-79 and dropped to 13.68 percent p.a. in 1980-90. Lower growth appears to have continued in 1990-91 and was also expected in 1991-92. Of course, individual sources of receipts registered varying rates of growth. But the fact that Kerala, with one of the highest tax-income ratios (generally the highest except in certain years when it fell below Tamil Nadu), suffered from declining growth of revenue receipts, must be mainly due to two factors. Its stagnant or declining nontax revenue contributed in a small measure to declining revenue growth, but the drop was largely due to a fall in central revenue transfers, particularly transfers on account of Finance Commission devolutions (discussed later in this chapter).

Another interesting index is that for per-capita revenue receipts, which also declined in recent years relative to the position in other states. Per-capita revenue receipts in 1974-75 were higher in Kerala than in the other southern states but below those of Maharashtra, while in 1980-81, 1985-86 and 1989-90, two other southern states collected more revenue in per-capita terms.

	<i>Per-Capita total revenue receipts (Rs.)</i>				<i>Increase between 1989-90 and 1974-75 (percent)</i>
	<i>1974-75</i>	<i>1980-81</i>	<i>1985-86</i>	<i>1989-90</i>	
Kerala	1129	2509	5374	8142	721
Karnataka	1111	2564	5415	9224	830
Tamil Nadu	1071	2637	5434	7923	740
Andhra Pradesh	982	2362	5177	8424	850
Maharashtra	1353	3240	6637	10950	810
All States	949	2405	4914	8097	852

Own Revenue

A state's own revenue comprises own tax revenue and receipts from own nontax sources; it does not include shares in central taxes and grants from the central government. Kerala's per-capita own revenue increased by 295 percent between the Fifth Five Year Plan and Seventh Five Year Plan, compared to 326 percent in Karnataka, 355 percent in Tamil Nadu and 368 percent in Andhra Pradesh (See Table 9.8). During the Fifth Plan period, Kerala's per-capita own revenue was higher than that of Andhra Pradesh and Tamil Nadu. Kerala's position in the Seventh Plan period was the lowest among the southern states, however. Kerala's per-capita own tax revenue was the highest during the Fifth Plan period, but it lost its position in subsequent plan periods, as Tamil Nadu and Karnataka overtook Kerala during the Sixth Plan period and remained ahead during the Seventh Plan period. A similar trend is seen in per-capita own nontax revenue, with Karnataka and Andhra Pradesh overtaking Kerala, which had topped the list during the Fifth Plan period.

The share of Kerala's own tax revenue in its total revenue receipts ranged between 54 percent and 58 percent between 1986-87 and 1989-90, compared to 53 to 57 percent in Karnataka, 60 to 61 percent in Tamil Nadu, 51 to 53 percent in Andhra Pradesh, and 44 to 45 percent for all states. From 1974-75 to 1979-80, the average annual compound growth rate of Kerala's own tax revenue was the highest among the southern states and also among all states. This trend was totally reversed during the 1980s, when Kerala's growth rate was the lowest among the southern states and also lower than the all-states average (see below).

Average annual growth of own tax revenue (percent)

	1974-75 to 1987-80	1980-81 to 1989-90
Kerala	16.37	15.22
Karnataka	9.29	16.60
Tamil Nadu	14.53	15.53
Andhra Pradesh	16.21	17.04
All States	15.39	15.75

The change in the growth rate for Kerala is accounted for by a decline in the growth rate of sales tax revenue from 16.5 to 15.4 percent per annum, in state excise from 16.8 to 10.5 percent, and in motor vehicles tax from 18.0 to 16.6 percent, as between the 1970s and the 1980s.

Sales Tax

Sales tax, by far the most important source of revenue for Kerala, just as for other states, accounts for more than 60 percent of total own tax revenue and 36 percent of total revenue receipts, compared to 55 percent and 30 percent for Andhra Pradesh and Karnataka and 62 percent and 41 percent respectively for Tamil Nadu. The contribution of sales tax revenue in Kerala has risen slightly from 60 percent in 1974-75 to 62 percent in 1989-90. As against this, the contribution of sales tax to total own tax revenue in Karnataka increased from 47 percent to 56 percent; in Andhra Pradesh from 45 percent to 55 percent; and from 62 percent to 67 percent in Tamil Nadu (Table 9.9).

Among the factors determining the growth of sales tax revenue in a state, the most important is changes in the level of consumption. The following table shows per-capita income and per-capita consumption expenditure for Kerala and for India as a whole in selected years.

	<i>Annual per capita consumption expenditure (Rs.)</i>		<i>Per capita income (Rs.)</i>		<i>Ratio of consumption expenditure to income (percent)</i>	
	<i>Kerala</i>	<i>India</i>	<i>Kerala</i>	<i>India</i>	<i>Kerala</i>	<i>India</i>
1965-66	271	365	380	427	71	86
1973-74	701	690	811	870	86	79
1977-78	922	925	1043	1194	88	77
1983-84	1838	1538	1951	2180	94	71

According to NSS consumer expenditure surveys, while Kerala stood seventh among 14 major states in per-capita consumption expenditure in 1970-71, by 1988-89 it ranked second among these states. A recent study on sales taxation in Kerala has revealed that the correlation between percentage changes in sales tax and percentage changes in state domestic product during the last two decades has been negative. The buoyancy and elasticity coefficients according to this study are shown below:

	<i>Buoyancy of sales tax</i>	<i>Elasticity of sales tax</i>
1960-61 to 1970-71	1.2598	1.1859
1970-71 to 1980-81	1.6394	1.3267
1980-81 to 1986-87	1.3464	1.0968

It is evident that compared to the 1970s, growth of sales tax revenue during the period from 1980-81 to 1986-87 was sluggish. The same study has also shown that shifting from the multi-point system to a single-point system in the latter half of the 1970s resulted in large-scale tax evasion. To prevent such evasion, in 1987 a few evasion-prone commodities were brought back under a double-point system, which yielded good results. The trade diversion taking place because of relatively high rates of tax on certain high-value items in Kerala caused the state government to take a number of steps to reduce and rationalize tax rates for some commodities during the last three years. This has resulted in higher collection figures. Total sales tax receipts in 1990-91 registered an increase of 17 percent over 1989-90, compared to an increase of 11 percent in 1989-90 over 1988-89.

Such success, however, does not imply that the state has tapped the full revenue mobilization potential of the sales tax. One indication is the accumulated arrears built up over the years, part of it under litigation and part stayed by the government. At the end of 1990-91 sales tax arrears were of the order of Rs. 262 crores. Around 50 percent of this amount consisted of arrears that were uncollectible due to a variety of reasons.

Apart from the fact that there is still scope for better enforcement of tax laws on the part of the state government, certain decisions taken by the central government from time to time are partly responsible for deceleration in the growth in sales tax revenue. The major "exogenous" factors adversely affecting the tax base of Kerala include the following:

- (1) Agriculture in Kerala is dominated by export-oriented cash crops such as cashews, coffee, tea, pepper, cardamom, ginger, turmeric, etc. All of these commodities were subjected to purchase taxes when sold either for local consumption or for export. Based on the amendment to the Central Sales Tax Act in 1976, these commodities were exempted from the tax in the case of sales for export. The resulting loss of revenue in 1979 was estimated at Rs. 23 crores, equivalent to 1/8 of total sales tax revenue.
- (2) The share of Central Sales Tax collections in total sales tax revenue is very low in Kerala compared to that in many other states, primarily because a smaller part of commodity production in Kerala enters interstate trade than in other major states. In 1988-89 (Revised Estimates), Central Sales Tax collections in Kerala were equivalent to 7.9 percent of total General Sales Tax revenues, compared with 22.3 percent for all states taken together and 17-19 percent in the other southern states.
- (3) Kerala accounts for 90 percent of the rubber produced in India. About 80 percent of this is sent to other states through consignment transfers, for which no tax can be levied under existing laws. A favorable decision on the states' longstanding demand for a tax on consignment transfers has yet to be taken, though some progress has been made in this regard.

State Excise Tax

There was a steep decline in the growth of excise revenue between 1974-75 and 1989-90. Around 70 percent of the revenue from excise duties is derived from auctioning of liquor shops. The major reasons for the fall in revenue growth include an inadequate supply of country liquor (supply depends on the state's policy on importing country liquor to meet the gap between demand and locally-produced supply); policy changes imposed by the major supplying states of Tamil Nadu, Karnataka, and Maharashtra; and inadequacy in the availability of molasses. The auctioning system for liquor shops was in vogue for a long time in Kerala. This was changed to a licensing system for a few years in the 1980s. Realizing that this change was resulting in loss of revenue, the government reverted to the auctioning system in 1987-88.

Land Tax

Special mention should be made of a major policy change

introduced by the state government with regard to the land tax in 1988-89, resulting in a significant increase in land tax revenues, which almost doubled in 1988-89 compared to 1987-88. Before independence, the government of Travancore State introduced the basic tax on land, which was a unique experiment in the country. All land in the state, irrespective of the category to which it belonged and regardless of tenure, was subjected to levy of basic tax. After 1956 the tax was fixed at a flat rate of Rs. 2 per acre. A revision in the rates could not be attempted until 1988-89 in view of the specific protective provisions relating to this tax in the Ninth Schedule of the Constitution. The Constitutional amendment in 1988-89 enabled the state government to fix higher rates for holdings above 0.1 acre.

Plantation tax is levied on seven major crops, such as coconuts, rubber, coffee, tea, and cardamom. The definition of standard hectare was modified in 1981-82, with the number of yielding trees to form a hectare increased from the earlier level. In the same year the exemption limit was also raised from two hectares to four hectares. These two decisions adversely affected the tax base considerably. In 1987-88 the exemption limit was restored except for coconut and arecanut, but the changed definition was maintained.

Agricultural Income Tax

Agricultural income tax is levied only in seven states in the country. Out of total national collections in 1987-88, Kerala's share was 15 percent, which increased to 24 percent in 1988-89 and to 27 percent in 1989-90. Agricultural income tax in Kerala is levied in accordance with the provisions of the Kerala Agricultural Income Tax Act of 1950, which is modelled on the Central Income Tax Act of 1922. The central statute was replaced by an Act in 1961, which underwent many changes subsequently. In Kerala, though revenue from agricultural income tax in 1957-58 was less than Rs. 2 crores, it accounted for about 14 percent of the state's total own tax collections. By 1980-81 the share had declined to 3.4 percent, and there was a further decline to 2.9 percent in 1985-86 and 1.3 percent in 1989-90.

Mounting arrears have been the main reason for slow growth of collections. In 1989-90 actual receipts from this tax totalled Rs. 16.50 crores, whereas arrears in that year were about Rs. 32 crores, which increased further to Rs. 40 crores as of the end of March 1990. The Agricultural Income Tax Act until recently contained a certain amount of arbitrariness which led to harassment in its operation, with opportunities for large-scale avoidance by manipulating expenses and transactions.

The cumbersome procedures involved in administration of the agricultural income tax, mounting arrears, and declining collections even in absolute terms caused the state government to appoint a committee in 1986 to examine the reasons for the decline in revenue collection and to recommend modifications in the law. The Committee's recommendations for a compounding system of tax collection up to 20 hectares, along with other modifications in the law, are considered to be a major departure from the existing income based assessment system. The recommendations of the Committee have been accepted with very minor modifications and steps are underway to implement them. A substantial increase in receipts is expected from 1991-92 onwards.

Stamps and Registration Fees

Revenue from this source includes receipts from sale of judicial and non-judicial stamps and the registration of documents. The share of revenue from sale of judicial stamps is very small. There was large-scale evasion of registration fees through gross understatement of real estate values. To combat evasion, the state government introduced a novel idea. Through a notification, the government took steps to fix the minimum value of land at varying rates for city, Municipal and Panchayat Areas. This has paid handsome dividends, and revenue from stamps and registration fees shot up from Rs. 67 crores in 1987-88 to Rs. 113 crores in 1989-90, a jump of 69 percent.

Despite the fact that the rate of growth of Kerala's own tax revenue has declined over the years, the state is still one of the highest-taxed states in India. The tax-income ratio went up steadily until 1981-82, then slid down in 1982-83 and 1983-84 but regained ground in 1984-85. During the Seventh Five Year Plan period, the ratio remained consistently above 11 percent and touched 11.8 percent in 1989-90. Table 9.10 shows that only Tamil Nadu had a higher tax effort than Kerala until 1986-87; even it fell behind Kerala in 1987-88. Similarly the elasticity of tax effort was the highest in Kerala during the period 1970-71 to 1985-86. The elasticity of tax effort, defined as incremental receipts from taxes for every one rupee increase in income (SDP) in the period 1970-71 to 1985-86, was 2.58 for Kerala, 2.37 for Karnataka, 2.04 for Tamil Nadu, and 2.30 for Andhra Pradesh.

The major reason for the declining growth rate of revenue is the accumulation of arrears in collections. As of the end of March 1989, total tax arrears amounted to Rs. 537 crores. Sales tax, agricultural income tax, taxes on goods and passengers, and electricity duty accounted for most arrears. Efforts to realize a reasonable portion of

these outstanding arrears would substantially strengthen the resource position of the state.

Nontax Revenue

Kerala's nontax revenue growth has decelerated in recent years, particularly since 1982-83. Performance during the Seventh Five Year Plan was still worse. The share of own nontax revenue in own revenue in Kerala declined almost consistently during the period 1974-75 to 1989-90. It stood at 30.9 percent in 1974-75 and fell to 14 percent in 1989-90 (Table 9.11). The decline in this ratio for Karnataka and Andhra Pradesh was of a lower order, whereas Tamil Nadu improved its position in 1986-87, only to decline in 1989-90. The main components generating the decline in the rate of growth of nontax revenue in Kerala are: (1) revenue from forests, (2) interest receipts, (3) profits and dividends from departmental undertakings, (4) irrigation receipts, and (5) fees and fines.

The state's own nontax revenue originates principally from three sources, namely economic services, interest receipts, and miscellaneous general services. There has been a decline in interest receipts in recent years, largely due to defaults by state public undertakings. The decline in revenue from forests is a direct result of the decision by the central government on forest protection measures to preserve forest wealth. According to revenue records, 1,082 lakh hectares, constituting 27.8 percent of the total land area, is under forests in Kerala. There is already large-scale denudation of forests, not only in Kerala but in other states, too. Short-term interests should not be pursued beyond a limit which would be detrimental to the eco-system. Revenue from forests, which accounted for about a quarter of Kerala's own nontax revenues at the beginning of the 1980s, declined to nine percent in 1989-90 and an estimated seven percent in 1990-91.

Interest receipts went up from Rs. 9.8 crores in 1983-84 to a peak level of Rs. 38.34 crores in 1987-88; thereafter they steadily declined and reached a low of Rs. 18 crores in 1989-90. Outstanding loans and advances by the state government as of the end of 1989-90 totalled Rs. 333.30 crores. Thus interest receipts represented only 5.4 percent of outstanding loans and advances, against an effective rate of interest of 10-12 percent paid by the state government, which implies an interest subsidy of over 50 percent.

In an effort to tap sources of nontax revenue, the state government introduced lotteries a long time ago. Kerala has been a pioneer in this field, mobilizing substantial revenue from the lotteries it runs. Revenue from lotteries increased by almost five times between

1982-83 and 1987-88. The state's total own nontax revenue was Rs. 174 crores, of which collections from state lotteries amounted to Rs. 47 crores, or 27 percent. The net collection in that year was Rs. 13 crores, which was expected to double to Rs. 26 crores in 1991-92. Thus the criticism from certain quarters that Kerala is concentrating more and more on taxation and is neglecting to tap nontax sources is not very correct. But it is conceded that there are still some grey areas such as education, irrigation, health, etc., where collections have been stagnating for the last two decades. There is tremendous scope for raising additional resources from these sources.

School education, up to the 10th standard, is free in Kerala for all classes of people. With a view to spreading literacy, school education was made free in the early 1950s. (In many other states, this facility is confined only to girl students.) Subsequently direct payment of salaries and pensions to teaching and non-teaching staff of aided schools and colleges was introduced. This no doubt created a heavy financial liability for the government over the years. The budgeted revenue expenditure on education for 1991-92 was Rs. 797 crores. Revenue collected from this sector by way of fees and other charges was expected to be only about Rs. 22 crores in 1991-92, which would cover only 2.8 percent of the total cost. Tuition and other fees charged at higher education levels are at old rates fixed as early as the 1960s. The state has already achieved the national goal of making its citizenry literate; according to the 1991 census the literacy rate has reached 90.5 percent. A total literacy program is being implemented in the state. Since education is the one activity that uniformly touches the sentiments of all classes of people, a decision to impose new fees or raise existing rates of fees, even for higher education, may not be an easy task. Nevertheless, a change is absolutely necessary, for which public acceptance will have to be mobilized.

Similarly, charges levied for health care services are very low, and in many cases free services are provided. Total revenue from health was likely to be only Rs. 12.80 crores in 1991-92, against a budgeted revenue expenditure of Rs. 317 crores; hence receipts meet only four percent of expenditure. Here again, all classes of people enjoy the benefits of free or low-cost health services. Just as in the case of education, a correction is overdue, and free service has to be confined to deserving classes of people.

The state government had invested a total of Rs. 889 crores on irrigation projects by the end of the Seventh Five Year Plan. This figure is in historical prices; if corrected for price changes it would be much higher in 1990-91 prices. Many ongoing major and medium

projects are spillovers from as early as the Third Five Year Plan. In 1991-92, as in previous years, irrigation revenues were likely to be around Rs. 2.50 crores. Undue delays in completion of projects and the lackadaisical approach in collecting water charges have a serious impact on state finances. Collections at present are negligible considering the magnitude of investments.

Yet another source of nontax revenue is drinking water charges. A decision on revision of drinking water rates is long overdue. This matter again is sensitive, which acts as an obstacle in going ahead with rate revisions.

In all of these areas, quality improvements of a considerable magnitude are required. Given the constraints on resources, rates of charges should be revised, the sooner the better, to reasonable levels, which would provide the funds needed for proper maintenance and required quality improvements.

State Public Sector Enterprises

The sluggish growth of Kerala's revenue is traceable to a considerable extent to the poor performance of state public enterprises. Poor returns on past investments have contributed to the erosion in revenues, both tax and nontax. While the poor performance of public enterprises affects nontax revenue receipts directly when these undertakings fail to pay interest or dividends, tax revenues are affected when tax arrears accumulate. For example, electricity duty arrears at the end of March 1989 were Rs. 171 crores.

The total investment made by the state government in public enterprises up to the end of March 1990 was Rs. 377 crores. In addition, state government loans totalling Rs. 497 crores were outstanding as of that date. Thus a grand total of Rs. 874 crores has been invested by the state government in its public enterprises. Dividends received by the state government in 1989-90 were Rs. 1.33 crores, yielding a negligible return of 0.35 percent on equity investment. Even though the investment in state public enterprises has increased substantially over the years, the rate of return has not shown any sign of increase, as shown below:

	<i>Investment</i> (Rs. crores)	<i>Return</i> (Rs. crores)	<i>Rate of Return</i> (percent)
1980-81	181.91	0.634	0.35
1981-82	208.00	0.827	0.40
1982-83	231.43	0.904	0.39
1983-84	257.50	0.468	0.18
1984-85	279.55	0.644	0.23
1985-86	214.80	0.189	0.09
1986-87	264.56	0.676	0.26
1987-88	288.73	0.645	0.22
1988-89	327.34	1.742	0.53
1989-90	376.57	1.330	0.35

Source: Reports of the Comptroller and Auditor General.

The poor performance of Kerala state public enterprises is better understood by assessing their overall performance indicators. At the end of March 1990, accumulated losses of state government companies and statutory corporations reached a staggering total of Rs. 514 crores. As many as 36 enterprises had negative net worth, totalling around Rs. 203 crores. The Kerala State Electricity Board and the Kerala State Road Transport Corporation together provide the largest employment in the state, and they have generally not been able to make a contribution to state plan financing.

The paid-up capital of the Kerala State Road Transport Corporation (KSRTC) at the end of March 1989 was Rs. 62 crores, including Rs. 44 crores from the state government and Rs. 18 crores from the central government. In addition, loans outstanding were Rs. 44 crores (Rs. 28 crores from the state government). KSRTC has 40 percent of its fleet overaged and a staff-bus ratio of around nine; both of these ratios are higher than those in almost all other road transport undertakings in the country. Low fleet utilization and low staff productivity have contributed to heavy losses over the years. The accumulated loss at the end of 1988-89, the latest year for which audited figures are available, was Rs. 124 crores, even after the writing off of Rs. 84 crores by the state government from dues payable to it.

In terms of investment, the Kerala State Electricity Board (KSEB) ranks first among state public enterprises in Kerala. At the end of 1987-1988, outstanding loans from the state government amounted to Rs. 322 crores. Loans from other sources totalled another Rs. 342

crores. Unaudited figures show that loans outstanding from the state government at the end of 1989-90 stood at Rs. 402 crores. KSEB was expected to make a positive contribution of Rs. 96 crores to the Seventh Five Year Plan but instead ended up making a negative contribution of Rs. 41 crores (at 1984-85 prices). The rate of return on capital invested declined from 8.3 percent in 1985-86 to 0.3 percent in 1987-88. One of the main reasons for low returns has been high transmission and distribution losses in the neighborhood of 28 percent. The operating loss in 1989-90 was Rs. 10 crores. It must, however, be pointed out that there has been a considerable improvement compared with 1988-89, when the operating loss was as high as Rs. 57 crores. The tariff revision made in 1988-89 (its full impact was felt only from 1989-90) and the steps taken to reduce transmission and distribution losses have helped to further improve the situation. KSEB was expected to make a positive contribution to the state plan during 1991-92.

Central Transfers

A major component of state nontax revenues consists of grants from the central government for various purposes, such as grants for state plan schemes, centrally sponsored and central plan schemes, and grants based on Finance Commission Awards. The index of aggregate revenue transfers from the center to Kerala, taking the 1974-75 level as 100, started declining relative to the position in other states toward the end of the Fifth Five Year Plan period; the gap between the two indexes was almost 400 points by the end of the Seventh Plan. Grants from the center for central plan schemes and centrally sponsored schemes during the period from 1974-75 to 1989-90 fluctuated widely and did not show a definite trend. The four recent Finance Commissions including the Ninth Finance Commission (1989-90) allotted a grant of Rs. 2,029 crores to the states for upgradation of various social and administrative services. Out of this, Kerala received just Rs. 30 crores. Similarly, the Eighth and Ninth Finance Commissions provided Rs. 604 crores for solving various special problems, of which Kerala received nothing.

The Eighth Finance Commission assumed a nonplan surplus of Rs. 624 crores for Kerala during the period 1984-89. Instead, the state had a deficit of Rs. 341 crores, even after additional resource mobilization for meeting nonplan expenditure needs. (It may be noted that the yield from fresh resource mobilization was not included in the calculation of nonplan revenue balance by the Finance Commission.)

The Ninth Finance Commission calculated a negligible nonplan

surplus of Rs. 2.29 crores for Kerala in 1990-95. Going by past experience, Kerala is likely to end up with a very large nonplan deficit. The normative estimates of expenditure have not made adequate provisions for certain items, particularly in social and community services. The Finance Commission has assessed that Kerala is likely to generate a nonplan deficit of Rs. 124.79 crores in 1990-91 and deficits of a lower magnitude in the two subsequent years but will end up with a surplus of Rs. 2.29 crores at the end of 1994-95. Combining the estimated revenue deficit on plan account, Kerala according to the Commission's assessment is likely to generate a deficit of Rs. 823.71 crores by 1994-95. The Commission has recommended a grant of Rs. 412.54 crores to cover part of this deficit. The total grant-in-aid recommended by the Ninth Finance Commission (NFC) for the five year period 1990-95 to all states amounted to Rs. 15,017 crores, of which Kerala's share is only Rs. 412.54 crores, just 2.7 percent.

Undoubtedly, Kerala is treated harshly by the NFC in artificially assessing a surplus of Rs. 2.29 crores during 1990-95 and leaving the state to cover a very large overall revenue gap of Rs. 411.17 crores during the five year period. Deficits in 1990-91 and 1991-92 are estimated at Rs. 219.46 crores and Rs. 177.48 crores respectively. A government runs its affairs on a year to year basis and not over quinquennial periods. To assume that a state like Kerala with a weak resource base will wipe out such large deficits of around Rs. 200 crores each in the first two years of the five year period and generate revenue surpluses in the last two years is rather unrealistic. Moreover, any unforeseen event, such as the outbreak of war in the Gulf region during the previous financial year and the price spiral experienced thereafter, would certainly upset the budget of any government, no matter how sound its financial position is. The financial position of a state like Kerala would deteriorate further in such a situation.

Kerala was a beneficiary in terms of per-capita central transfers compared to the other southern states and to the all-states average during the Fifth Plan period. However, the all-states average was higher than the figure for Kerala during both Sixth and Seventh Five Year Plans. Per-capita central revenue transfers in Kerala during the Seventh Plan were Rs. 219, compared to Rs. 263 for all states and Rs. 221 in Andhra Pradesh, while Karnataka and Tamil Nadu received lower per-capita central transfers than Kerala (Table 9.12). Kerala's central transfers to cover revenue expenditures were consistently less than the all-states average in all sixteen years under study. From 1987-88 onward, Kerala's dependence on this source was even less

than that of Tamil Nadu (see Table 9.13).

The fact that Kerala has made above-average efforts in mobilizing resources and that it is not able to balance its revenue budget, instead generating large revenue deficits during the past few years, indicates that the state has been spending more than what can be financed by its own resources and central revenue transfers. The studies conducted by NIPFP on behalf of the Eighth Finance Commission and the NFC in its normative assessment have established that Kerala, along with Andhra Pradesh and Tamil Nadu, is an overtaxed state. NFC's assessment showed that the trend rate of growth of Kerala's tax revenue is higher than the normative estimates it has made. Therefore, the reasons for the financial difficulties being faced by the State will have to be sought on the expenditure side of the budget.

REVENUE EXPENDITURE

Growth of revenue expenditure, constituting mainly committed liabilities from past plans, has been quite phenomenal not only for Kerala but for other states, especially in the 1980s. Aggregate revenue expenditure for Kerala and all states during the period from 1974-75 to 1989-90 is shown in Table 9.14. In most years the growth of the index in the case of Kerala was much less than that of the index for all states.

The trend rate of growth of revenue expenditure in Kerala and in other states (calculated in the same way as in the case of revenue receipts) is shown below:

State	Values of coefficients		Growth rate % per annum
	Log a	Log b-	
Kerala	4.3920	0.0610	15.08
Andhra Pradesh	4.5750	0.0706	17.66
Karnataka	4.4828	0.0674	16.78
Tamil Nadu	4.6079	0.0644	15.98
Maharashtra	4.8191	0.0668	16.62
West Bengal	4.6094	0.0630	15.61
All states	5.6949	0.0679	16.92

The growth of revenue expenditure at current prices was the lowest in Kerala (15.1 percent p.a.) among the southern states; it was

also below the all-states average. But when compared with the growth rate of revenue receipts (14.0 percent p.a.), the gap was larger in Kerala than in other states, causing more strain on its financial position. The comparative position during the 1980s was still worse, as revenue expenditure rose by 15.5 percent p.a. while the trend growth rate of revenue receipts was only 13.7 percent p.a. This large gap, larger than in other states, has been mainly responsible for the fiscal crisis faced by Kerala.

The revenue expenditure of Kerala increased by 7.9 times between 1974-75 and 1989-90, compared to 9.7 times in Karnataka, 7.8 times in Tamil Nadu, 10.8 times in Andhra Pradesh, and 9.8 times for all states. Even though the increase was smaller in Kerala than in the other states, the base level of expenditure for Kerala was relatively higher, considering the size of its budget and the state's population. It is, however, interesting to note that Kerala's share in the total revenue expenditure of all states has declined from 4.8 percent in 1974-75 to 3.8 percent in 1989-90.

Of Kerala's total revenue expenditure in 1989-90, as much as 44 percent was on social and community services, education and health alone accounting for 34 percent. Another 13 percent was interest payments (constituting 36 percent of total nondevelopment expenditure). The composition of revenue expenditure at a more disaggregated level is discussed later.

The ratio of revenue expenditure to state domestic product (SDP) was by far the highest in Kerala among the southern states. It went up from 17.7 percent in 1984-85 to 22.5 percent in 1985-86, and then continued more or less at that level up to 1989-90. The relevant figures are furnished in Table 9.15.

Per-capita revenue expenditure in Kerala is the highest among the southern states and higher than the all-states average. This is mainly due to higher per-capita nonplan expenditure. The ratio of plan expenditure to nonplan expenditure for the past three Five Year Plans together was 1:5.75 in Kerala, compared to 1:3.79 in Karnataka, 1:3.12 in Tamil Nadu, 1:3.65 in Andhra Pradesh, and 1:3.89 for all states. Similarly, the share of nonplan expenditure in total revenue expenditure at 84.6 percent was the highest in Kerala, compared with the all-states average of 78.9 percent (Table 9.16). The factor responsible for the higher share of nonplan expenditure in Kerala is primarily the emphasis given in the past on developing social and community services by the state. Though the share of nonplan expenditure on social services in total revenue expenditure has been uniformly high in all states, in Kerala it has been the highest in India.

It averaged 49.8 percent in Kerala, compared to 42.7 percent in Karnataka, 40.4 percent in Tamil Nadu, 38.8 percent in Andhra Pradesh, and 23.4 percent for all states, during the past three Five Year Plans.

Nonplan expenditure in Kerala went up from Rs. 266 crores in 1974-75 to Rs. 1,876 crores in 1989-90, representing an increase of seven times. The increase in the index of nonplan expenditure in Kerala has been lower than that of the all-states average, however. (Using a 1974-75 base, the value of the index for Kerala in 1989-90 was 705, whereas for all states it was 863.) But during 1986-87 Kerala's index came very close to the all-states' average (539 and 542 respectively).

The trend rate of growth of nonplan revenue expenditure in Kerala, selected other states, and the all-states average is shown below.

State	Values of coefficients		Growth rate % per annum
	Log a	Log b	
Kerala	4.3370	0.0593	14.63
Andhra Pradesh	4.5193	0.0664	16.53
Karnataka	4.4221	0.0637	15.81
Tamil Nadu	4.5478	0.0595	14.69
Maharashtra	4.7828	0.0631	15.64
West Bengal	4.5228	0.0627	15.53
All States	5.6357	0.0644	15.91

As the last column shows, growth has been the lowest in Kerala. This is no consolation, however, as the state has been struggling to cover its nonplan revenue gap.

The nonplan component of expenditure on social services in Kerala is considerably higher because of the higher share of education, which has the largest nonplan component among social services. The average percentage share of nonplan revenue expenditure during the past three Five Year Plans was 33 percent, compared to 23.7 percent for all states, whereas it varied between 23 and 27 percent in the other southern states.

The higher share of expenditure on education in Kerala is in a way a legacy of the past. Thanks to the progressive policies followed by the

princely states of Travancore and Cochin in introducing free primary education and the efforts made by Christian Missionaries and other caste and community organizations, education became widespread in the far-flung areas of the state. The bulk of the material resources for education initially came from nongovernmental sources. In addition to setting up private schools and colleges, people also contributed land, buildings, and furniture for starting government schools. Subsequent democratically elected governments undertook to pay from the state budget the salaries and allowances of teaching and non-teaching staff of aided private schools and colleges. This further boosted the demand for educational institutions in the private sector. Per-capita expenditure on education in Kerala was Rs. 233 in 1989-90, while in 1988-89 it was Rs. 220, compared with the all-states average of Rs. 163.

A number of new schools were started during the plan periods, above and beyond those called for in the plans initially drawn up. Consequently, actual plan expenditures on education increased by several times over initial plan outlays in some years. In the past when school education was not free, around 75 percent of the total expenditure of educational institutions was financed by the government. Tuition fees from students and funds from private endowments accounted for the remainder. Presently, with school education up to the 10th standard being free (now extended to plus two in schools and pre-degree in colleges), and with private institutions also getting most of their financing through grants-in-aid from the state government, only a negligible part of the institutional costs of education is financed by private sources.

The High Level Committee on Education and Employment set up by the Government of Kerala in 1984 observed that the educational edifice built up in the state was basically unsound and beyond the capacity of the state to maintain. The annual per-pupil cost of education had risen rapidly from Rs. 95 in 1972-73, to Rs. 334 in 1982-83 at the primary stage and from Rs. 194 to Rs. 581 at the secondary stage. The Committee felt that the state could ill afford to sustain this edifice at the expense of the other productive sectors of the economy. For 1989-90, the cost of education per pupil works out to Rs. 805 at the primary stage and Rs. 1,269 at the secondary stage.

The wage bill for school teachers in the 1980s included salaries for a section of teachers who had put in two years of service in private aided schools, even though those teachers remained outside of active service due to declines in enrollment, through a special order of the Government. At one time the number of such teachers swelled to over 5000, and the expenditure on them was close to Rs. 10 crores per

year. These orders, however, were rescinded in 1984, and the "protected teachers", as they were called, were adjusted against future vacancies and now are almost non-existent.

More than 90 percent of the expenditure on education is on salaries, wages, and other personnel-related items, leaving very little for equipment, materials, and supplies. It is likely that this proportion will go up in coming years. This means that resources devoted to qualitative improvements have risen much less than the total. The proportion of plan expenditure to total expenditure in education has been less than 2 percent, indicating a very limited effort toward creating new facilities.

The last few years have witnessed major changes in educational policies of the government, with a view to providing adequate facilities for higher education in the state. The system of private registration for university examination under Art and Commerce subjects was introduced in the mid-1970s. Since then there has been a rapid growth of private coaching institutions called parallel colleges, which offer regular courses in subjects for which private registration is permitted. The proportion of privately registered candidates appearing for university examinations is currently as high as 45 percent. It is estimated that nearly a lakh of persons are employed in the parallel colleges. But for this development public expenditure on university education would have increased considerably during the eighties.

Health

Just as in the case of education, a major component of Kerala's revenue expenditure is on health. Revenue expenditure on Health and Family Welfare increased from Rs. 32 crores in 1974-75 to Rs. 194 crores in 1989-90, an increase of 6.1 times. It constituted about 14 percent of total nonplan developmental revenue expenditure in 1989-90. Out of the total revenue expenditure of Rs. 194 crores on health, Rs. 127 crores was accounted for by nonplan expenditure. It must be reiterated, to the credit of the state government, that its achievements in terms of reductions in infant mortality and death rates and birth rates and raising life expectancy are comparable with those of some of the developed countries. The health infrastructure in the state in the government sector consists of 2,106 medical care institutions covering western and Indian systems of medicines. Per-capita government expenditure on health care activities in the state is around Rs. 80. Despite the fact that such a large part of the cake is spent on this service, there is great scope for quality improvement in the health

care delivery system, which calls for more resources for this sector.

Nonplan Developmental Expenditure

An analysis of developmental and non-developmental expenditures on revenue account reveals that the average share of developmental expenditure for the period from 1974-75 to 1989-90 was higher in Kerala than for all states (78 percent versus 70 percent). The reason for this is that according to the present accounting division between plan and nonplan, continuing expenditures of state plan schemes, central plan schemes, and centrally sponsored schemes, after the plan period is over, become nonplan committed expenditure. Plan schemes with higher revenue components, especially those with higher salary components, will contribute to higher nonplan expenditure after the end of the plan period. Expenditures on social and community services generally have a larger revenue component than those on economic services. Since Kerala had given higher priority to social and community services in the earlier plans, past expenditures on them got accumulated in the nonplan account. Similarly, since Kerala gave lower priority to economic services in the past, the nonplan component of these services is less. The larger share of the revenue component of total expenditure normally leads to higher shares of compensation for employees in government consumption expenditure.

The high developmental content of nonplan revenue expenditure and the still higher nonplan content of development expenditure makes expenditure control in Kerala difficult. Any across-the-board cuts can render some expenditures unproductive or even wasteful, because such cuts reduce only the funds available for works and not staff salaries and office expenses.

Wage Bill

The total government wage bill in Kerala constituted around 55 percent of total revenue expenditure and around 60 percent of total revenue receipts in 1989-90. In 1980-81 the respective shares were 55 and 57. The state government is the single largest employer in Kerala, in the absence of a well developed private sector; it accounts for a little less than half of total employment in the organized sector. At present there are about 500,000 employees drawing pay from the state government, of which about 150,000 are in government-aided educational institutions. Teachers in educational institutions form the biggest single group in government employment, 60 percent of whom are in aided institutions. The growth in total state government employment during the period from 1980 to 1988 was about 25

percent. The growth in aided institutions was lower at 16 percent, which indicates that the number of state government employees other than teachers has been increasing faster, by about 33 percent between 1980 and 1988.

Employment in government (including local bodies) is relatively high in Kerala at about 17 per thousand population. The wage bill of government employees during 1990-91 was expected to be Rs. 1,623 crores. Out of this, Rs. 1,222 crores was toward the salary of government employees and the remainder toward teaching grants to aided private educational institutions (which represent salary and other allowances for the staff of aided educational institutions). These figures appear disproportionately high because a portion of the arrears related to the pay revision between July 1988 and November 1989 was included in the total wage bill of 1989-90, with the balance of arrears included in the amounts provided for 1990-91.

Growth of state government expenditure on salaries since 1980-81 is shown below.

Year	Salaries (Rs.crores)	Total revenue expenditure (Rs. crores)	Total revenue receipts (Rs. crores)	Salary as percentage of revenue expenditure	Salary as percentage of revenue receipts
1980-81	362	668	640	54	57
1981-82	321	754	850	43	38
1982-83	378	783	810	48	47
1983-84	447	992	934	45	48
1984-85	495	1139	1125	43	44
1985-86	624	1445	1344	43	44
1986-87	728	1655	1502	44	48
1987-88	792	1781	1586	44	50
1988-89	910	2061	1897	44	48
1989-90	1342	2298	2048	58	66
1990-91 (RE)	1623	2825	2504	57	65

The wage bill started rising at a faster rate from 1985-86 onward, the year from which the pay revisions recommended by the state's Fourth Pay Commission were implemented (though the reference

date was July 1983). Since then one more pay commission (the Fifth) was constituted, whose recommendations have been implemented from 1989-90, with arrears from July 1988 impounded in Provident Fund accounts. Even though a Pay Commission sits once every five years, and the revisions recommended by the Fifth in the series have been implemented, the fact remains that Kerala's pay structure is still lower than the central government's and that of most other state governments.

We have seen that nonplan expenditure in Kerala has increased faster than in the other southern states or in all states. Both developmental and nondevelopmental nonplan expenditure have shown a tendency of higher growth, especially in the 1980s. The share of non-developmental expenditure in total revenue expenditure in Kerala is the highest among the southern states; it increased from 27.2 percent during the Fifth Five Year Plan to 33.8 percent during the Seventh Plan, compared to 29.6 percent and 30.4 percent respectively for all states. It is interesting to note that the share declined in Tamil Nadu and Andhra Pradesh, while the rate of increase in Karnataka was less than that in Kerala (see Table 9.17). Almost the entire expenditure on this account is nonplan.

Though one would consider that it is the nondevelopmental expenditure that should be subjected to scrutiny and control, the scope for such control in Kerala is limited, as in most states, because two main components of such expenditure -- debt servicing and pension payments -- are contractual in nature and cannot be reduced in the short run. Interest charges in Kerala accounted for 12.8 percent of total revenue expenditure in 1989-90, an estimated 12.3 percent in 1990-91, and a budgeted 13.6 percent for 1991-92.

Debt service expenditure has grown substantially and witnessed a spurt in the mid-1980s. The share of debt servicing in nonplan expenditure in Kerala rose from 11.1 percent during the Fifth Plan to 26.6 percent during the Seventh Plan. Only Karnataka among the other southern states has a higher share than Kerala. It is, however, noteworthy that the debt service liability of Kerala is less than that of most other states (Table 9.18). The problem became more acute during the Seventh Plan period, mainly because of the bunching of short-term and medium-term loans taken by the state during the Sixth Plan and first two years of the Seventh Plan.

Kerala, like most of the other major states, has had to set aside a relatively large share of its nonplan budget for debt servicing, both repayment of loans and payment of interest. During the Seventh Five Year Plan period, interest payments by Kerala accounted for over 13

percent of total nonplan revenue expenditure, slightly less than the all-states average of 15 percent. But the repayment obligations of the state during the Seventh Plan period comprised as much as 95 percent of its nonplan capital outlay, indicating the dangerous aspect that the provision set apart for other nonplan capital expenditure on assets created was negligible. Against this, the all-states average was only 69 percent. Similarly, repayment of loans as a percentage of total debt servicing in Kerala reached a high of 49 percent, as against 37 percent for all states during the Seventh Plan period. Furthermore, total debt service as a percentage to total nonplan expenditure for Kerala was 23.4 percent, compared to 21.6 percent for all states.

There has been a spurt in the debt servicing expenditures of the state government since 1983-84. Its heavy dependence since then on short-term borrowings, including overdrafts from the Reserve Bank of India, medium-term loans to clear overdraft liabilities, utilization of borrowed funds for meeting nonplan and plan revenue expenditure, and drawing of advance plan assistance to finance the annual plans, all contributed to bunching of these obligations during this period. The major share of liabilities has been for loans from the central government. The magnitude of such obligations to the central government in recent years has been such that the net inflow of central assistance for the state plan during 1989-90 was a negative Rs. 5.07 crores. The total outstanding debt of Kerala as of the end of 1989-90 represented 3.3 percent of state domestic product.

Kerala's situation of having to borrow in order to square its revenue account is not unique. And when a state government feels obliged also to have a plan of minimum size, it very soon starts facing a liquidity problem. This problem normally arises because of a mismatch in the timing of the inflow and outflow of cash. The problem gets compounded by the bunching of loan liabilities. But states like Kerala have had to face a liquidity problem permanently because cash outflow almost always exceeded the inflow throughout the year. States could meet this problem as long as the Reserve Bank of India was willing to accommodate them through overdrafts. That is how the states accumulated large and continuing overdrafts from the beginning of the Sixth Five Year Plan. This necessitated extension by the central government of special medium-term loan assistance to the states aggregating to Rs. 1,743 crores in 1982-83, Rs. 499 crores in 1983-84, Rs. 352 crores in 1984-85, and another Rs. 1,743 crores in 1985-86, to clear accumulated overdrafts. The amount of special loan assistance drawn by Kerala during these years amounted to Rs. 378 crores, 8.7 percent of the total (more than twice Kerala's population

share or its share of central budgetary transfers). With the Reserve Bank of India becoming much more strict on the extension of overdraft facilities in recent years, the liquidity problems of states like Kerala have become extremely serious. In such circumstances the funding of plan schemes got interrupted often, and their execution suffered in the process. Is it any wonder, therefore, that state plan schemes face continuing problems of cost and time overruns? Externally funded schemes are no exception.

Since the mid-1980s, the share of pension payments to state government employees in Kerala's nonplan revenue expenditure has been rising rather rapidly. It increased from 5.0 percent during the Fifth Plan to 13 percent during the Seventh Plan. The share of pension payments in Kerala is the highest in India. Among the southern states, the next highest share of 9.3 percent was in Karnataka, the all-states average being 4.9 percent. The higher share of pension payments in Kerala is explained by the extension of pension benefits to staff of aided private schools and colleges. It is estimated that over 200,000 pensioners are receiving pensions at present. The annual number of retirements is in the range of 14,000 to 15,000. Annual spending on pensions in recent years is shown below:

<i>Items (Rs. crores)</i>	<i>1989-90 (Actual)</i>	<i>1990-91 (Revised Estimates)</i>	<i>1991-92 (Budget Estimates)</i>
Pensions to government staff	89.91	124.90	134.00
Pensions to employees of aided institutions	27.61	31.00	33.00
Family pensions	17.57	30.00	30.00
Commutation value of pensions	47.80	65.21	70.22
Gratuity	23.61	32.03	33.03
Miscellaneous	3.08	4.10	4.13
Total	209.58	286.34	304.38
Percentage of total revenue expenditure	8.1	10.1	9.8

(In the above figures the amount payable on account of the outstanding accumulated balance under the employees provident

fund, roughly Rs. 25 crores per annum, is not included.)

The major reasons for the higher pension commitment to government employees in Kerala are the following: (1) The retirement age in Kerala is 55 years, compared to 58 years in all other state governments and in the central government. (2) Due to the low death rate and high life expectancy, the proportion of pensioners in Kerala is invariably higher than in other states. (3) The age profile of staff in government service and aided institutions also tends to increase the number of pensioners. Considering the high incidence of unemployment, the age of entry into government service was raised to 35 years sometime back. This also adds to the number of pensioners.

Economic Services

Because of the higher share of social and community services in total revenue expenditure, Kerala's share of economic services is less than in other states. It remained at around 20 percent during the past three plan periods, whereas in the other southern states the share varied between 26.6 percent and 33.6 percent. A lower share of expenditure on economic services in Kerala is a consequence of the higher priority given by the state government to social and community services. On plan account, however, there has been a definite change in priorities in favour of economic services in recent years. Their share went up from 49.5 percent to 59.4 percent in the Seventh Plan, which was higher than in all the other states. The percentage share in the subsequent two annual plans of 1990-91 and 1991-92 would be 81 percent and 78 percent respectively. The low priority assigned to economic services in the past hampered Kerala's ability to promote economic growth, which would have increased generation of fiscal resources.

Government Services

The share of expenditure on government service is lowest in Kerala. The average share during the last three Five Year Plans stood at 13.3 percent, compared to 15.4 percent in Andhra Pradesh and 18.0 percent for all states (see Table 9.20). It is important to note, however, that for all the states (including the southern states) there was a declining trend in the share of government service in revenue expenditure. Per capita expenditure on government service was the highest in Kerala among southern states during the Seventh Plan, though less than the all-states average. The per-capita expenditure in Kerala was Rs. 80, compared to the all-states average of Rs. 94. The comparative position during the past three Five Year Plans is shown below.

<i>Per-capita revenue expenditure on government services (Rs.)</i>	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>
Kerala	23.8	40.1	80.0
Karnataka	23.5	37.1	78.0
Tamil Nadu	22.6	41.1	76.0
Andhra Pradesh	21.2	41.2	79.0
All states	24.3	44.3	94.0

During the three five year plan periods the increase in per capita spending on government services in Kerala was more than three times, compared to four times for all states. It is noteworthy that the share of expenditure on organs of state and fiscal services in Kerala is higher than that of the other southern states, which perhaps offers scope for economy.

To recapitulate, trend growth rates of total revenue receipts and total revenue expenditure from 1974-75 to 1989-90 are shown below:

	<i>Total Revenue receipts (percent p.a.)</i>	<i>Total revenue expenditure (percent p.a.)</i>
Kerala	13.99	15.08
Andhra Pradesh	16.01	17.66
Karnataka	15.19	16.78
Maharashtra	15.07	16.62
Tamil Nadu	15.45	15.98
West Bengal	14.90	15.61
All States	15.45	16.92

In all states the rate of growth of revenue expenditure far outstripped the growth rate of revenue receipts during the 16-year period. This definitely brought about a deterioration in the current budgets of the states. The difference between the two growth rates was smaller in the case of Kerala than for the all-states average. But the base level of expenditure in 1974-75 was much higher in Kerala than in other states. Per-capita revenue expenditure in Kerala in

1974-75 was Rs. 135, as against Rs. 112 for all states taken together. The state could not maintain its edge in subsequent years, as is shown by the fact that per-capita revenue expenditure for Kerala in 1989-90 was Rs. 892, compared with Rs. 877 for all states. The difference between Kerala and all states declined from 17 percent in 1974-75 to 1.7 percent in 1989-90. In 1975-76 total revenue expenditure outstripped revenue receipts by one percent in the case of Kerala, whereas revenue expenditure for all states together accounted for only 88 percent of revenue receipts. There was an excess of expenditure over receipts for all states taken together only beginning in 1987-88.

Finance Commission Awards

As noted earlier, the pressures on the Kerala budget originated from its revenue account. Within the revenue account there have been deficits in the nonplan account from 1985-86 onwards. The state, however, was supposed to have a surplus according to the Eighth Finance Commission's award. Deficits arose partly because of shortfalls in resources mobilized compared to what was projected by the Finance Commission and partly because of expenditures higher than the level forecast by the Finance Commission. As J.L. Bajaj and Renuka Viswanathan pointed out (in *Economic and Political Weekly*, October 7, 1989), variance from the Finance Commission's forecast was greater for nonplan revenue expenditure than for nonplan revenue. Differences between the revenue surplus/deficit forecast by the Eighth Finance Commission and the actuals reproduced from the article referred to above are given below.

States	Finance Commission Forecast (Rs. crores)	Actuals (Rs. crores)	Difference between Finance Commission estimates and actuals	
			Amount (Rs. crores)	Percent
Kerala	476	-446	922	-194
Karnataka	1672	919	753	45
Tamil Nadu	2705	1791	914	34
Andhra Pradesh	1592	1179	413	26

Variance between the Eighth Finance Commission estimates and actual expenditures in Kerala under selected nonplan categories is shown below:

<i>Items (Rs. crores)</i>	<i>Finance Commission Forecast</i>	<i>Actuals</i>	<i>Difference (percent)</i>
Interest payment	434.73	890.79	104.91
Police	216.56	310.11	43.20
Education	1499.50	2148.88	43.31
Medical	338.41	471.21	39.24
Social services and welfare	220.96	314.05	42.13
Irrigation	83.73	101.59	26.33
Buildings including housing	29.86	32.99	10.48
Roads and bridges	173.50	177.42	2.26
Total	2497.25	4447.04	48.57

The assumed surplus by the Finance Commission did not allow for upgradation of emoluments. The Commission assumed only Rs. 66 crores for this purpose for the five year period, while the salary revision commitments made in 1983-84 actually reached Rs. 348 crores. The Commission took 1981-82 as the cut-off point, even while knowing that the State Pay Commission was at work, and did not make suitable provision for the likely needs for upgradation of emoluments.

Another reason why Kerala's finances were upset during the Seventh Plan period was the failure of the Eighth Finance Commission to provide adequately for Dearness Allowance increases for state government employees and pensioners. As against Rs. 356 crores provided for the Finance Commission, the actuals amounted to Rs. 746 crores for the four year period 1985-89.

EXTERNALLY AIDED PROJECTS

Externally aided projects have grown in importance considerably during the Sixth and Seventh Five Year Plans, especially the latter. During the Sixth Five Year Plan about nine percent of the states' total plan outlay of Rs. 47,204 crores was for programs financed by external agencies. This share increased by 2.7 times in absolute terms during the Seventh Plan, reaching about 14 percent of the total approved outlay of Rs. 78,097 crores.

Externally aided projects clearly have helped to enhance the overall plan size of the states. How far this has benefited the states can best be understood by comparing per-capita assistance received for these

projects during the Sixth and Seventh Five Year Plans, using rank correlation analysis. The states have been ranked according to per-capita income and per-capita assistance received for externally aided projects. Values of the rank correlation coefficients are shown below.

	<i>Per-capita income</i>		<i>Per-capita assistance for externally-aided projects</i>	
	<i>1982-83</i> (A)	<i>1987-88</i> (B)	<i>Sixth Plan</i> (C)	<i>Seventh Plan</i> (D)
(A)	-	-	0.23	-
(B)	-	-	-	0.13
(C)	0.23	-	-	0.21
(D)	-	0.13	0.21	-

The rank order correlation coefficient between per-capita income and per-capita assistance for externally-aided projects during the Sixth Plan period was only 0.23. Though this is not negative, since the value is small, it can be inferred that some low-income states did receive relatively higher assistance. During the Seventh Plan a drop in the value of the correlation coefficient to 0.13 indicates that the low-income states improved their position with regard to assistance received for externally-aided projects. This is also confirmed by the low value of the correlation coefficient between per-capita assistance received during the Sixth Five Year Plan and the Seventh Five Year Plan (0.21).

In Kerala, over a quarter of the originally approved plan outlay of Rs. 2,100 crores for the Seventh Plan consisted of spending on projects benefiting from external assistance. The estimated reimbursement of assistance was Rs. 217 crores. Undoubtedly the additional financial assistance that became available through funding by external agencies has contributed to a relatively faster growth in plan outlays.

Generally project assistance by external agencies is limited to 50 percent of total project cost, in a few cases between 50 and 60 percent. Following the outbreak of the war in the Gulf region, the World Bank increased project financing to 80-90 percent of total project cost.

No state government can receive funds directly from external agencies; the assistance is passed on to the state governments through the central government. Until 1987-88 only 70 percent of the assistance received from external agencies was passed on to the states, while 30 percent was retained by the central government. This is a

has always been a major irritant in center-state fiscal relations. Following persistent demands from the states, in 1988-89 the Government of India decided to reimburse to the states 100 percent of external assistance for projects in social services, rural development, agriculture, irrigation, etc.

Much assistance by external agencies is on soft terms, with interest generally ranging from 0.75 percent p.a. to 3.5 percent p.a. and part of assistance received as grants. Most loans are repayable over a period of 20 years, including a moratorium of five years. But the terms on which such funds are passed on to the states by the central government are tougher: interest of 10.25 percent p.a. and repayment over 15 years.

At present assistance for externally aided projects is generally released by the Government of India on a quarterly basis, starting from August/September. These releases are made as reimbursements on the basis of expenditures incurred by the state governments and reported to the Government of India. Besides, there is a time gap generally of two months between the reporting of expenditure and release of assistance. The states have to squeeze their budgets on many other items, at times even priority items, to take up execution of these projects, right from the beginning. This causes considerable strain on the liquidity position of the states, especially those with a fragile resource base. The first few months of the financial year are generally lean months insofar as revenue flows are concerned, which makes it all the more difficult for the states to provide funds for such projects. In other words, these projects have to wait until the ways and means position of the states permits fund allocations to them. Therefore, the cash flow to these projects many times will not be at the desired level, thereby causing shortfalls in project implementation. In such a situation, apart from the delays caused by procedural wrangles, state governments' inability to provide counterpart funds causes delays in achieving targets.

For example, 35 water supply and sanitation schemes, including two new projects, are being implemented in Kerala with World Bank and bilateral assistance. In 1991-92 out of a total plan outlay of Rs. 77.5 crores for water supply and sanitation, 88.2 percent was for projects financed by external assistance. Most of these projects were started during 1985-87, and about 30 projects had been scheduled to be completed by 1990-91. The time schedule has slipped for almost all of them, and the revised schedule for completion is 1993-94. Inadequacy in cash flow is the major reason for delays. A system needs to be devised to make ad-hoc releases, just like release of

normal central assistance, to ensure timely cash flow to the states so that these projects are not starved of funds.

Implementation delays are also caused by the time taken for getting clearance from appropriate authorities. One of the reasons for the slow progress of the Kerala Power Project, a World Bank-aided scheme, is reported to be the time taken in getting clearance from the Central Electricity Authority for the purchase of certain equipment, such as turbine generators, transformers, etc. Efforts to reduce such delays are important, so that unnecessary cost escalation can be avoided.

For various reasons, the most important of which is the poor liquidity position, implementation of externally aided projects has been poor, and the actual reimbursement for Kerala during the Seventh Plan was only Rs. 134.47 crores, about 38 percent below the target of Rs. 217 crores. Moreover, the former is measured in current prices whereas the latter was set in terms of 1984-85 prices. In real terms the reimbursement amounted to Rs. 108 crores, constituting only 49.8 percent of the original estimate of Rs. 217 crores.

CONCLUSIONS

With respect to per-capita revenue receipts, per-capita own tax revenue, and per-capita own nontax revenue, Kerala performed poorly when compared to the other southern states during the Sixth and Seventh Plan periods. Kerala's average annual growth rate of own tax revenue, which was higher than that of the other southern states between 1974-75 and 1979-80, was the lowest among the southern states and also below the all states average during the 1980s. The period since 1982-83 witnessed a steep decline in the ratio of own nontax revenue to total own revenue for Kerala. User charges collected for services offered by the government have declined as a percentage of expenditure year after year. Time and cost overruns for irrigation projects have deprived the state not only to a large extent of the benefits from such investments on the production front, but also of the resulting revenues. The revenue collected from projects already completed is extremely low (Rs. 2.50 crores per annum on average) compared to the revenue potential.

State public undertakings continue to make large losses. Their accumulated losses as of the end of 1989-90 amounted to Rs. 514 crores. The rate of return is less than one percent of the investment, not to speak of the nonpayment of dues to the state government. In the absence of a well developed private sector, the government had to

step in and make direct investments in manufacturing activities. But inefficient management of these units meant that they failed to achieve their avowed goals.

The financial crisis faced by the state government is not due mainly to slow growth of revenue receipts, but rather largely to faster growth of revenue expenditure, particularly nonplan spending. While revenue receipts grew by 13.7 percent p.a. in the 1980s, revenue expenditure rose by 15.5 percent p.a. during the same period. Higher revenue expenditure, particularly nonplan expenditure, in Kerala was primarily due to a higher share of revenue expenditure on education and health in the total. Since the revenue component in plan programs relating to education and health is generally high, the proportion of committed expenditure compared to capital projects is also relatively high, contributing to the high nonplan content.

The high priority bestowed on social services had its fall-out in that economic services received smaller plan allocations in the past, leading to very slow growth in the commodity producing sectors in the state. Even in the case of social services, while paying greater attention to expanding the coverage of education and health care activities, the quality of services, particularly in education, took a back seat.

Government expenditure on pensions in Kerala is the highest in India, accounting for as much as 10 percent of total revenue expenditure. The state government's commitment to pay the salaries and allowances of staff of aided private educational institutions, coupled with high life expectancy, contribute to the higher share of pension expenditure.

The financial problems of the state are to a very large extent the consequence of achieving social goals set by national planners ahead of time. To achieve these goals the state had to spend a large share of its plan funds on these sectors, thereby partly starving economic services. To put it differently, the state is at present facing a success-induced problem. Though the Planning Commission and successive Finance Commissions have taken note of the success of Kerala in the field of social services and have praised the "Kerala Model" as something unique, there is still very inadequate recognition of the fiscal consequences of such priorities. The Finance Commissions, while allocating funds for meeting revenue gaps and for upgradation of social and administrative services, failed to take cognizance of the causative relationship between higher expenditures on social services in Kerala and resulting achievements in this field and the economic fall-out of such an investment pattern. While the Finance Commissions attempted to boost expenditure on social services in

states lagging behind by allotting additional funds (even in states with high per-capita incomes), there was no such attempt to support economic services. The relative decline in Kerala's per-capita plan outlays perhaps is related to this omission.

The Planning Commission and the Finance Commissions have taken note of the success achieved by Kerala in social services, only to deny it funds. They have also turned a blind eye to the second-generation problems generated by the success of the state in provision of social services. For instance, the problem of unemployment in Kerala is not only more severe than in other states, it is also qualitatively very different in that it is more a problem of the educated unemployed, clearly a result of the spread of education in Kerala. Public health and medical care schemes along with education have lengthened life expectancy, contributing to higher pension costs. Greater longevity combined with increasing unemployment has raised the dependency ratio in the state, and the government is compelled to cover some of these burdens of families by providing old age pensions and pensions for destitutes as well as unemployment allowances. High life expectancy has increased the proportion of old people, whose disease pattern calls for higher expenditure per patient. Notwithstanding the fact that Kerala's priorities in the past have been to attain some important national goals, leaving very little scope for accelerating investment in economic fields, resource allocation from the national kitty has not helped the state to bridge the consequent gap. Indeed, the share of central investment in Kerala has steadily declined over the years from 3.24 percent in 1975 to 1.50 percent in 1990. Maintaining central investment at least at the level of the state's population share is the minimum called for to ensure healthy development.

Kerala's inability to generate adequate budgetary saving seriously constrained its per-capita plan expenditure. The financing of over 11 percent of revenue expenditure by deficits has led the state into a sort of debt trap, further reducing its capacity to generate resources for plan financing. The state had to resort heavily to short-term borrowings during the Sixth Five Year Plan, a reflection of its liquidity problems. But such short-term borrowings further compounded the longer-term fiscal problem. Kerala's per-capita plan outlay, which was above the all-states average during the Third and Fourth Plan periods, started falling below the average subsequently. The gap has widened, so much so that Kerala's per-capita plan outlay during the Seventh Five Year Plan was almost 30 percent less than the all-states average.

Table 9.1

Selected Economic Indicators

	Per capita net SDP at current prices (1987-88)	Birth rate per 1,000 persons (1986-88)	Death rate per 1,000 persons (1986-88)	Infant mor- tality rate per 1,000 births (1986-88)	Life expectancy at birth (1976-80)	Per capita electricity consumption (kwh)	Electrification of villages at end of March 1990	Road length per 1,000 sq km area (thousand km)
Andhra Pradesh	2333 ^a	30	10	81	53	197	100	480
Assam	2335	34	12	103	51	64	95	759
Bihar	1904	37	13	100	40 ^b	104	68	483
Gujarat	3636	31	10	98	52	373	100	337
Haryana	3925 ^a	34	9	87	55	308	100	568
Karnataka	2802	29	9	74	56	207	100	599
Kerala	2834	21	6	28	66	130	100	2897
Madhya Pradesh	2404	37	14	120	49	187	84	262
Maharashtra	4490	29	9	66	56	347	100	597
Orissa	1983	32	13	124	49	165	65	788
Punjab	5477	29	8	64	61	515	100	960
Rajasthan	2326	35	12	104	52	162	75	243
Tamil Nadu	2980	23	10	77	53	249	100	1108
Uttar Pradesh	2146 ^a	37	14	128	46	135	71	551
West Bengal	3193	30	9	70	47 ^b	135	69	652
All India	3286	32	11	95	52	201	81	493

^aFigures relate to 1986-87.^bFigures relate to 1961-70.

Table 9.1 (Contd.)

	Railway route mileage for 1,000 sq.km area (km)	Enrolment children 6-11 group (1987-88) (% to total)	Enrolment children 11-14 group (1987-88) (% to total)	Hospital beds per lakh of population as on Jan '89	Doctors per lakh of population (1986)	Motor vehicle per 1,000 population (1987-88)	Banking offices per lakh of population as on March 1990	Population below poverty line 1983-84
Andhra Pradesh	18	104	43	63	55	1.32	7.17	36.4
Assam	30	106	53	72	46	0.77	4.64	23.5
Bihar	31	81	34	40	34	0.76	5.43	49.5
Gujarat	28	114	57	150	56	3.33	8.25	24.3
Haryana	34	85	64	61	--	2.64	7.75	15.6
Karnataka	16	105	54	94	72	2.22	9.48	35.0
Kerala	24	108	97	292	61	1.49	9.51	27.8
Madhya Pradesh	13	100	50	43	16	1.32	6.79	46.2
Maharashtra	18	122	69	152	85	2.74	7.41	34.9
Orissa	13	98	40	49	37	0.64	6.29	42.8
Punjab	43	95	62	133	147	4.92	10.87	13.8
Rajasthan	16	80	41	64	34	1.30	6.95	34.3
Tamil Nadu	30	132	84	98	83	1.69	7.66	39.6
Uttar Pradesh	30	75	46	48	28	0.89	6.16	45.3
West Bengal	43	118	65	99	71	0.97	6.15	39.2
All India	20	98	55	91	48	1.70	7.16	37.4

Table 9.2

Per Capita Plan Outlays

	First Plan 1951-56	Second Plan 1956-61	Third Plan 1961-66	Annual Plans 1966-69	Fourth Plan 1969-74	Fifth Plan 1974-79	1979-80	Sixth Plan 1980-85	Seventh Plan 1985-90
(Rs.)									
<i>Major States</i>									
Haryana	°	°	°	91	358	481	176	1,324	1,871
Punjab	175	146	212	90	316	531	155	1,118	1,685
Gujarat	58	76	108	84	204	376	115	1,034	1,485
Maharashtra	37	57	103	83	199	372	121	941	1,434
Madhya Pradesh	34	48	84	44	114	254	87	697	1,146
Tamil Nadu	28	57	98	71	134	201	63	631	1,063
Orissa	56	54	120	60	113	207	72	549	897
Assam	29	57	103	61	136	190	78	533	850
Andhra Pradesh	33	52	91	58	98	236	79	557	841
Uttar Pradesh	25	32	72	53	132	237	62	505	803
Karnataka	46	62	100	70	128	276	81	584	799

	First Plan 1951-56	Second Plan 1956-61	Third Plan 1961-66	Annual Plans 1966-69	Fourth Plan 1969-74	Fifth Plan 1974-79	1979-80	Sixth Plan 1980-85	Seventh Plan 1985-90
Kerala	31	49	101	73	156	224	67	587	727
Rajasthan	39	53	97	56	120	237	80	558	718
West Bengal	54	48	80	39	82	200	82	616	653
Bihar	25	40	67	40	85	155	51	442	626
<i>Other States</i>									
Sikkim	"	"	"	"	"	1,163	596	3,050	5,750
Nagaland	"	"	280	400	747	1,359	326	2,625	4,000
Meghalaya	"	"	"	"	358	705	254	1,679	2,750
Manipur	17	86	100	72	290	646	221	1,600	2,529
Himachal Pradesh	21	64	127	119	328	467	170	1,244	2,100
J & K	39	77	166	152	351	603	197	1,429	1,918
Tripura	21	94	156	82	223	320	133	1,114	1,760
All States	38	51	92	61	142	262	85	670	1,026

"Was not a state during this period.

Table 9.3

Overall Budgetary Position, 1974-90

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	-75	-76	-77	-78	-79	-80	-81	-82	-83	-84	-85	-86	-87	-88	-89	-90
Kerala	12	-15	-14	27	69	22	-67	-61	31	-15	-76	122	-169	-6	14	-55
Karnataka	15	7	23	34	7	-22	-19	45	-41	-8	160	87	-126	85	-117	-175
Tamil Nadu	5	12	3	-23	3	-11	12	103	35	63	-40	90	-5	-67	-150	-149
Andhra Pradesh	74	32	-8	-72	2	-11	4	-35	42	-111	-127	124	-104	108	-184	-183
Maharashtra	28	42	14	35	7	47	-30	38	59	-37	-59	25	81	77	-143	-8
West Bengal	-20	112	-16	-63	137	-66	-83	-132	-43	21	-78	146	-78	-6	9	326
All States	13	678	155	-69	1132	40	-218	-287	-144	-165	-1272	1707	-314	-286	-938	1346

(Rs. crores)

Table 9.4

Revenue Surpluses and Deficits

(Rs. crores)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	-75	-76	-77	-78	-79	-80	-81	-82	-83	-84	-85	-86	-87	-88	-89	-90
Kerala	0	-3	-3	29	43	58	-26	96	27	-57	-13	-73	-151	-194	-140	-188
Karnataka	48	86	64	65	52	81	59	164	42	73	-143	-84	79	-110	-29	-122
Tamil Nadu	-7	5	1	-23	48	95	128	82	102	52	17	189	104	-283	-309	-288
Andhra Pradesh	96	147	111	69	117	121	103	80	133	-88	-168	-6	-187	37	-72	-146
Maharashtra	56	130	176	163	126	195	121	147	210	71	-211	-316	0	74	-502	-193
West Bengal	8	18	24	-1	-78	-13	-23	-87	-241	-205	-371	83	-186	-115	-221	-198
All States	395	972	1097	1019	1135	1548	1465	1376	888	211	923	659	39	-1088	-2080	-4260

Table 9.5

Capital Account Surpluses and Deficits

(Rs. crores)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	-75	-76	-77	-78	-79	-80	-81	-82	-83	-84	-85	-86	-87	-88	-89	-90
Kerala	12	-12	-11	-2	26	-36	-41	-157	4	42	-63	195	-18	188	154	133
Karnataka	-33	-79	-41	-31	-45	-103	-78	-119	-83	-81	-17	171	-205	195	-88	-53
Tamil Nadu	12	7	2	0	-45	-106	-116	21	-67	11	-57	-99	-109	216	159	139
Andhra Pradesh	-22	-115	-119	-141	-115	-132	-107	-115	-91	-23	41	130	83	71	-112	-37
Maharashtra	-28	-88	-162	-128	-119	-148	-151	-109	-151	-108	152	341	81	3	359	185
West Bengal	-28	94	-40	-62	215	-53	-60	-45	198	226	293	63	108	109	230	524
All States	-382	-294	-942	-1088	-3	-1508	-1703	-1662	-1032	-376	-349	1048	-353	802	1142	2314

Table 9.6

Per Capita Plan Outlays

States	(Rs.)						
	1st Plan	2nd Plan	3rd Plan	4th Plan	5th Plan	6th Plan	7th Plan
Kerala	31	49	101	156	224	587	727
Karnataka	46	62	100	128	276	584	799
Tamil Nadu	28	57	98	134	201	631	1063
Andhra Pradesh	33	52	91	98	236	557	841
Maharashtra	37	57	103	199	272	941	1434
All States average	38	51	92	142	262	670	1026

Source: Centre for Monitoring Indian Economy.

Table 9.7

Revenue Receipts

	Amount (Rs. Lakhs)		Index (1971-75 = 100)	
	All States	Kerala	All States	Kerala
1974-75	643151	28797	100.00	100.00
1975-76	793816	35155	123.43	122.08
1976-77	903702	38618	140.51	134.10
1977-78	993057	44494	154.40	154.51
1978-79	1164669	52214	181.09	181.32
1979-80	1362931	59162	211.91	205.45
1980-81	1629330	64038	253.34	222.38
1981-82	1845460	85048	286.94	295.34
1982-83	2112554	81017	328.47	281.34
1983-84	2401382	93424	373.38	324.42
1984-85	2742547	112499	426.42	390.66
1985-86	3329414	137117	517.67	476.15
1986-87	3777601	150253	587.36	521.77
1987-88	4400039	158609	684.14	550.78
1988-89	5008592	188749	778.76	655.45
1989-90	5485959	207672	852.98	721.16

Table 9.8

Per Capita Own Revenue*(Rs.)*

	<i>Nontax revenue</i>			<i>Tax revenue</i>			<i>Total own revenue</i>		
	<i>5th Plan</i>	<i>6th Plan</i>	<i>7th Plan</i>	<i>5th Plan</i>	<i>6th Plan</i>	<i>7th Plan</i>	<i>5th Plan</i>	<i>6th Plan</i>	<i>7th Plan</i>
Kerala	31.5	54.9	68.4	80.5	177.4	374.0	112.0	232.4	442.4
Karnataka	42.3	73.6	120.6	78.1	184.4	392.6	120.4	258.1	513.2
Tamil Nadu	21.8	39.3	65.6	78.0	203.9	388.3	99.8	243.3	453.0
Andhra Pradesh	26.7	53.3	104.1	68.6	158.0	341.7	95.3	211.3	445.7
Maharashtra	48.6	98.2	184.0	114.4	253.3	512.0	163.0	351.4	696.1
West Bengal	16.0	29.0	35.2	62.0	127.3	275.1	77.9	156.3	310.3
All states	27.9	55.6	99.0	62.6	139.8	287.0	90.5	195.4	386.0

Table 9.9
State Tax Revenues

(Rs. crores and percent growth)

	Andhra Pradesh			Karnataka			Kerala			Tamil Nadu		
	Annual average growth		Annual average growth rate	Annual average growth		Annual average growth rate	Annual average growth		Annual average growth rate	Annual average growth		Annual average growth rate
	1974-75	1989-90	1974-75 1989-90	1974-75	1989-90	1974-75 1989-90	1974-75	1989-90	1974-75 1989-90	1974-75	1989-90	1974-75 1989-90
Sales tax	113.99	1328.39	17.79	93.64	1050.00	17.48	75.32	740.00	16.45	190.75	1577.56	15.12
State Excise	58.11	637.20	17.31	47.54	320.00	13.55	15.55	160.00	16.81	25.22	280.00	17.41
Motor Vehicle Tax	25.35	168.90	13.46	12.66	170.00	18.91	6.68	79.63	17.97	38.87	176.98	10.63
Stamps and registration fees	15.87	110.91	13.84	12.85	110.00	15.39	11.94	102.00	15.37	25.77	192.78	14.36
Others	38.68	153.83	9.64	332.31	240.45	-2.13	14.51	122.78	15.30	25.39	115.58	10.63
Total own tax revenue	252.00	2399.33	16.21	499.00	1890.45	9.29	124.00	1204.41	16.37	306.00	2342.90	14.53

Table 9.10

Ratio of Tax Revenue to State Domestic Product

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	(percent)
Kerala	5.9	7.2	7.8	8.5	9.2	9.2	9.4	10.1	9.3	8.9	9.7	11.4	11.1	11.4	11.4
Karnataka	6.3	7.7	8.2	7.8	8.4	8.4	8.9	9.7	10.3	9.8	10.3	11.6	10.9	11.9	11.9
Tamil Nadu	8.4	8.6	8.0	7.7	8.9	8.0	10.0	10.5	12.3	12.2	11.6	12.2	12.5	11.0	11.0
Andhra Pradesh	5.3	7.7	9.0	7.4	7.6	8.0	8.1	7.8	8.4	8.6	10.0	11.2	11.2	10.9	10.9
Maharashtra	6.8	7.6	7.9	7.4	8.0	8.1	8.1	8.9	9.7	9.2	9.1	9.7	10.5	10.0	10.0
West Bengal	4.3	5.1	5.2	5.3	5.8	5.7	5.8	6.5	6.1	6.0	6.2	6.9	7.0	7.3	7.3

Share of Own Nontax Revenue in Total Own Revenue, 1974-90

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	-75	-76	-77	-78	-79	-80	-81	-82	-83	-84	-85	-86	-87	-88	-89	-90
Kerala	30.9	28.2	26.7	27.4	26.6	29.6	22.9	38.3	21.0	19.5	17.7	16.2	16.8	16.9	14.2	14.0
Karnataka	38.7	39.7	36.5	32.8	35.4	30.5	29.8	28.0	28.3	29.4	27.6	24.9	25.6	23.6	21.6	22.9
Tamil Nadu	22.8	21.9	22.4	23.4	21.6	20.0	26.7	14.6	14.2	14.2	14.3	13.4	23.4	14.4	11.2	10.1
Andhra Pradesh	27.7	24.4	28.1	29.6	29.1	28.4	27.7	27.2	24.3	24.3	24.1	21.3	20.7	21.7	26.4	22.8
All States	30.5	30.0	30.6	30.2	30.5	29.7	29.3	27.5	27.0	27.3	26.7	26.2	28.0	25.9	28.1	24.6

(percent)

Table 9.12

Per-Capita Central Revenue Transfers

(Rs.)

	<i>Plan periods</i>		
	<i>Fifth</i>	<i>Sixth</i>	<i>Seventh</i>
Kerala	57.37	110.10	219.20
Karnataka	40.88	98.60	202.15
Tamil Nadu	42.66	107.17	211.40
Andhra Pradesh	54.06	110.44	221.03
Maharashtra	42.08	100.35	187.70
West Bengal	48.31	100.44	232.25
All states	53.66	120.31	263.48

Table 9.13

Share of Central Revenue Transfers in State Revenue Expenditure, 1974-90

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	-75	-76	-77	-78	-79	-80	-81	-82	-83	-84	-85	-86	-87	-88	-89	-90
Kerala	37.85	36.34	33.93	36.30	36.74	33.52	30.39	32.32	32.57	33.17	32.48	34.46	31.72	26.30	30.30	30.30
Karnataka	24.66	28.44	27.27	29.21	26.84	32.07	30.95	31.54	27.52	29.15	25.69	27.65	30.07	26.47	27.36	27.49
Tamil Nadu	23.48	27.60	29.14	29.75	30.64	39.65	35.50	30.74	29.95	30.40	32.31	34.78	31.30	30.64	30.77	29.97
Andhra Pradesh	41.40	43.76	40.68	38.81	42.44	44.14	39.62	36.08	37.89	33.20	30.37	33.98	33.59	33.57	30.43	30.18
Maharashtra	20.28	22.93	21.48	22.72	22.39	26.33	24.52	22.30	22.98	22.67	22.06	18.30	21.47	21.33	19.68	21.51
West Bengal	40.04	39.52	39.03	37.95	36.38	36.54	37.85	35.67	35.51	34.85	31.10	45.71	41.71	42.35	39.99	37.82
All States	37.27	40.45	40.11	40.89	42.11	45.44	43.30	40.91	39.61	36.66	37.45	41.24	39.92	39.78	39.62	37.43

(percent)

Table 9.14

Total Revenue Expenditure

	<i>Amount (Rs. Lakhs)</i>		<i>Index (1971-75 = 100)</i>	
	<i>All States</i>	<i>Kerala</i>	<i>All States</i>	<i>Kerala</i>
1974-75	603685	28766	100.00	100.00
1975-76	696650	35504	115.40	123.42
1976-77	794019	38948	131.53	135.40
1977-78	891144	41589	147.62	144.58
1978-79	1051132	47914	174.12	166.56
1979-80	1208105	53369	200.12	185.53
1980-81	1480781	66760	245.29	232.08
1981-82	1707524	75450	282.85	262.29
1982-83	2023743	78339	335.23	272.33
1983-84	2380329	99244	394.30	345.00
1984-85	2834900	113866	469.60	395.84
1985-86	3263547	144533	540.60	502.44
1986-87	3773657	165477	625.10	575.25
1987-88	4508846	178068	746.89	619.02
1988-89	5216636	202815	864.13	705.05
1989-90	5911984	226553	979.32	787.57

Table 9.15

Ratio of Revenue Expenditure to GDP

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
	-75	-76	-77	-78	-79	-80	-81	-82	-83	-84	-85	-86	-87	-88
Kerala	13.8	15.9	16.2	17.9	17.4	16.9	17.7	18.8	16.8	18.2	17.7	22.5	22.6	22.0
Karnataka	11.5	13.9	15.1	14.0	15.9	15.3	16.7	16.1	18.9	18.3	21.4	22.6	20.0	22.3
Tamil Nadu	14.5	15.0	14.6	15.0	15.0	13.9	18.1	17.0	19.2	20.4	19.8	19.3	19.7	22.4
Andhra Pradesh	9.2	12.0	14.4	14.9	15.0	16.6	16.1	15.4	15.7	18.2	21.1	21.6	23.4	23.1
Maharashtra	10.8	12.0	12.0	11.7	13.2	13.2	13.7	14.3	15.4	17.0	18.0	18.3	18.7	17.1
West Bengal	8.7	9.8	9.8	10.7	13.1	12.0	12.5	13.8	15.5	13.5	14.2	13.9	15.5	15.3

(percent)

Table 9.16

Share of Nonplan Spending in Total Revenue Expenditure

(percent)

	Developmental			Non-developmental			Total					
	Fifth Plan	Sixth Plan	Seventh Plan	Total	Fifth Plan	Sixth Plan	Seventh Plan	Total	Fifth Plan	Sixth Plan	Seventh Plan	Total
Kerala	83.2	75.9	77.5	78.0	97.9	97.8	99.7	99.0	87.2	82.1	85.1	84.6
Karnataka	77.8	77.8	71.6	74.0	99.7	104.4	99.5	100.6	84.0	85.5	80.0	81.9
Tamil Nadu	78.3	67.1	67.3	68.7	99.6	99.8	99.3	99.5	84.4	74.9	75.6	76.7
Andhra Pradesh	79.0	71.6	70.0	71.6	99.7	99.8	99.7	99.7	84.5	78.4	77.4	78.6
Maharashtra	83.2	76.7	73.1	75.5	99.7	99.7	99.9	99.8	89.1	84.6	81.5	83.5
West Bengal	72.4	74.5	72.4	73.0	99.8	99.9	99.9	99.9	80.3	81.5	80.6	80.9
All States	77.9	71.6	68.4	70.6	98.8	98.9	98.1	98.4	84.1	79.3	77.5	78.9

Table 9.17

Share of Nondevelopmental Expenditure in Total Revenue Expenditure

(percent)

	Plan			Non-Plan			Total					
	Fifth Plan	Sixth Plan	Seventh Plan	Fifth Plan	Sixth Plan	Seventh Plan	Fifth Plan	Sixth Plan	Seventh Plan			
Kerala	4.44	3.59	0.74	2.12	30.54	33.31	39.58	36.50	27.18	27.97	33.81	31.20
Karnataka	0.20	2.19	0.87	1.08	32.84	34.63	36.46	35.43	27.79	28.66	29.47	29.02
Tamil Nadu	0.33	0.15	0.79	0.55	32.66	30.93	33.20	32.48	27.81	23.40	25.44	25.19
Andhra Pradesh	0.32	0.22	0.27	0.26	30.68	29.80	31.29	30.80	26.11	23.52	24.36	24.36
Maharashtra	1.20	0.61	0.21	0.41	40.00	40.27	38.16	39.04	35.78	34.20	31.21	32.68
West Bengal	0.25	0.00	0.31	0.31	34.93	32.26	35.64	34.55	28.29	26.49	28.97	28.15
All States	2.31	1.44	2.61	2.27	34.64	34.63	38.34	36.79	29.57	27.86	30.40	29.59

Table 9.18

Share of Debt Servicing in Total Revenue Expenditure

(percent)

	<i>Non-plan</i>			<i>Total</i>		
	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>
Kerala	11.1	10.9	26.6	9.7	9.0	22.6
Karnataka	11.4	15.1	24.6	9.7	11.9	19.3
Tamil Nadu	11.4	10.9	23.0	9.6	8.2	17.5
Andhra Pradesh	10.2	8.4	18.5	8.7	6.6	14.4
All States	13.0	12.2	25.4	11.1	9.8	19.8

Table 9.19

Share of Pensions in Total Expenditure

(percent)

	<i>Non-plan</i>				<i>Total</i>			
	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>	<i>Total</i>	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>	<i>Total</i>
Kerala	5.03	8.29	13.00	10.50	4.39	6.80	11.07	8.88
Karnataka	5.67	8.49	9.31	8.52	4.78	6.79	7.48	6.70
Tamil Nadu	4.28	4.08	7.60	6.10	3.63	3.08	5.78	4.70
Andhra Pradesh	3.76	5.07	5.34	5.04	3.19	4.00	4.15	3.98
Maharashtra	2.17	3.04	4.58	3.79	1.93	2.57	3.74	3.16
West Bengal	1.89	2.76	3.77	3.20	1.53	2.27	3.06	2.60
All States	2.68	3.53	4.88	4.19	2.26	2.81	3.71	3.32

Table 9.20

**Share of Expenditure on Government Services in Total
Revenue Expenditure, 1974-90**

(percent)

	<i>Plan</i>			<i>Non-plan</i>			<i>Total</i>		
	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>	<i>Fifth Plan</i>	<i>Sixth Plan</i>	<i>Seventh Plan</i>
Kerala	4.8	3.5	0.6	14.3	13.6	12.8	13.2	11.8	11.0
Karnataka	0.2	0.1	0.4	16.5	13.5	13.4	14.0	10.7	10.7
Tamil Nadu	0.4	0.2	0.8	17.2	16.0	15.4	14.6	12.1	11.2
Andhra Pradesh	0.5	0.2	0.3	17.4	16.3	14.7	14.8	12.9	11.4
All States	2.2	1.3	2.6	19.4	18.1	16.1	16.8	14.7	14.1

PART III
PROCEEDINGS

Chapter 10

Summary of Seminar Proceedings

WILLIAM A. BYRD, TAPAS SEN and T.S. RANGAMANNAR

This chapter summarizes the discussions held during the conference, concentrating on the main points. Presentations of papers by their authors are not recapitulated, however.¹ It also should be noted that comments are based on the original versions of papers as presented at the seminar; hence some of the issues raised may have been taken into account in the revised versions published in this volume.

Inaugural Session (April 19, 1991, morning)

A. Bagchi thanked the participants for coming to the seminar, the contributors for preparing a good set of papers at short notice, the World Bank for financing and helping to organize the conference, the Department of Economic Affairs of the Ministry of Finance (DEA) for its support and guidance, and Dr. Bimal Jalan for agreeing to inaugurate the conference. He then asked Mr. Jochen Kraske to make some opening remarks.

Kraske first welcomed the participants and thanked the various people and institutions involved in organizing the seminar. He then outlined the background of the seminar. The idea of holding a workshop on the topic of state finances was first discussed at the annual Paris Consortium meeting in June 1990 by DEA and the World Bank. Subsequently the National Institute of Public Finance and Policy was asked to help organize the seminar and contribute its expertise. Various papers of a general nature as well as case studies of

1. Except in the case of one paper that was presented at the seminar but is not published in this volume.

particular states were commissioned, and government officials from both the center and the states and researchers on state finances were invited to the seminar.

Kraske noted that the subject of state finances is of great interest to the World Bank and other international agencies, for a number of reasons:

First, state finances have been facing a squeeze that predates the current fiscal crisis, severely affecting their development expenditures. Since some of the most important sectors of the economy -- agriculture, irrigation, education, etc. -- are state subjects, the question of how to deal with the fiscal squeeze on states looms increasingly important.

Second, state finances will be affected by and will be forced to participate in the major overall fiscal adjustment that India has to make over the next several years as part of macroeconomic stabilization. In this context it is important to ascertain the scope for reallocations of resources, streamlining, efficiency improvements, enhanced resource mobilization, and spending cutbacks that will minimize damage to India's development objectives.

Third, the system of center-state fiscal relations impinges on trade reform, tax reform, and other structural reforms, as well as influencing development priorities and regional imbalances. For example, given the way in which important taxes are shared between center and states, the central government has a strong incentive to rely heavily on customs duties and to a lesser extent on excise taxes, while neglecting direct taxes. These tendencies are clearly reflected in recent trends, which are probably the opposite of what would be desirable and harm the prospects for structural reforms.

Fourth, state finances affect plan and project implementation in important ways, differently across states. It is important to understand the effects and devise ways in which the resulting problems can be ameliorated.

Finally, the implementation of externally-aided projects is strongly influenced by issues related to state finances, including among others implementation capacities and availability of counterpart funds. As a result, not only the locus and pace of aid programs but also the inflow of foreign exchange resources to the central government are affected. Hence the large build-up of committed but undisbursed official development aid from both bilateral and multilateral donors is intimately related to state finances.

The inaugural address by Bimal Jalan followed.

Inaugural Address by Bimal Jalan²
(April 19, 1991, morning)

In this gathering it would be presumptuous of me to say very much about the technical issues of state finances and center-state relations. This is an under-researched area, and I am sure that the papers presented here as well as the deliberations and conclusions of the seminar will be of great value to researchers all over the country. I may perhaps briefly mention a few points which seem to me to be important and will no doubt figure prominently in your discussions today and tomorrow morning.

First, we must recognize the very difficult and persistent fiscal problem faced by both the center and the states. It goes well beyond, in my view, the question of center-state transfers, although much attention has been focussed on that particular issue. The overall fiscal problem cannot be sorted out by redistribution -- it is not that the central government is "affluent" and the states deprived. The center had a revenue deficit of Rs. 17,600 crores in 1990-91, as against the Finance Commission's projection of Rs. 8,500 crores. The States have a revenue deficit of Rs. 5,800 crores. The corresponding Finance Commission recommendation was, if I recall it correctly, that there should be no nonplan deficit after the recommendations on Finance Commission transfers are implemented. All in all, the center had a deficit twice as high as was implicit in the Finance Commission's recommendations and the states had a deficit which instead of being zero was substantial. I think that more-or-less the same political-economic reasons which explain why the center is in the red probably also explain why the states are suffering.

It also seems to me that we are now reaching the limits of borrowing to finance revenue deficits as well as to undertake capital formation. The sources of borrowing are drying up because a substantial part of borrowing has financed revenue expenditure, interest rates are being pushed up and there is great competition for funds not only between state governments and the central government but between public sector enterprises, state governments, the central government and private enterprises. Unless the situation is reversed, particularly with regard to revenue deficits at the center and the states, the debt problem will indeed become a debt trap. We have to take this eventuality very seriously.

The first consequence of the debt trap that I see is that the ability to finance through borrowing from the market or borrowing from the

2. This is a condensed summary of the highlights of the speech.

Reserve Bank of India is now limited. Second, the fiscal deficit is causing BOP problems; one does not have to be a strict monetarist to accept that there is a relationship between the BOP problem and the fiscal problem. Increasing deficits are leading to reliance on foreign savings to finance capital formation, as well as some revenue expenditure. Third, the fiscal deficit is eroding capital formation as well as resources for expansion of social services, anti-poverty programs, and employment programs. The main burden of India's fiscal problem is falling on state-provided social services as well as on plan investment. Spending on social services has actually declined as a percentage of total revenue expenditure, while interest payments and administrative outlays have gone up. As for capital expenditure, the picture is even more bleak, with the biggest shortfalls in areas like irrigation, flood control, power, water supply and sanitation.

Finally, fiscal problems and worsening financial stringency are leading to a crisis management approach to the budget, which is the enemy of any good fiscal policy. So apart from the economic effects in terms of capital formation, social services, competition for funds, higher interest rates, BOP problems and so on, I think our ability to devise sensible long-term fiscal policies including the resolution of the center-state transfer problem is being progressively weakened, simply because we are not able to put our fiscal house in order.

As a people, not as IAS officers from the center or the states, we have to ask the question "can we go on like this"? The answer, I am sure, is "no". It seems to me that we cannot go on like this without destroying the social and economic fabric of this country. The inability to tackle the fiscal situation is having an impact on our entire methodology of thinking about our problems. Why is it that we are not able to sort out this problem despite the fact that all of us regard it as very important? The anatomy of the problem is after all well-known.

I believe that we cannot solve the fiscal problem within the existing structure and functions of the central government and the state governments. The role of government is an issue that we all have to apply our minds to; the old assumption of a Benthamite State will have to be revised. As we mature in our politics I think these aspects will have to be taken into account: our bureaucracy and administration is so big that it has become unmanageable; the government cannot be a source of high wage employment; the government cannot solve employment problems; and we have to give up certain responsibilities in some areas. It is not an ideological question, it is purely a management question. The central government has 250 public

enterprises, and, I am sure, each state government has at least 100 or 150 of them. In a system where we are not even able to appoint the chiefs of public sector organizations, how can we manage? Each decision in the government -- whether large or small -- requires the same amount of time, the same procedures, the same process. I think we should take a purely management-administrative approach to the whole question of the role of government. Regarding any particular activity, can we do it? If not, we may better think of doing something else.

Decentralization from states to lower levels of government, it seems to me, is a philosophy and justifiable on philosophical grounds. Moreover, the benefit of a more centralized system of decision making in terms of coordination is entirely lost through delays, ambivalence, hesitancy, lack of flexibility and rigidity. Hence I think that decentralization, in addition to its philosophical content, is also a management philosophy and requires much more stress in our country than has been the case so far.

Subsidies are another issue, closely tied to the question of political will. Highly subsidized social services can work, if the money is available. But if not, quantitative expansion leads to deterioration of the quality of services due to lack of resources. This is a phenomenon not confined to India but also evident in other countries, including a number of industrial countries. But again, the question of government-provided services goes well beyond money; it is a question of being able to deliver the services at an acceptable level of quality. I think most of our people probably agree that the services we are providing at tremendous cost to the nation are deteriorating in quality; this issue has to be faced squarely.

As far as state finances are concerned, road transport and electricity undertakings are very important. Here again the question is how do we manage them, whether we can manage them, and how do we tackle problems of manpower and personnel. Because these entities have become instruments to increase employment, I do not know whether anything can be done. But if any solution can be found, it is not going to lie in exhortations like "improve your performance" or "develop a better management system". Structural change also will be necessary. What kind of transport service, what kind of electricity service, for whom, where, and whether state governments should provide them are questions that need to be addressed.

As far as I can see, the Five Year Plan documents and Finance Commissions have talked about the fiscal problem for several decades, and each state government has talked about it. All of us are men of

good will, but somehow the system as a whole functions in a manner that we cannot find a solution. If we cannot solve the fiscal problem we have to do something about the problem itself, that is, shrink the role of government. This is another issue which requires attention. There are great limitations at the bureaucratic level in getting anything done.

I feel that we do not have much time to lose, and the issues go beyond economics. If we cannot solve our fiscal problem, I think all of the things that we cherish as Indians, as people, are at stake; some manifestations of the gravity of the situation are already evident. The inability to tackle either the BOP problem or the fiscal problem has affected our psyche. I am sorry that I have not given a technical statement, but I do think that it may have been useful to put forward some broader issues for your consideration.

Session I: Overview Paper (Chapter 2)

April 19, 1991 (morning)

Discussants' comments. I.S. Gulati, while appreciating the paper for its detailed documentation, took exception to the conclusion of the paper regarding the bleak prospects for planning in the states, as he believed that the difficulties could be traced largely to the central government. He noted the differential contributions of BCR (Balance from Current Revenue) to plan financing at the center and in the states. In the Seventh Plan estimates, BCR accounted for only 11 percent of total plan financing at the center but 36 percent in the states; in terms of realizations, BCR accounted for 23.3 percent of total plan financing in the states and only 3.3 percent at the center. So despite the severe problems of state finances, the states managed a substantial BCR contribution, unlike the central government. Large-scale deficit financing by the central government has caused inflation and thus increased the revenue expenditure burden of the states. States lack the "elbow room" provided by extensive reliance on market borrowing, severely constraining their plan spending. While blaming the states for exporting tax burden to residents of other states, the paper seems to ignore the massive taxation of inputs by the central government. In this context, the consignment tax would plug a major loophole; hence the criticism of it in the paper is unwarranted.

Atul Sarma suggested that the crisis of state finances needs to be examined within the context of the general economic scenario, characterized by the following notable features: (1) the increasing share of nonwage income in total income and consequent slow growth of the tax base; (2) inadequate returns on capital invested in public

sector undertakings; (3) depreciation of the rupee, which has had asymmetrical effects on the private and public sectors, since the latter accounts for more than half of total imports but less than a quarter of exports; and (4) overcapitalization of the public sector through large borrowings, leading to high interest burdens.

The factors involved in the declining share of capital expenditure in the states may include the following: (1) centralization of investment in power and other areas, mentioned in the paper; (2) a shift from direct capital formation to various promotional investments; and (3) the changing political economy of expenditure in the states, leading to pressure to allocate more resources to revenue expenditure, especially subsidies, and resistance to price increases for public services. Finally, it was noted that the regressions performed in the paper may have multicollinearity problems.

General discussion. S. Guhan opened the discussion by echoing the sentiments of Gulati and stressing the need to look at equity in center-state relations. Inflation has had an effect on the emoluments of state government employees. The states have been trying to follow central pay increases, which as a result impose a big burden on state finances. The shortfall in state public enterprises' contributions has been partly due to increases in administered prices of inputs provided by central public enterprises. Since they deal directly with the final consumers, the state public enterprises cannot pass on these price increases and hence their contributions are squeezed. Overall, the Finance Commissions have failed to distinguish between factors inside and outside the control of state governments that were causing problems with their finances.

G.S. Sahota reiterated the doubts expressed by Atul Sarma concerning the regression equations reported in the paper; he also expressed a preference for use of per-capita plan outlay figures over plan outlay as a percentage of state domestic product, as the former indicator is at least welfare-oriented.

M. Godbole pointed out the fact that the poorer states tend to have higher debt ratios, the servicing of which accentuates their resource problems. He also suggested that the formulation of plans for the states is not entirely governed by objective considerations and is marred by a certain amount of ad-hocism.

M. Govinda Rao pointed out that a comparative evaluation of plan financing by the central and state governments was beyond the scope of the paper. The distinction between plan and nonplan expenditures is somewhat artificial; what happened to levels of public expenditures at the state level (plan and nonplan) is often a more relevant question.'

It is also important to look at what has happened to levels of public services provided and the effectiveness of their delivery. Increasing commitments at the state level as a result of centrally-sponsored schemes is another important issue. On the other hand, undertaxing by states and underpricing of state-provided services are essentially state choices. Finally, the balance from current revenue (BCR) of the central government and the states are not comparable, since the former is lower and the latter higher due to center-state transfers.

P.D. Mukherjee raised a technical point about consistent definition of BCR, keeping additional resource mobilization in mind; he was assured by the authors that all of the figures for BCR included additional resource mobilization. Mukherjee, however, felt that additional resource mobilization from public enterprises should be separated out from BCR to prevent misleading conclusions. He went on to suggest that recovery of most social welfare expenditures as well as the costs of some other services like agricultural subsidies was rendered difficult due to reasons such as user resistance, administrative difficulties and low income levels of target groups.

M.S. Mohanty suggested that it may be instructive to break down state government deficits into structural and cyclical components. He also clarified that, subject to guidelines from the central government, the states do have some discretionary borrowing capacity.

R.J. Chelliah believed that an examination of the impact of inflation on the level and structure of government expenditures at the state level could prove illuminating.

The authors pointed out in their rejoinder that the paper did not intend to make a comparative evaluation of plan financing by the central government and the states. They reiterated their doubts regarding measures like the consignment tax, which would be inefficient for the economy as a whole. They voiced their concern at the falling share of capital expenditure in states' spending and possible long-term consequences of such a trend. The reported regressions, it was clarified, are preliminary in nature and were intended only to indicate the role of other factors aside from state domestic product in determining plan outlays. Finally, the authors stressed that the heavy reliance on various forms of debt in financing state plans is certain to increase debt-servicing expenditures and further accentuate the resource crunch.

Session II: Analysis of Changes in State Government Subsidies (Chapter 3) (April 19, 1991, morning)

Discussant's comments. While complimenting the authors on

producing an excellent paper, William Byrd felt that the assumptions and definitions employed resulted in a rather broad definition of subsidies and consequently high estimates of their aggregate cost. For example, some would argue that no cost recovery should be expected from primary education. Arguments have also been made, perhaps not on very rational grounds, that cost recovery in sectors like irrigation should be confined to operating (or variable) costs. In any case, the magnitude of state subsidies is clearly very large, and they have been growing rapidly. Depending on the analytical perspective, the imputed interest costs in the paper's subsidy calculations could be considered too high or too low. The effective rate of interest actually paid by state governments is lower than the figure assumed, given the write-off of many loans by the central government. The social opportunity cost of capital, on the other hand, is higher than the assumed figure.

Byrd also emphasized the importance of intra-state inequality in the distribution of the benefits from subsidies, as opposed to the interstate differentials discussed in the paper. An important policy implication is that states can make the distribution of subsidies more equitable within their own territories, independent of any central actions.

He felt that to a large extent, rising subsidies and declining cost recovery rates can be explained by maintenance of user charges virtually fixed in nominal terms in the face of rapidly rising costs due to inflation and other factors. This pattern reflects neglect, policy drift, and the political clout of beneficiaries, rather than any conscious policy to increase subsidies. The logical policy implication would be in the short term to introduce some form of indexation of user charges to provide relief and over the longer term to reduce inflation through fiscal adjustment. Direct cuts or freezes in expenditures as a means of reducing subsidies may not work very well because they could lead to deterioration in the quality of subsidized services and consequently even greater user resistance to enhanced cost recovery.

General discussion. S. Guhan felt that for the purpose of estimating subsidies, reasonable normative costs rather than actual costs should be used, as users should not be expected to pay costs attributable to inefficiencies in provision of the service. He also suggested that the exclusion of pure transfers from the definition of subsidies is somewhat artificial.

M.K. Rakshit raised the question of the incidence of subsidies and how this would affect their justification. Maybe the benefits of subsidies actually go to the government employees providing the

services rather than to the consumers. Also, with quantitative rationing, the justification for subsidies becomes weaker.

A. Datta stated that unless universal primary education were required by law, it should remain in the category of merit goods and should not be considered a public good.

M. Godbole emphasized the role of value judgements in any study of subsidies and cost recovery; under certain circumstances, cost recovery through taxation rather than user charges may be desirable. He also pointed out that estimation of subsidies on the basis of budgetary data could be vitiated to some extent by fluctuations in the reported figures.

Nirmala Banerjee added that the standards of service need to be evaluated in any interstate comparisons of subsidies, as well as state-specific factors affecting costs and recovery.

V.J. Ravishankar suggested that given the current fiscal situation, involvement of private and/or voluntary agencies in the provision of presently subsidized services could be explored.

R.N. Gupta emphasized the need for a conscious policy on subsidies, based on a long-term perspective and on macroeconomic realities, including the capacity to recover costs of services provided. He also felt that one reason why user charges have been neglected as a potential source of revenue is the lack of any link between the receipts and expenditures of agencies and departments providing services. Education fees, for example, go into the states' general revenue receipts and have no relation to budgeting of education expenditures.

The authors clarified that they have considered only services for which excludability is applicable and for which cost recovery is not precluded by definition. They also clarified that the cost estimates include a rate of return in addition to imputed interest costs but do not exclude costs attributable to inefficiency in provision of services. Estimation of efficient cost of provision of services would have made the study extremely complicated, and actual costs of provision in any case are relevant for the budgetary implications.

Session III: Externally Aided Projects (Chapter 5) (April 19, 1991, afternoon)

Discussant's comments. Gene Tidrick noted that the paper sheds light on interesting issues, brings to bear good analysis, and makes potentially fruitful suggestions. He highlighted the following points made in the paper:

- (1) the implementation of externally aided projects by the states has generally been slower than by the center, but given the sectors now being emphasized (which are mostly state subjects) and the need to decentralize, there is no alternative to relying on the states;
- (2) although the distribution of flows of external funding among states has been inequitable, these comprise only a small share of total center-state flows, so the impact is not very significant;
- (3) the effect of external funding on the sectoral distribution of plan outlays could become important at the margin in a serious resource crunch;
- (4) the effective rupee cost of external borrowing to the central government is higher than the terms on which such resources are presently passed on to the states, which implies that there is a considerable interest subsidy; and
- (5) the central government has gone about as far as reasonably possible in providing additionality to the states from external resources, and it does not appear feasible to raise disbursements significantly with further minor changes.

This last point has adverse implications for the future growth of aid inflows and consequently for India's balance of payments. There are two possible ways to improve the situation:

- (1) The center could make it even easier for states to absorb additional external assistance by augmenting prefinance facilities and/or by "pump-priming" with additional special foreign assistance to provide counterpart funding for the undisbursed pipeline (as was done in Indonesia).
- (2) The states could be made more directly responsible for foreign aid, in particular for repayment of external loans in rupees, as part of overall fiscal reform giving states more responsibility for their finances.

General discussion. This mainly covered clarification of factual issues related to the terms and conditions for transfer of external fund. The author pointed out that the central government is now passing on prefinancing facilities received from external donors to the states, unlike in the past.

Session IV: Intergovernmental Transfers as an Instrument to Alleviate Poverty³

(April 19, 1991, afternoon)

Brief summary of paper. This paper analyzed the interaction between intergovernmental transfers and poverty alleviation, using a combination of theoretical and empirical analysis. It looked at interstate variations in levels of poverty and at factors that might explain such variation, the design of general-purpose and specific-purpose grants as part of a poverty alleviation strategy, the relative effectiveness of the central government and the states in alleviating poverty, optimal poverty alleviation transfers, and other related topics. The theoretical analysis was carried out using a model based on agency theory, deriving some normative results on the optimal type and combination of transfers. On the whole, the case for general-purpose grants was found to be stronger and more broadly applicable than that for specific-purpose transfers in support of direct poverty alleviation programs. More generally, the latter cannot compensate for inadequacy of the former in terms of permitting the needed fiscal capacity across states.

The main conclusions of the paper included the following:

- (1) General-purpose transfers through the Finance and Planning Commissions as well as other central loans have failed to offset the fiscal disadvantages of poorer states. If anything, these transfers have been disequilibrating. Consequently, increased spending on poverty alleviation in states with large concentrations of poverty could only be achieved by diverting funds from economic services, resulting in lower capital expenditures and slower growth, exacerbating interstate income disparities over the long run.
- (2) The amounts of funds involved in poverty transfers are negligible considering the magnitude of India's poverty problem; hence they are not likely to have a significant impact in reducing poverty.
- (3) The design of poverty alleviation transfers left much to be desired in the past. Transfers were not based on the number of poor or the intensity of poverty, so the impact was limited. In recent years this problem has been to some extent remedied.

3. This paper, written by M. Govinda Rao and Arindam Das-Gupta, is being published separately and therefore was not included in this volume. A brief resume of the paper is included to provide background for the summary of the discussion.

Discussant's comments. Pulin Nayak complimented the authors for covering an area of research that is extremely important and doing so with a good blend of theoretical, institutional and empirical analysis. He felt, however, that the theoretical and empirical parts of the paper could be better integrated.

General discussion. A. Datta pointed out that transfers in the paper do not include transfers to individuals (income transfers). Also, he felt that the emphasis on the efficacy of block grants may be somewhat misplaced, and that horizontal transfers should be more equitable.

Atul Sarma noted that the paper was based on poverty estimates from 1982, but that data are now available for 1987, showing a substantial decline in poverty. The reasons for this decline need looking into. Ramalingom Aiyar cited the case of Kerala, where the poverty ratio has come down despite slow growth.

Nirmala Banerjee noted that the urban poverty ratio is now somewhat higher than that in rural areas and that informal market wages in rural and urban areas are now almost at the same level. This suggests that anti-poverty programs have succeeded in putting a floor under rural wages.

Session V: Tamil Nadu and Kerala State Finances (Chapters 6 and 9)

(April 19, 1991, afternoon and April 20, 1991, morning)

Discussant's comments. M. Godbole stated at the outset that the four case studies of state finances brought out some common problems, which are probably common to all the states. The main problems in state finances can be summarized as follows:

- (1) Despite good performance in revenue mobilization, reaching 15-20 percent of state domestic product (SDP), all of the states are facing serious fiscal problems, and there is limited scope for additional revenue mobilization. Since the center also does not have any extra resources, a state can obtain higher central transfers only at the expense of other states. Various factors have resulted in fiscal difficulties even for states that were in good shape five years ago. Apart from limited scope for further resource mobilization, these factors include limits to and the high cost of state borrowings, the sharp rise in state expenditures, greater emphasis on state-provided social services and declining cost recovery in sectors like irrigation, power, roads, education and health.

- (2) Well-intentioned policies have often floundered in the past due to inertia, lack of political will and disharmony among the states as well as between the states and the central government. Examples include zero-based budgeting, sales tax concessions to attract investment and poverty alleviation programs.
- (3) The issue of local finances is tied up with that of state finances, due to the heavy dependence of local bodies on the states. The problem is essentially that of finding resources, and merely establishing Finance Commissions at the state level will not solve this underlying problem.

Godbole then outlined an action program that he considered necessary to tackle the problems of state finances, including, *inter alia*, the following elements:

- (1) cutbacks in nonessential government expenditures and services to help reduce levels of subsidy;
- (2) identification of appropriate target groups for subsidies and adequate cost recovery from other beneficiaries;
- (3) better use of the existing base in mobilizing resources, e.g. raising the professions tax (since the ceiling was increased by a recent Constitutional Amendment);
- (4) reducing interstate competition in lowering sales tax rates and providing tax incentives to attract industrial investment;
- (5) harmonization of state excise duties and sales taxes, both within and among states; and
- (6) rationalization and harmonization of staffing levels and patterns and emolument levels (including bonuses, pensions, etc.) to hold down costs, along with similar measures at the central level and development of a national consensus and policy on government employment.

In closing, Godbole suggested that a continuing center-state forum or group needs to be created to look into all of these issues and move forward with an action program.

General discussion. S. Mundle stressed the danger of "hand-out regimes" at both central and state levels. On subsidies, he felt that the Tamil Nadu paper did not improve on the methodology of the Mundle and Rao paper, contrary to the claim made by the author. He also felt that better targeting of subsidies is necessary and suggested locational targeting as a possible method, as has been advocated for the Public

Distribution System.

Mundle's suggestion generated extensive discussion on different ways of targeting subsidies. The general opinion was that it is not feasible to target subsidies precisely. Various participants commented on the political difficulties of targeting, the impossibility of means-testing, opposition that would arise to discriminating by geographical locality, and problems in trying to design self-selection mechanisms such as subsidization only of inferior goods consumed primarily by the poor.

Commenting on the Kerala paper, M. Govinda Rao suggested that it lacked balance in that it put all the blame for the state's fiscal problems on the center. Many self-created fiscal problems in Kerala were not cited in the paper, such as numerous stays on sales tax collections given by the state government at the behest of political parties in the ruling coalition and the "protected teachers" who have no jobs but still draw salaries from the state.

In his supplementary remarks, S. Guhan asserted that there is not much room for additional revenue mobilization through state sales taxes. On the expenditure side, Tamil Nadu has almost exhausted the potential for new irrigation schemes, contributing to the progressive shift from capital to consumption expenditure. But much more should have been done on irrigation upgrading and maintenance, rural power, rural infrastructure, etc.

He agreed that Tamil Nadu has been populist but argued that populism is not necessarily illegitimate. Some "populist" expenditures are justifiable on their own merits, such as the mid-day milk scheme and the social security scheme for the informal sector. "Compulsive populism" occurs when a new government, coming into power, feels compelled to continue populist programs started by the previous government. "Competitive populism" occurs before elections, when the party in power starts new schemes and the opposition promises new schemes, both as vote-getting mechanisms.

Guhan suggested that it is important to look at the distributional coalitions that have influenced state finances. Some of them pressure for reduced taxes, others for increased expenditures in areas where they benefit, and still others both. There are pork barrel coalitions for local projects, the liquor lobby, the bus drivers' lobby, and various lobbies for low interest rates. But the two most important distributional coalitions in Tamil Nadu are government employees and farmers. Distributional coalitions use their power to blackmail the state, not to corrupt the state.

Session VI: Gujarat and Uttar Pradesh State Finances

(Chapters 8 and 7)

(April 20, 1991, morning)

Discussants' comments. Nirmala Banerjee found the analyses of the four states made available through this seminar very useful; all of the papers added to the body of knowledge and potential for comparison. She saw diversities in states' fiscal patterns, not just the commonalities pointed out earlier. Differences across states can provide some clues as to what can be achieved, even in the face of constraints. For example, Kerala's experience shows positive results from expenditure on social services like education, health, family planning, etc. The social security programs of Tamil Nadu are of great interest. The management of public sector undertakings like the state transport corporations show large interstate differences.

Banerjee emphasized that looking at SDP alone as an indicator of living standards or well-being ignored other indicators that also should receive attention. More generally, it is not just the losses of state undertakings that are important but the standards of services being provided and the effectiveness of spending. For example, spending on police in West Bengal has been rising due to the creation of additional higher-level posts, without commensurate improvements in service. Despite increasing education expenditures, West Bengal spends very little on school inspections.

Referring to the discussion of lobbies in the previous session, she noted that numerous small lobbies influence state governments' policies in unobtrusive ways and together may be just as important as the major lobbies. It is important also to look at the losers -- those who get little or no benefit from state subsidies and expenditures. Her own study on poverty showed that the majority of the poor are children, although there is great variation across states in this aspect.

Finally, Banerjee suggested that price distortions caused by taxation should be looked at as a whole, not just those caused by state sales taxes.

M.C. Purohit confined most of his comments to the performance of Uttar Pradesh in taxation. To begin with, he wondered why purchase taxes on foodgrains and sugarcane are considered agricultural taxes, since they are indirect taxes. Many other taxes would qualify as agricultural taxes by the same criteria. To put estimates of buoyancy and elasticity of taxes in Uttar Pradesh in perspective, he suggested that between the 1960s and the 1970s the buoyancy of taxes rose in many states due to widening bases and tax exporting. In the 1980s the shift to single-point taxation and away from tax exporting narrowed

tax bases. Central sales tax also has had a deleterious effect on states' tax bases. Purohit advocated the use of specific tax bases for elasticity/buoyancy calculations rather than a broad base like SDP.

General discussion. M.S. Mohanty drew attention to the mounting arrears on tax collection, totalling Rs. 960 crore, for example, in Uttar Pradesh. Collections from stamp duties and registration fees are falling, due to undervaluation of property in real estate transactions. At one point stamps and registration fees were the third-highest source of revenue for states, but they have subsequently dwindled. He also pointed out that the impounding of Dearness Allowance and bonuses of government employees should not be treated as additional resource mobilization, because the impounded funds eventually have to be paid back.

Mohanty stated that the states engage in financial management rather than resource management. They typically overestimate revenues and underestimate expenditures at the time of budget preparation, with the result that late in the year they engage in (1) postponing expenditures into the following year; (2) disinvestment; (3) obtaining ways and means advances from RBI, or (4) drawing down cash balances. The whole budget procedure needs to be overhauled.

P.B. Rajagopalan pointed out that the figures on additional resource mobilization do not include measures undertaken outside the budget through departmental notifications; these should be taken into consideration in estimating buoyancy coefficients. He also felt that privatization of some social services like higher education could be explored as a measure to reduce expenditures, with private provision being registered and monitored by the government. Central organizations sometimes bring pressures to bear on the states for unwarranted tax concessions, which adversely affect state revenues. Forest conservation policies of the central government have caused large revenue losses to the states, without any compensation.

George Russell pointed out the large losses state governments make in financial transactions, often hidden in the budget statistics. There are large interest subsidies, as well as many nonperforming and doubtful loans. Many cooperatives are really state financial institutions in practice, and government loans to them need to be closely looked into. There is also poor management and lack of accountability in public enterprises. Many IRDP transfers are in the form of loans, with poor repayment prospects.

In supplementary remarks, Nizar Jetha argued that the problems faced by all states are basically similar, including high growth of expenditures, increasing emphasis on schemes related to employment

and income distribution, squeezing of needed developmental spending, and minimal improvements in services despite large increases in expenditures. The states rely on only a few instruments and overuse them. Moreover, their desperate search for additional revenues leads to ad-hoc levies and imposts. High taxation of inputs and equipment is very distortionary and needs to be curbed. In this respect sales tax is an important source of distortions in its own right.

J.L. Bajaj noted that his paper followed the framework and methodology used by S. Guhan. As the agriculture tax cannot yield much revenue, because most holdings are very small ones and moreover, the bulk of them are held jointly, Uttar Pradesh has used other methods for getting some tax revenue out of agriculture, including a tax on the wholesale purchase of foodgrains, a similar tax on sugarcane, and mandi taxes on other purchases. He clarified that agricultural purchase taxes were actually paid by the sellers, so they were included in the list of agricultural taxes. Poor sales tax administration also has been a problem. The performance of state public enterprises has been extremely poor, and there are substantial revenue losses due to tax exemptions. The seven-year sales tax exemption in effect becomes a permanent exemption, as after seven years firms simply change their names.

Turning to more general issues, Bajaj noted that at present the Finance Secretaries of states are only engaging in cash management; they do not have time for resource management. Accounting procedures in most states, especially those in north India, are very poor. Better training of officials at the grassroots level is needed, not just training for high-level officials.

Session VII: Local Government Finances (Chapter 4) **(April 20, 1991, morning)**

Discussants' comments. William Byrd noted that the paper covers an important, neglected dimension of public finance in India and contains many useful recommendations. Local government expenditure overall is far below the norms from international experience, and there has been substantial encroachment by state governments in this domain. State administration rather than elected local bodies have been the rule. Localities have often been required to take over maintenance of completed state projects, which has added to their financial problems. Local bodies appear to have exercised fiscal restraint, based on available data showing surpluses for most of them. In view of the worsening fiscal crisis and the danger of worsening fiscal indiscipline at the local level, it may be better to devolve explicit

revenue sources to local authorities, rather than providing them with stable transfer mechanisms.

Nirmala Banerjee pointed out that the variation in the structure of local bodies in India rules out any universal prescription. In some cases their role is so minimal that their existence is not justified. She suggested that it is hard to design user charges properly because of the difficulties in identifying users; an example is the well-known "exploitation" of central cities by residents of surrounding suburban areas.

General discussion. A. Bagchi asserted that surpluses in local bodies' budgets meant little because of (1) statutory requirements to run surpluses and (2) the extremely low level of services provided. He also felt that at least in some states like West Bengal, dependence of local bodies on the state government was greater than the figures in the paper indicated. He suggested that devolution to local bodies has become a major drain on state finances in recent years; in order to arrest this trend it would be necessary to keep spending and taxation powers at the same level of government. Bagchi further noted that in some cases salaries of local officials are paid directly by the state government, at rates applicable to state officials. Many local bodies in Tamil Nadu cannot even pay salaries of their employees. In Andhra Pradesh, some local bodies have asked to be "derecognized" by the state and to revert to Panchayats, since the state then covers all salary costs.

R.N. Gupta stressed that at present the lion's share of expenditure of local bodies is accounted for by the wage bill and interest payments. Local bodies must have adequate resources for carrying out their assigned tasks; if a major source of local revenue -- octroi -- has to be abolished, an adequate substitute needs to be found.

After a clarification by Datta that octroi was abolished in Uttar Pradesh without any compensatory revenue-generating mechanism put in place, M. Govinda Rao cited this as a case of the tendency among states to simply abolish octroi without dealing with the revenue consequences for local bodies. He also pointed out some problems in the collection of user charges. Capitalization of fiscal differentials in property and rental values creates difficulties in adjusting property tax structure suitably.

Tapas Sen pointed out that the abolition of octroi in Uttar Pradesh was to be accompanied by the introduction of an additional sales tax, the revenue from which would be distributed among local bodies. This new tax, however, met with strong resistance from traders, and Sen did not know the current status of the proposal. He also said that local

bodies in India have very little freedom in either expenditure or taxation decisions, so the extent of local autonomy is a major issue. The devolution of taxation powers to local bodies that has occurred so far has not resulted in significant revenue gains.

C. Ramachandraiah cited figures he had obtained from municipal bodies in Tamil Nadu and Andhra Pradesh to suggest that the National Institute of Urban Administration (NIUA) figures cited by the author in his paper underestimate the dependence of local bodies on state governments to a considerable extent. He suggested that state revenue from motor vehicle tax could be shared with localities.

I.S. Gulati argued for a well-thought out scheme of decentralization, including (1) decentralization of developmental functions, (2) devolution of funds through an appropriate mix of shared taxes and grants and (3) transfer of tax powers, keeping in mind their suitability for local administration. The transfer mechanism to local bodies should not duplicate the dual structure in center-state relations (Planning Commission and Finance Commission transfers). There is a need for fiscal responsibility and autonomy, reconciled with equity.

The author, in responding to the discussion, noted that historical factors led to major differences in the structure of local bodies in different states. In the Bombay Presidency under British rule, functions were devolved to local bodies on a self-sufficient basis, that is, revenue sources also were devolved (namely octroi). It was octroi that sustained this system. In West Bengal there was no octroi, so local bodies were dependent on the property tax. With rent controls the latter became inadequate as a source of revenue, so local authorities became dependent on grants from the state.

Session VIII: Summing Up and Conclusions **(April 20, 1991, morning)**

A. Bagchi identified three main areas around which to organize the discussion: (1) the main conclusions emerging from the seminar; (2) necessary actions to be taken; and (3) topics for further research. His list of items in these three areas was supplemented by S. Guhan, B.P.R. Vithal, I.S. Gulati, R.N. Gupta, R.J. Chelliah and George Russell. A consolidated list is presented below.

Main conclusions

- (1) It was generally agreed that state finances are in great difficulties, mainly attributable to faster growth of expenditures than of revenues.
- (2) In the area of taxation, two sources with potential for further

- revenue mobilization are the professions tax and (through removal of unnecessary tax incentives) sales tax.
- (3) Obvious candidates for close scrutiny among expenditure categories are subsidies, employment and wages, and transfers to local bodies.
 - (4) Financial management and accounting in state governments are weak and need improvement.
 - (5) Intergovernmental fiscal relations need to be restructured keeping in mind both equity and efficiency; a rational decentralization involving local bodies also is called for.
 - (6) Privatization of some government services is an option that deserves serious consideration.
 - (7) Fiscal discipline should be inculcated by, as far as possible, keeping spending and resource-raising decisions at the same level of government; appropriate incentives also are necessary for prudent fiscal management.
 - (8) The five-year cycle adopted by the Planning Commission has caused major problems in state finances, as this results in the shifting of the burden from centrally-assisted plan projects to the states after five years.

Necessary actions

- (1) A reliable, detailed and comparable database on state finances should be built up.
- (2) An ongoing body is necessary, to come up with new ideas, monitor implementation of recommendations, and act as a clearing house of information on state finances, particularly various measures and schemes adopted by individual states.
- (3) Ad-hoc grants under centrally sponsored schemes should be changed to formula-based ones.
- (4) Establishing an Inter-State Commission to reduce tax competition and to settle interstate claims and disputes not involving the central government would be desirable.
- (5) State budget documents should be improved in terms of their content and presentation of data; in recent years there has been a tendency for states to bring out budget documents that are sketchy, incomplete, and even inconsistent.
- (6) It is necessary to increase transparency and improve accounting in public sector enterprises.
- (7) The tendency for state governments to underwrite deficits in private provision of services like education should be checked.
- (8) Similarly, the tendency to equalize wages and salaries in

different agencies at different levels of government should be modified by taking into account factors like nonwage benefits, conditions of service and job responsibilities.

- (9) Financial institutions should evaluate applications from units in the public sector on their own merits instead of always asking for state government guarantees.
- (10) A retreat from the "net deficit" concept governing state grants-in-aid to supported private institutions (especially in education) to a more rational mechanism that provides adequate incentives for efficient management and private resource mobilization is needed.

Topics for further research

- (1) Cost recovery in publicly provided services.
- (2) Finances of local governments.
- (3) Subsidies and incentives for industrial development.
- (4) The efficiency of government spending.
- (5) Criteria and design of intergovernmental transfers.

Chapter 11

Reducing Government Revenue Expenditure: Some Issues

B.P.R. VITHAL

In discussing government revenue expenditure, attention is usually focused on subsidies. But there are three other items which are equally important, at least so far as state governments are concerned: grants-in-aid, emoluments of government employees and state subsidized services. This note deals with these three items.

Grants-in-aid

Grants-in-aid are an important constituent of the revenue expenditure of the state governments. This is one of those devices which we inherited from British India administration but which in the course of the last four decades has been so distorted by democratic pressures in its intent and application that the original purpose has been more or less subverted. Grants-in-aid were originally a useful device to encourage private initiative in areas of activity which the government wished to encourage. By so doing, it was intended to obtain the advantage of private management of institutions while also reducing the financial burden on government direct expenditure. The area in which grants-in-aid have been used to the largest extent is education.

Some decades ago, while revising the grant-in-aid code, a concept of "net deficit" was introduced. In the case of educational institutions, the government prescribed the fees that could be charged and the scales of pay for teachers and all other employees and then committed itself to make good the difference between these two (the net deficit) through a grant-in-aid from the government. This meant that, on the one hand, no discretion was left with the private institution nor any

incentive to raise resources and, on the other, government expenditure was no less than it would have been had the government itself run the institution. The only advantage that remained in this arrangement was that of private management, which was assumed to be more efficient than government management in the case of some educational institutions. However, the financing mechanism was such that the motivation of private agencies underwent a change, and mercenary attitudes toward the running of educational institutions were encouraged.

For these reasons, the grant-in-aid is no longer a useful instrument for transferring government activity to the private sphere with the objective of reducing government expenditure. If this substantial item of revenue expenditure is to be reduced, it is necessary to review the grants-in-aid code and give up the net deficit concept. The grant-in-aid should be so designed that it matches the resources raised by the private agency, since it is only in this way that transfer of an institution from the government sector to the private sphere would result in an actual saving of government expenditure.

Generally speaking, there has been a tendency on the part of the government that wherever it exercises a regulatory role, it starts prescribing scales of pay of the employees and begins to consider itself as a champion of this section against the management. This is not a role which a regulatory agency need necessarily assume. Like that of a Registrar of Societies, the function of government should only be to see that any private agency which collects public funds for the discharge of a public function, like education, uses those funds properly and prudently and applies them for the purpose for which they were collected. In the case of educational institutions, the government may also have to ensure that certain academic standards are maintained and that the interests of students are properly taken care of. Even when the government gives grants-in-aid and also discharges a regulatory function with regard to a particular institution, there is no reason why its functions should go beyond this. It is time, therefore, that governments review their own roles in this regard and go back to the more limited ones they were exercising some decades ago. Unless this is done, the financial burden on government will not be reduced and the whole purpose of shifting certain activities from the public sphere to the private sector would be lost.

Emoluments of Government Employees

If government revenue expenditure has to be cut back, a major factor will be reduction of expenditure on staff salaries, which is

determined by the number of employees and average emoluments per employee. Data indicate that the annual rate of absorption in the public sector (which includes not only government but the public sector in the broader sense) has come down from 3.4 percent in 1971 to 2.4 percent in 1986. But the real incomes of public sector workers have doubled during the 25-year period from 1960 to 1985, whereas incomes in the organized private sector have risen by only 60 percent. The emoluments of government employees, therefore, are an important factor in determining total public expenditure.

We inherited from the British a public bureaucracy which was considerably differentiated in terms of the emoluments and conditions of service of the employees of various public authorities. The conditions of service of employees of local bodies were different from those of government, and even within government there were several categories of employment such as contingent staff, work charged establishments and purely temporary staff. There was, of course, the broad division between state government employees and employees of the Government of India. This position continued for quite some time after independence, but subsequently it started changing, and today we are in a position where effectively the emoluments and terms and conditions of employment for most of these categories are the same.

There is a tendency for every service to demand parity with government employees, and among government employees the final goal is the terms and conditions applicable to employees of the Government of India. Several factors have encouraged this tendency. First, employees tend to make horizontal comparisons. If in any place there are Attenders of Government of India, of the state government, and of the local municipality, their duties are the same and the Attender of the Government of India is not subject to any extra hazard of being liable to be transferred anywhere in India. The only justification for a difference in their emoluments would be that their respective employers are different and have varying capacity to pay.

The idea that emoluments of an employee are related to the capacity to pay of his employer has gotten progressively vitiated to the extent that, very often, the option now is that either you do not employ or if you employ, you have to pay according to considerations other than your capacity to pay. In the public bureaucracy this tendency got further accentuated by the fact that each higher level in the hierarchy also has responsibility for financing the lower level. Thus the state governments finance the local bodies, and the Union Government, through the Finance Commission, provides grants-in-aid of revenue to the state governments. If, therefore, the immediate

employer at any lower level in the hierarchy resists demands for emoluments approximating those of the higher level, he can be told that he has only to create the liability and the financing will be taken care of by the higher level. This pattern was formalized by the Ninth Finance Commission when it explicitly took into account the cost of introducing basic pay according to central scales in each state in fixing normative estimates of their expenditure.

The basic nexus between an employer and employee, which is emoluments, is thus broken, and either the pay scales are actually prescribed by the higher financing level or each level is encouraged to take the line of least resistance by adopting the emoluments and conditions of service of the next higher level, leaving it to that level to pick up the bill. Given the fact that government accepts the salary liability of such agencies, the terms of reference of Pay Commissions are extended to cover all such categories of employees. In fact, this tendency has now extended not only to public authorities that the government finances, like the local bodies, but even to private institutions to whom the government gives grants-in-aid. Thus we now have a large, isomorphous though not monolithic organization, from the Union Government to the grants-in-aid institutions, where emoluments and prerequisites of the lowest level are set with reference to what prevails at the higher level and not with reference to the financial capacity of the agency at each level and the skill requirements of that level. The interpretation of the Courts of Article 12 of the Constitution and on issues such as the capacity to pay and the principle of "equal pay for equal work" have all contributed to this growing homogenization of emoluments in the public bureaucracy. The State now has a Midas touch. The moment the State, or any of its subordinate or auxiliary agencies, touches an employee, a demand for the terms and conditions of service available at the highest echelon of the institutional structure is created. The resolution of this problem requires clarity with regard to the role of the State as an employer in relation to the separate and distinct identities of the various quasi-governmental and non-governmental organizations financed by the State.

State Subsidized Services

Given our social and economic conditions, state subsidies and social security for the poor will be justified for a long time to come. The real issue, therefore, is to ensure that such schemes are sharply focused and narrowly targeted so that only the deserving and intended groups benefit from them. What is happening in practice is that a large

number of such schemes are initiated ostensibly for the benefit of the poor and are justified on this account. But in the course of implementation, they are hijacked by the nonpoor who are politically more influential. The poor may not be completely excluded but are edged out to a substantial degree. One of the familiar ways of avoiding this kind of distortion is to design the scheme in such a way that it is self-targeting. For instance, in food subsidy schemes, if the items distributed are those consumed only the poor, such as coarse rice or millet, then the nonpoor would be automatically excluded. This was the philosophy behind the old gruel centers started for famine works. But such targeting has become difficult for two reasons. Firstly, consumption patterns of the poor and the nonpoor are now increasingly converging, so that distinguishing between them has become difficult. For instance, a large section of the poor have ceased using millet or even coarse rice. Secondly, the nonpoor cleverly attack self-targeting on the ground that it is demeaning and inequitable to make such a distinction.

An entirely unintended phenomenon that has led to self-targeting for some government-provided social services has been the inefficiency of their provision. For instance, government hospitals are run in such a manner and their reputation is such that only the poor and the desperate go to them, so there is involuntary exclusion of the nonpoor. When a plea is made for dual pricing of government services, so that more is collected from the nonpoor, this consideration has to be kept in mind. If the performance of the government facility improves and is then offered, even on a higher payment basis, to the nonpoor, one consequence could be that the poor get pushed out. Once the nonpoor are also coming to a hospital, the attention of the staff, the allocation of medicines, etc. are bound to get diverted to them, to the detriment of the poor. The mere fact that the nonpoor are paying more will not remedy this situation.

It is possible to treat the paying section of a facility for the nonpoor as self-contained, that is, the charges would be so fixed that it finances itself. The government grant intended for the poor would not, in theory, be affected. This approach will not work, however, for common facilities that cannot be so separated, such as diagnostic and surgical equipment in hospitals. More importantly, the time of the doctor also is bound to be diverted to the nonpoor, not because they are paying but because they are more influential. In some states, one or two selected medical institutions with very advanced facilities have been established by the government, with higher charges than in a general hospital. Because of the quality of the facilities (sometimes

even better than those in private hospitals), the influential nonpoor use them. The poor do not get corresponding access to these institutions, and the other government facilities (the original general hospitals), which are much larger and also play a teaching role, do not compare at all in the standard of services they provide. This kind of phenomenon is bound to continue if the government tries to provide facilities for both the poor and the nonpoor. The only solution under these circumstances would seem to be the drastic one of pushing the nonpoor onto the market and leaving government facilities entirely for the poor.

Generally speaking, wherever the government offers a facility or a subsidy, the nonpoor, who are politically influential, compete with the poor, and it is not realistic to imagine that their political influence can be ignored. In a contest between the rich and the poor for government services, it is easy to resist the pressure of the rich, but this is not so in the case of the broader category we call the nonpoor. This includes the organized working class, civil servants, the lumpen elements and the well-to-do peasantry. These sections, by comparing their lifestyle with that of the really rich, propagate a myth that they are, in fact, poor and deserving. Having made a case that they are poor by comparing themselves with the rich, they then enter into competition not with the rich but with the poor for access to subsidized services.

On several economic issues the sympathies and interests of the nonpoor are, in fact, with the rich, because they now also are asset holders. The nonpoor have become the backbone of the consumer durable society. For instance, in the case of any proposal intended to tax the rich, this group has a sneaking sympathy for them, because there is a degree of overlap in the damage caused by such proposals. The nonpoor are somewhat muted in their reaction to higher marginal rates of income tax, because they also feel the pinch of the tax and are constantly agitating for benefits. When this group comes into competition with the poor it is more vocal and politically more powerful and succeeds in large measure in excluding the poor from schemes that were originally proclaimed to be for their benefit. The Public Distribution System is a good example of this phenomenon.

The nonpoor are an elusive but powerful group, and it is futile to expect that the government will be able to resist their political pressure and exclude the nonpoor from the benefits of schemes ostensibly offered for the poor. If, for instance, a steep increase in the fees for engineering and medical colleges is proposed, which would still leave their level far below that of private donation colleges, this group will organize a protest spearheaded by the poor. Both the

decision makers and the poor easily overlook the fact that any such increase would not affect the poor at all, because they would in any case get caste scholarships from the government. Dual pricing of a subsidized service while continuing to give access to the nonpoor is, therefore, not a feasible solution. A more practical approach would be to push this group entirely out of any subsidized government scheme. The encouragement of private initiative in educational and medical facilities should be looked at in this context. If the government offers commensurate facilities it will never be able to charge what those facilities justify if they are to be economically utilized. It would, therefore, be more practical to restrict government facilities entirely to the poor. The present approach that these facilities, like a general hospital, are intended for the entire public but with preference for the poor has to be given up. There must be restriction entirely to the poor, identified on some objective basis such as the issue of a card as is now being done in some Public Distribution Systems.

One consequence of excluding the nonpoor may be that the quality of services will suffer. This is already being noticed in the case of government medical facilities where, with the nonpoor increasingly going to private institutions, the standard of services has declined considerably. The decision makers and administrators no longer even know the conditions in government institutions because, unlike in previous times, they are no longer using them for their own medical care. If a senior civil servant goes to a general hospital for an X-ray, he may discover that the hospital does not have X-ray film for lack of budget provision. If he is no longer going to the government hospital but rather to a private institution, he will not know that X-ray film is not available until a file reaches him in due course. Hence excluding the nonpoor may mean that government facilities would continue to suffer from low standards of service. But there is no alternative to this except to reflect cynically that the poor will perhaps be better-off with greater access to a slightly inferior service than having no access to a better service.

In sum, in social services, social welfare and social subsidies, the government should cater only to the poor, and the nonpoor should be made to look to the market. The nonpoor should have no objection to this, because the intellectual elements among the nonpoor are today the most vociferous champions of the market as a panacea for the economic ills of society.

Chapter 12

Education in India: A Resource Perspective

V. S. OBEROI

In India there is an extensive debate on the content and directions of education policy. At the root of these discussions is an increasing awareness of quantitative and qualitative deficiencies in the country's education system. In the 1950s, in contrast to many other developing countries, India possessed a relatively large pool of skilled manpower and an established core of educational and administrative infrastructure. Since then, India's progress in education has not met with the same degree of success as in other fields, despite the national consensus on overall objectives and significant expansion of the system.

In the debate on education, funding has received comparatively little attention. Policy initiatives have tended to be "supply" oriented in their stress on enhanced provisioning of teachers, institutions and support systems. Financing of investments and operations is often dealt with in a cursory fashion, almost as a residual. Nor is there generally an evaluation of the relative efficiency of alternatives or their longer-term sustainability. As a result, planning perspectives in education have tended to be partial, adversely affecting the implementation of sectoral initiatives.

In the operation of India's planning system, the hesitancy to confront key financing questions is not confined to the education sector but extends to most aspects of public spending. Such a lacuna acquires particular significance, however, in the context of stridently enunciated goals of illiteracy eradication, skill enhancement and technological advancement, which are closely linked to national economic

and social development and carry large resource requirements.

Reinforcing the need for an adequate resource consciousness in planning for education is the overall public finance environment. In the 1990s it is likely that a stagnant, if not shrinking, real public resource base will constrain growth of public expenditures. In the face of competing demands from different sectors, further expansion of education infrastructure could be severely limited. The experience of India's planning and development process has been that social services are vulnerable in times of budgetary stress. This applies particularly to the education sector, which is increasingly dependent on the public exchequer and already absorbs a large part of government expenditures. At the same time, India's own development priorities necessitate expansion of educational opportunities and enhancement of quality. This paper seeks to identify key sectoral trends and characteristics, to facilitate a discussion on the resource aspects of education in India.

Spending on Education

Since independence there has been a massive expansion of education systems and infrastructure, reflected in large increases in the numbers of schools, colleges and teachers and in enrollments. There have also been significant increases in spending on education, as shown in Table 12.1.

A large part of the increase in sectoral spending is accounted for by inflation, but expenditure also grew in real terms. During the First Five Year Plan (1951-56), expenditures on education accounted for an average of 1.5 percent of Gross National Product (GNP). This proportion has since risen, although at different rates in different periods. It attained levels of 2.5 percent of GNP in 1960, 3 percent by 1970, and 4 percent in 1982. Subsequently, expenditure oscillated around 4 percent of GNP during the remainder of the Sixth Plan (i.e. up to 1986). There has been further growth since then.

These figures, which are derived from Department of Education data, do not fully reflect all expenditures on education. They are essentially compilations and estimates of institutional and organized spending in the public and private sectors. While expenditures financed directly or indirectly by the government sector are likely to have been accurately incorporated, it is possible that there has been underestimation of private institutional expenditures. In addition, the estimates only partly reflect the whole array of household expenditures, for instance on fees, uniforms, supplementary tuitions, textbooks, stationery and maintenance. Such expenditures are likely

to be considerable, in the aggregate adding at least 50 percent to the institutional costs of education.

Available data on per-capita education expenditures and costs per pupil support the assertion that spending on education has increased significantly in real terms. The former have been estimated to have grown at an average annual rate of over 10 percent in current prices since the First Plan. Expenditures per pupil are estimated to have grown at approximately five percent per year. These represent positive real growth rates, albeit marginal in the case of per pupil expenditures. It is possible, however, that the latter have been underestimated as a result of over-reporting of enrollment.¹ There are also other costs which should be taken into account, including, for instance, student transportation subsidies (which are particularly significant in urban areas) and the allocation of paper for textbooks at concessional rates. If the opportunity cost of foregone income is also considered, overall national spending on education would be even higher.

The lack of a resource perspective in the education sector is partly attributable to the derived nature of the bulk of its resources, most of which flow from pools of public funds. There is a tendency to treat these flows as entitlements, reinforced by the largely committed nature of expenditures. In education (as well as in other social sectors), there is also a reluctance to subject programs to intensive scrutiny regarding cost effectiveness. Some of this reluctance stems from a strong commitment to and belief in the validity of sectoral objectives. Such an approach may indeed provide benefits in terms of enhanced resource availability. In public allocation processes, however, this tends to be true only as long as the system as a whole can afford it. Beyond that, each sector, its contribution to national development notwithstanding, would need to compete for resources and demonstrate the efficiency of its operations.

Government Expenditures on Education

The rise in educational spending, over forty years of planned development, has been accompanied by increases in government spending (Table 12.2). From a level of only about Rs. 115 crores in 1950, government expenditures on the education sector rose to almost Rs. 14,200 crores in 1989-90. Education spending currently accounts for a large part of total government expenditure. During the Seventh

1. Such a trend may have been accentuated in recent years due to an emphasis on targets and their attainment.

Plan (1985-90), education accounted for 10.5 percent of the combined total budget expenditures of the central government, states, and union territories and 21.7 percent of total developmental expenditures. The education sector was the single largest block of sectoral developmental spending in government budgets in 1985-90 (Table 12.3). Expenditures on education grew at a faster rate than those on other social services. The only item that showed comparable rates of growth was spending on other economic services.²

These figures are likely to underestimate direct government support for education, since spending on education is not limited to Education Department budgets or heads of account. In the compilation of the above data, efforts have been made comprehensively to include all expenditures on education. Even so, the aggregate figures probably only partially reflect spending by other departments, including: (1) incentives for disadvantaged sections channelled through social welfare budgets in the form of cash subsidies, scholarship grants, supply of textbooks and uniforms; (2) expenditures on rural school construction and maintenance, met from Rural Development and Area Program budgets; and (3) funding of professional education, for instance, medical education, through the Health budgets.

Nongovernmental Expenditures

It is estimated that at present around 85 percent of expenditures on education consist of government outlays. India has a long-established tradition of community initiated and sponsored education, but over successive plan periods the role of private and community support has diminished. The interim report of the Acharya Ramamurthi Committee, established to review the implementation of the National Policy on Education (1986), estimated that the government's share in overall expenditures on education had increased from 57 percent in 1950 to almost 80 percent in 1979. Planning Commission data also indicate that, excepting the central and state budgets, the shares of all other funding sources for education have declined, including both rural and urban local government institutions, charitable trusts, endowments and fees.

The decline in nongovernmental support for education may well have been understated, as self-financing capacities of local government institutions also have been weakened. Most urban bodies, with

2. These expenditures showed higher rates of growth in the latter half of the Seventh Plan. Most of the increase was accounted for by foreign trade promotion.

exceptions confined to the larger cities, are almost exclusively dependent on government transfers for maintenance and other recurrent expenditures. In the rural sector, even where increased developmental responsibilities have been sought to be devolved, there have been no commensurate efforts at resource mobilization. Since the bulk of local bodies' resources is derived from government transfers, non-budget based financing may be even less important than was estimated by the Planning Commission and the Department of Education.

An enhanced role for the government is in consonance with the implementation of nationally determined priorities. Foremost among these are provision of enhanced and equitable access to education and greater responsiveness to the requirements of a nation in need of technological and economic advancement. Other objectives include the fostering of national identity and values and effecting qualitative improvements at different levels of education. Given present levels of attainment and the magnitude of the tasks ahead, the major burden must inevitably rest with Government.

The consistently declining private and community contribution to education financing is, however, of concern. In the first place, some of the expansion of public outlays has not been incremental but rather has substituted for private expenditures. To that extent, the impact of rising government outlays, already partly eroded by inflation, has been less. Secondly, the changing resource composition is partly a response to systemic pressure, for instance from increasingly organized teachers. The continuing dominance of public expenditures, unless accompanied by increasing efficiency, may lead to the entrenchment of relatively expensive delivery systems. An associated issue is that of centralization. Central funds tend to move through a complex and lengthy bureaucratic process. This not only impedes timely access to resources but acts as a disincentive to individual and collective initiative within the system.

These consequences are not unique to India's development process. In relatively well-off economies they may even be affordable. The longer-term impact in more constrained environments such as India's is often on quality and equity objectives. Clearly, one of the medium-term imperatives for educational planning is to encourage the resurgence of the private and community sectors.

Education Financing -- Center and States

During the Seventh Plan (1985-90) the states and union territories accounted for nearly 86 percent of total government budgetary expenditures on education. The central government's share of overall

education funding has varied over time. From seven percent in the First Plan (1951-56), it rose to levels of 17.5 percent in the Second Plan (1956-61) and 20 percent in the Third Plan (1961-66). Thereafter the central government's share dropped sharply, to eight percent in the Fourth Plan (1969-74). From 1966 to 1984 the central government's contribution varied in the range of 8-10 percent. During the Seventh Plan and particularly since 1987, central funding has again comprised a rising share. The states expend a far more significant proportion of their overall budgets on education than does the central government. During the Seventh Plan, the respective ratios were 17.6 percent and 2.3 percent.

In consonance with the division of responsibilities defined by the Constitution, the essentially state sector characteristic of education has remained unchanged since 1950. A portion of central budget outlays is not spent directly but earmarked for transfers to the states. These transfers have formed more than a third of the Department of Education (DOE) budget in recent years. In 1990-91, for instance, a third of the total budget provision of Rs. 1,711 crores was set aside for grants-in-aid to the states (Table 12.4).

An analysis confined to aggregate expenditures tends to understate the role of the central government, which can and does play catalytic, coordinating and complementary roles to state governments' efforts. The central government determines standards in institutions of higher education and research. Advanced institutions in technical and scientific education and research tend to be in the central sector. In addition, the central government has promoted and maintained a framework of educational resource and support institutions. It also coordinates the implementation of national initiatives and sponsors innovative programmes in the states. In addition, even though earmarked transfers to the states represent less than five percent of their annual expenditures, these are increasingly the main source of incremental funding available to the states.

Plan and Nonplan Expenditures

Even though the operational distinction between plan and nonplan expenditures may often be blurred, the plan represents the thrust of developmental activity. Intended to be incremental, plan spending in the education sector is expected to provide for infrastructure expansion and system effectiveness. The nonplan component of budgetary outlays, on the other hand, largely represents maintenance and committed expenditures.

Combined plan outlays of the center and the states reflect higher

levels of central support when compared with nonplan expenditures. In the first three Plans, the centrally financed element on average accounted for 25 percent of plan education outlays. In the succeeding three plans this proportion averaged a little over 30 percent. In the Seventh Five Year Plan, the importance of central plan outlays increased substantially, representing over 37 percent of total plan expenditure on education.

Enhanced central plan provisioning has succeeded in arresting the trend of declining relative allocations for education. Despite rising spending, education's share in total plan outlays dropped, from about eight percent in the First Plan to 5.1 percent in the Fourth Plan and further to 2.1 percent in the Sixth Plan. In the Seventh Plan, however, projected outlays on education rose to about 3.6 percent of total plan outlays. (Actual plan expenditures on education were lower, and are estimated to have comprised around 3.4 percent of total expenditures.)

Nonplan expenditures have increasingly dominated government outlays on education since 1967. Until the end of Third Plan, plan expenditures grew at a faster rate than nonplan expenditures, resulting in an increase in the plan component of educational spending from 30 percent in the First Plan to 40 percent in the Third Plan. This trend was subsequently reversed, and plan outlays averaged only 20 percent of sectoral expenditures in the Fifth Plan and 15 percent in the Sixth Plan. In the Seventh Plan the dominance of nonplan expenditures has been accentuated -- only an estimated 12 percent of government spending on education was funded through the plan.

These trends show that increasing outlays have been needed to provide for maintenance and committed expenditures, partly as a result of previous plan expenditures. At the end of a Five Year Plan or on termination of a plan scheme, the recurrent burden is normally shifted to the nonplan component. The accelerating process of displacement of plan by nonplan expenditures may have been deleterious to sector efficiency. It has raised the cost of delivery of educational services. It has also limited the extent to which schemes for improvement in the quality of infrastructure and services can be taken up. Unless this trend is reversed, there may come a time when significant incremental investments no longer can be generated.

Nonplan expenditures are overwhelmingly financed from state government resources. Since 1975 the central contribution to sectoral nonplan expenditures has averaged only six percent. Moreover, a portion of DOE nonplan outlays is used for support of state nonplan commitments. In the period 1988-91 such transfers accounted for

around 23 percent of DOE's nonplan outlays (as against 34 percent of plan outlays). The bulk of nonplan transfers to the states (71 percent) consisted of a single scheme in higher education -- for improvement in pay scales of university and college teachers.

The states have found it increasingly difficult to fund their growing nonplan expenditures. One of the consequences has been to shift a part of the burden of committed expenditures onto the plan, weakening the ability of plan schemes to achieve their objectives. This is particularly true of special category states, whose plans are effectively wholly centrally funded. Other states seek to utilize central plan schemes for much the same purpose. In many cases resources transferred by the central government for such schemes have been used by the states for temporary ways and means support. In extreme cases there have been outright diversions.

Classification And Composition Of Expenditures

Relative to other sectors, education has received a declining share of outlays for incremental investments over time. This may not be entirely attributable to neglect on the part of national planners of sectoral goals. To some extent the composition of education expenditures is also responsible, as indicated in the preceding section. It is likely that the increasing amounts required for maintenance of existing sector infrastructure have tended to limit the ability to finance educational expansion.

Government statistics also distinguish between expenditures on revenue account and on capital account. The capital account, in this functional classification, incorporates incremental capital expenditures for instance on construction and equipment. To the revenue account are ascribed expenditures for establishment, maintenance and working expenses. Table 12.5 indicates that the vast bulk of spending at both central and state levels is of a recurrent nature. These data, however need to be interpreted with some caution. Grants-in-aid to autonomous agencies and institutions comprise a large part of total spending. For instance, the Basic Siksha Parishad (in the U.P. budget) and the IIT in the central budget are funded through grant-in-aid provisions, classified as expenditures on revenue account. A part, admittedly small, of these transfers is utilized for investments of a capital nature in buildings and equipment. To that extent the accounting classification underestimates capital investments.

The dominance of recurrent expenditures is in any case confirmed by other sources. Data published by DOE (*Education in India*, Vol

II), indicate that recurrent expenditures, including outlays on salaries, maintenance, consumables and financial concessions, comprised over 94 percent of total expenditures at the end of the Fifth Plan. Less than six percent was available for expenditures of a non-recurring nature. Over 85 percent of recurrent costs were accounted for by the salaries of staff.

In the 1980s upward pressures on recurrent costs have been accentuated. Expenditures on remuneration of teaching, non-teaching and supervisory staff have risen, partly due to pressures for "provincialisation", that is, for the government takeover, directly or through grant-in-aid mechanisms, of privately managed institutions. (This provides financial benefits to the teachers, since government scales are higher than what can be offered by private institutions.) A reinforcing factor has been substantial increases in government pay scales, particularly those of teachers, since 1986.

It is clear that the present composition of expenditures does constrain sector capabilities. Committed expenditures foreclose the bulk of revenue and nonplan budgets. Funds for teacher training, program development, and even sometimes for basic teaching aids are consequently limited and are based largely on residual funding; actual expenditures therefore often fall short of intended outlays.

Financial Management And Internal Resource Generation

Most sector resources are exogenously derived, through a not always transparent system of budgetary allocations. Limited internal resource generation renders education vulnerable to cuts in times of budgetary contraction. When this occurs, relative priorities among different components of educational activity are often subjectively determined, in the absence of systems of comprehensive investment evaluation. Cutbacks therefore can often be arbitrary and inconsistent.

The dependence on exogenously derived allocations has inhibited the development of financial management perspectives for the sector. Departments, directorates and other sector organizations tend to function as conduits for the flow of funds and to limit their functions to flow management. Since the system of allocation and resource flows is centralized, financial management is an issue mainly in the upper echelons. In fact, the systemic pressure is not to conserve or manage resources but to expend them (partly because this tends to strengthen claims on subsequent budgetary allocations).

In addition to improved financial management, there are also other reasons for generating resources from within the education sector or

from non-governmental sources. There is undoubtedly a strong logic to below-cost, and in particular circumstances, even free provision of educational services. This would apply to activities which generate a relatively high social return, or where there are major issues of access for the socially or economically disadvantaged, but not necessarily to all educational activity. A recent study by the National Institute of Public Finance and Policy (NIPFP) found that the lowest recovery rates among government-provided social services were in the education sector. In fact, the highest absolute unrecovered costs in any sector were attributable to education services. In the 14 major states the cost recovery rate was only 1.4 percent for education, as against 3.2 percent for all social services and 31.5 percent for economic services. For seven educationally backward states (excluding Assam), the unrecovered costs of publicly delivered education services were estimated to be Rs. 4,400 crores.

The study also shows that unit subsidies and unrecovered costs in higher education are much larger than in secondary education and in elementary education. This intra-sectoral inequity means that there is potential for enhanced internal resource generation and perhaps even elements of cross-subsidization, which has been increasingly recognized. Current perspectives reflect an evolving consensus among planners on the need to modify archaic fee structures in higher and technical education.

From the perspective of financial management, there are also other lessons from the experience of preceding decades. One of these is the importance of multiple sources of finance. Non-governmental and internally generated resources are no doubt important for their additivity in the current resource environment. Of similar significance, however, is their complementary relationship with government funding; they are not easily or efficiently replaced by the latter. For instance, there has been a gradual reduction in the importance of fees in sector resources, resulting from a combination of reluctance to effect direct cost recovery and a desire to provide incentives and increased educational opportunities. Among the possibly unintended consequences has been centralization and the deprivation of educational institutions of resources for maintenance and incremental, small improvements. This is not fully compensated by flows of government resources, which to a large extent go into rising salary and establishment expenses. The sequencing and timing of government resource flows, for expenditures which are not of a committed nature, tend to be irregular, further weakening their impact.

Subsectoral Allocations in the Context of Illiteracy Eradication

In the aggregate, the largest share of budgetary resources for the sector is earmarked for elementary education, in line with its dominant share of enrollment and the priority attached to universalization of elementary education. As can be seen from Table 12.6, over 45 percent of total government spending on education went to the elementary level in 1986-87.

There are, however, indications that elementary education is disadvantaged, compared to other levels and to the goals set for elementary education coverage. The bulk of spending on elementary education is in the nonplan component, reflecting high recurrent and committed expenditures. Incremental plan outlays per enrolled student in elementary education were less than half of similar outlays in secondary education and less than a quarter of incremental plan outlays in higher (general) education. Plan outlays for elementary education have dropped from 56 percent of education sector plan outlays (for general and technical education) in the First Plan to 29 percent in the Seventh Plan. This trend assumes added significance because (1) allocations for technical education have in fact declined marginally as a proportion of sector outlays (from 13 percent in the First Plan to 11 percent in the Seventh Plan) and (2) the education sector as a whole has received a declining proportion of allocations, from eight percent of total outlays in the First Plan to 3.6 percent in the Seventh Plan. An emphasis on basic educational goals would necessitate provision of vastly enhanced resources for elementary education.

Future Perspectives

The Planning Commission has estimated that Rs. 36,000 crores of plan resources will be needed for general education (elementary, secondary and higher) during the Eighth Plan (1990-95). In addition, the requirements for technical education and adult education were assessed at Rs. 7,000 crores. These estimates were arrived at after lowering targets for intended coverage, reducing the scale of investment and implicitly assuming a further expansion of nonplan support for the sector. Even so, funding of this magnitude appears to be unattainable. Aggregate plan outlays for the sector in the Seventh Plan provisions were Rs. 6,380 crores, including spending on arts, culture and language promotion, which have in recent years accounted for almost 20 percent of plan spending on the education sector. Table 12.7 shows the pattern of central budget outlays on

education in 1989-90 and 1990-91.

Central plan support for general education in the last year of the Seventh Plan was around Rs. 630 crores. Assuming that the share of central funding of plan outlays in the sector is maintained at a level of 35 percent, the requirement of central plan funds for general and technical education would be of the order of Rs. 3,000 crores annually. It would also entail plan expenditures by the states of around Rs 5,600 crores each year. Neither appears feasible in the present resource environment. On the contrary, in the face of mounting fiscal deficits the system is likely to be hard put to maintain present levels of plan expenditure in real terms. While the central government has suffered from revenue deficits since the end of the Fifth Plan, such deficits have now risen to levels that may not be sustainable in the medium term. The revenue receipts of the states (including central transfers) have only just kept pace with revenue expenditures in the Seventh Plan. Hence the states will also experience considerable difficulties in meeting expanded nonplan requirements for education in the 1990s.

This is, indeed, a difficult situation. On the positive side, there is an increasing awareness of resource constraints and their impact on the attainment of sectoral objectives. A number of suggestions have been put forward by, among others, the Ramamurthi Committee in its final report. While increasing government outlays is still a dominant concern, several suggestions relate to raising additional resources from non-governmental sources and internal resource generation. The measures envisaged include making technical education self financing and raising fees in higher education. Other steps include the provision of student and institutional loans, an educational cess, and fiscal incentives for individual and community donations for education. In general, however, most approaches continue to underplay the issue of efficiency of investment and better utilization of existing facilities.

The resource factor need not become an overriding concern in the formulation of education policy. It is, however, essential that perspectives on resources and their efficient use be integrated into planning and policy formulation. This would facilitate the evaluation of relative efficiency and prioritization. Finally, the emergence of more effective resource and financial management in the education sector will also depend on the quality of the databases available to education policy planners. At present, educational statistics tend to be sporadically collected and only partly reliable. Improvements in this respect would contribute considerably to greater efficiency of education sector operations.

Table 12.1

Educational Institutions and Spending, 1950-90

	<i>Population (millions)</i>	<i>Recognized Educational Institutions (thousands)</i>	<i>Estimated overall spending on education (Rs. crores)</i>
1950-51	361	231	228
1960-71	439	398	536
1970-71	548	538	1452
1980-81	685	6578	4350
1990-91	837 ^a	858 ^b	17350

Note: The figures for recognized educational institutions do not take into account institutions for professional education.

^aProjected.

^bEstimated.

Source: Census of India, Department of Education and Department of Economic Affairs.

Table 12.2

Government Expenditures on Education, 1950-89

(Rs. crores)

<i>Year</i>	<i>Government expenditure on education</i>
1950-51	114
1965-66	344
1970-71	1118
1975-76	2105
1979-80	3500
1985-86	7741
1989-90	14181

Source: *Basic Educational Data*, National Institute of Educational Planning and Administration, 1990; and *Indian Economic Statistics*, Economic Division, Department of Economic Affairs.

Table 12.3

**Sectorwise combined Developmental Budgetary
Expenditures of Centre, States and Union Territories**

(Rs. crores and percent of total)

	1985-86	1986-87	1987-88	1988-89	1989-90	Total
Agriculture and allied services	5422 (14.1)	6082 (13.7)	6938 (14.2)	8171 (14.5)	8116 (13.0)	34729 (13.9)
Power and irrigation	5266 (13.7)	5476 (12.3)	7172 (14.6)	7853 (13.8)	8136 (13.1)	33903 (13.5)
Public works	570 (1.5)	800 (1.8)	922 (1.9)	914 (1.6)	1064 (1.7)	4270 (1.7)
Fertilizer subsidy	1924 (5.0)	1897 (4.3)	2164 (4.4)	3250 (5.7)	3651 (5.9)	12886 (5.1)
Industry and Minerals	4762 (12.4)	5400 (12.1)	4206 (8.6)	4107 (7.2)	3939 (6.3)	22414 (8.9)
Transport and communications	3737 (9.7)	4971 (11.2)	4651 (9.5)	5517 (9.7)	5941 (9.5)	24817 (9.9)
Other economic services	1899 (4.9)	1978 (4.4)	2187 (4.5)	3027 (5.3)	5534 (8.9)	14625 (5.8)
Social services	14862 (38.7)	17916 (40.2)	20736 (42.3)	23981 (42.2)	24949 (41.6)	103444 (41.2)
Of which:						
Education	7741 (20.1)	8939 (20.1)	10878 (22.2)	12763 (22.5)	14181 (22.8)	54502 (21.7)
Other services	7121 (18.6)	8977 (20.1)	9858 (20.1)	11218 (19.7)	11768 (18.8)	48942 (19.5)
Total	38442 (100.0)	44520 (100.0)	48976 (100.0)	56820 (100.0)	62330 (100.0)	251088 (100.0)

Note: Education expenditures include spending on art and culture; figures in parentheses denote proportions of annual spending.

Source: Economic Division, Ministry of Finance.

Table 12.4

Grants-in-Aid to the States, DOE Budget*(Rs. crores and percent of total)*

	1988-89 (Actuals)	189-90 (Revised Estimates)	1990-91 (Estimates)
DOE budgetary expenditures	1956 (100.0)	1519 (100.0)	1711 (100.0)
Grants in aid	644 (32.9)	515 (33.9)	572 (33.4)
of which:			
Non-plan expenditures, state plan schemes	274 (14.0)	196 (12.9)	174 (10.2)
Central Plan sector schemes	370 (18.9)	319 (21.0)	398 (23.3)

Source: Detailed demands for Grants, Ministry of Human Resource Development, 1990-91.

Table 12.5

Functional Classification of Expenditures*(Rs. crores and percent of total)*

	Centre	States	Total
Revenue Expenditure	7545 (96.7)	46197 (98.4)	53742 (98.1)
Capital Expenditure	258 (3.3)	762 (1.6)	1020 (1.9)
Total Expenditure	7803 (100.0)	46959 (100.0)	54762 (100.0)

Source: Economic Division, Ministry of Finance.

Table 12.6

Subsectoral Outlays in General Education, 1986-87

(Figures in Rs. Crores)

	<i>Plan</i>	<i>Non-plan</i>	<i>Total</i>	<i>Enrollment Millions</i>
Elementary education	387 (39.9)	3135 (46.1)	3522 (45.3)	45.32
Secondary education	222 (22.9)	2346 (34.5)	2658 (33.0)	14.92
Higher education	167 (17.3)	1004 (14.8)	1171 (15.1)	3.68
Other general education	193 (19.9)	318 (4.6)	206 (6.6)	
Total	969 (100.0)	6803 (100.0)	7772 (100.0)	

Source: *Basic Educational Data*, NIEPA, January 1990; *Fifth Educational Survey*, NCERT, 1990.

Table 12.7

**Central Budget Allocations for Education,
1989-90 and 1990-91**

(Rs. crores and percent of total)

	1989-90 ^a			1990-91 ^b		
	Plan	Non-Plan	Total	Plan	Non-Plan	Total
Elementary education	201 (20.9)	14 (1.8)	215 (12.4)	265 (25.4)	-- (0.0)	266 (13.6)
Secondary education	185 (19.3)	144 (18.6)	328 (19.0)	176 (16.8)	229 (25.0)	405 (20.7)
Higher education	154 (16.1)	335 (43.5)	490 (28.8)	150 (14.4)	345 (37.7)	495 (25.3)
Adult education	88 (9.2)	4 (0.5)	92 (5.3)	96 (9.2)	6 (0.6)	102 (5.2)
Technical education	168 (17.5)	140 (18.2)	308 (17.8)	159 (15.2)	153 (16.7)	312 (15.9)
Other expenditures	38 (4.0)	51 (6.6)	89 (5.1)	73 (7.0)	61 (6.7)	135 (6.9)
Sub-total	834 (87.0)	688 (89.3)	1522 (88.1)	919 (88.0)	794 (86.8)	1713 (87.5)
Sports and culture	125 (13.0)	83 (10.7)	208 (12.0)	125 (11.9)	120 (13.2)	245 (12.5)
Total	959 (100.0)	771 (100.0)	1730 (100.0)	1044 (100.0)	915 (100.0)	1957 (100.0)

^aRevised Estimates.

^bBudget Estimates.

Source: Detailed demands for Grants, 1990-91, Ministry of Human Resources Development.

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