

FINANCE COMMISSION

**REPORT
FOR
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ERRATA

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2.	16	Para 3.69 - Last word	expendiutre	expenditure
3.	17	CHAPTER IV - Heading	CENTRES'	CENTRE'S
4.	18	Para 4.11 - 3rd line from bottom	buoyany	buoyancy
5.	39	Table 3 - Col. 1 - State	20. Punjab 21. Rajasthan 22. Sikkim 23. Tamil Nadu 24. Tripura 25. Uttar Pradesh 26. West Bengal	19. Punjab 20. Rajasthan 21. Sikkim 22. Tamil Nadu 23. Tripura 24. Uttar Pradesh 25. West Bengal
6.	60	Para 13.13 - Notes - Last line below Table 2	Receipts Budet	Receipts Budget
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INTRODUCTION

1.1 This Finance Commission is the tenth since the commencement of the Constitution. The Order of the President [SO No.431 (E) dated 15th June, 1992], constituting the Commission is reproduced below :

"In pursuance of the provisions of article 280 of the Constitution of India and of the Finance Commission (Miscellaneous Provisions) Act, 1951 (33 of 1951), the President is pleased to constitute a Finance Commission consisting of Shri Krishna Chandra Pant as the Chairman and the following four other Members, namely:-

1. Dr. Debi Prosad Pai, Member of Parliament, Member
2. Shri B.P.R. Vithal Member
3. Dr. C. Rangarajan Member
4. Shri M.C. Gupta Member Secretary

2. The Chairman and other members of the Commission shall hold office from the date on which they respectively assume office upto the 30th day of November, 1993.

3. The Commission shall make recommendations relating to the following matters :

- (a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be divided between them under Chapter I of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;
- (b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States which are in need of assistance by way of grants-in-aid of their revenues under article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article.

4. In making its recommendations, the Commission shall have regard, among other considerations, to:-

- (i) the objective of not only balancing the receipts and expenditure on revenue account of both the States and the Central Government, but also generating surplus for capital investment and reducing fiscal deficit;
- (ii) the resources of the Central Government and the demands thereon, in particular, on account of expenditure on civil administration, defence and border security, debt-servicing and other committed expenditure or liabilities;
- (iii) the maintenance and upkeep of capital assets and maintenance expenditure on plan schemes to be completed by 31st March, 1995 and the norms on the basis of which specified amounts are recommended for the maintenance of the capital assets and the manner of monitoring such expenditure;
- (iv) the requirements of States for modernization of administration, e.g. computerization of land records and providing faster channels of communication upto and

above district level, and for upgrading the standards in non-developmental sectors and services, and the manner in which such expenditure can be monitored;

- (v) the revenue resources of the States for the five years commencing on 1st April, 1995, on the basis of the levels of taxation likely to be reached in 1993-94, targets set for additional resource mobilization for the Plan and the potential for raising additional taxes;
- (vi) the requirement of the States for meeting the Non-Plan revenue expenditure also keeping in view the potential for raising additional taxes;
- (vii) the tax efforts made by the States;
- (viii) the need for ensuring reasonable returns on investment by the States in irrigation projects, power projects, state transport undertakings, departmental commercial undertakings, public sector enterprises, etc.; and
- (ix) the scope for better fiscal management consistent with efficiency and economy in expenditure.

5. The Commission may suggest changes, if any, to be made in the principles governing the distribution of :-

- (a) the net proceeds in any financial year of the additional excise duties leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, in replacement of the sales tax levied formerly by the State Governments; and
- (b) the grants to be made available to the States in lieu of the tax under the repealed Railway Passenger Fares Act, 1957.

6. In making its recommendations on the various matters aforesaid, the Commission shall adopt the population figures of 1971 in all cases where population is regarded as a factor for determination of devolution of taxes and duties and grants-in-aid.

7. The Commission may review the present scheme of Calamity Relief Fund and may make appropriate recommendations thereon.

8. The Commission may make an assessment of the debt position of the States as on 31st March, 1994, and suggest such corrective measures as are deemed necessary also keeping in view the financial requirements of the Centre.

9. The Commission shall make its report available by the 30th November, 1993, on each of the matters aforesaid, covering a period of five years commencing on the 1st day of April, 1995. The Commission shall indicate the basis on which it has arrived at its findings and make available the State-wise estimates of receipts and expenditure."

1.2 Shri K.C.Pant served as the full-time Chairman for the entire period of the Commission. Dr. Debi Prosad Pai and Shri B.P.R.Vithal served for the entire period as part-time Members. Dr.C.Rangarajan was also a part-time Member, until he resigned with effect from 21st December, 1992 to take up his new

assignment as Governor of the Reserve Bank of India. Shri M.C.Gupta, Member Secretary, relinquished charge of his office on 31st January, 1994 to take over as Chief Secretary to the Government of Haryana.

1.3 Shri Manu R.Shroff was appointed by the President vide his Order SO No. 800(E) dated 14th October, 1993 in the vacancy caused by the resignation of Dr.Rangarajan. Shri Shroff assumed charge the same day.

1.4 The post of Member Secretary, which lay vacant since 31st January, 1994, was filled up by Shri Arun Sinha who was appointed by an order dated 1st March, 1994. Shri Sinha assumed charge of his office the same day.

1.5 Information sought by the Commission from the Centre and the States was slow in coming. Even by November, 1993 many States had not submitted forecasts or memoranda to the Commission. Besides, the vacancy caused by the resignation of Dr.Rangarajan on 21st December, 1992 was not filled till 14th October, 1993. The Commission at that stage requested the President for extension of time for submission of the report up to 30th June, 1994 and the same was granted by the President. The order is reproduced at Annexure I.1.

1.6 The Commission did not receive the forecasts/memoranda from all the States even till the last week of May, 1994. The working of the Commission's secretariat was disrupted when the Member Secretary, who had been with the Commission right from the beginning, was transferred at the end of January, 1994. In the meantime the Central and State Budgets having been presented for the year 1994-95, it became necessary to take a fresh look at the resources of the Centre and the States. For all these reasons, the Commission requested a further extension of its term up to 30th November, 1994 and the same was granted by the President. The order is reproduced at Annexure I.2.

1.7 The first meeting of the Commission was held on 18th June, 1992. The Commission issued a press note in the month of July, 1992 inviting the general public to offer its views on the issues before the Commission. The Chairman of the Commission sought the views of Union Ministers, Chief Ministers, Members of Parliament, Members of State Legislatures, eminent economists and other prominent citizens. In response, close to two hundred memoranda were received by the Commission. Besides, a number of individuals and organizations met the Commission during the time of its visits to States. A list of those from whom memoranda were received is given at Annexure I.3. A list of those who met the Commission is given at Annexure I.4. We are thankful to those who submitted memoranda or had discussions with us.

1.8 A conference of all State Finance Ministers was organized at New Delhi on 27th August, 1992, which proved very helpful to us in our work. We had a round of discussions with representative interest groups including Union and State Ministers, Members of Parliament, leaders of political parties, chairmen and senior office bearers of chambers of commerce and industry, chiefs of public sector organizations, leaders of trade unions and of employees' associations, agriculturists, agricultural experts, economists, engineers, educationists, journalists and media persons. Our interaction with these groups gave us valuable insights into their perception of issues before the Commission. A list of such meetings is at Annexure I.5.

1.9 The Member Secretary had a series of discussions with the chief secretaries/finance secretaries, heads of department and senior officers of State Governments. These discussions were very informative and useful to the Commission in its deliberations.

1.10 We had requested the Comptroller and Auditor General to issue directions to Accountants General of the States to provide a critical appraisal of State finances and to assist the Commission during its visits to the States. We wish to record our appreciation of the cooperation given to us by the Comptroller and Auditor General and the Accountants General in the States.

1.11 The Commission had a meeting with the Governor of the Reserve Bank of India. In addition, meetings were also held with Member Secretary, Planning Commission and secretaries in the Union Ministries/Departments of Power, Surface Transport, Textiles, Fertilizer, Education, Rural Development, Defence, Home Affairs and Chairman and Member (Traffic) of the Railway Board. Discussions were also held with Finance Secretary and Secretary (Expenditure) along with the Chairmen of the Boards of Direct Taxes and of Excise and Customs. We had a detailed discussion regarding the financing of calamity relief expenditure with the Relief Commissioner in the Ministry of Agriculture, and representatives of State Governments. We are thankful to all of them for helping us in our work. A list of the meetings is at Annexure I.6.

1.12 The visits of the Commission to the States commenced with Punjab on 7th September, 1993 and ended with Bihar on 20th August, 1994. The dates of discussions with different States are at Annexure I.7. We found the visits to the States of great value. They enabled us to have free, frank and detailed discussions with the Chief Ministers, their cabinet colleagues and officials. The visits also provided us with an opportunity to hold discussions with leaders of the opposition, eminent persons, economists, and representatives of political parties, chambers of commerce and industry, employees' associations and the media. The States arranged field visits to enable us to acquire first hand knowledge of different projects and of the ground realities. We are grateful to all the State Governments for the courtesies extended to us. We are also grateful to the media which took keen interest in our work and helped us in appreciating local problems.

1.13 The National Institute of Public Finance and Policy (NIPFP) organized a seminar on issues before the Commission which was attended by experts from the Central and State Governments and academe. We would like to place on record our appreciation of the efforts of NIPFP and of the contributions made by the participants.

1.14 We commissioned a number of studies. The Institute of Public Enterprises, Hyderabad undertook a study on 'Financial Contribution and Requirements of State Level Public Enterprises in India'; Professor Hemlata Rao of the Institute for Social and Economic Change, Bangalore on 'Taxable Capacity, Tax Efforts and Forecasts of Tax Yield of States'; Ms. Laxmi Reddy on 'Girls' Education and Role of Non-Governmental Organizations' and a team of experts led by Professor K.L. Krishna of the Delhi School of Economics on 'Measuring Inter-State Differentials in Infrastructure'. We are grateful to all of them.

1.15 We also constituted three advisory groups on State Electricity Boards, State Transport Undertakings and Central Public Sector Undertakings. The detailed composition of the advisory groups is given at Annexure I.8. The reports of the advisory groups of experts contributed substantially to our understanding of their respective areas of study.

1.16 The Commission is thankful to the National Informatics Centre which provided the computer facilities in the Commission's Office. In particular, we would like to thank Shri V.M.Raman, our Computer Programmer.

1.17 Our Terms of Reference required meticulous and elaborate collection of information and its processing. We were fortunate in having a harmoniously working, dedicated team of officers and other members of the staff, advisers and consultants who ungrudgingly put in hard work for long hours and gave of their best. At the end of June 1994, at a crucial stage in our work, Professor Atul Sarma, Economic Adviser, who had been with us

since the beginning, left to take up another assignment. In his place, Professor D.K.Srivastava of Benaras Hindu University joined us as Economic Adviser. We are grateful to him for having done so at short notice, regardless of the personal inconvenience.

1.18 We would like to place on record our appreciation of the valuable and wide ranging work done by our officers, advisers and consultants who carefully guided the staff and painstakingly scrutinised, sifted and analysed the voluminous material received by us and presented options for consideration of the Commission. The officers included Shri Kamal Pande, Shri M.N.Prasad, Smt.Neelam Nath, Joint Secretaries and Shri Laxman Das, Director. The excellent contribution of these officers and, at the technical level, of Professors Atul Sarma and D.K.Srivatsava was of immense benefit to us and proved crucial to our work. Apart from providing excellent technical support, Shri Haseeb Drabu, Consultant, worked meticulously and untiringly for the preparation of the Report. Our advisers/consultants S/Shri L.C.Gupta, V.S.Jafa, G.N.Tandon, Bharat Karnad, N.I.Vyas and

T.S.Rangamannar likewise gave us the benefit of their rich experience and knowledge of their respective areas of work.

1.19 We are also grateful to our Joint Directors, Shri Satish Kumar and Shri Pushp Raj Singh, and to Deputy Directors S/Shri H.S.Puri, S.R.Dongre, H.M.Dass and R.K.Gaur who did an excellent job of the work allotted to them. We would like to make a special mention of S/Shri A.K.Raina, Deputy Director and B.K.Aggarwal, Assistant Director who carried on their shoulders much more than their share of work. We also acknowledge the first rate work put in by S/Shri S.Roy, S.S. Sharma, Radhey Shyam, R.N.Tiwari, and T.C.Aggarwal Assistant Directors, and all other staff members including Superintendents, Private Secretaries, Personal Assistants, Economic Investigators, Technical Assistants, Computers, Stenographers, Cashier, photo-copy operators, Clerks and Class D employees without whose untiring support it would not have been possible to produce this report. Our special thanks are due to our personal staff who worked unsparingly without a thought to themselves.

FRAMEWORK AND APPROACH

Introduction

2.1 Our approach has been guided by the paramount need to restore fiscal equilibrium in the economy. Our recommendations have been informed by our Constitutional responsibilities, the terms of reference, the budgetary scenario of the Centre and the States, the emerging issues in federal finance, and the evolving macroeconomic policy environment.

2.2 The period covered by our recommendations will witness the completion of half a century of fiscal federalism. Federal relations, as envisaged in the Constitution, have evolved over the years through political, institutional and functional changes. In this changing scenario, the Finance Commission, as an institution, has had an important role to play as resource sharing, based on a Constitutional division of functions and finances, is a critical element in the federal system.

2.3 While the charter of the Commission flows from the Constitution itself, the terms of reference of each Commission have reflected some of the dominant concerns in the area of Centre-State relations and the emerging issues in national public finance. It is, therefore, not surprising that our terms of reference mirror the anxiety regarding the finances of the country and have been influenced by the systemic changes in the economic regime that have been initiated since 1991.

2.4 The whole gamut of policy changes is reflective of a change in the nature, content and extent of state intervention. The outcome of these changes will edge into view in the period which coincides with the period of our recommendations. Another dimension has been added by the 73rd and 74th amendments to the Constitution which have brought into being a third tier in the federal structure. It is these changes that provide the context for our recommendations and, in conjunction, with our concern for equity and efficiency, delineate the contours of our approach.

Centre and State Finances : An Analytical Overview

2.5 The macroeconomic vulnerability of the economy is linked in no small measure to the secular deterioration in its fiscal balance. The magnitude of aggregate deficits - revenue and fiscal - had reached levels in the late eighties that set the economy on a medium term path of stagflation and a recurring balance of payments problem.

2.6 From a revenue surplus the economy moved into a state of continuous deficit on revenue account in 1982-83. While in 1975-76 there was a revenue surplus of about 2.5 per cent of Gross Domestic Product (GDP), in 1990-91 revenue deficit reached 3.6 per cent and is estimated to be about 5 per cent of GDP in 1993-94. This rise has been even faster than that in the fiscal deficit which increased from 6 per cent in 1974-75 to about 12 per cent in 1990-91. It is estimated to be 11.5 per cent in 1993-94. A graphical presentation of the trends and pattern in the finances of the Centre and the States is at Appendix 1.

2.7 The change in the fiscal regime in 1982-83 - from revenue surplus to revenue deficit - has meant that what was earlier a non-debt creating source of financing has become a source of rising internal indebtedness. In other words, while

revenue receipts used to cover a part of the capital expenditure, now an increasing part of the capital receipts are used to finance revenue expenditure. The consequent build up of public debt and the interest burden, which is now the largest and fastest growing item of expenditure, further fuelled the growth of revenue expenditure. This led to a spiral of growing deficits, rising debt, escalating interest costs, and further expansion of deficit.

2.8 The statement that deficits have emerged because of differential rates of growth of revenue receipts and expenditures is tautological. It is, however, of prescriptive value to note that the total revenue receipts as a proportion of GDP increased from about 12 per cent in 1960-61 to 27.4 per cent in 1987-88. Thereafter it has levelled off. A major part of the increase is accounted for by a sustained improvement in tax revenues while the potential for exploiting the sources of non-tax revenues has remained largely untapped. During the same period the tax/gdp ratio of the economy more than doubled from 8.3 per cent to 17 per cent which is impressive at the prevailing levels of per capita income. Thus, the principal factor underlying the fiscal imbalance is the unbridled growth of government expenditure.

2.9 The accelerating growth of revenue expenditure is a recent phenomenon. Till the mid-seventies revenue expenditure as a percentage of GDP remained constant at about 15 per cent. In fact, in the early seventies, aggregate government expenditure was actually declining in real terms. Thereafter, till 1987-88 it increased exponentially to reach 27 per cent of GDP - the real rate of growth being close to double digit during this period. After 1987-88 revenue expenditure as a percentage of GDP has remained stable at about 27 per cent. This appears to be in line with the behaviour of revenue expenditure over the last three decades during which it has increased in steps. The structure of expenditure has imparted downward rigidity and inflexibility to its level in recent years. Interest, and wages and salaries have emerged as the major components of expenditure as a direct result of the mode of financing of expenditure and the expansionary policies pursued by government. These two items are at any given point of time "committed expenditure" which can be curtailed only in the medium term. This has made expenditure more income elastic than revenue receipts thereby generating an inbuilt tendency towards deficits. As a result the economy has moved away from resource based fiscal management to expenditure based budgeting.

2.10 From a diagnostic point of view, it is important to analyse the profile of deficits and their composition across levels of government. In the case of the Central Government, the revenue deficit increased from 0.2 per cent of GDP in 1981-82 to 3.5 per cent of GDP in 1990-91. It is estimated to be 4.3 per cent in 1994-95. The fiscal deficit for the corresponding period increased from 5.4 per cent to 8.4 per cent. Apart from the increase in magnitude, a disturbing aspect relates to the financing of fiscal deficit. Over the years, especially since 1991, the monetised deficit has been reduced significantly. Without a corresponding reduction in the fiscal deficit the proportion of other forms of borrowings has increased. The implication of this change is that the unit cost of financing government expenditure is increasing. This is of particular concern because revenue deficit as a proportion of

fiscal deficit is also rising and this underlines the need for reducing the revenue deficit and the fiscal deficit along with a reduction in monetised deficit.

2.11 The higher cost of financing government expenditure will make its impact felt on expenditure by increasing the burden of interest payments. This is so because borrowings are financing such revenue expenditure as cannot possibly yield financial returns and a fair amount of capital expenditure which yields inadequate returns. In other words, it is the burden of interest payments arising out of the none too prudent use of borrowings that lies at the root of the fiscal malaise. This is borne out by the fact that the primary fiscal balance (i.e. fiscal balance net of interest payments) of the Central Government has turned surplus after 1991-92.

2.12 At the aggregate level, the combined accounts of the State Governments exhibit a similar picture of increasing revenue deficits though the deficits emerge on a secular basis from 1987-88. While the share of States in total revenue deficit of the economy has increased, its share in fiscal deficit has remained constant perhaps on account of their inability, unlike the Centre, to finance the expenditure-revenue gap through borrowings.

2.13 It is important to recognise that there is a pattern in the transition from healthy revenue surpluses that the system used to generate to chronic deficits. This becomes evident by disaggregating the revenue account into plan and non-plan. The plan revenue account has been in marginal deficit till the early eighties. Thereafter it has increased in response to the plan size. On the other hand, the non-plan account has been in surplus till 1990-91.

2.14 Almost all States have gone through a three phase deterioration in the revenue account balance. In the first phase up to 1986-87, the non-plan account surplus was larger than the plan deficit and to that the extent it was yielding an overall revenue surplus. Between 1986-87 and 1991-92 the magnitude of plan revenue deficit increased sharply and it became larger than the non-plan surplus which itself had been declining. The third and final phase started in 1991-92 when the non-plan revenue account went into deficit. That all States have had almost identical turning points seems to suggest that there are systemic factors underlying this deterioration rather than State specific reasons.

2.15 The magnitude of the fiscal problem can be gauged by the level of deficits projected in the Central and State forecasts submitted to us. It is significant to note that the Centre did not project a crisis of resource availability to the Ninth Commission. There was a clear break with the past when the Finance Ministry submitted a forecast which showed a pre-devolution deficit on the revenue account. Again, for the first time not a single State has submitted a forecast showing a pre-devolution surplus on the non-plan revenue account. Thus the problem posed to us was far worse than that faced by earlier Commissions.

Macroeconomic Stabilisation and Structural Reforms

2.16 The stabilisation and structural adjustment programme of the Centre was initiated in response to the situation of fiscal disequilibrium which reached crisis proportions in 1991. The components of the reform package are: deregulating industry, activist monetary management, gradual dismantling of the complex protective trade regime, a liberal policy towards foreign investment, strengthening the capital markets, restructuring the tax system, full convertibility on current account and an efficiency oriented hard budget approach towards the public sector. The overhauling and restructuring of the financial sector, which is the bridge between macro stabilisation and structural adjustment, is still under way.

2.17 The reforms aim at tackling a series of macroeconomic imbalances, both external and internal. The components of the reform, which are of particular relevance to government finances, are the policies relating to tax reform and reduction in fiscal deficit. Tax reform has revolved around simplification of procedures and reduction in rates of income and corporation tax, selective reduction in excise duties and a substantial reduction in customs duties. The premise is that the stimulus to growth provided by tax reforms and better compliance will more than offset the loss of revenues on account of lower rates.

2.18 The reduction in fiscal deficit was expected to come about both through improved revenue receipts and reduced revenue expenditure. However, in the face of temporary shortfalls in revenue and the inflexibility displayed by revenue expenditure in the short run, the fiscal deficit has been reduced primarily by compressing capital expenditure. Thus, contrary to expectation, the fall-out has been an increasing revenue deficit and reduced capital expenditure.

2.19 In the case of States, the rising revenue deficit has also cut into maintenance expenditure in the revenue budget. In order to accommodate the rising interest payments and the growth of wages and salaries, which have come to be regarded as committed expenditure, maintenance expenditure has been treated as a residual item. This has had a visible impact on infrastructure. The deteriorating conditions of roads, poorly maintained hospitals, neglected school and administrative buildings have together become a formidable supply side constraint on growth. Most assets like power stations, irrigation systems, and highways are operating at levels well below their capacity on account of poor maintenance and continual neglect.

2.20 Clearly, any attempt to curtail the growth of expenditure must be accompanied by measures to protect essential expenditure on maintenance of existing infrastructure and creation of new capacities. This requires a change in the emphasis and priorities of government expenditure. Development of physical and human infrastructure is also essential if the market oriented process of development, with its emphasis on competition and private investment, is not to bypass many States and sectors. If such development does not take place, regional inequalities are bound to accentuate. Quite paradoxically, expenditure priorities of States have in a number of ways tended to reinforce rather than reduce inter-regional disparities.

2.21 The long term implication of this will be that the resource raising capacity of States will be differentially affected. While to some extent this can be addressed through a greater degree of progressivity in transfers to States, the primary responsibility for strengthening the resource base is that of the States. The States will have to make continuous efforts to improve their revenue base, strengthen their capacity to provide better services and curtail expenditures.

2.22 As for receipts, States should initiate restructuring of the tax system through rationalisation of the complex multi-layered sales tax system. The multiplicity of rates is counterproductive and can be rationalised by reducing dispersion in the rates. Inter-State variations in the rate and structure of taxes can be harmonised and move in the direction of uniformity. It would lead to an increase in the tax revenues of States as they will no longer be forced to indulge in unhealthy reduction of rates. If this is done, it would be an important step towards removing impediments to developing a common economic space which would give a substantial fillip to the rate of growth.

2.23 The potential of non-tax revenues as a buoyant source of revenue is virtually untapped by the States. Much greater attention must be focussed on non-tax receipts for resource mobilisation. There are two specific areas that merit attention viz. rates of return on investment and user charges. The total investment in public enterprises runs into thousands of crores of rupees but the rate of return is next to nothing. In many areas particularly power supply, transport services, irrigation, and higher education only a small portion of the expenditure incurred is recovered. It is important to reverse these trends not only for budgetary considerations but also for the overall growth of the economy.

Approach

2.24 Given the evolving scenario, and the goals set out by our terms of reference - of not only balancing the revenue account but generating surplus for capital investment - the task before us was far from enviable. We could reach this objective for the States by recommending the requisite increase in transfers from the Centre but leave it with an unmanageable deficit. Alternatively, we could have left the States with an uncovered deficit. We have chosen not to do either because in doing so we would be just shifting the deficits while our aim was to arrive at a sustainable and healthy fiscal balance.

2.25 This concern would be fully tackled by taking a holistic view of government finances and looking for an integrated solution. It should be obvious that no policy prescription for the fiscal malaise can be given if a large component of the budget, viz. plan outlay, is left out of reckoning. Even if we leave out that part of the plan outlay which is financed by borrowings and is used for creating new capital assets which would eventually earn a return, there is a revenue plan which ought to be covered by revenue receipts. The clubbing of the revenue and capital components in one category termed as plan outlay has generated a tendency to use borrowings to finance revenue expenditure. It is imperative to match the revenue resources separately with the revenue component of the plan. Failure to appreciate this basic requirement of fiscal discipline is one of the main causes of the endemic fiscal disequilibrium.

2.26 In an effort to project larger plan outlays, inadequate provision is made for crucial expenditures like the maintenance of existing assets which are, in current practice, regarded as non-plan expenditure and hence of lower priority. New schemes take priority over maintenance resulting in sub-optimal use of resources. We think that such a bias arises at least in part from the artificial classification of expenditures between plan and non-plan and the attitude of regarding all non-plan expenditure as of low priority. It needs to be appreciated that a large part of non-plan expenditure is of a developmental nature and should enjoy the same priority, if not higher, as new plan schemes.

2.27 We are of the view that there is a clear rationale for the Finance Commission to deal with the revenue account as a whole, and not merely the non-plan revenue expenditure. Our terms of reference require us to keep in view the objective of reducing fiscal deficit and generating surplus for capital investment which cannot be done adequately unless we reassess the projection of plan expenditure also. But our terms of reference also explicitly require us to assess non-plan revenue expenditure. Our period of recommendations not being co-terminus with the Eighth plan has further complicated the issue. The practical difficulties of making acceptable projections of plan outlay - even for the remaining two years of the plan - were brought to our notice by the representatives of the Planning Commission. Most States have also chosen not to hazard any estimates. In view of these

constraints we have confined our reassessment to the non-plan revenue account.

2.28 We have, however, not lost sight of the need to reduce the fiscal deficit. Our approach to this issue has been based on the understanding that a reduction in fiscal deficit has to come about through improvements in the revenue account balance emanating from the non-plan revenue account. Accordingly, our attempt through the reassessment of Centre and State forecasts, has been to generate sustainable non-plan revenue surpluses. The premise is that a recurring revenue surplus is the basic prerequisite for achieving desirable macro fiscal balance.

2.29 In estimating the base and reassessing the non-plan revenue account of the Centre and States we have maintained, to the extent permitted by functional specificities and compositional differences, a uniform pattern of reassessment. The principles and methodology of the reassessment of Central and States forecasts is dealt with in detail in the subsequent chapters. Briefly, the reassessment of tax revenues is based on a study of the buoyancy of major taxes of the Centre and States with respect to the GDP and individual state domestic product. Non-tax revenues and some items of expenditure have been reassessed on a normative basis. Expenditure reassessment in general is based on price elasticity of expenditure besides allowing for a uniform 1.5 per cent rise in real terms independent of the rate of growth of nominal or real GDP. We have provided for higher real growth for priority sectors like elementary education, health, and family welfare. In contrast, we expect that even implicit subsidies in sectors like power, transport, and irrigation would be reduced greatly. Subsidies on food and fertilisers should be given on a uniform scale and pattern from a single source. We are of the view that the quantum of subsidies should progressively account for a smaller proportion of GDP.

2.30 In estimating revenues and expenditure a major determinant is the nominal GDP growth rate and its decomposition into real growth and inflation. In its forecast, the Ministry of Finance had assumed nominal GDP to grow at 11 per cent per annum comprising a rate of inflation of about 5 per cent and real growth of 6 per cent. While we accept the underlying premise of the medium term growth rate being around 11 per cent, we find it unrealistic that the rate of inflation will decline suddenly from about 10 per cent in the 1994-95 to 5 per cent next year. In an attempt to approximate reality we have assumed that the rate of inflation would decline gradually and reach a level of 5 per cent by the year 2000 A.D. At the same time the real rate of growth will increase in a secular manner. On this graduated basis we have assumed the nominal rate of growth to be 12.5, 12, 12, 11.5 and 11 per cent in successive years of the period 1995-2000.

2.31 The balance on the non-plan revenue account that we have sought to achieve is contingent on the profile of receipts and expenditure as reassessed by us. On this basis we have formulated our recommendations on vertical resource sharing and horizontal distribution. Our basic approach to vertical resource sharing has been influenced by the view that it would be in the interest of better Centre-State relations if all central taxes are pooled and a proportion devolved to the States. There is considerable merit in moving to such a system as it would make the vertical sharing simple and transparent. It also gives greater freedom to the Centre in choosing tax policy measures in an integrated manner. If a proportion of all taxes goes to the States, any apprehensions of bias in the choice of tax measures will be allayed. Therefore, we have proposed an alternative scheme of devolution.

2.32 We are conscious that moving over to such a system of pooling will require amendment of the Constitution. Our terms of

reference do not require us to consider such a change. As such, we have made our recommendations in accordance with the existing provisions of the Constitution. The share of income tax and excise duty to be devolved has been recommended in a way that will facilitate a move towards the pooling of all central taxes and devolving a proportion to the States. We have reduced the gap between the percentage of income tax and excise duty shared with the States. This has been accompanied by uniform criteria for distribution of both the shareable taxes.

2.33 Our concern for equity and efficiency has been built into our criteria for horizontal distribution. We believe that the two are not mutually exclusive and we have in our devolution formula tried to blend equity with efficiency. Towards this end, tax effort - which represents fiscal efficiency on the revenue side - has been explicitly rewarded in our scheme. We have incorporated two new elements, area and infrastructure, keeping in view the spatial dimension of providing public services and the enhanced importance of infrastructure development across States.

2.34 A healthier fiscal attitude can be generated if the grants are not based only on the emerging picture of surpluses or deficits but also on the urgent needs and special problems of the States as identified on the basis of discussions and field visits in the States. In our scheme of transfers, we have used grants as an instrument for upgrading services and providing earmarked resources for some important purposes.

2.35 Following the 73rd and 74th amendments of the Constitution, enabling legislation has been enacted by all States and State Finance Commissions have been constituted by them. While our terms of reference do not require us to consider the financial needs of the third tier of the federal structure, we feel that the development of these institutions would be impaired if they are not put into funds at their inception. We are aware that a major part of their needs would come by transfers of functions and funds from the States, including plan funds, and central and centrally

sponsored schemes. However, we still consider it important that initial funding of priority areas of basic services like drinking water, health facilities, and elementary education to our rural population and civic amenities to the huge population living in the slums in our megapolises, metropolises and other urban centres should be made. Accordingly, we have provided grants to all States for this purpose.

2.36 Our approach to the problem of the accumulating debt burden has been informed by the need for economy in expenditure and efficiency in raising resources. The solution to the problem of debt lies in restoring the revenue account balance and generating surpluses for investment. We are firmly of the view that debt relief offers only temporary reprieve and a long term solution to the problem lies in corrective measures discussed later. In line with our diagnosis we have tried to introduce an incentive based system of debt relief which is related to an improvement on the revenue account balance. We have, utilising the opportunities offered by the new economic environment, recommended a scheme of debt retirement from the proceeds of disinvestment of equity in the public sector enterprises. We have introduced an incentive scheme in this respect also.

2.37 Our projections of revenue and expenditure for the period 1995-96 to 1999-2000 set out the direction in which policies to restore fiscal balance have to move and provide a picture of what should happen in the five-year period if these are undertaken. Our projections, while showing an improvement over the present picture, are still far from the goal of having revenue surpluses for each State. It is not too much to expect that the measures we recommend would be implemented fully by the Centre and the States. If in actual practice the picture turns out to be worse than what is being projected, even our conservative assessment of what can realistically be done would have been proved wrong. It is a perpetual battle between hope and experience.

STATES' RESOURCES : ASSESSMENT OF REVENUE AND EXPENDITURE

Introduction

3.1 Our reassessment of the forecast of revenue receipts and non-plan revenue expenditure of State Governments during the period covered by our Report has been guided by the considerations set out in Para 4 of the Presidential Order. These relate to the objective of not only balancing the receipts and expenditure on revenue account but also generating surplus for capital investment and reducing fiscal deficit, the tax efforts made by the States and the potential for raising additional taxes, the need for ensuring reasonable returns from investment in power and irrigation projects, transport undertakings, departmental schemes and public enterprises, the requirement of the States for meeting the non-plan revenue expenditure, including the maintenance and up-keep of capital assets and the maintenance expenditure on plan schemes to be completed by 31st March, 1995. Our overriding concern has been the need for promoting better fiscal management consistent with efficiency and economy in expenditure.

3.2 We received forecasts of revenue receipts and non-plan revenue expenditure for the period 1995-2000 from all the States. However, the forecasts were not strictly comparable as the base year, basis of projections, assumptions regarding inflation, treatment of committed liability of past plan schemes etc. varied widely. What was common to all the forecasts was that they presented a gloomy picture of the fiscal scenario for the period 1995-2000. Some idea of the magnitude of the problem could be gathered from Table 1.

3.3 Two features stand out which deserve special mention. The first is that the States have projected a deterioration in all major budgetary variables : revenue receipts as a percentage of GDP are forecast to decline and revenue expenditure is estimated to increase by about two percentage points. As a result there is a doubling of the deficit on the non-plan revenue account. The second is that, perhaps for the first time, not a single State has forecast a pre-devolution surplus. It is a matter of grave concern that even those States which had always taken pride in keeping their finances on a sound footing seem reconciled now to accepting a regime of increasing deficits on the revenue account. This trend needs to be reversed. It is against this background, coupled with the deteriorating fiscal picture of the Centre, that we have carried out our reassessment. We have been guided in this task by the paramount need for ensuring fiscal balance, reducing reliance on borrowings and making available adequate resources for investment in critical sectors like health and education.

Table 1

Pre-devolution Revenue Account of States

	<i>per cent of GDP</i>	
	1990-95 Actuals/Estimates	1995-2000 Forecast
I. Revenue receipts		
(i) Tax revenue	5.61	4.89
(ii) Non-tax revenue	1.20	0.42
(iii) Non-Plan grants	0.08	0.02
Total	6.89	5.33
II. Non-plan revenue expenditure	10.11	12.06
III. Non-plan revenue deficit	-3.22	-6.73

General Methodology

3.4 The forecasts of revenue receipts and non-plan revenue expenditure were received from the States over a long period beginning from early 1993 to the middle of 1994. These were projected on different base levels of taxation, varying assumptions about inflation and instalments of dearness allowance etc. Our first task, therefore, was to arrive at a reasonable estimate for the base year, i.e. 1994-95, before we could make any projections for 1995-2000. It would have been simpler for us to adopt the budget estimates for 1994-95 of all the States as these had become available to us by the time we completed our reassessment. However, we found considerable variations between the budget estimates of earlier years and the actuals. This compelled us to go by the latter for arriving at base year estimates on a comparable and uniform basis. We worked out the trend growth rates for revenue receipts and expenditure on a fairly disaggregated basis. For receipts, we took a ten year period spanning 1983-93. For expenditure, the period was 1986-93 as the reclassification of accounts from 1st April, 1987 made it difficult to develop a comparable series for a period prior to that. We estimated the base year figures using the observed trend growth rates and applied it to the actuals for 1992-93. We then carefully looked at the results in the light of the entire series of receipts and expenditure, the budget estimates for 1994-95 and the State forecasts and moderated them wherever warranted. Our effort has been to arrive at such estimates as would reflect the most likely position at the commencement of the forecast period.

Tax Revenues

3.5 Our terms of reference require us to assess the revenue resources of the States for the five years commencing from 1st April, 1995 on the basis of the levels of taxation likely to be reached in 1993-94, the targets for additional resource mobilisation for the plan, the potential for raising additional taxes

and the tax efforts made by the States. In estimating tax revenues for the forecast period, we have looked at past trends and future potential. We had commissioned a study by the Institute of Social and Economic Change, Bangalore, for assessing the taxable capacity of different States. The study brought into focus the problems inherent in estimating the tax potential of different States. After giving considerable thought to the recommendations made therein, we were unable to accept the same. We were of the view that though the study gave insights into the problem, it did not offer a dependable basis for estimation of taxable capacity. The study utilizes two alternative methods of estimating taxable capacity - the first based on the representative tax system and the other based on a regression analysis. The study itself discards the first. Regarding the second approach, we had reservations about the specifications prescribed in the study as also the reliability of the data base. This is an area of research that ought to be accorded priority and a suitable data base built up if later Commissions are not to encounter similar handicaps.

3.6 For our in-house exercise regarding estimation of tax revenues of States, we adopted a regression based approach for seventeen States for which disaggregated data were available for a reasonable length of time. Such a series was not available for Goa for which we adopted the rates of a neighbouring State. For six States of the North-East and Sikkim, an entirely different exercise was done to which we shall revert shortly.

3.7 For the seventeen States, tax revenues have been disaggregated into six categories, i.e. sales tax, including receipts from central sales tax ; state excise duties ; motor vehicle tax, including receipts from taxes on goods and passengers ; stamps and registration ; land related taxes and taxes on agricultural income and all other tax receipts, except proceeds from electricity duty. For the four major taxes, tax receipts were regressed on the state domestic product of each State for which we had received updated figures from the Central Statistical Organisation (CSO). The sample period chosen was 1980-81 to 1989-90. A brief note on the methodology is at Appendix 2. Since the buoyancy of different taxes was worked out with respect to income, it was not necessary to make any allowance for additional resource mobilisation ; in any case segregating receipts on this account from the total tax receipts would necessarily be a somewhat arbitrary exercise. We have adopted, by and large, the buoyancy estimates emerging from this exercise and the growth rates derived from them. However, we have taken care to see that States which have been doing well are not penalised by our assuming high growth rates for the forecast period and States which have lagged behind are not given similar benefits in the future. We have, therefore, not accepted for any State a buoyancy estimate of less than unity for any of the four taxes and have adopted suitable ceilings in each case. The buoyancies and the growth rates derived therefrom on the basis of our assumption regarding graduation in the growth profile of GDP and inflation are as indicated at Annexure III.1 to III.4.

3.8 In view of the stickiness of land revenue and fluctuations in collection on account of suspensions, remissions etc. we have taken the average of the past five years i.e. 1990-95 and assumed the same levels during each year of the period of our Report except in cases where the State forecast gave us a more realistic estimate. For agricultural income tax, we have retained the estimates of the State Governments. We have accepted the estimates of electricity duty as projected by the States and have taken these into account while estimating the net return from power projects. All other residual taxes have been combined together. Looking at their past behaviour, we have taken their buoyancy as one.

3.9 We found it very difficult to conduct a similar exercise for the States of the North-East (except Assam) and Sikkim. The lack of data, small size of the tax base and instability in the pattern and growth of taxes precluded any meaningful relation being established with either the state domestic product or any other specified tax base. On the other hand, we found that much more acceptable results were available if we looked at the growth of aggregate tax revenues. Accordingly, we have proceeded on an aggregate basis taking into account the need for some improvement in their tax effort over the period covered by our Report. The growth rates adopted by us are at Annexure III.5.

3.10 We have taken note of the prohibition policy followed by certain States like Gujarat and Tamil Nadu and more recently by Andhra Pradesh and Orissa apart from some of the North-Eastern States. This is an issue which came up repeatedly in our meetings with the concerned State Governments. The States concerned have been at great pains to impress upon us the need for compensating them for the losses on this account as they have taken these measures in furtherance of the Directive Principles of State Policy. The approach to prohibition is not the same in all such States. While there is a total ban on production, sale and consumption in some States like Gujarat and Manipur, most others have only imposed restrictions on the sale of country liquor. We do not propose to go into the necessity or otherwise of a uniform prohibition policy throughout the country and the responsibility, if any, of the Central Government for compensating the States for the resultant loss of revenue. We have, therefore, only adjusted the base year estimates taking into account the effect of the prohibition policy of the State on its excise revenues and made projections on that basis.

Arrears of taxes

3.11 We expect that the States would tackle vigorously the problem of substantial arrears of taxes which have accumulated by the end of 1992-93. We have assumed that 90 per cent of sales tax arrears and 95 per cent of the arrears of other taxes as on 31st March, 1993 would be recovered during 1995-2000. We also hope that the States would take steps to ensure that in future large arrears do not accumulate.

Non-tax Revenues

3.12 The major sources of non-tax revenues are interest receipts, royalty on mines and minerals, revenues from forests and receipts from irrigation works and departmentally run schemes. We have dealt with most of these items separately on a normative basis. The performance of States on this account has been a matter of great concern for us. While tax revenues have been generally more buoyant than estimated by successive Finance Commissions, non-tax revenues have consistently fallen behind. This has been a major reason for the yawning gaps between receipts and expenditures which have eroded the revenue resources of the States and crippled their efforts at providing reasonable services in many vital sectors like power, transport, irrigation and water supply. All these constitute vital elements of infrastructure and hold the key to faster development in the new economic regime. They are critical for attracting investment. We are painfully conscious of the fact that most States have preferred the softer option of letting services deteriorate rather than improving their spread and quality by realising economic returns on the investment in these areas and deploying the additional resources for this purpose. We have adopted norms in the light of this concern without losing sight of the feasibility of our prescription and the capacity of the State Governments to achieve the same. We have been emboldened in our efforts by the response we have received in the course of our

meetings with different State Governments where we perceived greater sensitivity now to the need for improvement as also a degree of determination to turn things around. We now turn to the major components of non-tax revenues.

Interest

3.13 We find that receipts from this source have been extremely unsatisfactory. Cutting across all States, the interest receipts on loans advanced by the State Governments, excluding loans to State Electricity Boards and State Road Transport Corporations, have remained at a level which does not correspond to the rates at which loans have been advanced. We are conscious of the difficulty in effecting full realisation but we see no reason why considerable improvement cannot be brought about through concerted efforts. Accordingly, we have assumed interest receipts at the rate of 4 per cent on the loans outstanding to third parties as on 31st March, 1995. For the purpose of calculations, we have ignored further accretion to the loans outstanding as on 31st March, 1995.

Dividends

3.14 It has been estimated that the equity investment of the States in public enterprises and cooperative institutions (other than State Electricity Boards and State Road Transport Corporations) would be of the order of Rs. 14,416.79 crores as on 31 March, 1995. Most of these enterprises have not been functioning in a satisfactory manner and they have incurred huge losses over the years. In fact, we have been distressed to note that in State after State even the accounts of many undertakings have not been finalised for long periods ranging from 5-20 years. Clearly, such a state of affairs reduces accountability and is hardly an incentive for good management. It is expected that the State Governments would take up this task in right earnest and bring the accounts up-to-date in a time bound fashion.

3.15 It has been the view of successive Finance Commissions that the substantial investment made in these enterprises should yield a reasonable return. Most Finance Commissions have set very modest goals but the actual yield has been much below even these. Nevertheless, it has been the view of most States that it would still be useful if the Commission were to set standards towards which they could strive. In the context of the new economic policy it appears necessary that such areas of economic activity, in which Government chooses to intervene directly, are selected carefully and Government enterprises in these areas perform competitively. Taking all these issues into account, we are of the view that it would be reasonable to expect a return on the investment made by State Governments in such enterprises and cooperative institutions.

3.16 We commissioned a study by the Institute of Public Enterprises, Hyderabad regarding the performance of, and expected rate of return on equity invested in state level public enterprises (SLPEs). The Institute has recommended that the enterprises (including cooperatives) be classified as commercial, commercial-cum-promotional and promotional. We are in agreement with the classification proposed. The Institute has also recommended that a reasonable rate of return on equity for these three categories of SLPEs would be 7.5 per cent, 5 per cent and 2.5 per cent respectively. While we accept the logic of a differential rate of return as suggested by the Institute, we are of the view that it might not be feasible for the States to achieve the suggested standard of performance during 1995-2000. Accordingly, we have adopted 6 per cent, 4 per cent and 1 per cent respectively as the expected rates of return on equity for commercial, commercial-cum-promotional and promotional enterprises and on this basis calculated the absolute level of dividends in each of the years of

the period of our report. The details are given at Annexure III.6.

3.17 We are also of the view that a stage has now come when there should be no addition to the number of SLPEs. In fact, there might well be a case for reverting certain functions of a purely promotional nature to either Government departments or even to non-governmental organisations of proven record. This is relevant for all such enterprises where the intended goals of better performance and additional resource mobilisation have not been achieved. In fact, in some cases, such an experiment has tended to erode accountability and dilute the responsibility of government in crucial areas.

3.18 We have noted with concern that the capital structure of a number of SLPEs is quite inadequate in relation to the objectives set forth for them. Generally, there has been an overwhelming reliance on borrowed funds as compared to equity capital, burdening such enterprises with heavy debt-servicing liabilities in their infancy and leading to progressive sickness. The Institute of Public Enterprises has examined this aspect at some length and suggested that the debt-equity ratio should be re-aligned in such a manner that it should not be a disadvantage for such enterprises. We support this view and expect that all State Governments would draw detailed plans for capital restructuring of viable enterprises in such a manner that no enterprise remains handicapped on this account by the turn of the century.

3.19 In keeping with the changed economic scenario, we consider it necessary for all States to devise a suitable disinvestment strategy based on considerations of performance, profitability and mobilisation of resources. Considering that less than 15 per cent of the equity has been invested in promotional enterprises and only a third of these enterprises are in the core sector, it should not be difficult to disinvest at least 20 per cent of the aggregate equity during the period covered by our Report through outright sale or substantial disinvestment of the equity invested in such enterprises.

3.20 We are firmly of the opinion that the proceeds of such disinvestment should be utilised only for retirement of debt owed to the Central Government. This would not only reduce the stake of government in such activities as are not of vital concern, but it would also help diminish the debt burden of the States. As an incentive, we recommend that the Central Government should additionally write-off debt equivalent to the debt retired by the States in this manner limited, however, to 20 per cent of the equity investment of the State as on 31st March, 1995.

Forests

3.21 Forests have not been perceived as a major source of revenue for the State Government in view of the restrictions imposed by the Forest (Conservation) Act, 1980 and the growing need for preserving our forest wealth. We share the concern for ensuring ecological balance and preventing any depletion of our forest resources. As such, we have not envisaged any growth in the receipts from this source during the period of our report, except for such increases as might accrue on account of rise in prices.

Mines and Minerals

3.22 For our reassessment, we have retained the estimates provided by the State Governments. The Ministry of Mines and the Ministry of Coal have expressed their inability to make any forecast of royalty payments to States during 1995-2000. We have received projections from the Ministry of Petroleum and Natural Gas, but these are at variance with the estimates of the State Governments. However, as this affects only a few States, we have taken the view that in case the actual realisation of the concerned States from royalty is higher than that assumed in our

estimates, it would be open to the Central Government to make suitable adjustments in the grants-in-aid under Article 275 recommended by us for meeting their non-plan revenue deficits.

Major and Medium Irrigation

3.23 The losses incurred by irrigation projects have continued to mount. They have increased from Rs.367 crores in 1987-88 to Rs.881 crores in 1992-93. We have also noted that while some earlier Commissions had prescribed a rate of return on the capital invested in irrigation projects, the previous two Commissions, perhaps in view of the dismal performance, did not go beyond assuming that the receipts should cover atleast the cost of operation and maintenance (O and M). Presently, the receipts from irrigation projects are not only meagre but they constitute a negligible proportion of the value of produce per hectare of irrigated area. Receipts seem to be quite insensitive to the very substantial gains in agricultural productivity in irrigated tracts. The Vaidyanathan Committee on Pricing of Water has referred to an assessment that indicates that the gross receipts per hectare for major and medium irrigation projects are less than 3 per cent of the value of production. They are also less than 5 per cent, except in two States, of the difference in the value of output per hectare in irrigated and unirrigated areas. Obviously, the States have not succeeded in capturing the gains from higher productivity in terms of better irrigation receipts. The Vaidyanathan Committee has made a number of recommendations in this regard which should be given urgent consideration. We are of the view that the irrigation receipts should cover not only O and M costs but also give a return of at least 1 per cent per annum on capital. We suggest that the State Governments should strive to achieve this goal during the forecast period. Having regard to the ground which still remains to be covered, however, we have included in our reassessment of forecasts only such receipts as are sufficient to meet O and M charges. We have taken a more liberal view for the hill States and have assumed recovery of only 75 per cent of the O and M expenditure on the utilised potential. Receipts have not been assumed from the unutilised potential for any State. The receipts assumed from major and medium irrigation projects on this basis are shown at Annexure III.7.

Minor Irrigation

3.24 For receipts from minor irrigation works, we have assumed that there will be full recovery of expenditure on maintenance by the terminal year 1999-2000. However, this would come about in a graduated manner. For hill States, and hill areas of non-hill States covered by the Hill Area Development Programme we have assumed that the percentage of recovery in the terminal year would rise to 75 per cent of the expenditure on maintenance. The receipts assumed from this source are shown at Annexure III.8.

Lotteries

3.25 Most States have projected much lower receipts from lotteries than realised in the preceding five years. We have accepted these estimates as fresh restrictions are being imposed by the Central and State Governments in tapping this source of revenue. However, we have not provided for any loss on this account and we have confined our estimates in such cases to the last positive contribution.

Elections

3.26 The receipts under this head represent the amounts likely to be reimbursed by the Central Government to the States for the expenditure incurred in holding elections to Parliament and

other preparatory work connected with the conduct of general elections. We have gone by the estimates furnished by the Ministry of Law and Justice. We have been advised that the Central Government is also likely to reimburse to the States a part of the cost of preparing photo identity cards but we have not included these in receipts as the amounts are not firm.

Departmental Schemes

3.27 The receipts from departmental schemes, namely, water supply schemes, milk schemes and industrial schemes continue to be negligible and most States are incurring heavy losses on this account. Conceptually, it should be possible to distinguish between water supply schemes, which address a minimum need, and milk schemes and industrial schemes, which are semi-commercial/commercial in nature. The former provide services for which it should be possible to recover reasonable charges from the beneficiaries. Accordingly, we have assumed that the aim should be to recover 50 per cent of the O and M expenditure on water supply schemes by the year 1999-2000, subject to the increase in the ratio of recovery in any year of the period covered by our Report being not more than 50 per cent of that in the previous year. Milk schemes should generate receipts which are atleast equal to the O and M expenditure incurred on these activities. Industrial schemes are no different from the activities of commercial public sector enterprises. As such we have assumed that they should give the same return on investment i.e. 6 per cent per annum. The details are at Annexure III.9 to III.11.

3.28 We would also like to take this opportunity of suggesting that many of these schemes should be transferred progressively to local bodies, cooperatives, and non-governmental organisations which might be more responsive to local needs and also be in a better position to effect recoveries.

Power Projects

3.29 The performance of power utilities, particularly the State Electricity Boards (SEBs), is crucial to the finances of States. The total investment by State Governments in Boards and power undertakings is expected to exceed Rs.45,000 crores by the end of 1994-95. Far from getting any return on this huge investment, the States have had to countenance ever increasing commercial losses which are expected to cross Rs.6,000 crores in 1994-95.

3.30 In fact, we have reached a stage where the poor financial health of the Boards is not only hindering their own development but is also inhibiting others from investing in the power sector. The inability of the Boards to pay promptly for the power purchased by them from other organisations, whether they be Central Sector undertakings or private utilities, has cast a shadow on investment in this sector.

3.31 The reasons for this dismal state of affairs are well known and have been gone into at considerable length by previous Commissions and a number of expert groups. No doubt a part of the blame is attributable to the adverse capital structure of the Boards which is tilted heavily in favour of loans rather than equity even though power projects have long gestation lags and are very capital intensive. The reluctance of States to revise their tariffs to keep pace with the increasing costs of operation and inputs and in particular, the provision of power to agriculture at rates much below the cost of supply or at just a token charge, compounds the problem. The average rate of realisation in most States is thus much below the average cost of production and supply of power. Boards also need to be recompensed for extending power supply to areas which cannot bear the economic costs as cross-subsidization through differential tariffs is possible only upto a point. Excessive subsidization of power, particularly

for agricultural uses, leads to a waste not only of power but also of diminishing groundwater resources.

3.32 Equally serious are the deficiencies in physical performance. Capacity utilisation is low, transmission and distribution losses are unconscionably high, the numbers employed bear no relation to the task in hand and billing and collection procedures are hopelessly out of date. These again are not insurmountable problems as has been demonstrated by some Boards which have managed to achieve very high levels of operational efficiency.

3.33 A large number of representatives of State Electricity Boards, Central Electricity Authority and the Department of Power of the Central Government, with whom we had detailed discussions, share our views. We had also set up an Advisory Group of Experts on Power. This Group has recommended that the statutory minimum return of 3 per cent on net fixed assets is not sufficient and it should be possible for the Boards to aim at a rate of return around 7 per cent by 1999-2000. This is necessary if the Boards are to generate at least 25 per cent to 30 per cent of the resources needed for new projects.

3.34 Taking all this into account, we have assumed a gross rate of return of 3 per cent on investment in 1995-96 and 1996-97, 5 per cent in 1997-98 and 1998-99 and 7 per cent in 1999-2000. We have adopted this graduated approach keeping in view the distance to be traversed by most Boards to arrive at the desired level of performance in the terminal year of the period covered by our report. We have estimated the investment by reducing the amount of loans outstanding as on 31 March, 1995 by the amount tied up in the works-in-progress (with one sixth of the value as on 31 March, 1995 being added on to outstanding loans in each year) and the amount attributable to rural electrification schemes. We have relied on the data furnished by the State Governments regarding the works in progress for 1992-93. We have applied the ratio of this to the total capital block in 1992-93 to arrive at the figures for 1994-95. We have, however, not made allowance for fresh loans during the period covered by our report, though we are aware that all States will be investing substantial additional sums in this sector during 1995-2000. The investment in rural electrification has been estimated by adding the actual expenditure figures for the period 1990-93 and the approved outlays for the period 1993-95 to the investment figures for 1989-90. In our estimation, we have not assumed any subsidy as a receipt of the Boards and we have correspondingly excluded it from the expenditure of the States. Receipts from electricity duty (except the amounts received from private utilities), as projected by the State Governments, have been set off against the gross return. On this basis, the net return, after setting off electricity duty, works out to Rs. 2369 crores during 1995-2000 as shown at Annexure III.12.

3.35 We have prescribed no returns for the departmentally run power undertakings of Arunachal Pradesh, Goa, Manipur, Mizoram, Nagaland, Sikkim and Tripura and Boards in the special category states of Jammu and Kashmir, Himachal Pradesh, Meghalaya and Assam, in view of the special operating conditions in these States.

3.36 We have been advised that particular attention needs to be paid to the management of the power systems, improvements in which have lagged behind additions to capacity. Such improvement can be effected with relatively lower capital investment. Transmission and distribution links need to be strengthened in keeping with the developing loads, transformers have to be of adequate capacity and capacitors introduced. Proper metering and billing arrangements in all sectors of usage

should be introduced at the earliest. Ideally, there should be time-of-the-day metering which will induce some consciousness regarding wasteful consumption besides reducing the need for additional capacity. Tamper proof meters could be installed at the earliest to prevent rampant pilferage of power. Finally, a suitable institutional arrangement should be established to facilitate exchange of power between States and regions. This would improve capacity utilisation and discourage economically wasteful flogging of inefficient plants when less expensive options for purchase of power are available.

3.37 In view of conflicting interests and with divided ownership of power utilities and the growing size and complexity of the system, more disputes are likely to arise. It would, therefore, be necessary for the Central Government to develop such guidelines which facilitate the economic exchange of power and help resolve such disputes, as might arise, regarding the terms and conditions on which such exchange takes place. Otherwise, chronic problems like overdrawal of power and non-payment of dues would get compounded and accountability and efficiency eroded further.

State Road Transport Undertakings

3.38 This is another important area where State Governments have a considerable stake. The total investment by the States in these undertakings is expected to be Rs. 3084 crores at the end of 1994-95. For our purpose, we have considered together all undertakings established under the Road Transport Act, 1950, companies registered under the Indian Companies Act as also the eight undertakings run departmentally.

3.39 Road transport is a commercial business notwithstanding the social obligations cast on Government for providing essential transport services to areas which might not be serviced by private operators. These obligations do impose a financial burden on these undertakings but they cannot be construed to be sufficient justification for the poor financial position of most State road transport undertakings (SRTUs) in the country. Our analysis of the physical and financial working of the SRTUs confirms the impression that improved physical performance in the areas of fleet utilisation, vehicle utilisation, load factor, staff-bus ratio and kilometers covered per litre of fuel would alter the picture substantially. While the percentage of fleet utilisation in 1992-93 was more than 90 per cent in Punjab, Haryana, Andhra Pradesh, Rajasthan and Tamil Nadu, it was as low as 36 per cent in Bihar. Similarly, the vehicle utilisation ranged from 361 kms. per bus per day in Tamil Nadu to a mere 70 kms. per bus per day in Bihar amongst non-special category States. Overstaffing is a common malaise in most undertakings with some States having a staff-bus ratio as high as 18. On the other hand, it has been possible for others to manage with a ratio close to 5. We see no reason why it should not be possible for the States that are lagging behind to ensure that the operational efficiency of their undertakings improves during the next five years.

3.40 We have had detailed discussions on the subject with representatives of the Ministry of Surface Transport, Planning Commission, Transport Ministers of States and State Road Transport Undertakings. We had also constituted an Advisory Group of Experts on SRTUs to assist the Commission in its deliberations in this regard. There was general agreement that there is considerable scope for improving the physical and financial performance of SRTUs. This would be facilitated if the SRTUs were compensated for the social obligations imposed on them as a matter of State policy. Several States permit private operators to provide services and other States could also do so to augment services and improve efficiency through a measure of

competition. The barriers for collection of sales tax and other taxes hinder efficient operations by wasting time and fuel. These need to be eliminated over a period of time. It might also be necessary to consider setting up a Tariff Commission, either at the national or regional level, to ensure some degree of compatibility in the fare structure.

3.41 The Advisory Group also recommended that it should be possible to achieve a rate of return on investment of 8 per cent per annum in the terminal year i.e. 1999-2000 commencing from a level of 6.5 per cent in 1995-96 and rising in a graduated fashion subject to fares being cost based and fare revisions being done promptly. We have neither included subsidies in the receipts of SRTUs nor have we made any provision for these in the expenditure estimates of States. However, keeping in view the environment in which SRTUs operate today and their past performance, we have settled for a relatively lower rate of return starting from 2.5 per cent in 1995-96 and rising to 6 per cent in 1999-2000. State-wise details are as at Annexure III.13.

3.42 We have adopted the same standards for the functioning of the Inland Water Transport Undertakings in the States of Goa, Kerala, Tamil Nadu and West Bengal. The details are at Annexure III.14.

3.43 On account of the nature of the terrain and low load factors, we have not assumed any return for SRTUs operating in the special category states and the hill areas of non-special category states. However, we would like to stress that even within this category there are wide variations in performance. We hope that all these States would endeavour to improve their operational performance in the next five years and come close to the levels prevailing in the better managed undertakings.

Other non-tax revenue

3.44 All other items of non-tax revenues have been treated in a composite fashion. Our analysis reveals wide variation in the performance of States in this regard. While the trend growth rate in most States has been more than 11 per cent per annum during the period 1983-93, some have lagged behind at less than 5 per cent per annum. The overall buoyancy of these receipts taken together for all States with respect to the gross domestic product has been close to one. Accordingly, we have assumed a buoyancy estimate of one for this item. We hope all States will review the structure of fees, charges and levies presently in force with a view to tapping these neglected sources of revenue.

Other non-plan Grants

3.45 We have assumed that non-plan grants from the Centre, other than those under article 275, would continue to flow to the States on the same basis as at present. These grants are meant to cover special expenditure liabilities which have been assumed to grow at a particular rate in our expenditure projections. We have provided for these grants to grow at the same rate. The base year receipts are generally as provided for in the 1994-95 budget estimates of different States except in such States where estimates were not available for which we have made suitable adjustments. We have excluded grants which are given for meeting capital expenditure or a one time expenditure.

Non-plan Revenue Expenditure

3.46 We have reassessed the non-plan revenue expenditure of the States keeping in view the past trends in the growth of expenditure and their reasonable requirements. Our examination of the fiscal behaviour of States for the last 15 years or so gives an unmistakable impression that the problem in

ensuring fiscal balance hinges primarily on the capacity of States to curtail unproductive and wasteful expenditure. Non-plan revenue expenditure has grown at a trend growth rate of about 18 per cent during the period 1986-93. There is little possibility of a step-up in revenue resources which can accommodate such a rapid increase in expenditure. While some growth in non-plan revenue expenditure in priority sectors like basic health and elementary education could be considered desirable, there is need to curtail expenditure on most other items.

3.47 The rapid rise in non-plan revenue expenditure has also been accompanied by a rapid increase in the numbers employed by government without commensurate increases in efficiency and productivity. In State after State, we have come across the phenomenon of salary bills growing relatively much faster than the growth of expenditure, pre-empting an ever increasing proportion of resources for the mere maintenance of the government apparatus. Very little resource is left for improving the coverage and quality of services which government is expected to provide. The result is manifest in the poor maintenance of government assets, the upkeep of government offices and even the unbelievable situation of non-payment of salaries to employees in time. This is an unsustainable position which is bound to erode the capacity of State Governments for providing essential services to the people.

3.48 For estimating non-plan revenue expenditure, we have disaggregated the total expenditure into certain broad heads like police, health, education, buildings, irrigation and flood control, roads and bridges, interest payments, committed liabilities and others. While the expenditure on the maintenance of buildings, roads, irrigation works, flood control works and liabilities on account of interest payments have been worked out on a normative basis, we have followed a statistical approach for the rest tempered with an element of prescription as explained earlier in the general methodology. It may be clarified that while estimating the trend growth rates and arriving at base year figures, we have eliminated unusual items of expenditure which are not part of the normal trend and have occurred on account of special contingencies in one or two years.

3.49 We conducted an exercise to examine the responsiveness of the expenditure on the residual items to the price increases during the period 1980-90. We find that the price elasticity of non-plan revenue expenditure, excluding the normative items, is around 0.85. We have used this figure as we think it will suffice to cover increases in expenditure which arise on account of inflation, primarily for payment of additional instalments of dearness allowance.

3.50 Considering the unprecedented expansion of the Government machinery that has occurred over the years, we are of the view that there is little justification for further expansion. On the contrary, there has to be a deliberate and conscious attempt to reduce the size of establishment if government machinery is to be lean and effective. In the circumstances, we have provided for a modest real growth of 1.5 per cent per annum in non-plan revenue expenditure over and above the increase accounted for by prices. For certain priority sectors like health and elementary education we have provided a relatively faster rate of growth. A higher rate of 2.5 per cent has been provided for expenditure on health and family welfare services for all States. We have provided a growth rate of 2.5 per cent for expenditure on elementary education, only for States where literacy levels are below the national average viz. Andhra Pradesh, Arunachal Pradesh, Bihar, Jammu and Kashmir, Madhya Pradesh, Meghalaya, Orissa, Rajasthan and Uttar Pradesh.

3.51 We have retained the amounts forecast by the State Governments for social security and terminal benefits except in cases where we found these estimates to be out of line with the trends in expenditure and the rates of growth of non-plan revenue expenditure assumed by us. However, we are not convinced that we are required to provide for the varying food subsidy schemes in different States. Schemes like these raise a number of questions of inter-personal and inter-State equity which are not easy to resolve. We also feel that it is sufficient if we have provided fully for food subsidy in our assessment of the expenditure needs of the Central Government. This is available to all needy persons in the country on a uniform basis. To obviate any hardship to any State, we have provided for a gradual phasing out of the provisions on this account such that beginning in 1995-96 with an amount equivalent to the provision in the budget estimates 1994-95, it becomes nil after the financial year ending on 31st March, 2000.

Interest Payments

3.52 Interest payments constitute a major item of expenditure for the States accounting for nearly 17 per cent of the total non-plan revenue expenditure in 1992-93. We have been able to obtain from all the States estimates of outstanding loans as on 31st March, 1995. We have also been able to estimate the implicit rate of interest on such loans. On this basis, we have generated a stream of interest liabilities on this account for the period covered by our Report. As for new loans likely to be contracted during the forecast period we expect that the States would be much more prudent while borrowing in the future in the light of their outstanding debt. For many, the opportunity to borrow would also get somewhat circumscribed in the new economic regime. For the purpose of our reassessment, we have looked at past trends and assumed a 10 per cent growth in the outstanding amount every year and provided fully for the interest liability on this account.

Maintenance of Capital Assets

3.53 We have felt greatly concerned about the poor maintenance of capital assets which is a neglected area in most States. The poor state of our roads, irrigation works and government buildings bear testimony to the lack of care in this regard. While there is intense jostling amongst States for more and more new projects, this zeal is not matched by corresponding attention to the upkeep of the assets created at great expense. Even though an improvement in the maintenance of these assets would make available additional capacity immediately at a fraction of the cost involved in setting up corresponding new capacities. We are also extremely concerned that though successive Finance Commissions have provided for this purpose and the actual expenditure has exceeded the provisions, most of it has got diverted to payment of salaries and wages rather than to material and equipment necessary for maintenance work. We have been quite liberal in providing for the expenditure needs on this account and we hope this would motivate the State Governments not only to earmark sufficient funds for this purpose but also to ensure that the funds are utilised efficiently and economically. We expect that not more than 20 per cent of the provision would be spent on establishment, and tools and plant in any year. We also hope that the possibility of maintenance being done by groups of beneficiaries or non-governmental organisations or even through private bodies would be explored by the States if they happen to be cost-effective options.

Major and Medium Irrigation Works

3.54 The Ninth Finance Commission adopted a norm of

Rs. 180 per hectare for the utilised potential and Rs. 60 per hectare for the unutilised potential. The norms for hill States were higher by 30 per cent.

3.55 In view of the price rise and other changes during the period 1990-95, we have adopted a norm of Rs. 300 per hectare for the utilised potential and Rs. 100 per hectare for the unutilised potential. We have also accepted norms which are higher by 30 per cent for hill States. We have provided for suitable increase in the norms in each year of the forecast period to insulate them against inflation.

3.56 We are quite concerned about the very high percentage of unutilised irrigation potential in certain States. Irrigation capacity is created at considerable cost, time and effort. Non-utilised capacity, whatever might be the cause, is an avoidable waste which we can ill-afford. Accordingly, we have assumed that in States where the utilisation of the potential is 90 per cent or more, there would be no unutilised potential by the year 1999-2000. For those which have a utilised potential between 75 per cent and 90 per cent, we expect the levels to rise to 95 per cent by 1999-2000. For the rest, we expect the utilisation to rise to 90 per cent by the terminal year of the forecast period.

3.57 The requirement for maintenance expenditure for each of the years 1995-96 to 1999-2000 has been worked out on the basis of the data regarding utilised and unutilised potential obtained from the Planning Commission and the norms assumed by us. We have taken care to ensure that in such States where the norms imply a very sharp increase in expenditure in 1995-96 compared to the base year, the increase is graduated without affecting the aggregate provision available for the forecast period. The details are at Annexure III.7.

Minor Irrigation

3.58 The Ninth Finance Commission did not adopt a normative approach in making provisions for the maintenance of minor irrigation works for want of requisite data. We too did not have adequate data. We have attempted to assess the requirements on this account on the basis of the ratio of the average weighted expenditure per hectare on minor irrigation in a State to the average weighted expenditure per hectare on major and medium irrigation schemes. On this basis, we are of the view that a norm of Rs. 150 per hectare i.e. half that for major and medium irrigation schemes, should suffice. As usual, the hill States have been given a norm which is higher by 30 per cent and hill areas of non-hill States have been treated similarly. We have provided for enhancement of the norm for each year during 1995-2000 period to protect it against price rise. We have used the information furnished by the Planning Commission regarding the expected irrigation potential from minor irrigation schemes at the end of the current financial year. Wherever we found that our provision for 1995-96 was too high compared to the expenditure provided for in 1994-95, we have opted for a gradual increase without affecting the total provision for the five years. The details are at Annexure III.8.

Flood Control Works

3.59 For working out the requirements for maintenance of flood control works, we have proceeded with the average expenditure in each State during the five years from 1990-91 to 1994-95. As that expenditure would have been incurred on maintenance of capital stock as on 31st March, 1990, and as per our terms of reference we have to provide for the maintenance of capital stock as on 31st March, 1995, the average expenditure was increased by 10 per cent in all, assuming an increase of 10 per cent in the capital stock during these five years. The

requirements for 1995-96 to 1999-2000 have been assessed by providing for inflation during the years 1995-96 to 1999-2000. We took the estimates so worked out or those assessed by the States in their forecasts, whichever were lower. The assessed requirements are as shown at Annexure III.15.

Buildings

3.60 The Ninth Commission had made provisions for the maintenance of buildings taking into account the plinth area of the buildings of different categories in three broad age groups, viz. 0-20 years, 20-40 years and over 40 years and the relevant norms obtained from the Central Public Works Department. The Commission had moderated the expenditure arrived at on the basis of norms so as to ensure that no State would be provided in 1994-95 less than 180 per cent and more than 220 per cent of the annual provision made for this purpose by the Eighth Commission for 1988-89. Keeping in view the trends in expenditure, the steep increase in the costs involved and the poor state of up-keep of government buildings, we have provided a step-up of 250 per cent by 1999-2000 of the norms accepted by the Ninth Commission for 1994-95. The provisions for the intervening years have been worked out on the basis of these two boundary estimates after protecting the provision against inflation. Wherever the estimates for 1995-96 are very high compared to the estimates for the preceding year, the provisions have been graduated without affecting the total availability for the forecast period. The year-wise provisions are at Annexure III. 16.

Roads and Bridges

3.61 We obtained norms for the maintenance of roads from the Ministry of Surface Transport. The norms were at the 1992-93 level of prices and were suitably increased to take into account the effect of rise in prices in 1993-94 and 1994-95. The norms were also increased by 20 per cent to take into account the cost of establishment, and tools and plant. We obtained from the State Governments information about the length of different categories of roads in the States. The norms were applied to the likely road lengths of different categories of roads as on 31st March, 1995 to assess the expenditure as per norms in different States during the forecast period. As the expenditure so worked out came out to be very high, we have limited the total provision for all the States to twice that provided by the Ninth Commission. The State-wise distribution has been made on the basis of the average of their percentage shares in (a) the all-State total as per norms and (b) the all States total estimated expenditure in 1994-95. The provisions for the individual States worked out in this manner were, wherever necessary, suitably modified to provide for each State at least twice the amount provided by the Ninth Commission. It was also ensured that the provision for each State was at least 20 per cent higher than the expenditure in 1994-95. As usual we have provided for a graduated increase in the expenditure without affecting the totals. The year-wise provisions are at Annexure III.17.

Monitoring of Maintenance Expenditure

3.62 We know it is not enough if we just provide liberally for the maintenance of capital assets. In the past, maintenance has been poor not so much on account of paucity of resources as misdirection of available resources. The main reason has been the exhaustion of a large part of the provision for maintenance on establishment expenditure leaving very little for maintenance per se. However, in State after State, we found that the information system was not geared to providing data regarding the exact amount spent on maintenance and on maintenance-related establishment. No doubt, the respective work divisions entrusted with maintenance had the details but these were not reflected in

the accounts or in any other reporting system in a fashion which would permit easy monitoring. In view of this, we feel it is necessary to redesign the presentation of accounts in such a way that the expenditure on the works component and the establishment expenses get reflected separately and are easily accessible. The reporting formats should be brought in line with this change in the presentation of accounts. The outline of a scheme in this regard is at Appendix 3. We recommend that the Ministry of Finance, in consultation with the State Governments and with the concurrence of the Comptroller and Auditor General of India, may introduce appropriate changes in the accounting and reporting system in accordance with this scheme.

3.63 We also recommend that the State Governments should ensure that the provisions for maintenance are made in accordance with our recommendations. We further recommend that a high powered committee chaired by the Chief Secretary and with secretaries of the State Government concerned in the departments of Finance, Planning, Irrigation and Public Works and the concerned chief engineers of the works departments should review every quarter the allocation and utilisation of such funds. In particular, this committee may concentrate on ensuring that the funds meant for maintenance per se are not diverted to wasteful expenditure on unrelated and unnecessary establishment. It should also check compliance with the stipulated quality norms through suitable reporting and sample checking at the field level. Similar committees at the district level could report periodically to the state level committee. The district level committees could associate representatives of users/beneficiaries and the media to ensure proper utilisation of the amounts provided for maintenance of specific schemes and adequate dissemination of information about the commencement and completion of such works.

3.64 Finally, we would suggest that in all exercises for assessing resources for the annual plans, whether at the State level or in the Planning Commission, due care should be taken to ensure that the anxiety for enlarging the size of plans does not result in cutting down the provisions necessary for a reasonable level of maintenance. This was a salutary practice in the past and its going into disuse has led to an erosion of the funds available for maintenance.

Pay and emoluments

3.65 Our terms of reference do not make any specific reference to the subject of emoluments of State Government employees. However, we have taken note of the fact that in a few States the emoluments paid for certain categories of employees are higher than those of the Centre. For making the comparison, we have considered the emoluments at the mid-point of the minimum and maximum basic pay scale for comparable categories of the Centre and States as on 31st March, 1993. Five States, viz. Haryana, Himachal Pradesh, Mizoram, Punjab and Tripura have granted higher emoluments than the Central Government. While these States might be of the view that their financial position permits them to do so, we are not in a position to accommodate these differentials in our assessment. We have, therefore, made suitable deductions from the expenditure estimates of the five States mentioned above in order to ensure an equitable treatment to all States.

3.66 We have noticed that almost all State Governments are following the same pattern in payment of dearness allowance as the Central Government. The sanction of dearness allowance instalments by the Central Government is followed sooner or later by the States. Since we have taken note of the expenditure figures of 1992-93 in our estimates for arriving at the base year estimates,

we are of the view that the expenditure on dearness allowance instalments sanctioned upto that year are adequately provided for. The trend growth rates of expenditure adopted for arriving at the base year also take into account the expenditure liabilities which have arisen on account of payments of dearness allowance during 1993-95. In our forecast, we have already provided adequately for the effect of such price increase on non-plan expenditure through the price elasticity of such expenditure.

3.67 All State Governments have projected liabilities likely to arise from the recommendations of the Fifth Pay Commission. We have no basis for estimating the requirements on this account. Accordingly, we have decided to exclude these requirements from our estimates just as we have done for the Central Government. If any State chooses to go in for pay revision during the forecast period, it would have to raise the resources for the purpose.

Elections

3.68 We have provided fully for the conduct of general elections to Parliament and the State Assemblies and for other expenditure incidental to such elections as estimated by the Ministry of Law and Justice.

Other expenditure

3.69 All other items of expenditure have been clubbed together. We have provided the same growth rate for such expenditure as for other items of non-plan expenditure.

Committed Liability

3.70 Para 4(iii) of our terms of reference requires us to provide for the maintenance of plan schemes to be completed by 31st March, 1995. Normally, such a transfer is effected at the conclusion of a plan period. This has become difficult as the period of the Eighth Plan is not co-terminus with the period of our Report. We have followed our terms of reference though it involves a transfer from the plan to non-plan in the middle of a plan period. We have broadly adopted the approach of the Seventh and Eighth Commissions while arriving at a reasonable estimate of committed liability on account of plan schemes to be completed by 31st March, 1995. We have not admitted the committed liability for different States on the basis of their estimates as the proportion of

committed liability in relation to the revenue plan outlay in 1994-95 varies from as low as 18 per cent to as high a figure as 115 per cent. Such wide differences defy rational explanation. We have found that the overall proportion of committed liability estimated in 1990-91 for the completed Seventh Plan schemes worked out to 30.8 per cent of the revenue plan component in 1989-90. We have adopted a norm of 30 per cent of the revenue plan outlay for the year 1994-95 for committed expenditure in 1995-96 in respect of State plan schemes to be completed by 31st March, 1995. We have adopted a higher norm for the special category States, except Meghalaya. As these States did not effect a transfer of completed plan schemes to the non-plan side at the conclusion of the Seventh Plan, the provision for committed liability in 1995-96 for such States would have to cover the backlog of the schemes completed by the end of the Seventh Plan, apart from whatever is completed during 1990-95. We have adopted an overall percentage of 40 per cent for such States. Estimates of committed liability for 1995-96 thus arrived at, on the basis of the budget estimates of the revenue component of the State plan for 1994-95, have been protected against inflation but no real growth has been assumed as has been done for other non-plan revenue expenditure. State-wise details of the provision on the above basis are at Annexure III.18.

3.71 We have made no additional provision for committed liability on account of centrally sponsored schemes. A number of them have already been discontinued or transferred to the States. These form part of the State plan. Those schemes which are continuing are not expected to be completed by 1994-95.

3.72 As mentioned earlier, we have gone by our terms of reference in deciding the cut-off date for transfer of committed liability on account of plan schemes. However, the incremental liabilities that would arise in 1997-98 on account of Eighth Plan schemes completed in the next two financial years would have to be provided for. We are of the view that the Planning Commission may consider providing for the maintenance of such schemes till 1999-2000 in the plan itself as was done for the schemes of the two Annual Plans of 1990-91 and 1991-92.

3.73 The summary position on the non-plan revenue account of each State, as reassessed by us, is indicated in Annexures III.19 to III.43.

CENTRES' RESOURCES : ASSESSMENT OF REVENUE AND EXPENDITURE

Introduction

4.1 The resource position of the Central Government during the period 1995-2000 has been assessed in conformity with our terms of reference. These require us to assess the revenue receipts and non-plan revenue expenditure of the Central Government having regard to the demands on the Central Government for expenditure on civil administration, defence and border security, debt servicing and other committed expenditure or liabilities. The terms of reference emphasise the need for improving overall fiscal management consistent with efficiency and economy in expenditure so as to generate surplus for capital investment and reduce fiscal deficit.

4.2 Our assessment is based on an analysis of the forecast of receipts and expenditure submitted by the Ministry of Finance. The Ministry of Finance submitted a memorandum which provided the overall context for our reassessment. We also had the benefit of discussing the issues under consideration with representatives of the Ministry of Finance.

Analysis of the Forecast

4.3 The Ministry of Finance first submitted a forecast in July, 1993 and revised it in May 1994 after the budget of 1994-95 was presented to Parliament. Our reassessment has been carried out on the revised forecast.

4.4 To put the forecast in perspective, Table 1 compares the projected behaviour of major fiscal and budgetary variables with their observed pattern in the past. It is evident that the current fiscal imbalance gets accentuated in the forecast submitted to us: revenue receipts as a percentage of GDP are declining while revenue expenditures are rising. The Central forecast shows that the revenue receipts as a percentage of GDP are estimated to be 13.28 per cent during 1995-2000 as against the actuals of 14.56 per cent during 1985-90. On the other hand, revenue expenditure as a percentage of GDP is forecast to rise from 13.94 per cent in 1985-90 to 14.53 per cent during 1995-2000. Non-plan revenue expenditure is also projected to increase to 11.44 per cent. Thus, non-plan revenue expenditure as a proportion of revenue receipts is estimated to rise from about 80 per cent during 1985-90 to about 86 per cent of revenue receipts in the forecast period.

Table 1

Pre-Devolution Revenue Account of Centre

(per cent of GDP)

Item	1980/ 85 Actual	1985/ 90 Actual	1990/ 95 Actual/ Estimates	1995/ 2000 Fore cast
REVENUE				
I. Revenue Receipts	12.81	14.56	13.36	13.28
a) Gross Tax	9.96	11.22	10.21	10.26
b) Non Tax	2.85	3.34	3.15	3.02

(per cent of GDP)

Item	1980/ 85 Actual	1985/ 90 Actual	1990/ 95 Actual/ Estimates	1995/ 2000 Fore cast
EXPENDITURE				
II. Revenue Expenditure	11.17	13.94	13.67	14.53
a) Plan	2.17	2.75	2.93	3.09
b) Non-plan	9.00	11.19	10.74	11.44
Revenue surplus/deficit	1.64	0.62	-0.31	-1.25
Non-plan revenue surplus/deficit	3.81	3.37	2.62	1.84

4.5 We note with concern that the tax/gdp ratio is anticipated to stagnate at the levels achieved during 1990-95 which is lower than what has been achieved during 1985-90. The average tax/gdp ratio during the period 1985-90 was 11.22 per cent, while it has been forecast at 10.26 per cent by the Ministry. Non-tax revenues are also expected to register a decline. The net effect is that the revenue deficit as a percentage of GDP is projected to increase four-fold during the next five years. Non-plan revenue surplus is estimated to decline from 2.62 per cent of GDP to 1.84 per cent.

4.6 Thus the projections for 1995-2000 aggravate rather than reverse the trend of deterioration of fiscal balance which started in the the mid-eighties. We recognise that the stabilisation and structural adjustment initiated by the Government of India since mid 1991 might result in a temporary drop in revenues, but we are not convinced that this should persist over the medium term covered by our recommendations. In fact, the forecast appears to be at variance with the position taken by the Ministry in its memorandum where it is submitted that the Ministry would, over the forecast period, raise tax/gdp ratio by 1 percentage point.

4.7 The Ministry's forecast of revenue receipts and revenue expenditures and its memorandum present a scenario of extreme fiscal imbalance. The projections indicate that the Centre does not have adequate resources on the non-plan revenue account to meet its constitutional obligation of devolution at existing levels as indicated in the forecast. We find it difficult to accept the position as the assumptions underlying the forecast are unsustainable.

Reassessment of Centre's Receipts and Expenditures

4.8 We have, as explained in our approach, confined ourselves to the non-plan revenue account informed by the view that substantial recurring surpluses on the non-plan account are the first requisite for ensuring a sound and stable fiscal balance.

4.9 The reassessment was carried out in two stages: arriving at the base year of 1994-95 and then forecasting for 1995-2000. The estimation of the base year is important in view of the sensitivity of forecast values to the base year estimates. The need

for estimating the base year rather than accepting the budget estimates for 1994-95 is reinforced by the fact that the budget estimates for 1994-95 are out of line with the past. There is no prescriptive element in estimating the base year. We have been guided solely by the consideration of what the Central Government would most realistically be able to achieve in 1994-95. As regards the forecast, we take into account the historical patterns of revenue mobilisation and expenditure behaviour, current trends and recent changes in the macro-policy framework and blend them with prescriptive or normative considerations as appropriate.

4.10 We have estimated the trend rate of growth for the period 1983-84 to 1992-93 (the last year for which actuals were available) in the case of receipts and the trends for the period 1986-87 to 1992-93 for different categories of revenue expenditure. Having arrived at the trend rates of growth, these were applied to the actuals for 1992-93 to arrive at the base year figures. These were suitably moderated wherever necessary in the light of the budget estimates for 1994-95. Given the fact that the sample period 1986-87 to 1992-93 has been one of the most expansionary phases of government expenditure, the trend figures for expenditure categories in all cases were higher than the budget figures. We have accepted the latter. In the case of receipts, an exception was made for customs duties with a slight upward revision of the budget figures keeping in view the collection from customs in the first six months of the current year. For "other tax revenues", suitable adjustments have been made on account of the changed status of Delhi. However, the estimated receipts from new service taxes announced in the budget but not included in the budget estimates for 1994-95 have been taken into account.

Revenue Receipts

4.11 In the case of major taxes of the Centre, viz. income tax, excise duty, customs duty and corporation tax, the buoyancy coefficients have been estimated with respect to the GDP at current market prices for the sample period 1980-81 to 1990-91. It needs to be appreciated that these are historical buoyancies which reflect the responsiveness of taxes to the changes in GDP. Forecasting on the basis of these buoyancies would imply a continuation of the historical trends in the future. Such an assumption would not be valid in view of the significant changes in the economic regime. We have, therefore, used this information on buoyancy coefficients as the basis of forming our judgement regarding reasonable rates of growth of individual taxes during the forecast period.

4.12 In this context, we have deemed it appropriate to stipulate a buoyancy coefficient of 1.2 for excise duty as against an estimated buoyancy of 1.004. This prescriptive revision has been carried out in the light of the expanding tax base, changing composition of GDP, the rates of growth projected by the Ministry of Finance and the evidence tendered by the representatives of the Ministry of Finance in their deposition before the Commission. On the other hand, in view of the fact that there has been substantial reduction in customs duties we have adopted for it a buoyancy coefficient lower than its historical value. The buoyancy coefficient of customs duties is reckoned to be 1.2 having regard to the recent rates of collection, the anticipated average rate of custom collection during the forecast period and the continuance of the process of liberalised import policy.

4.13 In the case of income tax and corporation tax, the historical buoyancies have been revised as in the liberalised environment corporation tax is likely to be more buoyant and

lower rates and an expanding base for income tax are expected to yield higher revenues. For corporation tax the historical buoyancy has been enhanced to 1.35 and in the case of income tax 1.2.

4.14 In the case of "other tax revenues" we have used the trend rate of growth as the buoyancy could not be estimated on account of a compositional change with the sales and other tax receipts of Delhi no longer being a part of the Central resource pool. As explained earlier in the chapter, we have lowered the base in the case of "other tax revenues" but used the historical trend rate.

4.15 In general, we have followed a principle, both for the Centre and the States, that no revenue source should have a prescriptive buoyancy of less than unity and more than 1.35. Further, differential year wise growth rates have been used for major taxes following our basic assumption of a graduation in the profile of the growth rate of GDP and inflation as explained earlier in para 2.31. The buoyancy estimates and growth rates are at Annexure IV.1.

4.16 Non-tax revenues of the Centre mainly comprise interest receipts on loans advanced by the Centre, dividends and profits from public sector undertakings (PSUs), fees and other receipts on account of the services rendered by the government and its agencies and other transactions of a commercial nature. We have not found it necessary to reassess the interest receipts of the Centre. The interest receipts of the Centre on its loans and advances to the States are consistent with the interest liability of the States to the Centre and we have provided matching amounts in the expenditure estimates of the States.

4.17 The reassessed items of non-tax revenues are dividends and profits from PSUs and "other non-tax revenues". The estimates furnished by the Ministry on dividend and profits from PSUs imply a rate of return on equity as low as 1.82 per cent. According to the Advisory Group set up by us to assess an adequate rate of return on equity investment of the central PSUs it should not be difficult for these PSUs to give a return of 8-10 per cent. We have estimated the outstanding equity as on 1994-95 and prescribed a normative rate of return of 8 per cent to arrive at the estimates of dividends.

4.18 In the case of "other non-tax revenues" we have accepted the Ministry's forecast on three specific items - grants from external sources, royalty from petroleum and revenues from forestry and wild life. This is in line with our approach to such items as discussed in Chapter III in the case of States. For the remaining non-tax revenues we have estimated the buoyancy with respect to GDP and grown these at the graduated rates of GDP growth.

4.19 As a result of our reassessment, tax receipts of the Centre increase by Rs 62,858 crores and the non-tax receipts improve by Rs 27,782 crores for the five year period. The total revenue receipts of the Centre thus stand reassessed at Rs 9,25,040 crores. The reassessed position of revenue receipts is at Annexure IV.2. The tax/gdp ratio of 10.94 per cent in 1991-92 which is estimated to decline to 9.59 per cent in 1994-95 improves, in our reassessment, to 11.4 in 1999-2000. The average tax/gdp ratio of 10.26 forecast by the Ministry for 1995-2000 rises to 10.94 in our reassessment. Revenue receipts as a percentage of GDP are now reassessed to be 14.31 per cent of the GDP as against 13.28 forecast by the Ministry.

Non Plan Revenue Expenditure

4.20 For reassessment, non-plan revenue expenditure has been disaggregated into four major categories: interest

payments, defence expenditure, subsidies, and "other non-plan revenue expenditure".

4.21 For estimating interest payments, the composition of capital receipts and the rate of interest provided by the Ministry of Finance have been accepted. However, we have taken into account the likely impact of our reassessment of the revenue receipts and non-plan revenue expenditure on the net borrowing requirements of the Centre.

4.22 As regards defence expenditure we have increased the estimated expenditure submitted by the Ministry. This has been necessitated by a revision of the GDP growth profile. Defence expenditure as a percentage of the GDP has been kept at the same level as in the Ministry of Finance forecast.

4.23 The aggregate subsidies have been kept at the same level as in the base year level in nominal terms. At a disaggregated level, this is sufficient to accommodate the Ministry's forecast on food subsidies while implying a gradual reduction in the others.

4.24 For the "other non-plan revenue expenditure", we have:

- i) adopted a price elasticity of 0.75 which is applied to the assumed rate of inflation and
- ii) allowed for a real growth of 1.5 per cent per annum.

4.25 The Ministry of Finance had built into their forecast an additional requirement of Rs 19,926 crores in anticipation of the expected recommendations of the Fifth Pay Commission. We also feel that the Finance Commission is not required to take such anticipated developments into account in assessment of non-plan revenue expenditure which has to be based on commitments already made. The terms of reference do not require such an exercise to be done either. As admitted by the representatives of the Ministry of Finance in their evidence before the Commission, they have no specific basis and methodology for making such an estimate except past precedents. In these circumstances, we have made no provision for pay revision for the Central Government as in the case of States. If pay revisions is taken up during the forecast period additional resources would have to be raised to meet the fresh liability.

4.26 On the basis of the foregoing assessment, the total non-plan revenue expenditure during 1995-2000, as reassessed by us, is placed at Rs 6,56,640 crores as shown at Annexure IV.3.

Non-plan revenue expenditure as a proportion of GDP has been reassessed at 10.16 per cent as against 11.44 per cent as in the forecast.

4.27 As a result of the reassessment of revenue receipts and the non-plan revenue expenditure the pre-devolution surplus of the Centre, which had been forecast at Rs 1,15,797 crores is now estimated to be Rs 2,68,400 crores.

4.28 A comparison of the forecast submitted by the Ministry of Finance and the reassessed non-plan position of the Central Government is summarised in Table 2.

Table 2

	Ministry's Forecast		Reassessment	
	(Revised) Absolute	% GDP	Absolute	% GDP
I. Revenue Receipts	834400	13.28	925040	14.31
a) Tax Revenue	644553	10.26	707411	10.94
i) Income Tax	82326	1.31	85239	1.32
ii) Corporation Tax	94043	1.50	100115	1.55
iii) Union Excise Duty	292773	4.66	303710	4.70
iv) Customs	162012	2.58	198198	3.07
v) Other Tax Revenue	13399	0.21	20149	0.31
b) Non Tax Revenue	189847	3.02	217629	3.37
i) Interest Receipts	115937	1.85	115934	1.79
ii) Dividends & Profits	15363	0.24	29249	0.45
iii) Other Non Tax Revenue	58547	0.93	72446	1.12
II. Non Plan Revenue Expenditure	718603	11.44	656640	10.16
a) Interest Payments	368000	5.86	348138	5.38
b) Defence Expenditure	111773	1.78	115063	1.78
c) Other Non-plan Revenue Expenditure	238830	3.80	193439	2.99
III. Non Plan Revenue Surplus	115797	1.84	268400	4.15

RESOURCE SHARING : DEVOLUTION AND DISTRIBUTION

Introduction

5.1 The distribution of the net proceeds of income tax which "are to be", and of the net proceeds of Union excise duties which "may be" divided between the Union and the States under Chapter I of Part XII of the Constitution is the centre-piece of the deliberations of Finance Commissions. Related to this is the issue of determining the respective shares of the States in the distributable proceeds of these two taxes.

5.2 Para 4(ii) of our terms of reference requires us to have regard to "the resources of the Central Government and the demands thereon, in particular, on account of expenditure on civil administration, defence and border security, debt-servicing and other committed expenditure or liabilities".

5.3 In addition, the Central Government has, in a memorandum to us, separately drawn our attention both to the limited scope for adjustment in its expenditure and the likely downward impact on tax revenues in the context of structural reforms in indirect taxation, especially those related to customs duties. The States, on the other hand, have sought larger devolution through upward revisions in their shares in the net shareable proceeds of both income tax and the Union excise duties. In making our recommendations, we have taken into account the overall fiscal scenario of the economy and the submissions of the Central and State Governments.

5.4 We have already discussed the resource position of the State Governments and the Central Government in Chapters III and IV respectively. We now go on to deal with the specific issues relating to the devolution of income tax and Union excise duties and make our recommendations pertaining to the aggregate share of all States in the net proceeds of these taxes, and their individual shares in respect of both the taxes.

Income tax

5.5 Under the provisions of article 280(3)(a), read with article 270 of the Constitution, our task with respect to income tax is to make recommendations in regard to three matters, viz.

- the percentage of the "net distributable proceeds" which shall represent the proceeds attributable to the Union Territories ;
- the percentage of the divisible pool of the "net proceeds" of income tax to be assigned to the States; and
- the share of each State in the divisible pool.

5.6 Under article 270(3) of the Constitution, the share of the net proceeds of income tax "attributable to the Union Territories" has to be prescribed. Previous Finance Commissions had adopted the practice of treating all Union Territories together as a group, and determining their joint share by applying the same principles as for the other States. As would be evident in the ensuing discussion, we have used some allocative criteria for the States for which adequate corresponding information for the Union Territories is not available. We have, therefore, decided to determine their share on the basis of population. We recommend that the share attributable to the Union Territories in the net

distributable proceeds of income tax for each of the financial years during 1995-2000 should be 0.927 per cent.

5.7 The present share of the States in the net proceeds of income tax is eighty five percent. It would be useful to review the path that this ratio has traversed through the recommendations of earlier Commissions. The States' share out of the net proceeds of income tax was fixed at 55 per cent by the First Commission. The succeeding three Commissions enlarged the share progressively to 60 per cent, 66 2/3 per cent and 75 per cent. While recommending the increase in the States' share, the Third and Fourth Commissions took due note of the representation of the States about the need for making good in some measure the loss sustained by them on account of the non-inclusion of corporation tax in the divisible pool consequent upon the reclassification brought about in the Income Tax Act in 1959. The Fifth Commission did not recommend any further increase in the States' share, on the ground, among others, that the divisible pool of income tax would for the first time also include advance tax collections. Arrears pertaining to the advance tax collections were distributed among the States in three instalments during the period covered by the recommendations of that Commission.

5.8 The Sixth Commission raised the States' share from 75 to 80 per cent taking into consideration various factors including the fact that the arrears referred to above were no longer available. The share of the States was further increased to 85 per cent by the Seventh Commission keeping in view the States' grievance in regard to the levy of surcharge by the Centre as a normal tax revenue measure. The Eighth and the Ninth Commissions let it remain at 85 per cent.

5.9 Notwithstanding its present high level, a number of States have sought an increase in the States' share in income tax. While Bihar has favoured a figure of hundred per cent, Arunachal Pradesh, Goa, Madhya Pradesh, Punjab and Uttar Pradesh have indicated a figure of 95 per cent. Gujarat, Nagaland, Orissa, Tripura and West Bengal have called for an upward revision in this share to 90 per cent. Rajasthan and Tamil Nadu stressed the need for an increase in the share. Andhra Pradesh, Assam, Himachal Pradesh and Kerala have not suggested any change in the existing share of 85 per cent. Mizoram has proposed a reduced share of 65 per cent in favour of a larger flow of resources through grants-in-aid.

5.10 Haryana and Karnataka have suggested that the proceeds of corporation tax and income tax be pooled and the share of the States may be fixed at 50 per cent. Alternatively, Karnataka would like that 85 per cent and 15 per cent shares respectively out of the net yields from income tax and corporation tax be distributed among the States. Maharashtra is in favour of reducing the States' share to 75 per cent provided 20 per cent of the proceeds of the corporation tax are also simultaneously shared. However, pending a Constitutional amendment to this effect, the State would not want any change in the existing share of 85 per cent. Haryana, Punjab and West Bengal have even suggested that till the Constitution is amended, a compensatory grant equal to a specified percentage of the net proceeds may be

recommended in lieu of sharing the corporation tax with the States.

5.11 The main grounds on which the States have pleaded for an enhancement in the share of income tax proceeds may be summarised as below:

- i) As compared to income tax, corporation tax has turned out to be more buoyant but its proceeds, which were shareable prior to the Income Tax Act amendment in 1959, have been excluded from the divisible pool.
- ii) States were losing revenue due to the surcharge on income tax being continued by the Centre as a normal source of revenue.
- iii) Various kinds of reliefs and concessions being provided in the Central budget almost every year and periodic increases in the basic exemption limit for income tax have led to a shrinkage of the divisible pool.
- iv) The expenditure responsibilities of the States, particularly for infrastructure, have grown in the wake of economic liberalisation.

5.12 The States have been pleading for inclusion of the proceeds from corporation tax in the divisible pool for a long time now. We understand their desire to share the proceeds of corporation tax. This issue deserves to be seen in the wider context of diversifying and broadening the base of tax devolution. We have given our views in this regard in the alternative scheme of devolution suggested in Chapter XIII.

5.13 A number of States have raised the issue regarding the reintroduction of surcharge on income tax in 1987-88. The States have pointed out that instead of the measure being used for meeting any emergent requirements of a specific nature, the surcharge was being continued by the Centre as a normal source of revenue. In the process, the States were losing considerable revenue which would have been available to them had it been integrated into the income tax rates. We note that the Centre has completely withdrawn the surcharge on income tax from the financial year 1994-95. We, nevertheless, would like to emphasise that the surcharge on income tax should not be levied except to meet emergent requirements for limited periods.

5.14 States have been critical of the allocation of the 'cost of collection' as between income tax and corporation tax. This cost is deducted from the proceeds of income tax while working out the share of States. They regarded as unfair the ratio of 7:1 which was fixed on the basis of the findings of an expert committee set up in 1985 at the suggestion of the Eighth Commission. Some States have suggested allocation of the collection charges in proportion to the yields from income tax and corporation tax. A few States desire that due weightage be given to the workload involved under the respective taxes. The Ninth Commission, before which the States had made similar suggestions, had felt that there was need to re-examine the entire matter taking into account factors such as the introduction of simplified procedures of assessment and the nature and complexity of the cases involved under the respective taxes.

5.15 In pursuance of the observations made by the Ninth Commission in its first Report, an Expert Committee headed by Shri M.M.B. Annavi, Additional Deputy Comptroller and Auditor General of India was constituted by the Government of India on the 8th of June, 1989 to examine the apportionment of the cost of collection between income tax and corporation tax. The committee has observed in its report that:

- a) the number of officers deployed in the collection of corporation tax and income tax is in the ratio of 255:1926 or 1:7.5;

- b) the ratio between the number of officers engaged in assessment of corporation tax and income tax in mixed circles, after segregation, works out to 1:6.52; and,
- c) there has been no significant reduction in the workload involved in individual assessments with the introduction of a summary assessment scheme with effect from 1st April, 1989 because every individual return is required to be physically checked to detect arithmetical errors, and examine the admissibility of deductions.

5.16 The Committee after analysing various parameters which could have a bearing on the cost of collection concluded that it would be reasonable to apportion the cost of collection of corporation tax and income tax in the ratio of 1:6.5. This ratio has been worked out after a detailed study by experts which included representatives of the State governments. It is being used currently. This may be considered acceptable.

5.17 The States have further contended that the receipts from 'penalties' and 'interest receipts', which form part of the "miscellaneous receipts", should be included in the divisible pool of income tax. The Eighth Commission had recommended the inclusion of these receipts in the divisible pool on the ground that since the power to levy penalties and recover interest under the Income Tax Act emanates from the power to levy income tax itself, these two classes of receipts must fall within the concept of 'income-tax' as that term is used in article 270 of the Constitution. The Ninth Commission examined the matter de novo, and keeping in view the pronouncements of the Supreme Court on the subject and other relevant factors, recommended that receipts on account of 'penalties' and 'interest receipts' should form part of the divisible pool of income tax.

5.18 We have been informed by the Ministry of Finance that the matter is under their active consideration. We are of the opinion that the receipts on account of interest recoveries and penalties form part of the divisible pool and should be shared with the States. We, therefore, recommend that this should be done with effect from 1st April, 1995.

5.19 Karnataka, Rajasthan and Tamil Nadu have contended that the receipts from pre-emptive purchases of immovable properties represent accretions to capital gains and should, therefore, form part of the income tax pool for purposes of sharing. On a representation made by the Tamil Nadu Government, this matter was examined by the Ninth Commission in its first Report. The Commission felt that, as this was a matter of accounting procedure, it would be appropriate if the matter was settled in consultation with the Comptroller and Auditor General of India. Now more States have raised this issue with us. They have pointed out that the amount involved may be significant and the device of using pre-emptive purchases under the Income tax Act is now widely spread in many metropolitan towns. They argue that the proceeds arising out of the scheme are in the nature of capital gains and should be shared with the States. The Ministry of Finance has expressed the view that these receipts do not form part of the shareable proceeds of income tax. We are of the same opinion.

5.20 We now return to the key issue of determining the share of the States in the net proceeds of income tax. Having considered this matter at length, we have come to the conclusion that our recommendation in the matter should be guided by two considerations, viz.

- i) that the authority that levies and administers the tax should have a significant and tangible interest in its yield, and

- ii) that any change in the share on this account should not materially affect the level of overall devolution to the States.

In other words, any downward revision in the share of States in the net proceeds of income tax should be mirrored in a revenue equivalent increase in their share in the net proceeds of Union excise duties.

5.21 Accordingly, we recommend that the share of States in the net proceeds of income tax be fixed at 77.5 per cent. We later recommend a suitable increase in the share of the States in Union excise duties. These changes reflect our concern that the Centre retains adequate interest in income tax.

Union Excise Duties

5.22 Entry 84 of list I (Union List) of the Seventh Schedule read with article 272 of the Constitution vests in Parliament the power to levy Union excise duties. The article also provides for the sharing of the net proceeds of these duties with the States, if Parliament by law so provides.

5.23 The sharing of Union excise duties started with the First Commission itself, although the beginning was modest. It was restricted to 40 per cent of just three commodities, viz. tobacco, matches and vegetable products.

5.24 Since then, the sharing of the net proceeds of Union excise duties has become a regular feature, with successive Finance Commissions devolving larger amounts to the States, through either upward revisions of the coverage of the shareable items, or by increasing the magnitude of the States' share. The Second Commission extended the list of shareable commodities to eight but reduced the States' share to 25 per cent. The Third Commission reduced the States' share to 20 per cent but enlarged the list of shareable items to 35, the yield from each of which was Rs.50 lakh or more per year. Since the Fourth Commission, the coverage of items for States' share has been near - universal, but the States' share was limited to 20 per cent. The Seventh Commission doubled the States' share to 40 per cent on the ground that if the States had sufficient resources with them their dependence on the Centre would be reduced. The Eighth Commission raised this share to 45 per cent, but the increment of 5 per cent was used for meeting the assessed post-devolution deficits of the States. The Ninth Commission let the overall share remain at 45 per cent, but used 5 per cent and 7.425 per cent from it for deficit-based devolution, in its First and Second Reports, respectively. In effect, therefore, the portion of the net proceeds of Union excise duties from which all States receive a share was 40 per cent for the Eighth Commission. It remained so in the one year (1989-90) report of the Ninth Commission, but it was reduced to 37.575 per cent in its second report pertaining to the period 1990-95.

5.25 States have generally asked for an upward revision in their share in the net proceeds of Union excise duties from the present 45 per cent to 55 per cent and even 60 per cent. They have also pleaded for an enlargement of the divisible pool by including cesses levied under specific Acts, and a portion (20 per cent) of the yield from administered prices which are periodically increased by the Government. Some State Governments argue that instead of raising the administered prices, the Government should raise the excise duty tariff on the concerned product. This will automatically entitle the States to a share in the proceeds.

5.26 It may be noted that, in the context of the greater market orientation of the economy, the scope for the Central Government to raise administered prices would be progressively constrained except in cases where it might have a monopoly. We would

suggest that even in these cases, decisions to raise administered prices should aim at minimising budgetary support and increasing operational efficiency of the concerned public enterprises.

5.27 As regards the inclusion of revenues from the cesses in the divisible pool, it may be mentioned that a cess is levied on a specified commodity and is governed by a special Act of Parliament with the stipulation that it should be utilised for the development of the specific industry, the products of which bear the cess. The proceeds of such cesses cannot, therefore, be shared with the States.

5.28 Having regard to the views of the Central and the State Governments in the matter, and having recommended a decrease in the States' share of the net proceeds of income tax, we further recommend that the share of States in the net proceeds of Union excise duties be raised to 47.5 per cent.

Distribution of Divisible Amounts

5.29 The criteria for determining the inter se shares of States in income tax and Union excise duties have tended to converge since the recommendations of the Seventh Commission. However, 10 per cent of the distributable amount of income tax was allocated amongst the States on the basis of contribution and a portion of Union excise duties set aside for distribution according to assessed deficits. The convergence of the criteria determining the shares of States in the remaining portion of these two taxes is a move in the right direction. We now consider the determination of the inter se shares of States in income tax and excise duties.

5.30 For the distribution of the net proceeds of income tax among the States, successive Finance Commissions, till the Seventh Commission, gave weightage to 'population' as a major factor and 'contribution' as a minor factor. The Eighth and the Ninth Commissions gave a weight of 10 per cent to the factor of contribution in the distribution of the net proceeds of income tax, but reduced the weight of population substantially.

5.31 In their memoranda submitted to us, while nine States have favoured providing a weightage ranging from 10 per cent to 45 per cent to the 'contribution' factor, fourteen States are against including it at all in the distribution criteria. As for the 'population' factor, while eighteen States have recommended its retention, there is wide divergence in the views regarding the weightage to be given to it. Haryana and Punjab want to increase the weightage to 100 and 80 per cent, respectively. Maharashtra has suggested 55 per cent, while Karnataka, Kerala, Nagaland and Uttar Pradesh want it kept at 50 per cent. The other States have proposed weights ranging from 20 per cent to 40 per cent.

5.32 A number of States have argued before us, as also before previous Finance Commissions, that there is no case for attaching any weight to the factor of 'contribution'. While discussing the subject, the Eighth Commission had noted that the basic argument in favour of including this as a factor in determining the inter se shares was premised on a portion of income having a 'local origin' such as that arising from State emoluments, small businesses, retail trade and house property. However, the same report had noted the views of one of its members, "Dr. C.H. Hanumantha Rao feels that there is no case for distributing part of the States' share of income tax among the States on the basis of contribution." (para 5.20, page 43, Report of the Eighth Finance Commission). Earlier Dr. Raj Krishna, as a member of the Seventh Commission, had observed in his minute of dissent "...it is important to perceive that the State in which income seems to originate for the purpose of assessment is not necessarily the State where this income originates in a more

fundamental economic sense." (emphasis in original; page 114, Report of the Seventh Finance Commission).

5.33 The generation of income, especially non-agriculture income, is a spatially interdependent activity. The linkages run through the input side as well as the demand side. An output being produced in a specific place may be using inputs produced in various other locations. The income generated from the sale of this output also depends on the incomes of consumers who may be spatially dispersed throughout the country. The country as a whole represents a common economic space and market, and growing interdependence in economic activities has considerably weakened the case for locally originating incomes in the non-agricultural sector. We are, therefore, persuaded there is no need to retain contribution as a criterion of distribution. Besides, the only factor that now stands in the way of a common formula for distribution of the two taxes is this component of 'contribution' in the case of income tax. Accordingly, we have not used 'contribution' as a factor in determining the respective shares of States in the distributable amount of the net proceeds of income tax. To the extent, however, that 'contribution' is interpreted as 'collection', it is the effort of the States in collecting their own taxes that is relevant rather than a tax levied and collected by the Centre. We have recognised this while recommending later that tax effort of the States, which necessarily includes collection effort, be a factor with a weight of 10 per cent in the distribution of the divisible pool.

5.34 Since the recommendations of the Eighth Commission, the allocative criterion determining the shares of States has mainly made use of an information base comprising population and per capita incomes of the States. The three criteria derived from this information base are, the population criterion, the distance criterion, and the inverse of income criterion, which has sometimes been called the income adjusted total population (IATP) criterion. In addition, the Ninth Commission had used an index of poverty, in their first report, and an index of backwardness in their second report.

5.35 Andhra Pradesh, Assam, Bihar, Goa, Karnataka, Kerala, Madhya Pradesh, Manipur, Meghalaya, Nagaland, Orissa, Rajasthan, Tamil Nadu and Uttar Pradesh have suggested inclusion of such criteria as would take into account the relative backwardness of the States, e.g., composite index of backwardness, distance of per capita income of a State from the highest per capita income and inverse of per capita income weighted by population. Some States have suggested that 'area' and 'index of infrastructure' are relevant factors in this context.

5.36 Arunachal Pradesh, Assam, Meghalaya and Kerala have urged that a certain percentage of the divisible proceeds be reserved for distribution among the revenue deficit States, while Himachal Pradesh, Manipur, Mizoram and Nagaland have suggested that a specified percentage be pre-empted for exclusive distribution among the special category States.

5.37 The Eighth and the Ninth Commissions (First Report) evolved an approach whereby 90 per cent of the divisible pool of income tax and 40 per cent of the net proceeds of Union excise duties were distributed among the States on the basis of a common formula. In the second report of the Ninth Commission, although the approach was the same, there was some variation in the relative weights assigned to different criteria for the two taxes, as summarised in Table 1.

Table 1

Distribution Criteria:Relative Weights

COMMISSION CRITERIA	EIGHTH Income tax*	NINTH First Report UED**	NINTH Second Report	
			Income	UED#
Population	25	25	25	29.94
Distance	50	50	50	40.12
Inverse Income	25	12.5	12.5	14.97
Poverty/Backwardness		12.5	12.5	14.97
	100	100.0	100.0	100.00

* relates to 90 per cent of the States' share.

** relates to 40 per cent of the net proceeds of UED.

relates to 37.575 per cent of the net proceeds of UED.

Weights in the last column are derived by multiplying the weights as given in Para 5.36 of the second report of the Ninth Commission by a factor of (100/83.5).

5.38 Evidently, the distance and the inverse income formulae, which utilise the same information base, namely, population and per capita income, have jointly carried a very high weight. Yet because of the common information base in the two formulae, viz. inverse income and distance, both of which are progressive, the issue of their relative merit requires further discussion.

5.39 The population criterion allocates the same per capita share or transfer to a State, independent of its ranking in the income-scale. By itself, therefore, it is not a progressive criterion. When progressivity is imparted to the allocative criterion, as in the case of the distance or the inverse-income, the lower income States are allotted a higher share in per capita terms. This is achieved only by a corresponding reduction in the per capita share of higher income States, i.e. States with more than average per capita income. We find that, compared to the distance formula, in the inverse income formula, owing to the implicit convexity in it, the middle income States have to bear a relatively higher burden of this adjustment. This may be interpreted as a deficiency of the inverse-income formula (see Appendix 4).

5.40 We have, therefore, decided to use the distance formula for generating progressivity in distribution that hitherto was being achieved by a conjunction of the two formulae. In view of the shares already given jointly to the two formulae in the earlier awards, we have decided to give a weight of 60 per cent to the distance formula. In the pure version of the formula, the highest income State would not get any share because its distance measured from its own income would be zero. Presently, as for the Ninth Commission, this State happens to be Goa. Like them, we have decided to measure the distances from the per capita income of Punjab, giving it, and Goa, the notional distance between the per capita SDP of Punjab and that of the next highest income State, viz. Maharashtra. The respective 'distances' are multiplied by the population of the States, and the share of a State is obtained by dividing the product by the sum of such products for all the States. This procedure of multiplying an index by respective populations, and deriving shares according to such products has been called 'scaling' in the following paragraphs.

5.41 For the population criterion, we have given a weight of 20 per cent. This is a marginal reduction from the weight of 22.5 (i.e. 25 per cent of 90 per cent) used by the Ninth Commission.

Since as a scale factor, its influence, in any case, is spread across all formulae, we consider that this adjustment is of relatively minor importance.

5.42 Some States have urged us to use 'area' as one of the distribution criteria. Earlier Commissions had also considered this issue. The argument in favour of using area depends primarily on the additional administrative and other costs that a State with a larger area has to incur in order to deliver a comparable standard of service to its citizens. However, we also recognise that this difference in the costs of providing services may increase with the size of a State but only at a decreasing rate. Beyond a point, increment in costs may, in fact, become negligible. At the same time, there are many States with a very small area. Nevertheless they have to incur certain minimum costs in establishing the framework of governmental machinery. Many of these smaller States are in hilly terrain, and the costs there may be higher because of the nature of the terrain. Taking these considerations into account, we are of the opinion that although area as a factor may be used, certain adjustments may be required at the upper and lower ends. We thought that it would be relevant to use an adjustment procedure whereby no State gets a share higher than 10 per cent at the upper end, and no State gets a share less than 2 per cent at the lower end. The shares of other States are derived accordingly. We have assigned a small weight of 5 per cent to area.

5.43 The Ninth Commission had used in its first report, an index of poverty, and in the second report, an index of backwardness for imparting greater progressivity to the devolution scheme. From the very beginning of our deliberations, we have been of the opinion, that some corrections are required for the relative disparities in infrastructure as between the States. For this purpose, we had commissioned a study with a view to obtaining a set of indices which would reflect inter-State differentials in infrastructure. The study was carried out by a group of eminent economists. We appreciate that they estimated for us a number of alternative indices despite the difficulties in obtaining relevant data and setting up a suitable methodology for the purpose.

5.44 The index of infrastructure that we have utilised, reflects the relative achievement of a State in providing an economic and social infrastructure to its citizens. The economic infrastructure here consists of a number of sub-sectors, viz. agriculture, banking, electricity, and transport and communications. The social infrastructure consists of education and health. An aggregate index was derived pertaining to these subsectors. The relevant details are given in Appendix 5. For utilising this infrastructure index (which assigns a higher share to a State with better infrastructure) as an allocative criterion, we have used the distance method, as in the case of the distance formula described earlier, and scaled these distances with population, so as to derive the respective shares of the States. A State lower on the infrastructure scale gets a higher share, because its distance is measured by the difference of the value of its own index from that of the highest indexed State. The highest indexed State, itself gets a notional distance equal to its distance from the next highest reading. We have decided to give this factor a weight of 5 per cent.

5.45 Our terms of reference direct our attention to 'the tax efforts made by the States.' Measurement of tax effort on a comparable basis among the States is not a straightforward exercise because tax effort must be related to some notion of tax potential, and there are differences in the nature and composition of tax-bases among the States. Given the data constraints on a

suitably disaggregated information base pertaining to different tax-bases, our choice has been narrowed down to using per capita state domestic product as a proxy for the aggregate tax-base. Tax effort could then be measured by the ratio of per capita own tax revenue of a State to its per capita income. We felt that there was still a need to provide for an adjustment for States with poorer tax bases. If the tax effort ratio as defined above is divided by per capita income, it would imply that if a poorer State exploits its tax-base as much as a richer State, it gets an additional positive consideration in the formula. Thus, using an index of tax effort, as measured by the ratio of per capita own tax revenue to the square of per capita income, the respective shares are worked out after scaling by population. We have decided to give this index a weight of 10 per cent. Basic data relating to all the criteria are given in Annexures V.1 to V.5.

5.46 While the criteria explained above shall apply to the entire divisible pool of income tax, we have decided to reserve a portion of Union excise duties to be distributed on the basis of deficits as assessed by us. The Eighth Commission had set apart 5 per cent in the 45 per cent share recommended by it for distribution among deficit States. These percentages were retained in the first report of the Ninth Commission. In its second report that Commission incorporated this 'deficit-based' devolution in the overall devolution formula. It recommended that 16.5 per cent of the 45 per cent, i.e. 7.425 per cent of the net proceeds of the Union excise duties be used for distribution among the 'deficit' States. Apart from the difference in the manner in which these percentages are stated, there is no effective difference in the two procedures. We have decided to keep apart 7.5 per cent out of the 47.5 per cent of Union excise duties assigned to the States for distribution amongst States assessed by us to be deficit. This deficit has been assessed after taking into account devolution of income tax and 40 per cent of the net proceeds of Union excise duties, and after taking into account shares of States in additional excise duties and grant in lieu of tax on railway passenger fares, in each of the years during the period 1995-2000, as a proportion of the total deficit so assessed for all the States.

5.47 To summarise, the criteria for determining the inter se shares of the States in the shareable proceeds of income tax are based on the following indices :

- i) 20 per cent on the basis of population of 1971 as explained in para 5.41;
- ii) 60 per cent on the basis of distance of per capita income as explained in para 5.40;
- iii) 5 per cent on the basis of 'area adjusted' as explained in para 5.42;
- iv) 5 per cent on the basis of index of infrastructure as explained in para 5.44;
- v) 10 per cent on the basis of tax effort as explained in para 5.45;

We thus recommend that for each financial year in the period 1995-96 to 1999-2000

- a) Out of the net distributable proceeds of income tax, a sum equal to 0.927 per cent shall be deemed to represent the proceeds attributable to Union Territories.
- b) The share of the net proceeds of income tax assigned to the States shall be 77.5 per cent.
- c) The distribution among States of the share assigned to them in each financial year should be on the basis of the percentages shown in Table 2 .

Table 2

Income Tax : Shares of States 1995 - 2000

State	Per cent
Andhra Pradesh	8.465
Arunachal Pradesh	0.170
Assam	2.784
Bihar	12.861
Goa	0.180
Gujarat	4.046
Haryana	1.238
Himachal Pradesh	0.704
Jammu & Kashmir	1.097
Karnataka	5.339
Kerala	3.875
Madhya Pradesh	8.290
Maharashtra	6.126
Manipur	0.282
Meghalaya	0.283
Mizoram	0.149
Nagaland	0.181
Orissa	4.495
Punjab	1.461
Rajasthan	5.551
Sikkim	0.126
Tamil Nadu	6.637
Tripura	0.378
Uttar Pradesh	17.811
West Bengal	7.471
TOTAL	100.000

5.48 We have used the same set of criteria for distribution of 40 per cent of the net proceeds of Union excise duties. Accordingly we recommend that 40 per cent of the net proceeds of Union excise duties during each financial year in the period 1995-96 to 1999-2000, should be distributed as per the shares in Table 3.

Table 3

40 per cent of Union Excise Duties : Shares of States 1995 - 2000

State	Per cent
Andhra Pradesh	8.465
Arunachal Pradesh	0.170
Assam	2.784
Bihar	12.861
Goa	0.180
Gujarat	4.046
Haryana	1.238
Himachal Pradesh	0.704
Jammu & Kashmir	1.097
Karnataka	5.339
Kerala	3.875
Madhya Pradesh	8.290
Maharashtra	6.126
Manipur	0.282
Meghalaya	0.283
Mizoram	0.149
Nagaland	0.181
Orissa	4.495
Punjab	1.461
Rajasthan	5.551
Sikkim	0.126
Tamil Nadu	6.637
Tripura	0.378
Uttar Pradesh	17.811
West Bengal	7.471
TOTAL	100.000

5.49 We also recommend that the remaining 7.5 per cent of the net proceeds of Union excise duties be distributed among the States in accordance with the shares specified by us for each financial year in the period 1995-96 to 1999-2000 as given in Table 4.

Table 4

Shares of States in 7.5 per cent of the net proceeds of Union Excise Duties

State (1)	(per cent)				
	1995-96 (2)	1996-97 (3)	1997-98 (4)	1998-99 (5)	1999-2000 (6)
Andhra Pradesh	12.069	7.988	0.000	0.000	0.000
Arunachal Pradesh	3.410	4.300	5.871	6.224	6.667
Assam	8.543	9.836	11.849	10.748	9.290
Bihar	6.434	2.965	0.000	0.000	0.000
Goa	0.973	1.058	1.161	0.917	0.604
Himachal Pradesh	8.816	10.744	14.057	14.230	14.338
Jammu & Kashmir	13.366	16.491	21.985	22.741	23.700
Manipur	3.930	4.891	6.602	6.917	7.348
Meghalaya	3.590	4.403	5.815	5.994	6.130
Mizoram	3.676	4.628	6.278	6.784	7.074
Nagaland	5.818	7.417	10.247	11.072	12.025
Orissa	4.815	5.248	4.934	2.773	0.680
Rajasthan	0.835	0.000	0.000	0.000	0.000
Sikkim	1.199	1.473	1.938	1.982	2.055
Tripura	5.465	6.807	9.263	9.618	10.089
Uttar Pradesh	17.061	11.751	0.000	0.000	0.000
TOTAL	100.000	100.000	100.000	100.000	100.000

TAX RENTAL : DISTRIBUTION OF ADDITIONAL DUTIES OF EXCISE

6.1 Paragraph 5 (a) of the President's Order requires us to suggest changes, if any, to be made in the principles governing the distribution among the States of the net proceeds in any financial year of the additional excise duties leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, in lieu of the sales tax levied formerly by the States.

6.2 The scheme of the levy of additional excise duties on sugar, tobacco, cotton fabrics, woollen fabrics, and man-made fabrics was the outcome of an agreement reached at the meeting of the National Development Council held in December, 1956, by which the States agreed to refrain from exercising their power to levy sales tax on these commodities in lieu of a share in additional excise duties to be levied by the Centre. In pursuance of the said arrangement, the additional excise duties have, since 1957, been levied and collected by the Centre and the entire net proceeds (after deducting the share of Union Territories) are distributed amongst the States in accordance with the principles of distribution laid down by Finance Commissions from time to time. The arrangement stipulated that the distribution among the States should assure to them the revenue realised in 1956-57 from their respective sales taxes on these articles. Thus the scheme was essentially in the nature of a tax-rental arrangement. While a state has even now the constitutional right to reimpose sales tax on these commodities there are two deterrents. First, in view of sections 14 and 15 of the Central Sales Tax Act (1956), which declare these goods to be goods of special importance in inter-state trade and commerce, the rate of sales tax, even if reimposed by the States, cannot exceed 4 per cent. Secondly, if in any year a State levies sales tax on any of these commodities, no sums will be paid to that State as its share in the proceeds from additional excise duties of that commodity unless the Central Government otherwise directs.

6.3 The Second, Third, Fourth and Fifth Commissions adopted a procedure under which they first set apart the guaranteed level of States' revenue which the States were realising from sales tax on these commodities in 1956-57, and then the balance amount of additional excise duties was distributed according to specific principles. The Second Commission, which was the first to examine this matter, adopted consumption figures along with population as a corrective factor. The Third Commission felt that since the additional duties of excise were being levied in lieu of sales tax, the shares in the additional excise duties in excess of the guaranteed amount, should be determined partly on the basis of percentage increase in the collection of sales tax in each State since 1957-58 and partly on the basis of population. The Fourth Commission was of the view that the collection of sales tax in a State was more directly indicative of the contribution made by each State than population. Hence, that Commission adopted sales tax realised in each State as the sole criterion and dispensed with the factor of population. The Fifth Commission took into consideration certain limitations in relying exclusively on sales tax which was raised from a wide range of commodities comprising luxuries, semi-luxuries, raw materials and intermediate goods and, therefore, assigned equal

weight to both sales tax (excluding inter-State sales tax) and population.

6.4 The Sixth Commission made a departure from the earlier practice of first setting apart the guaranteed amounts as they were convinced that there was no risk of the share of any State not coming up to the guaranteed amount. As regards the basis of distribution, they took the view that the levels of consumption of these commodities would have been the 'best possible indicator' but in the absence of data state domestic product and population were considered to offer a reliable approximation of such levels. But that Commission also felt that the States would have realised sales tax not merely on what was consumed in the State but also on what was produced in the State and sold in the course of inter-state transactions of these commodities. It, therefore, gave a small weight to production. For all these reasons it decided to allocate the shares on the basis of population, state domestic product and production in the ratio of 70:20:10.

6.5 Like the earlier Commissions, the Seventh Commission felt that the appropriate basis for the distribution of revenue from additional excise duties would be the levels of consumption of the dutiable articles in each state. For this purpose, the Commission examined the data compiled by the National Sample Survey Organisation (NSSO) from the consumer expenditure survey of 1972-73 (27th round). However, they did not rely on it because the coverage of the three items in terms of variety in the NSS differed from the description of these items for the purpose of additional excise duties and in the case of sugar and textiles, the non-household consumption which was not reflected in the NSS data, was also considered significant. That Commission finally adopted two separate bases for the distribution of the net proceeds, one for sugar and the other for textiles and tobacco. In the case of sugar, the Commission decided to treat the despatches of sugar to the States as a fair approximation to the consumption of sugar. As regards textiles and tobacco they preferred to rely on the generally accepted proposition that higher income levels would lead to higher consumption of textiles and tobacco, specially the varieties which account for a major part of the revenue from additional excise duties. Accordingly, they determined each State's share in the net proceeds from additional excise duties on textiles and tobacco by multiplying its average per capita SDP for the three years ending 1975-76 by its population according to the 1971 census.

6.6 The Eighth Commission did not favour the use of either the consumption data based on NSS data, or sugar despatches to different States or sales tax revenues. They recommended that the shares of States in the additional excise duties be determined by giving equal weightage to state domestic product and population. The Ninth Commission maintained the view that since the additional excise duties were levied in lieu of sales tax which itself is a tax on consumption, the share of the States should correspond to their share in the consumption of these commodities. Direct and reliable data of State-wise consumption of these commodities, however, could not be obtained by that

Commission. The Commission, therefore, relied on proxies, namely state domestic product and population of the respective States and recommended the shares of individual States by giving equal weightage to these two factors. The Ninth Commission preferred to use 1981 census figures of population because in their view, distribution of additional excise duties was not in the nature of devolution for which census figures for 1971 were to be used as per their terms of reference.

6.7 In their memoranda, the State Governments have not only put forward their suggestions on the principles of distribution of the net proceeds from additional excise duties but also commented upon the manner in which the scheme of replacement of sales tax by additional duties of excise has been operated by the Central Government. Reviewing first the principles of distribution, most State Governments have recognised the situation that in view of the inadequacy of reliable data on the State-wise consumption levels of the three articles, the distribution has to be based on the best available proxies. Karnataka, Kerala, Maharashtra, Tamil Nadu and Manipur have urged that the distribution of the entire proceeds be done on the basis of the proportion which the sales tax revenue of each state bears to the total sales tax revenues of all the States. Gujarat has expressed the view that the distribution be done in proportion to the guaranteed amounts as worked out by the Second Commission. As an alternative, it has suggested a criterion based on trends in the growth of sales tax revenues. Haryana has pointed out that the trend in its sales tax collections showed a very high growth in comparison to that of its share in the additional excise duties and, therefore, suggested that the existing tax- rental arrangement be scrapped. Alternatively, it has supported the distribution of the proceeds of additional excise duties on the basis of sales tax collections. Bihar, Madhya Pradesh and Orissa have proposed that distribution be done on the basis of population. Uttar Pradesh has also favoured the population factor. In the alternative, it has suggested that the proceeds should be distributed among the States in proportion to their share in the guaranteed amounts. Punjab Government has proposed that distribution among the States be done in the ratio of the respective products of population and average per capita state domestic product.

6.8 Andhra Pradesh wants the existing scheme of tax-rental arrangement to be revoked as it finds that States have lost heavily due to the delay in setting up the Standing Review Committee as decided by the National Development Council in 1970 and the long period allowed by the Committee for the incidence of additional excise duties to reach the level of 10.8 as a percentage of the value of clearances. For the interim period, it has suggested that the distribution be done in the same manner as recommended by the Ninth Commission. West Bengal has felt that the original rights of the States to levy sales tax on these articles be restored as the Centre has not fulfilled its commitments in time and States have thus lost substantial sums of revenue. Rajasthan has suggested that the distribution be done on the basis of current consumption of the commodities in the light of the NSS data. If this was not feasible, the State Government has suggested that 75 per cent weightage be given to population as projected for 1997 and the balance of 25 per cent be distributed on the basis of per capita income.

6.9 Arunachal Pradesh has suggested that 30 per cent of the proceeds be set apart for distribution among deficit States and the balance be allocated on the basis of population and state domestic product. Similarly Nagaland has also proposed that 20 per cent of the total net proceeds be earmarked in the first instance

for the hill States and the balance be distributed by giving weightage of 75 per cent to population and 25 per cent to state domestic product. Himachal Pradesh has pleaded that the distribution be based on NSS consumption data. Goa and Meghalaya have favoured equal weightage to state domestic product and population. Jammu and Kashmir has expressed the view that the 1993-94 population figures should be used. While Sikkim has suggested the use of identical criteria for the distribution of shares under Union excise duties and additional excise duties, Tripura has suggested that the scheme be abolished and, in the interim period, the distribution of additional excise duties should be on the same criteria as for Union excise duties.

6.10 Before we discuss the principles for the distribution of additional excise duties for 1995-2000, we may refer to the major complaints of the States regarding the manner of the operation of the scheme. The complaints, by and large, relate to the following decisions taken at the meeting of the National Development Council held in December 1970 to discuss the subject of the replacement of sales tax on sugar, tobacco and textiles by additional excise duties:

- i) The ad valorem system of additional excise duties be extended to all items except un-manufactured tobacco.
- ii) The incidence of additional excise duties be raised to 10.8 per cent of the value of clearances as soon as possible during the next two or three years.
- iii) While making upward adjustments in basic excise duties in future, the Government of India should keep in view a ratio of 2:1 between the yield of basic and special excise duties on the one hand and additional excise duties on the other.
- iv) A Standing Review Committee be set up to review the working of the new arrangement at least once a year and make suitable recommendations for its further improvement.

6.11 The implementation of the above decisions remained tardy in the initial stages as would be evident from the fact that the first meeting of the Standing Review Committee was held in February 1981 i.e. after a gap of over ten years. The Committee in its meeting held in November 1981 recommended that the incidence of additional excise duties of 10.8 per cent of the value of clearances may be achieved in three stages viz : 8.5 per cent by 1984-85, 9.75 per cent by 1987-88 and 10.8 per cent by 1989-90. The States have a grievance that delay in setting up the Standing Review Committee amounted to a breach of agreement and has caused them financial loss.

6.12 In regard to the stipulation for moving towards ad valorem system of additional excise duties we find that the duty structure for cotton and man-made fabrics which was based on specific-cum-ad valorem rates has now been converted into ad valorem rates. However, in the case of sugar, bidis and cigarettes, which are major revenue yielding commodities, rates continue to be specific. From the data obtained from the Ministry of Finance which is indicated in Table 1, the ratio between basic and additional excise duties is seen to have satisfied the norm envisaged by the National Development Council. The incidence of additional excise duties as per cent of value of clearances also reached 10.87 in 1989-90 as against the targeted level of 10.8.

Table 1

Year	Ratio between basic* and additional excise duties	Incidence of additional excise duties in terms of per cent of value of clearances
1982-83	1.79:1	7.43
1983-84	1.57:1	8.17
1984-85	1.29:1	8.93
1985-86	1.28:1	8.84
1986-87	1.19:1	9.02
1987-88	1.23:1	9.87
1988-89	1.23:1	10.67
1989-90	1.22:1	10.87

* including special, regulatory and auxiliary duties.

6.13 Having regard to the tax rental nature of the levy, the most appropriate principle to be used for distribution among States is that of compensation for the loss of revenue from sales tax on sugar, textiles and tobacco. Therefore, the demands of certain States to set aside a certain percentage for exclusive distribution among hill States or deficit States, or to adopt identical criteria for the distribution of additional excise duties and Union excise duties cannot be accepted as they are not in keeping with the spirit of the tax-rental scheme.

6.14 It has been well accepted that State-wise figures of consumption of the three articles on which the additional excise duties are levied would closely reflect the potential loss of sales tax revenue sustained by the States. Like the earlier Commissions, we also sought data from the NSSO in regard to State-wise consumption on sugar, textiles and tobacco, based on their latest round of survey. The NSSO furnished to us estimates of household consumption expenditure on clothing, tobacco and sugar based on the 43rd round of the survey carried out by them in 1987-88. The Seventh, Eighth and the Ninth Commissions did not use similar data furnished by the NSSO on earlier occasions owing to various infirmities. The data furnished to us also suffer from similar infirmities. As the estimates relate only to household consumer expenditure, the segment of non-household consumption, which is quite significant, particularly in the case of sugar and textiles, is not covered. Besides, there are discrepancies between the description of the articles on which the additional excise duties were levied and the items covered in the 43rd round of survey. For example, while various types of textiles, textile fabrics and textile articles including those for industrial use were subject to additional excise duties, the household consumption expenditure in the NSS estimates was related only to the category of 'clothing'. Also, there would be a gap of eight years between the year 1987-88, to which the NSS data relate and the year 1995-96 from which our recommendations would be operative. It would be reasonable to assume that the consumption pattern in regard to certain varieties of tobacco and textiles would change over the years. We are unable to use the NSS estimates and are constrained to consider the distribution of additional excise duties on the basis of suitable proxies.

6.15 In evolving our approach for the distribution of the States' shares, we have kept in view the bases adopted by the earlier Commissions, the views of the State Governments and the availability of reliable data for the proxies which would represent a fair approximation to the consumption of the three articles. The commodities on which additional excise duties are levied are articles of mass consumption and accordingly, in our view, population should have a substantial weight in the formula. We also agree with the views of the earlier Commissions that the level of State income has a significant bearing on the consumption of sugar, textiles and tobacco and should be a factor in distribution.

6.16 Since sales tax is a levy on consumption, some of the past Commissions have accepted proportion of sales tax revenues as capturing the consumption levels of the three

commodities. Some of the States are of the same view. The other point of view is that since sales tax is levied on a host of commodities ranging from luxuries to raw materials, the proceeds of this tax do not represent the consumption levels of these three alone. Nevertheless, there is a relationship between consumption, as represented by sales tax, and consumption of these commodities. Accordingly, we feel some weight can be given to sales tax.

6.17 We have worked out the shares of the States by assigning a weight of 50 per cent to population according to the 1991 census, 40 per cent to the average of state domestic product for the three latest years 1987-88 to 1989-90 for which the requisite data is available and 10 per cent to the average collection of State sales tax (excluding inter-State sales tax) for the three years 1990-91 to 1992-93, these being the latest three years for which final accounts are available. The State-wise data are placed at Annexures VI.1 and VI.2

6.18 We agree with the view of the Ninth Commission that distribution of additional excise duty is not in the nature of devolution for which the population figures of 1971 census should be used as per our terms of reference. Hence, we are using the latest census figures of 1991 which are placed at Annexure V.1.

6.19 As regards the share of the Union territories they should be treated as one unit, and their share determined on the same basis as that of all the States. Accordingly, the share of Union territories amounting to 2.203 per cent should be retained by the Central Government. We recommend that the balance should be distributed among the States as shown in Table 2.

Table 2.**Shares in Additional Excise Duties : 1995-2000**

States	Per cent
Andhra Pradesh	7.820
Arunachal Pradesh	0.104
Assam	2.483
Bihar	7.944
Goa	0.232
Gujrat	5.995
Haryana	2.366
Himachal Pradesh	0.595
Jammu & Kashmir	0.856
Karnataka	5.744
Kerala	3.740
Madhya Pradesh	7.236
Maharashtra	12.027
Manipur	0.197
Meghalaya	0.188
Mizoram	0.079
Nagaland	0.137
Orissa	3.345
Punjab	3.422
Rajasthan	4.873
Sikkim	0.053
Tamil Nadu	7.669
Tripura	0.286
Uttar Pradesh	14.573
West Bengal	8.036
TOTAL	100.000

6.20 Successive Commissions have faced difficulties in obtaining reliable and comprehensive data on State-wise consumption of the three articles viz. sugar, textiles and tobacco which attract additional excise duties. We would like to urge the Government of India to take appropriate steps for the regular collection and maintenance of the requisite data on consumption of these commodities, both household and non-household, to facilitate the task of the future Finance Commissions.

GRANTS IN LIEU OF TAX ON RAILWAY PASSENGER FARES

7.1 As per paragraph 5(b) of our terms of reference, we are required to suggest changes, if any, to be made in the principles governing the distribution of grants to be made available to States in lieu of the tax under the repealed Railway Passenger Fares Act, 1957.

7.2 Article 269 of the Constitution empowers the Government of India, amongst other things, to levy and collect taxes on railway fares and freights but the net proceeds are to be assigned to the States. The tax was levied for the first time under the Railway Passenger Fares Tax Act, 1957. The Act was repealed with effect from 1st April, 1961. In pursuance of the recommendations of the Railway Convention Committee, the tax was merged with the basic fares. The tax was revived briefly in 1971 at the time of the Bangladesh war and was repealed again on 31st March, 1973. It was agreed that the States should be compensated for the consequential loss of revenue through an ad-hoc grant of Rs.12.50 crores a year in lieu of the tax for the period 1961-62 to 1965-66. The grant was raised to Rs. 16.25 crores per annum from 1966-67 to 1970-71. It was raised again to Rs.23.12 crores for the period 1980-81 to 1983-84 in view of the recommendations contained in the seventh report of the Railway Convention Committee, 1980.

7.3 Earlier Finance Commissions, starting from the third, made recommendations in regard to the principles that should govern the distribution of this grant to the States. The existing principles for distribution of the grant were first laid down by the Seventh Commission :

"If the tax had continued and were to be collected by the States, each State would be competent to collect tax only on railway fares paid within that State, irrespective of the States through which the journeys may be performed. There can be no extra-territorial collection by any State. Railway passenger fares are paid in advance before the commencement of the journey. The tax was collected at source and was a percentage of the fare. It, therefore, appears to us that the most appropriate distribution of the grant in lieu of the tax would be in proportion to the non-suburban passenger earnings from traffic originating in each State." (para 6, page 53, Report of the Seventh Finance Commission)

7.4 The Eighth Commission endorsed the formula adopted by the Seventh Commission. However, on the basis of the recommendations of the seventh report of the Railway Convention Committee (1980), which had recommended that the Finance Commission could look into the question of a further increase in the amount of grant from Rs.23.12 crores, the Eighth Commission chose to examine the issue and recommended that the States should be paid a grant equivalent to 10.7 per cent of the non-suburban passenger earnings in lieu of the tax as that was the tax element in the fare structure when the tax was in force. An amount of Rs.95 crores per annum was recommended for the period 1984-85 to 1988-89. The total amount of the grant was based on total non-suburban passenger earnings during 1981-82. The Ninth Commission, in its first report, endorsed the views of the Eighth Commission and kept the grant at the same level

i.e. Rs.95 crores for 1989-90. In its second report, the Ninth Commission made a departure in regard to the quantum of grant. They took the view that the Railways could not bear the burden of grant based on the 10.7 per cent incidence of non-suburban passenger fares without their finances and performance being seriously affected. At the same time, the Commission was also of the view that the existing amount of Rs. 95 crores was inadequate. Taking all aspects into account the Commission fixed the grant at an amount of Rs.150 crores per annum for the period 1990-95.

7.5 Though our terms of reference do not specifically require us to examine the quantum of the grant, we feel that the entire exercise would be futile if we ignore this aspect. Particularly so, as many States are aggrieved about the inadequacy of the grant and have suggested retaining the grant on the basis of a fixed percentage of the actual earnings from non-suburban fares for the years 1995-2000. Karnataka and Maharashtra have suggested 12 per cent of the non-suburban passenger earnings to be distributed among the States. Tamil Nadu has asked for the quantum of grant to be raised to Rs.750 crores per annum for the period 1995-2000. Haryana has suggested revival of the tax on Railway Passenger Fares. Most of the hill states have suggested adopting population as a criterion for determining the distribution of grants since they do not have railway lines and their people buy tickets from neighbouring States. Manipur and Jammu & Kashmir have suggested an increase in the quantum of the grant by giving additional weightage to the total traffic.

7.6 We have had the benefit of discussion with the Ministry of Railways. The Railways have submitted that they cannot bear the burden of the grant on the basis of the incidence of the tax when it was in force. This would affect their finances and performance seriously. They again brought to our notice that they were subsidising not only passenger but also freight traffic. In fact, the financial impact of the social burden borne by the Railways was estimated to be of the order of Rs.2000 crores in 1993-94. The substantial increase in the cost of operation, the policy of tariff restraint, dwindling budgetary support etc. have also to be taken into account before assessing the Railway's capacity to bear the burden of an increase in the grant in lieu of the tax on passenger fares.

7.7 Having regard to what has been stated above, we propose to consider the following issues:-

- i) Whether the tax on Railway Passenger Fares ought to be revived.
- ii) In case the tax is not revived, the quantum of the grant and the basis of its calculation.
- iii) The principles to be adopted for distribution of the grant in lieu of the tax on Railway Passenger Fares.

7.8 As regards the issue of reviving the tax, we do not consider it necessary to go into this as in our view there is no economic or operational advantage in reviving the tax.

7.9 As for the the quantum of the grant, we are unable to accept the argument of the Railways that they cannot bear the

burden of the grant at this level. We note that it is not the Railways but the Central Government which has all along been bearing most of the compensatory grants. What the Railways pay to the Central Government is a separate issue which is considered periodically by the Railway Convention Committee of Parliament. As such we would not like to go into the operational performance of the Railways and their capacity to contribute more to the general revenues. As far back as the Sixth Commission it had been observed that Finance Commissions were "not concerned here with the larger aspects of the working and financial results of the Railways" (page 23, para 9). We have come to the conclusion that the grant must bear some relation to the incidence of the tax when it was repealed. We agree with the views expressed by most State Governments and that of the Eighth Commission that the grants should be equal to 10.7 per cent of the non-suburban railway passenger earnings. The latest year for which State-wise figures of non-suburban passenger earnings have been made available by the Ministry of Railways is 1992-93. The total non-suburban passenger earnings for that year was Rs.3540.82 crores. We recommend that 10.7 per cent of this i.e. Rs.380.00 crores be paid to the States annually during the period covered by our report.

7.10 As regards the principles of distribution, we are in agreement with the Seventh, Eighth and Ninth Commissions which recommended distribution of the grant in proportion to the non-suburban passenger earnings from traffic originating in each State. The taxable event being the payment of fare, a State should get a grant in relation to the fare paid within its boundary. Considerations like route length etc. appear to be immaterial.

7.11 We have considered the views of States which do not have railway lines. In view of the clear position laid down in article 269 (1)(d) and article 269(2) of the Constitution, we are unable to accept the contention that such States ought to be compensated on the ground that the people of such States purchase tickets from stations falling within the boundaries of other States.

7.12 To sum up we recommend that :

- i) The quantum of the grant in lieu of the Railway Passenger Fares Tax for 1995-2000 should be Rs.380 crores annually.

- ii) The shares of the States be allocated in the same proportion as the average of the non-suburban passenger earnings in each State during the years 1988-89 to 1992-93 bears to the average of the aggregate non-suburban earnings in all States in those years. The relevant data is at Annexure VII.1. On this basis the shares of the States would be as in Table 1 :

Table 1
Grants-in-lieu of Tax on Railway Passenger
Fares : Shares of States 1995-2000

States	Per cent
Andhra Pradesh	8.345
Arunachal Pradesh	0.005
Assam	1.368
Bihar	9.326
Goa	0.194
Gujrat	6.901
Haryana	1.917
Himachal Pradesh	0.108
Jammu & Kashmir	0.728
Karnataka	3.388
Kerala	3.495
Madhya Pradesh	6.882
Maharashtra	17.548
Manipur	0.018
Meghalaya	0.034
Mizoram	0.001
Nagaland	0.145
Orissa	1.715
Punjab	3.280
Rajasthan	4.445
Sikkim	0.010
Tamil Nadu	6.458
Tripura	0.039
Uttar Pradesh	15.568
West Bengal	8.082
TOTAL	100.000

UPGRADATION GRANTS

8.1 Para 4(iv) of the Presidential Order constituting our Commission stipulates that recommendations may be made taking into consideration, inter alia, "the requirements of States for modernization of administration and for upgrading the standards in non-developmental sectors and services, and the manner in which such expenditure can be monitored." The aspects of administration requiring modernization have been further amplified, using illustrations of computerization of land records and providing faster channels of communication upto and above the district level. Being illustrative, however, the examples cannot be construed to mean that these must necessarily be taken up or to preclude consideration of any other aspect of administration .

8.2 The requirement of upgrading standards of State administration, as a specific consideration underpinning the recommendations of Finance Commissions, appeared for the first time in the terms of reference of the Sixth Commission. Much before that, however, the First Commission had in their report discussed in detail the need for general and specific grants. In para 16 of Chapter VII of their report, the First Commission recorded " We believe that both the methods of conditional and unconditional grants should have their part to play in the scheme of assistance by the Centre. Unconditional grants should reinforce the general resources of the State Governments, which they would be free to allocate among competing purposes according to their best judgement, subject to the usual administrative and parliamentary checks. Grants for broad purposes may be given to stimulate the expansion of particular categories of services rather than specified schemes under those categories." Thus, in pursuance of its belief that primary education needed to be encouraged, the First Commission recommended, without being specifically asked to do so, grants for primary education to eight States in proportion to the number of children of school going age not attending schools till then.

8.3 The Third Commission , likewise, took a view that impetus should be given to the development of communications to open up backward areas The Commission, therefore, recommended grants for the development of communications.

8.4 By the time the Sixth Commission was set up, it was realised that the upgradation of standards of administration required to be looked into by the Finance Commission. Accordingly the terms of reference of successive Finance Commissions, from the Sixth to the Eighth, require them to consider the need for upgradation of standards of state administration in one form or the other.

8.5 The terms of reference of the three Commissions refer to the need for upgrading the administration in 'backward' States with a view to bringing them to the level of more advanced States. The Sixth Commission wanted the standards of general administration in backward States to be brought to the "levels obtaining in the more advanced States over a period of ten years". The Seventh Commission confined the upgradation of standards in backward States to "non-developmental sectors and services" but introduced a more up-to-date comparison with more

advanced States i.e. "over the period covered by the report of the Commission." The terms of reference of the Eighth Commission reiterated the requirement of upgradation of standards in "non-developmental sectors and services" to bring them to the "levels obtaining or likely to obtain" in the more advanced States. Unlike the terms of reference of the Sixth and Seventh Commissions, which referred only to the States "which are backward", the Eighth Commission was required to consider the need for upgradation of States in general and 'in particular' of States which are backward. The Seventh and Eighth Commissions also introduced the element of monitoring of expenditure on upgradation. The terms of reference of the Ninth Commission did not require it to consider upgradation of the standards of administration.

8.6 The Sixth Commission drew a distinction between the need for making a 'provision' for upgradation of State administration and 'entitlement' of a State to receive the grant. In broad terms, the provision needed was worked out on the basis of per capita expenditure needed to bring the services in selected items of administration to the level of all States average by 1978-79. This was added to the expenditure estimates of States for the award period. The entitlement to a grant arose only if the result of the aforesaid exercise showed a revenue gap. The Sixth Commission had "concerned itself only with expenditure on revenue account and not on capital and loan accounts" though it had averred that it could deal with all the requirements of the States for upgradation of standards of administration including social services. The Seventh Commission examined the relative position of States in physical terms and made an assessment of the need for the upgradation of standards in terms of the norms set by it. The Seventh Commission also felt that it was open to them to recommend grants for capital expenditure apart from grants for revenue expenditure under article 275. The Commission did not recommend any grants to revenue surplus States. It felt that the revenue surplus States could, of their own, upgrade their standards of administration. The Eighth Commission also did not recommend any grants for upgradation of services to Gujarat, Haryana, Karnataka, Maharashtra, Punjab and Tamil Nadu as they had a sufficiently large surplus before devolution of taxes. The Ninth Commission was also required by its terms of reference to keep in view the special problems, if any, of each State. Accordingly, the Commission made recommendations in its first report regarding special problems in some of the States. Earlier, the Eighth Commission had also recommended grants for special problems in some States.

8.7 A statement indicating amounts recommended by the Eighth and Ninth Commissions, amounts approved by Inter-Ministerial Empowered Committee (IMEC) and releases made is at Annexure-VIII.1.

8.8 The aspirations of all the States in wishing to attain higher standards of administration in various sectors are reflected in the numerous proposals we have received. Together, the proposals amount to Rs. 1,17,519.77 crores. The

special problems alone account for 41.7 per cent of the total amount.

8.9 It is obviously not possible for us to cover all the areas in which the States would like to improve their existing standards of services. Computerization of land records is one of the areas we are expected to look at. We discussed the possibilities in this regard with the Ministry of Rural Development and the National Informatics Centre (NIC) and were advised that the Eighth Plan already had a scheme for this purpose. We saw the implementation of this scheme of computerization of land records in several districts. By 1993-94 its coverage included 75 districts. 300 districts are scheduled to be covered by the end of the Eighth Plan and the remainder by the turn of the century. In view of this we decided not to pursue this matter further.

8.10 There is also a mention in our terms of reference of the need for providing faster channels of communication upto and above the district level. This has several dimensions. Telecommunication links are already fairly well spread-out and are being strengthened and made faster and more reliable with the help of technological advances and the participation of private industry. We understand that the Department of Telecommunications plans to link all district headquarters on the telex network and through digital media. The NIC has also established a country-wide network, called NICNET. Police communication, however, remains a weak area. We have dealt with this aspect while considering the upgradation of facilities for the police.

8.11 In identifying areas of upgradation, we have been largely guided by such considerations as their relevance and importance to administration and society, neglect across States and the long-term deleterious consequences if no remedial action is taken soon. State specific special problems have also been considered. On this basis, we have selected the following areas for upgradation :

- A. District Administration :
 - i) Police
 - ii) Fire services
 - iii) Jails
 - iv) Record rooms
 - v) Treasuries and Accounts
- B. Education :
 - i) Promotion of girls' education
 - ii) Additional facilities for upper primary schools
 - iii) Drinking water facilities in primary schools
- C. Special Problems

8.12 Upgradation grants are not being recommended for those States which have been assessed to have an overall non-plan revenue surplus before devolution. In our view it is not only desirable but also necessary and possible for these States to give from their own resources priority allocation to the areas needing upgradation.

8.13 The need for such grants in respect of items under A and B in para 8.11 is examined as follows :-

A. District Administration :

i) Police

Our proposals on this subject as well as fire services and jails have been formulated on the basis of information received from the States and in consultation with the Ministry of Home Affairs.

(a) Buildings for Police Stations/Out-posts :

According to available data, there is an acute shortage of buildings for police stations and out-posts in almost all the States. As on 1st January 1993, there were 12,064 police stations and 5,899 out-posts in all the States. Out of these, 4,246 police stations and 3,002 out-posts did not have proper accommodation. Many of these operate from temporary sheds and tents. There is also a shortage of separate lock-up rooms for women. Such deficiencies are a drag on the operational efficiency of the police. We have assessed a requirement of Rs.28.76 crores to cover at least 10 per cent of the existing shortage of buildings for police stations/out-posts at an average cost of Rs.4 lakhs per building.

(b) Police Housing (Family Accommodation):

Housing facility for the lower subordinate staff in the police is inadequate at present. While the all-States' average satisfaction level was of the order of 30.09 per cent, as on 1st January 1993, it was much lower in the case of several States; the lowest being 6.29 per cent in the case of Assam. We accept that a redressal of this situation is necessary as housing satisfaction has a bearing on the general levels of police performance. We feel that at least a minimum of 20 per cent satisfaction level should be reached in respect of all the States. Fourteen States fall in this category. In calculating the amounts required we have worked out the unit cost as Rs.1.25 lakhs for family accommodation with a plinth area of 435 sq. ft. at the rate of Rs.285 per sq. ft. The requirement thus worked out for fourteen States is Rs.375.61 crores.

(c) Police Training :

We find that training facilities for police personnel continue to be inadequate. We consider that investment in training is essential and have therefore assessed a requirement of Rs.56.47 crores for upgrading the facilities for training of subordinate police personnel in the States. The detailed schemes may be formulated by States in consultation with the Ministry of Home Affairs. The assessment made by us is on the basis of weightage assigned to population, strength of police personnel, and crime per lakh of population in the proportion of 30, 50 and 20 respectively.

(d) Police Telecommunication

The importance of police telecommunication can hardly be over-emphasized. It has been brought to our notice that the scheme of POLNET seeks to upgrade the existing police telecommunication system and also extend it to rural and remote areas, at an approximate cost of Rs.154.20 crores. This cost, estimated by the Ministry of Home Affairs, is to be shared by both the Central and State Governments. The non-recurring amount of the share of States works out to Rs. 94.38 crores and the recurring cost as Rs.11.07 crores. To facilitate quick implementation of the scheme, it is considered necessary to provide for the non-recurring cost of the share of States which are eligible for upgradation grants.

ii) Fire Services

With growing industrialization, urbanization and development of congested markets, fire hazards have increased manifold. The development of fire services has not made commensurate headway. We are convinced that it would be prudent for States, to strengthen and upgrade fire fighting capabilities. This would include adequate and suitable modern equipment, effective fire call communication system, rescue equipment, training of manpower, well designed functional fire stations, adequate water availability and protective equipment

for functionaries etc. The total requirement of funds needed for this purpose is assessed as Rs. 100 crores for all the States.

iii) Jails

Proposals have been received from States urging improvement of facilities in jails. It is hidden from none that the prevailing conditions leave much to be desired. We are aware that plan funds are available for this sector; the amounts, however, are not sufficient to make an appreciable dent on the problem. We have, therefore, provided Rs.50 crores for repair and renovation of the existing accommodation for prisoners and Rs.30 crores for medical equipment, consumable items and sanitation, in the ratio of the capacity of jails in different States. The amounts provided for in respect of medical care etc. may be so used that not less than the proportionate allocation for female prisoners is ensured in each jail.

iv) Record Rooms

Records are an important part of administration. They are required to be referred to time and again, over long periods, by different agencies. In districts, they are necessary for the proper and efficacious functioning of administration. Unfortunately, in most places the upkeep of records is in poor state and needs to be improved. Considering that in the districts, revenue records are crucial to the welfare of the large rural population, we have assessed the requirement under this sector based on estimates of operational holdings in a State and the area covered by them. Accordingly, we have assigned 60 per cent weightage to operational holdings and 40 per cent to area in arriving at the State-wise requirement. We have used the data for 1990-91. in respect of Assam, Bihar, Jammu & Kashmir, Meghalaya and Sikkim, information is available only upto 1985-86. We have therefore projected these on the basis of average growth rates of operational holdings/area in other States, to arrive at the figures for 1990-91. The averages have been taken separately for special category and non-special category States. We have thus

assessed a requirement of Rs.100 crores for construction of/ addition to record rooms and provision of ancillary equipment for modernization. This provision will not be available for staff.

v) Treasuries and Accounts

We have received proposals from several State Governments in respect of the creation of new treasuries/sub-treasuries, construction of new buildings, purchase of furniture, office equipment, racks, almirahs, computers, data entry machines, provision for staff, imparting of training etc. The Commission's attention has also been drawn towards considerable delays in rendition of accounts for reasons of lack of adequate and skilled staff, mechanical aids etc.

We are not inclined to support staff proposals or proposals for expenditure on normal expansion or equipping of treasuries. States should be able to deal with such items on their own. We are, however, of the view that computerization of district treasuries would go a long way in improving the managerial control of both the State and district level administration. It would also make for speedy and accurate generation of accounting information that might be needed for purposes of better planning, budgeting and monitoring. Information regarding the number of district level treasuries and the state of computerization thereof, has been obtained from the office of the Comptroller and Auditor General of India, Accountants General, NIC and States. Computerization of treasuries has been found to be at various stages in different States. While some of the States have achieved computerization of all treasuries, others are still to do so. Many have not embarked on computerization as yet. We have taken the view that at least all the district level treasuries should be computerized. We have, for this purpose, assessed a requirement of Rs.23.10 crores at an average unit cost of Rs.10 lakhs per treasury. The details of the latter are indicated in Annexure VIII.2

A statement showing State-wise requirement for each sector under District Administration is given in **Table 1**.

Table 1
Requirement for Upgradation of District Administration

(Rs. Lakhs)

State	Building for Police Stations/Outposts	Police Housing	Police Training	Police Telecomm- unications	Fire Services	Jails		Record Rooms	Computeri- station of Treasuries	Total (2 to 10)
						Repairs and Renovation	Medical Facilities			
1	2	3	4	5	6	7	8	9	10	11
Andhra Pradesh	204.00	—	401.51	683.00	400.00	257.00	154.00	871.83	—	2971.34
Arunachal Pradesh	32.00	537.50	10.96	163.75	200.00	—	—	13.65	60.00	1017.86
Assam	68.00	8291.25	179.81	374.50	200.00	154.00	92.00	226.67	230.00	9816.23
Bihar	504.00	5267.50	524.73	919.25	700.00	587.00	353.00	989.19	400.00	10244.67
Goa	20.00	—	10.21	44.75	200.00	7.00	4.00	5.73	20.00	311.69
Gujarat	240.00	—	291.62	399.50	500.00	135.00	81.00	446.37	—	2093.49
Haryana	100.00	3611.25	124.23	246.50	200.00	90.00	54.00	175.68	—	4601.66
Himachal Pradesh	32.00	1471.25	43.89	178.75	300.00	14.00	9.00	71.99	20.00	2140.88
Jammu & Kashmir	32.00	2466.25	84.54	214.25	300.00	32.00	19.00	98.02	150.00	3396.06
Karnataka	112.00	—	273.27	429.00	300.00	190.00	114.00	622.46	—	2040.73
Kerala	128.00	1028.75	192.24	322.25	300.00	140.00	84.00	348.42	—	2543.66
Madhya Pradesh	140.00	—	449.07	889.25	800.00	414.00	248.00	1006.52	—	3946.84
Maharashtra	172.00	—	571.32	611.50	1000.00	441.00	264.00	1038.04	—	4097.86
Manipur	28.00	1382.50	26.46	124.25	200.00	43.00	26.00	12.21	—	1842.42
Meghalaya	8.00	—	22.14	107.50	200.00	14.00	8.00	17.95	50.00	427.59
Mizoram	12.00	282.50	11.89	58.75	100.00	15.00	9.00	5.46	30.00	524.60
Nagaland	28.00	1606.25	31.72	122.25	200.00	30.00	18.00	31.36	90.00	2157.58
Orissa	120.00	—	200.09	399.50	400.00	182.00	109.00	350.00	180.00	1940.59
Punjab	68.00	6271.25	185.55	312.00	300.00	180.00	108.00	160.22	140.00	7725.02
Rajasthan	124.00	—	288.63	581.00	500.00	212.00	127.00	793.66	340.00	2966.29
Sikkim	16.00	38.75	5.93	68.75	200.00	1.00	1.00	4.84	10.00	346.27
Tamil Nadu	220.00	—	369.62	623.50	400.00	467.00	280.00	630.52	—	2990.64
Tripura	8.00	818.75	30.63	62.25	100.00	20.00	12.00	25.33	20.00	1096.96
Uttar Pradesh	224.00	—	907.62	1149.25	1200.00	886.00	532.00	1563.75	460.00	6922.62
West Bengal	236.00	4487.50	409.67	352.50	800.00	489.00	294.00	490.13	110.00	7668.80
Total	2876.00	37561.25	5647.35	9437.75	10000.00	5000.00	3000.00	10000.00	2310.00	85832.35

B. Education :**i) Promotion of Girls' Education**

There is a strong correlation between rise in female literacy and the decline in fertility and infant mortality rates. Low female literacy has been a source of many other social ills. While much has been achieved in the sphere of education through planned effort, girls education continues to lag behind. It is, therefore, felt that the States which have very low female literacy rates may be assisted by upgradation grants for specific districts. Thus, 83 districts where female literacy rates were below 20 per cent and 199 districts with rates between 20 and 40 per cent in 1991, have been identified for upgradation grants. The assessment has been made on the basis of Rs.20 lakhs and Rs.10 lakhs respectively per district per year. The total requirement works out to Rs.182.50 crores.

ii) Additional facilities for upper primary schools:

On the basis of the Fifth All India Educational Survey (AIES, 1986, published in 1992) only 67 per cent of the upper primary schools had drinking water facilities. We feel this percentage should be raised to at least 80 per cent. Even more important is the necessity of providing for separate toilet facilities for girls at the upper primary level to ensure that they do not discontinue education for want of basic amenities. The present

availability of this facility is of the order of 12.7 per cent. We feel that in the interest of promoting girls education it is necessary to reach a level of at least 75 per cent satisfaction in this regard by the year 2000. The number of girls and co-educational schools in 1993 have been arrived at by applying the ratio prevailing in 1986 to the total number of schools in each State. The same unit cost of drinking water facility has been taken as in the case of primary schools; the unit cost for low-cost sanitation has been taken as Rs.10,000. Accordingly a total requirement of Rs.116.93 crores has been estimated.

iii) Drinking water facilities in primary schools :

As per the Educational Survey (referred to above) only 52.8 per cent of primary schools had drinking water facilities. For some States, the percentage was even lower. In view of the abysmally low levels of such a basic and essential facility, we have decided to provide upgradation grants for drinking water in all primary schools of the country. We have arrived at the number of schools requiring this facility by applying the ratio obtaining in AIES 1986 to the number of schools in 1992-93 in each State. At an average unit cost of Rs.15000 for a hand pump, we have assessed a requirement of Rs.456.32 crores.

A statement showing State-wise requirement for upgradation in the educational sector is given in **Table 2**.

Table 2
Requirement for Upgradation of Education

(Rs. Lakhs)

States	Girls Education			Upper Primary School			Primary School	Total
	Female Literacy in Distt.			Drinking Water	Toilets for Girls	Total	Drinking Water	Col. 4 7 and 8
	Less than 20%	Between 20%-40%	Total					
1	2	3	4	5	6	7	8	9
Andhra Pradesh	200.00	850.00	1050.00	144.75	391.70	536.45	4329.84	5916.29
Arunachal Pradesh	300.00	400.00	700.00	6.60	17.90	24.50	89.30	813.80
Assam	---	500.00	500.00	289.05	415.10	704.15	3665.44	4869.59
Bihar	1800.00	1100.00	2900.00	61.50	884.40	945.90	4221.96	8067.86
Goa	---	---	---	1.80	6.20	8.00	59.30	67.30
Gujarat	---	150.00	150.00	255.00	1048.10	1303.10	949.31	2402.41
Haryana	---	350.00	350.00	---	72.70	72.70	211.95	634.65
Himachal Pradesh	---	200.00	200.00	28.35	71.50	99.85	562.33	862.18
Jammu & Kashmir	1000.00	200.00	1200.00	173.55	86.70	260.25	1020.72	2480.97
Karnataka	---	450.00	450.00	333.15	1083.30	1416.45	1962.89	3829.34
Kerala	---	---	---	37.20	162.20	199.40	239.87	439.27
Madhya Pradesh	1000.00	1450.00	2450.00	478.20	759.40	1237.60	7003.02	10690.62
Maharashtra	---	450.00	450.00	462.45	1152.80	1615.25	3391.73	5456.98
Manipur	---	200.00	200.00	32.55	44.80	77.35	353.99	631.34
Meghalaya	---	100.00	100.00	44.25	48.30	92.55	551.46	744.01
Mizoram	---	---	---	43.05	35.50	78.55	109.46	188.01
Nagaland	---	50.00	50.00	19.35	22.00	41.35	146.77	238.12
Orissa	200.00	400.00	600.00	641.55	841.10	1482.65	4656.16	6738.81
Punjab	---	150.00	150.00	---	68.90	68.90	186.99	405.89
Rajasthan	1900.00	400.00	2300.00	50.10	386.60	436.70	2284.34	5021.04
Sikkim	---	50.00	50.00	4.65	8.30	12.95	46.79	109.74
Tamil Nadu	---	150.00	150.00	---	248.40	248.40	695.53	1093.93
Tripura	---	50.00	50.00	18.00	31.10	49.10	194.34	293.44
Uttar Pradesh	1900.00	1900.00	3800.00	148.65	334.40	483.05	5548.63	9831.68
West Bengal	---	400.00	400.00	7.50	190.70	198.20	3149.63	3747.83
Total	8300.00	9950.00	18250.00	3281.25	8412.10	11693.35	45631.75	75575.10

C. Special Problems :

8.14 Our visits to the States, and discussions with State Government representatives and others who appeared before us to present their point of view, have left a deep impression on us that there are special problems in every State, irrespective of their financial status, which need to be attended to in a responsive manner. We take the view that by providing assistance for such problems of each State, in howsoever small a measure, we recognise the priority the States attach to these problems. Accordingly, we recommend the following :-

Andhra Pradesh

The Naxalite movement is a special problem of the State since it tends to draw sustenance from the inadequacy of development programmes in remote areas. We have focussed attention on this aspect. To enable the State to provide for some programmes, a special assistance of Rs.65 crores is recommended. Of this, Rs.40 crores is for the development of minor irrigation and Rs.25 crores for solving drinking water problems.

Arunachal Pradesh

As represented by the State, it has no referral hospital/medical college. The people of Arunachal Pradesh are forced to seek such medical facilities in other States at great expense and inconvenience to themselves. To overcome this problem, we are supporting the State's proposal for the establishment of a 500 bedded tertiary care referral hospital and recommend Rs.50 crores for that purpose.

Assam

The State Government has represented that it does not have a proper secretariat building in the capital, Dispur. We are, therefore, recommending Rs.60 crores for the construction of the civil secretariat.

Bihar

Inundation of lakhs of hectares of agricultural lands, over long periods, is the special bane of Bihar. Two such areas comprise the tal and diara lands. Accepting the State Government's proposals in regard to these two vast areas, we are recommending Rs.31 crores for the development of tal lands and Rs.21 crores for the development of diara lands. In addition, we are also recommending Rs.5.50 crores for the purchase of X-ray plants and diagnostic equipment to be provided in sadar and sub-divisional hospitals. A total of Rs.57.50 crores is thus being recommended to take care of some of the special problems of Bihar.

Goa

The building housing the Assembly and the secretariat is understood to be unsafe, having become 400 years old. Provision for a new Assembly complex having already been made, we now recommend Rs.5 crores for the construction of a new Secretariat. We also recommend a provision of Rs.2 crores for the construction of transit accommodation at Dona Paula.

Gujarat

550 villages of Mehsana district have been facing the problem of excessive fluorides in drinking water. We are recommending for Rs.50 crores towards the early solution of this problem.

Haryana

To relieve congestion in Delhi, Haryana has to invest in the

development of satellite towns. Special assistance of Rs.40 crores is being provided for this purpose.

Himachal Pradesh

Himachal Pradesh offers year round facilities for tourism. To facilitate further flows of tourists, we are providing for Rs.30 crores for the construction of air strips at Banikhet and Rangrik. We are also providing for Rs.40 crores for reorganization and augmentation of existing water supply system and extension of sewerage system of Shimla town, capital and principal hill resort of Himachal Pradesh. In addition, acknowledging the need for a MLA's hostel and augmentation of library facilities in the State Assembly, we are also recommending a total of Rs.5 crores (Rs.4 crores for a hostel and Rs.1 crore for the library) for the Assembly. Altogether a provision of Rs.75 crores is being recommended.

Jammu & Kashmir

Jammu & Kashmir is beset with many problems. For the development of Leh and Kargil districts, as proposed by the State, we are recommending a provision of Rs.10 crores (Rs. 5 crores each). In addition, we are also supporting the proposal of the State for upgrading equipment in various departments of medical colleges in Jammu/Srinagar. A provision of Rs.37 crores is being recommended on this account. The total grant recommended for special problems is Rs.47 crores.

Karnataka

For Karnataka we recommend Rs 29 crores as grants. Of this, Rs.12 crores are for a regional training institute at Gulbarga, Rs.7 crores for construction of/completion of district stadia, including laying cinder tracks therein, and Rs.10 crores for computerization of the tax collection departments.

Kerala

The State Government has represented that annually about 18,000 fishermen are rendered homeless and road and drinking facilities are badly affected during squally conditions. Accordingly a provision of Rs.50 crores is being made to provide : (i) Rs.30 crores for better housing , (ii) Rs.13 crores for fisheries road and (iii) Rs.7 crores for water supply . In addition, Rs.2 crores is recommended to protect shola forests. The total grants recommended are Rs.52 crores.

Madhya Pradesh

Forests are vital to the ecology of Madhya Pradesh and the country at large. In order to help preserve and regenerate forests and also improve the lot of villages in and around forest areas, the State Government has proposed a socio-economic development project in 500 such villages. We recommend Rs.60 crores for this project.

Maharashtra

Maharashtra has special problems arising out of high degree of urbanization in the State. We therefore recommend a provision of Rs.50 crores for the improvement of slum conditions in Bombay and another Rs.50 crores for the development of urban water supply and sewerage systems.

Manipur

The State Government made a special plea to us for funds for the maintenance and preservation of Loktak Lake, which is of prime importance to the economy and eco-system of Manipur. This fact was also recognized by the Ninth Commission. We recommend Rs.30 crores for the development of the lake, including its desilting, afforestation of the catchment area and enlargement of its capacity. We also recommend Rs.10 crores for

putting up a cultural complex either at Moirang or at Imphal and a memorial for the Indian National Army, and Rs.10 crores for a sports complex at Imphal.

Meghalaya

The State Government has represented that there is an urgent need to extend the secretariat building. We recommend Rs.5 crores for this.

Mizoram

The construction of an airport at Lengpui is widely recognised as a special requirement of Mizoram. We endorse the same and recommend Rs.57 crores for an airport with a 10,000 ft. runway, as proposed by the State and supported by the Ministry of Home Affairs.

Nagaland

The internal security problem of Nagaland is a major bottleneck in the overall development of the State and, therefore, requires special and timely assistance. In this context we are inclined to endorse the State Government's proposal to strengthen the law and order machinery, and recommend Rs.30 crores for security equipment like bullet proof jackets, jeeps, communication equipment, construction and repair of barrack type police accommodation and establishment of appropriate helicopter facilities.

Orissa

The preservation of Chilka lake and restoration of the eco-system have attracted attention. Area shrinkage, siltation, pollution, and weed infestation threaten to choke the lagoon. We recommend Rs.27 crores for the scheme of the State in this regard. A large number of ancient monuments including temples and pre-historic caves etc. need to be preserved and protected. We acknowledge this special requirement and recommend Rs.10 crores for this purpose. For supporting flood control measures in especially vulnerable areas, that are endemic to floods, we are recommending Rs.8 crores (Rs.4 crores for providing 800 deep tube-wells and Rs.4 crores for the construction of livestock shelters). In addition, appreciating the State's desire to conserve plant genetic resources with an aim to introduce, conserve and propagate special species of plant, Rs.6 crores are recommended for the development of the Regional Plant Resource Centre at Bhubaneshwar.

Punjab

The special problem of Punjab relates to debt arising out of special loans to fight insurgency. Accordingly we have dealt with this in Chapter XII para 12.40.

Rajasthan

The severity of the problem of drinking water particularly in the western arid region of Rajasthan stands out as the special problem of the State. Both the quantity and quality of drinking water need to be considerably augmented and improved. We recognise this need and recommend Rs.70 crores for capital expenditure directed towards a long term solution of the problem.

Sikkim

The construction of an airfield at Gangtok appears to be a

requirement on which several other developments hinge. We are, therefore, convinced of the need to support this project and recommend Rs. 3 crores for it. We also recommend Rs.1.5 crores for the much needed stadium complex at Gangtok, Rs.0.70 crores for equipment for 23 PHCs and Rs.0.30 crores for equipment for post-partum units, as asked for by the State.

Tamil Nadu

The metropolitan city of Madras is continuously expanding. About one third of the city's population lives in slums and the task of improving their lot is urgent. We, therefore, recommend Rs. 60 crores for this purpose.

Tripura

The State made a plea for supplemental funds for the G.B. Pant Hospital at Agartala. We accept their plea and recommend Rs. 10 crores for the same. We recognise the need for timely completion of the sports complex at Bhadarghat at Agartala. We recommend Rs.2 crores for the same thereby supplementing the grant made available to the State by the Government of India.

Uttar Pradesh

The disruption of water supply services poses a critical problem in the hill districts of the State. We found urban areas in these districts to be particularly affected, chiefly the towns of Almora, Nainatal, Pithoragarh and Pauri. We, therefore, recommend Rs. 40 crores for the augmentation, improvement and maintenance of water supply services. Restoration of roads, buildings, irrigation channels, and godowns for storage of essential supplies for distribution to remote and inaccessible areas has been neglected for want of funds. We recommend Rs.20 crores for the purpose. We find strength in the contention of the State that national pilgrimage centres play a major role in promoting national unity and integration. Besides, a reasonable level of facilities needs to be provided for hygiene and sanitation. We therefore recommend Rs.40 crores for providing and improving yatra services to Kailash, Mansarovar, Badrinath and Kedarnath, including the widening of main yatra roads and provision of adequate transportation services. The lake areas in the Kumaon region are getting more and more polluted everyday and urgently need some financial support for their regeneration. We recommend Rs. 8 crores for this scheme. The total of special problem grants for Uttar Pradesh comes to Rs.108 crores.

West Bengal

The problem of slums in Calcutta continues to be a special one requiring large sums of money, time and effort. We have decided to provide assistance of Rs. 50 crores. Two other special problems of West Bengal have attracted our attention. We are recommending Rs.35 crores for the development of the Sunderbans and another Rs.20 crores for tackling the problem of erosion and related narrowing of the critical gap between the Bhagirathi and Ganga-Padma river systems.

8.15 Our assessment of the State-wise requirements for upgradation of District Administration and Education have been indicated in Tables 1 and 2. The consolidated statement of grants recommended by us for upgradation and special problems is at Table 3. We are conscious that the States will take some time to finalise estimates, get the necessary technical and administrative approvals, select agencies for

implementation etc. We are of the view that the requirements shall arise from 1996-97 in a phased manner. Accordingly, the year wise entitlements for grants for States is as indicated in Tables 4 and 5.

Monitoring and Evaluation

8.16 Previous Commissions have stressed the need for ensuring that the grants recommended for upgradation were used for the purpose for which they were intended. They also sought to establish effective monitoring. The Eighth Commission reviewed the monitoring system suggested by the Seventh and stated that they could not get complete data from the State either in respect of the utilization of grants, or physical progress of the schemes. They therefore, recommended the following arrangements:-

- a) At the Government of India level, there was to be an Inter-Ministerial Empowered Committee for monitoring the progress of utilisation of upgradation grants. The Committee consisted of representatives of the concerned Central Ministries as Members and had to meet as often as necessary, but not less than once in a quarter. The Committee was empowered to alter the physical targets in case escalation in prices warranted it, or transfer the grants from one scheme to another within the same sector. For example, under Tribal Administration, the Ministry of Home Affairs transferred funds from compensatory allowance to staff quarters while implementing the recommendations of the Seventh Commission. Similarly, adjustments like transferring grants from the establishment of new treasuries to the construction of buildings for existing treasuries, or effecting structural alterations to existing

treasuries, were within the competence of the Empowered Committee. The members of the Empowered Committee were also expected to visit the States and make random inspection of the works under construction/offices set up out of the upgradation grants..

- b) At the State level, a similar State Level Empowered Committee under the Chairmanship of the Chief Secretary or a very senior officer was constituted. It was competent to sanction schemes, provide funds and monitor progress. It was expected to meet frequently but not less than once in two months.

8.17 The Commission had also recommended that an evaluation study be conducted by a suitable organisation to assess the benefits of upgradation programmes.

8.18 The Ninth Commission recommended the continuation of the same mechanism for monitoring.

8.19 A consideration of the above, as well as the deposition of the Ministry of Finance before us, leads us to conclude that the existing system of monitoring, as introduced by the Eighth and continued by the Ninth Commission, is working in a satisfactory manner as evidenced by the details at Annexure VIII.1. We, therefore, propose to retain it. In order to eliminate administrative bottlenecks and delays, we would however, like the State Level Empowered Committee to be more vigilant. Details of the various schemes, their unit cost, physical targets etc. may need to be suitably revised during their implementation. Keeping in mind the overall objective of timely completion of schemes coupled with financial prudence, the State Level Empowered Committee may be vested with a measure of flexibility within agreed parameters to effect necessary changes.

Table 3
Grants for Upgradation and Special Problems

(Rs. lakhs)

State	Upgradation												Special Problems	Total (14+15)	
	Record Rooms	Computerisation of Treasuries	Primary Schools	Upper Primary Schools	Girls' Education	Buildings for Police Stations/Outposts	Police Housing	Police Training	Police Tele-communications	Fire Services	Repair & Renovation of Jail Bldgs.	Med. facilities in Jails			Total (2 to 13)
1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.	16.
1. Andhra Pradesh	871.83	-	4329.84	536.45	1050.00	204.00	-	401.51	683.00	400.00	257.00	154	8887.63	6500.00	15387.63
2. Arunachal Pradesh	13.65	60.00	89.30	24.50	700.00	32.00	537.50	10.96	163.75	200.00	-	-	1831.66	5000.00	6831.66
3. Assam	226.67	230.00	3665.44	704.15	500.00	68.00	8291.25	179.81	374.50	200.00	154.00	92	14685.82	6000.00	20685.82
4. Bihar	989.19	400.00	4221.96	945.90	2900.00	504.00	5267.50	524.73	919.25	700.00	587.00	353	18312.53	5750.00	24062.53
5. Goa	5.73	20.00	59.30	8.00	-	20.00	-	10.21	44.75	200.00	7.00	4	378.99	700.00	1078.99
6. Gujarat	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	5000.00	5000.00
7. Haryana	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	4000.00	4000.00
8. Himachal Pradesh	71.99	20.00	562.33	99.85	200.00	32.00	1471.25	43.89	178.75	300.00	14.00	9	3003.06	7500.00	10503.06
9. Jammu & Kashmir	98.02	150.00	1020.72	260.25	1200.00	32.00	2466.25	84.54	214.25	300.00	32.00	19	5877.03	4700.00	10577.03
10. Karnataka	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2900.00	2900.00
11. Kerala	348.42	-	239.87	199.40	-	128.00	1028.75	192.24	322.25	300.00	140.00	84	2982.93	5200.00	8182.93
12. Madhya Pradesh	1006.52	-	7003.02	1237.60	2450.00	140.00	-	449.07	889.25	800.00	414.00	248	14637.46	6000.00	20637.46
13. Maharashtra	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	10000.00	10000.00
14. Manipur	12.21	-	353.99	77.35	200.00	28.00	1382.50	26.46	124.25	200.00	43.00	26	2473.76	5000.00	7473.76
15. Meghalaya	17.95	50.00	551.46	92.55	100.00	8.00	-	22.14	107.50	200.00	14.00	8	1171.60	500.00	1671.60
16. Mizoram	5.46	30.00	109.46	78.55	-	12.00	282.50	11.89	58.75	100.00	15.00	9	712.61	5700.00	6412.61
17. Nagaland	31.36	90.00	146.77	41.35	50.00	28.00	1606.25	31.72	122.25	200.00	30.00	18	2395.70	3000.00	5395.70
18. Orissa	350.00	180.00	4656.16	1482.65	600.00	120.00	-	200.09	399.50	400.00	182.00	109	8679.40	5100.00	13779.40
20. Punjab	160.22	140.00	186.99	68.90	150.00	68.00	6271.25	185.55	312.00	300.00	180.00	108	8130.91	**	8130.91
21. Rajasthan	793.66	340.00	2284.34	436.70	2300.00	124.00	-	288.63	581.00	500.00	212.00	127	7987.33	7000.00	14987.33
22. Sikkim	4.84	10.00	46.79	12.95	50.00	16.00	38.75	5.93	68.75	200.00	1.00	1	456.01	550.00	1006.01
23. Tamilnadu	630.52	-	695.53	248.40	150.00	220.00	-	369.62	623.50	400.00	467.00	280	4084.57	6000.00	10084.57
24. Tripura	25.33	20.00	194.34	49.10	50.00	8.00	818.75	30.63	62.25	100.00	20.00	12	1390.40	1200.00	2590.40
25. Uttar Pradesh	1563.75	460.00	5548.63	483.05	3800.00	224.00	-	907.62	1149.25	1200.00	886.00	532	16754.30	10800.00	27554.30
26. West Bengal	490.13	110.00	3149.63	198.20	400.00	236.00	4487.50	409.67	352.50	800.00	489.00	294	11416.63	10500.00	21916.63
All States	7717.45	2310.00	39115.87	7285.85	16850.00	2252.00	33950.00	4386.91	7751.25	8000.00	4144.00	2487.00	136250.33	124600.00	260850.33

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** Special debt relief has been provided for as indicated in Chapter XII para 12.40.

Table 4
Year-wise Grants for Upgradation

(Rs. lakhs)

State	1995-96	1996-97	1997-98	1998-99	1999-2000	Total 1995-2000
1.	2.	3.	4.	5.	6.	7.
Andhra Pradesh	-	1778	2222	2666	2222	8888
Arunachal Pradesh	-	366	458	549	458	1831
Assam	-	2937	3672	4406	3671	14686
Bihar	-	3663	4578	5494	4578	18313
Goa	-	76	95	114	94	379
Gujarat	-	0	0	0	0	0
Haryana	-	0	0	0	0	0
Himachal Pradesh	-	601	751	901	750	3003
Jammu & Kashmir	-	1175	1469	1763	1470	5877
Karnataka	-	0	0	0	0	0
Kerala	-	596	746	895	746	2983
Madhya Pradesh	-	2927	3659	4391	3660	14637
Maharashtra	-	0	0	0	0	0
Manipur	-	495	619	742	618	2474
Meghalaya	-	234	293	352	293	1172
Mizoram	-	143	178	214	178	713
Nagaland	-	479	599	719	599	2396
Orissa	-	1736	2170	2603	2170	8679
Punjab	-	1626	2033	2439	2033	8131
Rajasthan	-	1597	1997	2396	1997	7987
Sikkim	-	91	114	137	114	456
Tamil Nadu	-	817	1021	1225	1021	4084
Tripura	-	278	347	417	348	1390
Uttar Pradesh	-	3351	4188	5026	4189	16754
West Bengal	-	2284	2854	3425	2854	11417
All States	-	27250	34063	40874	34063	136250

Table 5
Year-wise Grants for Special Problems

(Rs. lakhs)

State	1995-96	1996-97	1997-98	1998-99	1999-2000	Total 1995-2000
1.	2.	3.	4.	5.	6.	7.
Andhra Pradesh	-	1300	1625	1950	1625	6500
Arunachal Pradesh	-	1000	1250	1500	1250	5000
Assam	-	1200	1500	1800	1500	6000
Bihar	-	1150	1438	1725	1438	5750
Goa	-	140	175	210	175	700
Gujarat	-	1000	1250	1500	1250	5000
Haryana	-	800	1000	1200	1000	4000
Himachal Pradesh	-	1500	1875	2250	1875	7500
Jammu & Kashmir	-	940	1175	1410	1175	4700
Karnataka	-	580	725	870	725	2900
Kerala	-	1040	1300	1560	1300	5200
Madhya Pradesh	-	1200	1500	1800	1500	6000
Maharashtra	-	2000	2500	3000	2500	10000
Manipur	-	1000	1250	1500	1250	5000
Meghalaya	-	100	125	150	125	500
Mizoram	-	1140	1425	1710	1425	5700
Nagaland	-	600	750	900	750	3000
Orissa	-	1020	1275	1530	1275	5100
Rajasthan	-	1400	1750	2100	1750	7000
Sikkim	-	110	138	165	138	550
Tamil Nadu	-	1200	1500	1800	1500	6000
Tripura	-	240	300	360	300	1200
Uttar Pradesh	-	2160	2700	3240	2700	10800
West Bengal	-	2100	2625	3150	2625	10500
Total	-	24920	31150	37380	31150	124600

CALAMITY RELIEF

9.1 Para 7 of our terms of reference requires us to review the existing scheme of Calamity Relief Fund (CRF) and to make appropriate recommendations thereon. The scheme, introduced by the Ninth Commission (Second Report), is designed to enable the States to manage and provide for calamity relief on their own by drawing upon the resources available with a fund constituted for that purpose separately for each State. The prescribed annual contributions to each State CRF are required to be made by the Centre and the concerned State in the proportion of 75:25. The scheme further provides for an accumulating balance with the proviso that if there is any unutilised amount left at the end of five years, it would be available for augmenting the plan resources of that State. On the other hand, it is permissible under the scheme to draw upon a percentage of the next year's Central assistance, if it became necessary to tide over the insufficiency of resources in the CRF in any particular year. The CRF dispensed altogether with the requirement under previous calamity relief schemes of maintaining 'Margin Money', submitting a memoranda to the Central Government for determining the ceiling of approved expenditure (which entitled the States to the Central assistance) and receipt of assistance in the form of loans and grants. The Centre's contribution to the CRF of a State is now entirely in the nature of a grant.

9.2 While recommending the constitution of a CRF, the Ninth Commission noted certain deficiencies in the existing scheme. They thought it tended to encourage the States to present inflated claims with the expectation of receiving a higher Central assistance. Moreover, the arrangements in the wake of a calamity were far from satisfactory. Further, to overcome the procedural delays in sanctioning, releasing and deploying the assistance for carrying out the actual relief works the Ninth Commission recommended the constitution of a CRF from which the concerned State could draw funds as the need arose for the same.

9.3 In determining the size of the CRF and the annual contributions to it the Ninth Commission followed more or less the same basis as adopted by the previous Commissions. It took the State-wise average of the ceilings of expenditure approved during the ten years ending 1988-89 as the amount which should be available for relief in the respective States. The total of all the States aggregated to Rs. 804 crores. If any region faced a calamity of 'rare severity' the Centre was expected to take appropriate action as the situation demanded and incur the necessary expenditure. The Commission did not define what constituted 'rare severity'.

9.4 Most States have expressed themselves in favour of continuation of the existing scheme, albeit, with some modifications here and there. Jammu and Kashmir, Nagaland and Tripura have pleaded that they should be completely exempted from making any contribution towards the CRF. Assam has stated that deficit States should be exempted from making any contributions to CRF and Madhya Pradesh has suggested total exemption for backward States. Orissa, Arunachal Pradesh and Himachal Pradesh have suggested reduction in the share of

States from 25 per cent to 10 per cent. A number of States have asked for adjustment for inflation. Gujarat has stated that the amount provided as CRF should be adjusted for inflation over the last ten years and of subsequent years within the time frame of the Tenth Commission. A similar plea has been made by Rajasthan. Rajasthan also joins Madhya Pradesh, Maharashtra, Gujarat and Kerala in suggesting that the actual expenditure, and not the approved ceilings, should be taken into account for working out the size of the CRF. Mizoram is more specific and has pleaded that all expenditure incurred in connection with natural calamities and not only those booked under the Major head "2245-Natural Calamities" should be taken into account. Tamil Nadu has stated that it was not correct to determine the annual CRF on a historical basis according to the expenditure ceilings approved by the Centre in the period 1979-80 to 1988-89, as this historical trend failed to take note of the current price levels.

9.5 A number of States have raised objections against the investment pattern laid down for investments out of the CRF. The Finance Ministry has laid down that the accretions to the Fund should be invested in the following manner :

- a) 15 per cent in Govt of India securities.
- b) 25 per cent in 182 days Treasury bills.
- c) 10 per cent in State Govt. securities.
- d) 10 per cent in Public Sector Bonds/units.
- e) 25 per cent to be maintained as deposits with Public Sector Banks (PSBs)
- f) 15 per cent to be maintained as deposits with State Cooperative Banks (SCB)

9.6 Punjab is one of the few States which has actually created a separate fund and it found that the purchase of securities/bonds was a time-consuming process which tended to negate the objective laid down in the original scheme. Rajasthan has stated that investments out of the CRF should not be held on a long-term basis and that too in a basket of securities the sale and purchase of which has to be effected in the open market. Haryana has pleaded that the entire amount available should be deposited in a fixed deposit/term deposit. Assam has suggested that the procedure for investment of funds may be made simpler with greater freedom for investment in profitable avenues.

9.7 As regards calamities of rare severity, Gujarat has stated that these should be objectively defined in terms of the number of villages/people affected, quantum and extent of relief and similar other factors. Andhra Pradesh has cited the case of the disastrous cyclone which occurred on 9th May, 1990 and resulted in unprecedented loss of life and property for which no additional assistance was given; it has suggested that standard criteria should be evolved for determining 'rare severity'. Tamil Nadu has stated that though it suffered an unprecedented calamity in 1992, no special help was forthcoming and as such the recommendations of the Ninth Finance Commission cannot be said to have provided a durable arrangement for such national disasters of unprecedented severity.

9.8 The Ministry of Finance, on the other hand, has stated that the scheme recommended by the Ninth Commission is advantageous to the States as the Central contribution is now entirely in the form of grants and the States left free to manage their affairs at their own discretion. The Ministry has also opposed the suggestion of the State Governments for a change in the investment pattern of the fund, lest the balances in the fund may not be available when needed. They have argued for the continuation of the present arrangement.

9.9 We have also received the comments of the Department of Agriculture and Cooperation of the Ministry of Agriculture who have been assigned a nodal role within the Government of India for overseeing the operation of CRF. They have reported that the response of the State Governments to requests by them for information for purposes of monitoring has not been encouraging, as the States accorded very low importance to the submission of any information to the Centre in the absence of any additional monetary assistance which could flow based on these communications. They have observed that in the absence of clear guidelines being prescribed, the States have tended to charge to the CRF all types of expenditure, including some only remotely related to calamity relief, such as office expenses at the State level and construction of new flood protection works and embankments. Their specific comments regarding the role of the Government of India under the changed scenario are as follows:

"...in a vast country like ours, any calamity with substantial adverse impact involved the involvement of the Central Government as well (but) the scope of giving expression to the concerns of the Central Government in concrete terms has been significantly reduced under the new arrangement based on Ninth Finance Commission's recommendations." They stated that the Centre had received 30 Memoranda for additional Central assistance between June 90 and May 93 regarding natural calamities that, according to the States, required to be handled at the national level.

9.10 The Department has suggested that the States CRF should be shared between the Central and the State Government in the ratio of 50:50, and the basis for fixing the amount of the fund should be the average of the actual expenditure on relief measures during the last four years of the existing state corpus, whichever is higher. The instalments of Centre's share of the CRF may be released by the Ministry of Finance on the recommendations of the Department or the submission of utilisation reports by the States. The expenditure from the CRF should be incurred on the basis of guidelines framed by the Government of India in this regard. If the funds available under the CRF are not sufficient to meet the situation in the wake of a natural calamity, additional funds should be made available by the Central Government on the basis of the recommendations of the Central teams to be deputed for this purpose and these additional requirements should be shared between the Central and the State Governments in the ratio of 3:1. The Department has also stated that the Central Government would make an annual provision of adequate funds in addition to the Centre's share of CRF for meeting these additional requirements.

9.11 There is near unanimity on the part of the States that the present arrangement should be continued, even though certain

reservations were expressed by one or two States during discussions. In the light of the fact that almost all States have asked for the continuance of the existing scheme and the Ministry of Finance have also suggested that sufficient time should be given for the scheme to be operationalised, we do not consider it necessary to change the present scheme or the pattern of the Centre-State contributions to it.

9.12 There is some substance in the observation of the Department of Agriculture and Cooperation that the practice regarding charging of different types of expenditure to the CRF has not been uniform among the States. While acknowledging that there is room for inter-State variations in items of relief expenditure, depending upon local requirements, there is nevertheless a need to evolve an All-India framework. To give one instance, it would be invidious if one State gives Rs.10,000 ex-gratia payment for the loss of life, and another gives Rs. 1,00,000. Adherence to certain broad parameters may also be necessary to withstand undue local pressures. Successive Commissions have, while noting the varying capacity of different States to meet the cost of calamity relief, also stressed the need to avoid unwarranted and wasteful expenditure.

9.13 We, therefore, recommend that the Department of Agriculture and Cooperation of the Ministry of Agriculture should set up a committee of experts and representatives of State Governments to frame common guidelines in regard to the items and their rates and norms, that can be debited to the CRF. The State committees will then work out the details for their respective States. In auditing the expenditure from the CRF it should be ensured that the designated items alone are charged to the fund and the norms are observed. We are also in agreement with the Finance Ministry that a separate fund outside the Public Account must be created so that the balances in the fund are available when needed.

9.14 Another issue raised by several States is that the quantum of the CRF should be based on an average of the actual expenditure incurred by them on natural calamities over a given number of years and not on the basis of ceilings of expenditure approved by Government of India. However, the States have claimed expenditure booked under a variety of Heads as being expenditure relating to calamity relief. In the case of other Heads it is difficult to distinguish between expenditure incurred in connection with calamity relief and other normal expenditure booked to those Heads. On the other hand, expenditure under various Minor Heads such as gratuitous relief, supply of fodder, drinking water, veterinary care, housing etc. is subsumed under the Major Head 2245 - Natural Calamities, which can therefore be justifiably taken to represent the expenditure of State Government on all relief activities. We are, therefore, of the view that the most appropriate and objective manner of assessing relief expenditure is to take into account only the expenditure booked to Major Head 2245-Natural Calamities.

9.15 We do, however, fully share the States' misgivings with regard to the factor of inflation which may not have been suitably accommodated in the present dispensation. We have taken into account the average of the aggregate of ceilings of expenditure for the years 1983-84 to 1989-90 and the amount of calamity relief fund for the years 1990-91 to 1992-93. The amount so worked out for all the States, has been adjusted for inflation upto 1994-95 and

thereafter at graduated rates with the same elasticity as for other non-plan revenue expenditure up to 1999-2000. The amount thus worked out for all States for the period of our Report is Rs.6304.27 crores as at Annexure IX.1. Out of this, the Centre will be required to contribute Rs.4728.19 crores (75 per cent) and the States Rs.1576.08 crores (25 per cent). The share of the States has been included in their expenditure estimates. We accordingly recommend the continuation of the current scheme of the Calamity Relief Fund with modifications. The main features of the modified scheme will be as follows:

- a) The contribution of the Centre and States to the Calamity Relief Fund shall be as at Annexure IX.2 and IX.3 respectively.
- b) The CRF should be held outside the Public Account of the State in a manner to be prescribed by the Ministry of Finance as explained next. Before releasing the amount due in any year, Ministry of Finance shall ensure that the Central contributions released in earlier years have been credited to the CRF.
- c) The existing scheme for the "Constitution and Administration of the Calamity Relief Fund and Investment therefrom", issued by the Ministry of Finance, should be modified so as to provide flexibility in the choice of avenues for investment subject to ensuring security and liquidity. Holding the funds entirely in a nationalised bank should be considered by the Finance Ministry. The Ministry should circulate a modified scheme after consulting the States by 30th June, 1995.
- d) The balance in this fund will be available to the State at the end of the fifth year or thereafter for being used as a resource for the next plan.
- e) The State Level Committees constituted under the existing scheme shall decide on all matters connected with the financing of the relief expenditure subject to the general guidelines issued by the Union Agriculture Ministry in terms of para 9.15 (j).
- f) If it is found by the State Level Committee (constituted under the existing scheme) that in a particular year, the amount required is more than the sum available in the CRF, it may draw 25 per cent of the funds due to the State in the following year from the Centre, to be adjusted against the dues of the subsequent year. The Ministry of Finance may consult the Agriculture Ministry before making such advance releases. The Central Government may, at its discretion, allow a higher percentage of advance from the State's entitlement in the next year.
- g) Periodic information relating to expenditure from the CRF and relief operations may be collected by the Department of Agriculture from the State Level Committees of the CRF.
- h) The present arrangement for co-ordinating relief work at the Centre in the Ministry of Agriculture may continue so that the assistance from Defence Forces, Railways as also supply of seeds, etc., which may be required in time of natural calamities could be co-ordinated.

- i) A Committee of experts, and representatives of States, may be set up by the Ministry of Agriculture to draw up a list of items, the expenditure on which alone will be chargeable to the CRF. This should be done by 1st April, 1995.
- j) The norms for the amounts that can be given or spent under each of the approved items be prescribed by the State Level Committees. This should be done by 30th June, 1995. The norms so fixed should be communicated to the Union Ministry of Agriculture. They should check the norms and, if they are significantly out of line, modify them.
- k) The Accountants General should then be instructed to see that only expenditure on the items approved by the Ministry of Agriculture is booked to the Head 2245 - Natural Calamities. The Ministry of Agriculture may monitor whether the State is adhering to the norms prescribed by its own Committee.

9.16 Lastly, we consider how to deal with a calamity of rare severity. Between June, 1990 and May, 1993 the Central Government is reported to have received thirty memoranda from the States claiming additional Central assistance on the ground that they had experienced a calamity of rare severity. While it is no doubt true that the country has been spared the agonies of the type witnessed during the severe drought in 1986-87 and 1987-88, which affected Rajasthan and Gujarat, nevertheless, floods and drought of varying intensity and magnitude have continued to be experienced in various parts of the country almost every year. From time to time calamities of such a severity may occur in various regions that the States are not able to manage with their own CRF. At such times the Central Government must be in a position to come to the rescue of the State and organise relief on a national scale.

9.17 We have considered the issue carefully and are of the view that a calamity of rare severity would necessarily have to be adjudged on a case-to-case basis taking into account, inter alia, the intensity and magnitude of the calamity, level of relief assistance needed, the capacity of the State to tackle the problem, the alternatives and flexibility available within the plans to provide succour and relief, etc. Any definition bristles with insurmountable difficulties and is likely to be counter-productive.

9.18 Once a calamity is deemed to be of rare severity it really ought to be dealt with as a national calamity requiring assistance and support beyond what is envisaged in the CRF Scheme. It goes without saying that additional assistance from the Centre would be required. But the national dimensions of such a calamity can be brought out only if all States also come to the succour of the affected State. In actual fact this has been happening in the past when many States did extend support to the affected State both in terms of financial grants and by sending material help and teams of doctors, etc. We would like to place this urge for national solidarity in a moment of distress on a more formal basis in our scheme. We, therefore, propose that in addition to the CRFs for States, a National Fund for Calamity Relief should be created to which the Centre and the States will subscribe and which will be managed by a National Calamity Relief Committee on which both the Centre and the States would be represented. This fund

will be for dealing with calamities of rare severity and will be managed at the national level by a sub-committee of the National Development Council. This committee headed by the Union Agriculture Minister could comprise the Dy. Chairman, Planning Commission, and two Union Ministers and five Chief Ministers to be nominated by the Prime Minister annually by rotation. The Department of Agriculture should provide the secretariat for this fund. The nomination of the Chief Ministers should be done in March of each year for the next financial year.

9.19 The National Fund for Calamity Relief (NFCR), will be operated by the Ministry of Agriculture, Government of India but it will be maintained outside the Public Account of the Government of India as recommended by us for CRFs of States. The Ministry of Finance will prescribe guidelines for this as we have recommended it should do in the case of the CRF. The accounts of the NFCR shall be audited annually by the Comptroller and Auditor General. The admissible items of expenditure, norms etc. for this fund should be worked out by the Committee of Experts which we have recommended above for a similar purpose in the case of CRFs.

9.20 The size of the fund would be Rs.700 crores, to be built up over the period 1995-2000, with an initial corpus of Rs.200 crores to which the Centre would contribute Rs.150 crores and the States Rs.50 crores in the proportion of 75:25. In addition, for each of the five years from 1995-96 to 1999-2000 the contributions of the Centre and the States would be Rs.75 crores and Rs.25 crores respectively. The contribution by both the Centre and the States would be made annually in the beginning of the financial year. Contribution of States inter-se would be in the same proportion as their estimated total tax receipts after devolution. The share of each of the States, as indicated at Annexure IX.4, has been included in the reassessment of expenditure of the States.

9.21 We hope that with the setting up of the National Fund for Calamity Relief it would now be possible to tackle calamities of rare severity more effectively. What is more, we hope that the system recommended by us would also help create a sense of national solidarity in a common endeavour which would then abide beyond the period of distress.

GRANTS FOR LOCAL BODIES

10.1 The provisions of article 280 of the Constitution, under which Finance Commissions have been constituted, prescribe (a) mandatory terms of reference as laid down in clause (3) of article 280 and (b) such other matters as may be referred to the Commission by the President "in the interests of sound finance". Till the time this Commission was constituted i.e. by the Presidential Order dated 15th June, 1992, mandatory terms of reference under article 280(3) were as follows:

Article 280(3)

- (a) the distribution between the Union and the States, of the net proceeds of taxes which are to be, or may be, divided between them under this Chapter and the allocation between the States of the respective shares of such proceeds;
- (b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India."

10.2 Subsequent to the setting up of this Commission, article 280(3) has been amended to provide for yet another mandatory duty to be performed by the Finance Commission. By the 73rd and 74th amendments to the Constitution, two new sub-clauses (bb) and (c) have been introduced in clause 3 of article 280. These sub-clauses make it obligatory upon the Commission to recommend "the measures needed to augment the Consolidated Fund of a State to supplement the resources of the panchayats/municipalities in the State on the basis of the recommendations made by the Finance Commission of the State."

10.3 The Union Ministries of Rural and Urban Development, several State Governments, the National Commission for Women and the Rajiv Gandhi Foundation have taken note of the fact that the recommendations of the State Finance Commissions are not likely to be available during our term. Nevertheless, they have represented that the Commission should recommend measures needed to augment the resources of States to enable them to supplement the resources of newly created constitutional bodies i.e. panchayats and municipalities. Assuming that the reports of the State Finance Commissions will not be available earlier than mid-1995, the Union Ministry of Rural Development has argued "while the Tenth Finance Commission cannot therefore wait for the recommendations of State Finance Commissions, it cannot also leave the subject of supplementing the resources of the Panchayats untouched as it would mean ignoring a key area which represents the basic tier of administration throughout the country. In our opinion, the Tenth Finance Commission must necessarily look into the measures needed to supplement the resources of the Panchayats." In his evidence before the Commission, Secretary, Ministry of Rural Development had argued in much the same vein. A similar plea has been made by the Ministry of Urban Development. It has argued that "The third stratum of self-governance has been constitutionally created at a time when almost all the States are suffering from a severe financial crunch. That apart, the

resource base of the States is rather narrow. Self-governance connotes a sense of autonomy. There cannot be any measure of autonomy without some degree of independence in relation to access to resources. Hence, in order to implement the Constitution (74th Amendment) Act in letter and spirit, sufficient provisions have to be made from now on for access to resources by Municipalities."

10.4 Several States have submitted that even in the absence of recommendations of State Finance Commissions, it would still be necessary to provide for the augmentation of the consolidated fund of the State, in order to enable the latter to set up local bodies, hold elections thereto and supplement their resources. Assam has requested us to bridge the gap of Rs.88.45 crores for the urban local bodies in the State. Karnataka has laid claim to Rs.372.93 crores for panchayats. Orissa has asked for a provision of Rs.492 crores to be made available for municipalities and notified area councils of the State. Rajasthan has projected a requirement of Rs.1000 crores for the five year period. Himachal Pradesh has asked for Rs.158.55 crores for panchayats. Bihar, Goa, Madhya Pradesh, Maharashtra, Uttar Pradesh and West Bengal have also argued for strengthening their resource base to enable them to effectively discharge their constitutional obligation of making panchayats and municipal bodies financially viable.

10.5 The amendment of article 280(3) was not followed-up by an amendment of our terms of reference. The question before us now is whether we should and can recommend measures for augmenting State resources (for the purpose of supplementing the resources of panchayats and municipalities) by taking cognizance of the purpose, intent and spirit underlying the Constitution 73rd and 74th amendments.

10.6 Article 280 sub-clauses (bb) and (c) stipulate that the recommendation by the State Finance Commissions is to be the basis of our recommendation to the President regarding "the measures needed to augment the Consolidated Fund of a State" to supplement the resources of panchayats/municipalities. The State Finance Commissions are required to be constituted under article 243-I of the Constitution. In terms of article 243-I and article 243-Y, the State Finance Commission is required to review the financial position of the panchayats/municipalities and recommend to the Governor, inter-alia, the principles of distribution and shares of proceeds of shareable taxes, duties, tolls and fees as between the State and panchayats/municipalities. The Commission is also required to recommend to the Governor "the measures needed to improve the financial position" of the panchayats/municipalities.

10.7 Under article 280 (3), "The Finance Commission" has "the duty" to make a recommendation to the President regarding the "measures needed to augment the Consolidated Fund of a State", once the recommendations of State Finance Commissions become available to it. On the 'basis' of the recommendations made by the State Finance Commission, the Finance Commission would have to first ascertain the "need" for augmentation of the consolidated fund of a State and then

recommend 'measures', which may not necessarily involve any transfer of resources. It is obvious to us, however, that once the State Finance Commissions complete their task, it would be obligatory upon the Finance Commission to assess and build into the expenditure stream of the States the funding requirement for supplementing the resources of panchayats/municipalities. This would be necessary to determine the measures needed for augmentation of the State consolidated fund.

10.8 Since at present the recommendations of the State Finance Commissions are not available, there is no duty cast on this Commission to make a recommendation in terms of article 280(3) of the Constitution. At the same time the Commission is not precluded either, in terms of article 275 of the Constitution, from making a recommendation regarding grants-in-aid of the revenues of such States as may be determined to be in need of assistance. That being so, we have to consider whether or not we would be failing in our duty if we were to overlook the implications for State finances of local self-government consequent on the Constitutional amendments.

10.9 Our recommendations have a time span of five years i.e. 1995-2000. This entire period would witness the emergence and consolidation of the new place and role of panchayats/municipalities in the Constitution. Now the Constitution envisages supplementation of their resources by the State with the help of the Union. It would not be wrong to assume, therefore, that while a proper consideration of the measures as such to augment the resources of the States must await the recommendations of respective State Finance Commissions, ad hoc augmentation of the Consolidated Fund of States would be in keeping with the spirit of the amendments.

10.10 The panchayats/municipalities are late entrants in our federal democratic structure but their action or inaction is likely to affect the welfare of the people and area under their jurisdiction more directly than either the actions of the State or the Union. Therefore, within the constraints imposed on us by our terms of reference, we are inclined to consider assistance to the States for panchayats/municipalities.

10.11 The Ministry of Rural Development has stated that the finances of panchayats have unfortunately not been studied in detail for several years now and the published figures relate only to the year 1976-77. Based on these figures, two projections have been offered for the year 1992-93. One of the projections is based on the derived share of allocable taxes and grants to panchayats and the other on the proportion of States' own resources made available to panchayats. In 1976-77, taking all States together, per capita share of taxes and grants assigned to panchayats has been worked out as Rs.14.75. This has been projected for the year 1992-93 to reach a per capita figure of Rs.54.87. It has been then multiplied with the latest census figure of rural population of 62.87 crores to arrive at the needed amount of Rs.3445 crores, rounded to Rs.3500 crores.

10.12 The Ministry of Rural Development has, however, not recommended this alternative as in their view it would amount to freezing the grant at 1976-77 level. Instead, the second alternative, by working out the share of taxes and grants to panchayats as a proportion of States' own revenues, has been pursued. It is claimed that in 1976-77 taxes and grants assigned to panchayats for all States put together worked out to 12.02 per cent of the own resources of all the States. The Ministry is of the view that the percentage share of States' own resources being made available to panchayats by way of assigned taxes and grants would have to be improved upon. In 1976-77, 87 per cent of the all States' total assigned taxes and grants to panchayats

was contributed by only four States - Andhra Pradesh, Gujarat, Maharashtra and West Bengal. The rest of the States put together accounted for only 13 per cent. The Ministry's view is that "it will be necessary to provide them (panchayats) a minimum of 15 per cent of the total resources of the States specifically earmarked for the purpose." On this basis and taking into account the revised estimate for 1992-93 of resources of all States and Union Territories, the Ministry of Rural Development has suggested that it will be "appropriate to earmark a sum of Rs.7,500 crores specifically for being distributed to panchayati raj institutions out of the States (and Union Territories) own resources during the period covered by the Tenth Finance Commission."

10.13 The responsibility of sharing taxes with panchayats and assigning grants to them has not been transferred from the States to the Centre. The responsibility for providing panchayats with an independent source of revenue as also grants for specified purposes is very much that of the State Governments. The State Finance Commissions are there to ensure proper allocation of resources as between the State and panchayats. If in the process of supplementation of the resources of panchayats a need arises for the augmentation of the State Consolidated Fund, it has to be considered by the Finance Commission. The percentage of States' own resources made available to panchayats in 1976-77 may be an indicator of what the States should do to help panchayats but it cannot become a standard for augmentation by the Centre of a State's Consolidated Fund. Some of the States like Gujarat and Maharashtra have had, for many years, a three-tiered panchayati raj structure similar to the one now incorporated in the 73rd amendment of the Constitution. The figures of 1976-77 supplied by the Ministry of Rural Development indicate that in Gujarat the share of assigned taxes worked out to 29.60 per cent of States' own resources and grants accounted for 22.90 per cent of the total. Since in many other States similar institutions did not exist, they did not transfer a comparable level of resources from the States to the panchayats.

10.14 In terms of the 73rd amendment to the Constitution, many of the functions of the State would have to be transferred to panchayats. It can be assumed that the transfer of functions and responsibilities from the State to panchayats would be accompanied by the transfer of staff already working on these schemes/projects as also the financial allocations budgeted for and envisaged to be spent on the transferred activities. Such a transfer is, therefore, not likely to result in any extra burden on the State. The States are still in the process of setting up panchayats and as such it is not yet feasible to work out the additional financial burden a State might have to bear to enable the panchayats to discharge their duties effectively. Even so, it is possible to visualise that the local bodies, rearing to get on with their job once they are in position, would generate a need at least in the initial stages for augmentation of the consolidated fund of states. A few States have already reported that the number of panchayats may increase as a result of fresh delimitation exercises. Even taking into account the existing infrastructure and other facilities available to panchayats, there would still be an initial need for supplementation of resources in order to provide for not only the additional set up, including infrastructure facilities, but also the heightened expectations of people from these bodies.

10.15 While considering the 'measures' needed to augment the consolidated funds of states, in pursuance of article 73 of the Constitution, we have taken note of the fact that a large amount of money is already going to the rural areas through Jawahar Rojgar Yojana (JRY) and other district level schemes. In future these amounts are likely to be channelised through the panchayats.

Even if much of it is tied to specific programmes and activities, it would still leave some leeway for discretionary programmes to be taken up. The corpus of untied funds in the hands of panchayats would, however, require to be supplemented. We assume, though, that the need for measures to augment the State Consolidated Funds, on account of supplementation of the resources of panchayats, would not really arise until 1996-97, since in most cases the panchayats are yet to become functional.

10.16 In the above background we have approached our task as one of making an ad hoc provision of specific grants to States. This has been estimated with reference to the rural population according to the 1971 Census figures. The rural population of all States in India was 4,380.93 lakhs. Most of the funding requirements of panchayats are likely to be met by transfer along with functions from the States and their own resources. We are making an ad hoc provision of Rs.100 per capita of rural population. For all States the figures are indicated at Annexure X.1. This amount should be distributed amongst the panchayati raj institutions, over and above their due by way of their share of the assigned taxes, duties, tolls, fees, transferred activity related budgets and grants. Even in those States which are not required to have panchayats, as envisaged in the 73rd amendment of the Constitution, the additional amounts would be required to be given to supplement the resources of similar local level representative bodies.

10.17 As regards the need for additional funds for municipal bodies, in pursuance of the 74th amendment of the Constitution, the Ministry of Urban Development has stated that without waiting for the recommendations of the State Finance Commissions, a sum of Rs.500 crores, Rs.100 crores per annum, in the next five years may be provided to improve the basic civic services in various urban local bodies. In support of its representation, the Ministry has pointed out that between 1981-91 the urban population had increased from 159 million to 217 million. It registered a decadal growth of 36 per cent. By the year 2001 the urban population is expected to be more than 300 million. In 1991 the slum population in urban areas was of the order of 46.62 million. By the year 2001, it is estimated to be 63.76 million. The increase in urban population, particularly the growth of slum population, is overstraining the meagre resources of urban local governments who are now finding it difficult to provide even the

basic civic services like drainage facilities, garbage disposal, latrines, street lighting, etc. The Ministry of Urban Development has, therefore, represented that there is an urgent need to supplement the resources of municipal bodies to enable them to discharge atleast their primary functions in an effective manner. The danger arising from the break-down of urban civic services has been tragically illustrated by the outbreak of epidemics. These are reminders of the cost of neglect of civic services in urban agglomerations.

10.18 An estimate of financial needs for operation and maintenance of core municipal services in urban India made by the National Institute of Urban Affairs indicates that the estimated gap in 1995 worked out to Rs.5,987 crores. It is expected to go up to Rs.12,980 crores in the year 2000. While the accuracy of these estimates and the measures that the state and urban local bodies can adopt to bridge the gap are matters to be discussed and studied by the State Finance Commissions, we are of the view that a provision of Rs.1,000 crores for the five year period covered by our recommendation will go a long way in enabling the urban local bodies to meet their primary obligations. The inter-State distribution of this sum indicated at Annexure X.2 is based on the inter-State ratio of the slum population derived from the urban population figures as per 1971 Census.

10.19 While we have made these provisions for grants to panchayats / municipalities for the discharge of their enhanced responsibilities, this need not necessarily be a precedent for future Commissions. In any case after the reports of the State Finance Commissions become available the need for measures required for augmentation would have to be determined in terms of article 280(3) of the Constitution. For the present, grants recommended by us should be made known to the State Finance Commissions. Further, these amounts should be an additionality over and above the amounts flowing to the local bodies from State Governments. They should draw up suitable schemes with detailed guidelines for utilisation of the grant. The local bodies should be required to provide suitable matching contributions by raising resources. The grant is not intended for expenditure on salaries and wages.

10.20 The total provision should be made available to the States in four equal instalments commencing from 1996-97, as at Annexure X.3 as the rural and urban local bodies are not likely to be fully functional prior to that.

GRANTS-IN-AID

11.1 Under Article 280 (3)(b), the Constitution requires us to make recommendations as to the principles which should govern the grants-in-aid of the revenues of the States that are in need of assistance. In addition, the Presidential Order constituting the Commission asks us to determine, "the sums to be paid to the States by way of grants-in-aid of their revenues under article 275".

11.2 We have already explained the manner in which the estimates of the non-plan revenue receipts and non-plan revenue expenditures of the Centre and the States were reassessed by us. Thereafter, we have made our recommendations regarding the devolution of taxes to the States. Other components of resource transfer have also been considered, e.g. additional excise duties and the grants in lieu of tax on railway passenger fares. We now bring these threads together to determine the overall "need of assistance" for grants-in-aid of the revenues of each State.

11.3 A comparison at this juncture with the relevant clauses of the Presidential Order constituting the Ninth Commission would be in order. The terms of reference of that Commission contained a clear directive to "adopt a normative approach in assessing the receipts and expenditures on the revenue account of the States and the Centre and, in doing so, keep in view the special problems of each State, if any, and the special requirements of the Centre." In contrast, no explicit reference to a "normative approach" figures in our terms of reference, and our assessment has been limited specifically to the non-plan revenue expenditure of the States.

11.4 On the other hand, what is entirely new in our terms of reference is the mention of the objective of reducing fiscal deficit in Para 4(i). We are thus required to consider the fiscal balance on revenue as well as capital accounts.

11.5 Clearly, any improvement in the non-plan revenue account will go to reduce fiscal deficit only if it is not offset by a corresponding deterioration in the plan revenue account and capital account. We have not gone into the question of plan outlays or the non-plan capital account. We assume that to the extent our recommendations help improve the non-plan revenue account of the Centre and the States, they would contribute to a reduction in fiscal deficit.

11.6 The difference between assessed needs and assessed post-devolution resources on the non-plan revenue account is a resource gap. This gap is ideally estimated through a full-fledged normative exercise. In that case, the comparison would be between what a State 'ought' to be raising in terms of revenues by the application of a vector of normatively determined tax rates on the relevant tax bases after specific fiscal disabilities have been taken into account and what it 'ought' to be spending in terms of desired levels of governmental services. At the other extreme is the gap that would emerge from a comparison of what a State 'does' raise in terms of revenues with what it 'does' spend, i.e. from a comparison of the historical patterns of revenues and expenditures, projected into the future.

11.7 The absence of an explicit mention of a 'normative approach' in our terms of reference does not debar us from

adopting one. However, lack of availability of suitably disaggregated data on the tax bases of the States (especially relating to their quality and coverage) and the difficulties in evolving a suitable methodology under these limitations, place serious constraints on using a normative approach. We have not used a full-fledged normative methodology. However, our exercises do contain relevant normative and prescriptive considerations as indicated in Chapters III and IV.

11.8 Views of the States on the principles that ought to be followed in determining grants-in-aid are arrayed in a broad spectrum. Gujarat has suggested that no grants-in-aid should be given for covering post-devolution revenue gaps. Madhya Pradesh, on the other hand, has argued not only for covering this gap, but increasing its scope to include the entire 'fiscal gap'. Kerala has advocated an effective use of the grants-in-aid mechanism to rectify horizontal fiscal imbalances. Goa suggested that a built-in buoyancy should be provided for in the grants. Maharashtra has indicated that, in its view, the last three Commissions have progressively increased the ratio of grants to devolution, and that this trend needs to be arrested. Some States, e.g., Rajasthan and Manipur, have favoured linking grants to achieving a reduction in disparities in the availability of administrative and social services, not merely in terms of revenues, but in physical or real terms.

11.9 Grants-in-aid of revenues to cover post-devolution assessed deficits constitute only a component of our overall recommendations regarding grants-in-aid. The provision for devolution of 7.5 per cent of the net proceeds of Union excise duties according to assessed deficits makes for a built-in buoyancy in transfers to cover deficits.

11.10 Table 1 gives the year-wise pre-devolution surplus/deficit profile of the States, when their assessed expenditures on non-plan revenue account are posited against their own revenue receipts. In 1995-96, only Haryana and Maharashtra emerge with a pre-devolution surplus. The position of some of the other States improves in the succeeding years. By 1999-2000, six of the non-special category States have a pre-devolution surplus, viz. Gujarat, Haryana, Karnataka, Maharashtra, Punjab and Tamil Nadu.

11.11 Grants-in-aid that are meant for covering assessed deficits on non-plan revenue account of the States, are calculated after considering transfers to the States on account of (i) devolution of income tax and Union excise duties (ii) share in additional excise duties, and (iii) share in grants in lieu of tax on railway passenger fares. As indicated in Para 11.9 above, the devolution of taxes is inclusive of 7.5 per cent of the net proceeds of Union excise duties, which are devolved on the basis of deficits as they emerge after the distribution of 40 per cent of the net proceeds of Union excise duties alongwith the devolution of income tax according to the formula given in Chapter V, and the transfers on account of additional excise duties and grants in lieu of tax on railway passenger fares, according to the distributive criteria given in Chapters VI and VII, respectively.

Table: 1

Pre-Devolution Non-Plan Revenue Surplus/Deficit: 1995-2000

						(Rs. lakhs)
State	1995-96	1996-97	1997-98	1998-99	1999-00	Total 1995-00
1.	2.	3.	4.	5.	6.	7.
Andhra Pradesh	- 321410	- 318618	- 308220	- 295375	- 275477	- 1519100
Arunachal Pradesh	- 28141	- 30431	- 32823	- 35241	- 37567	- 164203
Assam	-136545	- 146239	- 155413	- 164177	- 171676	- 774050
Bihar	- 392855	- 415431	- 435901	- 457733	- 476647	- 2178567
Goa	- 11994	- 12216	- 12181	- 11990	- 11519	- 59900
Gujarat	- 16920	6643	38221	76025	122434	226403
Haryana	28225	44062	65490	89120	119721	346618
Himachal Pradesh	- 80363	- 85201	- 89686	- 93920	- 96924	- 446094
Jammu & Kashmir	- 122660	- 131264	- 140050	- 148835	- 156974	- 699783
Karnataka	- 1492	30279	73087	120662	181413	403949
Kerala	- 103000	- 94036	- 79112	- 60726	- 36578	- 373452
Madhya Pradesh	- 151922	- 145870	- 141796	- 137000	- 125004	- 701592
Maharashtra	88221	145166	216694	298984	391711	1140776
Manipur	- 34817	- 37422	- 40196	- 42994	- 45805	- 201234
Meghalaya	- 32471	- 34562	- 36600	- 38772	- 40341	- 182746
Mizoram	- 29378	- 31669	- 33901	- 36909	- 38383	- 170240
Nagaland	- 45216	- 49193	- 53385	- 58022	- 62283	- 268099
Orissa	- 156179	- 171271	- 183169	- 195235	- 209400	- 915254
Punjab	- 46152	- 43732	- 28618	- 20180	185	- 138497
Rajasthan	- 160648	- 157023	- 149205	- 143070	- 121009	- 730955
Sikkim	- 11603	- 12426	- 13194	- 13983	- 14781	- 65987
Tamil Nadu	- 150330	- 117248	- 72918	- 24137	34690	- 329943
Tripura	- 48103	- 51717	- 55861	- 59316	- 62588	- 277585
Uttar Pradesh	- 612203	- 633492	- 639943	- 642133	- 624764	- 3152535
West Bengal	- 211367	- 215035	- 203306	- 194457	- 176314	- 1000479
Total (Net)	- 2789323	- 2707946	- 2511986	- 2289414	- 1933880	- 12232549
Deficit	- 2905769	- 2934096	- 2905478	- 2874205	- 2784034	- 14403582
Surplus	116446	226150	393492	584791	850154	2171033

11.12 After taking into account the transfers pertaining to taxes and duties indicated in the previous paragraph, some States still emerge with residual deficits. We recommend grants-in-aid, to be given to the States under the substantive portion of Article 275(1), equal to the amount of these deficits as estimated for each of the years during 1995-96 to 1999-2000. These amounts have been specified in **Table 2**.

11.13 It may be observed that no State has a post-devolution deficit on the non-plan revenue account in the terminal year. The total amount of grant, on account of non-plan revenue deficit for the period 1995-2000, is Rs. 7,582.68 crores. It may be noted that the dependence of States on the deficit grants declines in successive years. This pattern applies to each of the States, indicating that their budgetary position on the non-plan revenue account keeps improving over the years thereby changing their balance on the non-plan revenue account from deficit to surplus as indicated in **Table 3**.

11.14 In addition to the deficit grants, we have also recommended grants for upgradation of standards of

administration, grants meant for local bodies consequent upon the Constitution Amendment Acts 73 and 74, and grants for special problems. Grants have also been recommended for meeting expenditure relating to calamity relief. These grants have been discussed in the relevant Chapters.

11.15 Total estimated transfers to the States for the period 1995-2000, on account of transfers relating to taxes and duties and all grants, are given in **Table 4**. For the five year period from 1995-2000, the estimated amount of devolution is Rs.1,84,457 crores. In addition, Rs.19,986 crores and Rs.1900 crores are the estimated amounts of transfers pertaining to the additional excise duties and grants in lieu of tax on railway passenger fares respectively. The total transfer on account of taxes and duties thus amounts to Rs.2,06,343 crores. The overall transfers recommended by us add to an estimated amount of Rs. 2,26,643.30 crores. The estimated position of the Central Government on the non-plan revenue account after the above mentioned transfers to States is given at Annexure XI.1.

Table: 2
Non-Plan Revenue Grants:1995-2000

State	1995-96	1996-97	1997-98	1998-99	1999-00	(Rs crores)
						Total 1995-2000
1.	2.	3.	4.	5.	6.	7.
Andhra Pradesh	483.47	202.98	0.00	0.00	0.00	686.45
Arunachal Pradesh	136.60	109.26	45.63	16.11	0.00	307.60
Assam	342.20	249.94	92.08	27.81	0.00	712.03
Bihar	257.72	75.34	0.00	0.00	0.00	333.06
Goa	38.98	26.88	9.03	2.37	0.00	77.26
Himachal Pradesh	353.11	273.00	109.25	36.82	0.00	772.18
Jammu and Kashmir	535.39	419.05	170.85	58.84	0.00	1184.13
Manipur	157.43	124.28	51.31	17.90	0.00	350.92
Meghalaya	143.83	111.89	45.19	15.51	0.00	316.42
Mizoram	147.25	117.60	48.79	17.55	0.00	331.19
Nagaland	233.04	188.46	79.63	28.65	0.00	529.78
Orissa	192.87	133.35	38.34	7.18	0.00	371.74
Rajasthan	33.45	0.00	0.00	0.00	0.00	33.45
Sikkim	48.05	37.45	15.06	5.13	0.00	105.69
Tripura	218.92	172.98	71.99	24.89	0.00	488.78
Uttar Pradesh	683.40	298.60	0.00	0.00	0.00	982.00
Total	4005.71	2541.06	777.15	258.76	0.00	7582.68

Table: 3
Non-Plan account of States after devolution of Taxes
and Duties and Deficit Grants

<i>(Rs crores)</i>						
State	1995-96	1996-97	1997-98	1998-99	1999-00	Total 1995-00
1.	2.	3.	4.	5.	6.	7.
Andhra Pradesh	0.00	0.00	21.57	571.87	1227.95	1821.39
Arunachal Pradesh	0.00	0.00	0.00	0.00	25.60	25.60
Assam	0.00	0.00	0.00	0.00	35.67	35.67
Bihar	0.00	0.00	188.50	589.66	1071.68	1849.84
Goa	0.00	0.00	0.00	0.00	2.32	2.32
Gujarat	1047.23	1454.32	1965.85	2557.82	3253.76	10278.98
Haryana	669.75	882.90	1159.69	1464.35	1844.45	6021.14
Himachal Pradesh	0.00	0.00	0.00	0.00	55.05	55.05
Jammu & Kashmir	0.00	0.00	0.00	0.00	91.00	91.00
Karnataka	1503.16	2037.76	2713.37	3459.62	4360.22	14074.13
Kerala	62.81	307.99	634.77	1012.62	1464.29	3482.48
Madhya Pradesh	793.36	1183.31	1600.07	2058.87	2623.97	8259.58
Maharashtra	2839.94	3681.81	4708.10	5871.00	7166.75	24267.60
Manipur	0.00	0.00	0.00	0.00	28.21	28.21
Meghalaya	0.00	0.00	0.00	0.00	23.54	23.54
Mizoram	0.00	0.00	0.00	0.00	27.16	27.16
Nagaland	0.00	0.00	0.00	0.00	46.17	46.17
Orissa	0.00	0.00	0.00	0.00	2.61	2.61
Punjab	18.63	110.22	338.27	506.75	801.57	1775.44
Rajasthan	0.00	199.20	529.31	865.90	1384.75	2979.16
Sikkim	0.00	0.00	0.00	0.00	7.89	7.89
Tamilnadu	408.33	1011.04	1764.70	2591.63	3547.41	9323.11
Tripura	0.00	0.00	0.00	0.00	38.74	38.74
Uttar Pradesh	0.00	0.00	49.36	904.81	2029.15	2983.32
West Bengal	23.27	290.05	753.73	1220.72	1812.29	4100.06
Total	7366.48	11158.60	16427.29	23675.62	32972.20	91600.19

Table 4

Total Transfer to States: 1995-2000

(Rs. crores)

State	Taxes and Duties					Grants-in-Aid					Total Transfer (col. 6+12)	
	Income Tax	Basic Excise Duties	Additional Duties of Excise	Tax on Railway Passenger Fares	Total (col. 2 to col. 5)	Non-Plan Revenue Deficit	Upgradation	Special Problems	Local Bodies	Relief Expenditure		Total (col. 7 to col. 11)
1	2	3	4	5	6	7	8	9	10	11	12	13
Andhra Pradesh	5313.06	9291.43	1562.90	158.55	16325.94	686.45	88.88	65.00	424.94	490.33	1755.60	18081.54
Arunachal Pradesh	106.70	1232.44	20.79	0.10	1360.03	307.60	18.31	50.00	4.63	27.79	408.33	1768.36
Assam	1747.38	4794.51	496.25	26.00	7064.14	712.03	146.86	60.00	147.56	197.46	1263.91	8328.05
Bihar	8072.21	13465.35	1587.69	177.20	23302.45	333.06	183.13	57.50	574.28	205.14	1353.11	24655.56
Goa	112.98	361.01	46.37	3.70	524.06	77.26	3.79	7.00	5.91	4.23	98.19	622.25
Gujarat	2539.47	4146.22	1198.16	131.10	8014.95	0.00	0.00	50.00	259.47	551.17	860.64	8875.59
Haryana	777.03	1268.66	472.87	36.40	2554.96	0.00	0.00	40.00	99.22	98.93	238.15	2793.11
Himachal Pradesh	441.87	3180.97	118.92	2.05	3743.81	772.18	30.03	75.00	34.23	106.41	1017.85	4761.66
Jammu & Kashmir	688.53	5031.24	171.08	13.85	5904.70	1184.13	58.77	47.00	49.68	77.80	1417.38	7322.08
Karnataka	3351.02	5471.25	1147.99	64.38	10034.64	0.00	0.00	29.00	291.96	165.23	486.19	10520.83
Kerala	2432.14	3970.98	747.48	66.40	7217.00	0.00	29.83	52.00	204.24	218.74	504.81	7721.81
Madhya Pradesh	5203.22	8495.34	1446.19	130.75	15275.50	0.00	146.37	60.00	410.43	201.67	818.47	16093.97
Maharashtra	3844.98	6277.74	2403.72	333.40	12859.84	0.00	0.00	100.00	479.96	269.28	849.24	13709.08
Manipur	177.00	1472.91	39.37	0.35	1689.63	350.92	24.74	50.00	11.54	9.79	446.99	2136.62
Meghalaya	177.62	1318.74	37.57	0.65	1534.58	316.42	11.72	5.00	10.12	11.01	354.27	1888.85
Mizoram	93.52	1289.04	15.79	0.02	1398.37	331.19	7.13	57.00	3.32	5.00	403.64	1802.01
Nagaland	113.61	2053.64	27.38	2.75	2197.38	529.78	23.96	30.00	5.21	6.71	595.66	2793.04
Orissa	2821.29	5260.99	668.53	32.60	8783.41	371.74	86.79	51.00	220.10	193.51	923.14	9706.55
Punjab	917.00	1497.19	683.92	62.30	3160.41	0.00	81.31	**	133.95	213.80	429.06	3589.47
Rajasthan	3484.09	5712.80	973.92	84.45	10255.26	33.45	79.87	70.00	255.40	706.89	1145.61	11400.87
Sikkim	79.08	472.20	10.59	0.20	562.07	105.69	4.56	5.50	2.48	18.59	136.82	698.89
Tamil Nadu	4165.71	6801.40	1532.73	122.70	12622.54	0.00	40.84	60.00	402.86	234.33	738.03	13360.57
Tripura	237.25	2030.65	57.16	0.75	2325.81	488.78	13.90	12.00	14.97	17.75	547.40	2873.21
Uttar Pradesh	11179.07	19139.24	2912.56	295.80	33526.67	982.00	167.54	108.00	880.70	494.00	2632.24	36158.91
West Bengal	4689.17	7656.06	1606.07	153.55	14104.85	0.00	114.17	105.00	453.77	202.63	875.57	14980.42
Total	62765.00	121692.00	19986.00	1900.00	206343.00	7582.68	1352.50	1246.00	5380.93	4728.19	20300.30	226643.30

** Has been dealt with in Chapter XII para 12.40

DEBT POSITION OF STATES

Introduction

12.1 We are required, under Paragraph 8 of the Presidential Order, to make 'an assessment of the debt position of States as on 31st March, 1994, and suggest such corrective measures as are deemed necessary keeping in view also the financial requirements of the Centre'. However Para 4(iii) of our terms of reference requires us to have regard to the maintenance and upkeep of capital assets as on 31st March, 1995. Many States have also suggested that the relevant date for the assessment of their debt position should be the same. In line with our approach we shall endeavour to make an assessment of the debt position of the States as on 31st March, 1994 as well as 1995.

12.2 Our terms of reference regarding the debt position of States would bear comparison with those of earlier Commissions in several respects. Like the Ninth Commission we have been asked to review the debt position of the States with respect to their entire debt and not merely for Central loans to States. Further, the Sixth, Seventh and Eighth Commissions were asked to consider the non-plan capital gap while considering the debt position of States, and to suggest measures to deal with those gaps. The Ninth Commission, like us, were not so asked although they did keep an assessment of the non-plan capital gap of the States in the background of their considerations (Para 9.11 of the Second Report). In the context of "corrective measures", our terms of reference differ from those of the Ninth. Whereas a specific reference was made to them to consider investments made in infrastructure projects and to provide a 'linkage with improvements in financial and managerial efficiency' in suggesting corrective measures, there is no such reference to us.

12.3 In para 4(i) of our terms of reference, a reference has been made to 'reducing fiscal deficit'. Fuelled by rising fiscal deficits, the indebtedness of the Central and State Governments has continued to rise. While considering the indebtedness of States, the appropriate perspective is, in fact, the indebtedness of the entire fiscal system. As such, in designing a suitable policy for alleviating the debt burden of the States, the debt position of the States as well as that of the Centre has to be kept in mind.

12.4 The Ninth Commission (Paras 9.12 and 9.29) noted with concern the state of indebtedness of the States which appeared to be sliding into a vicious cycle. Loans are advanced to States with specific maturity periods and rates of interest. Finance Commissions subsequently recommend corrective measures, often across the board, consisting of write-offs, extensions of maturity periods, and lowering of interest rates, thus converting loans effectively into grants, partially or fully. Periodically repeated debt relief exercises may induce States to overstate their demand for borrowed funds. Corrective measures should, therefore, be formulated in a manner as would provide an in-built incentive for prudent use of borrowed funds.

Debt Position of States

12.5 Total debt of State Governments is estimated to rise from Rs 1,83,886 crores as on 31st March, 1994 to Rs. 2,09,159

crores as on 31st March, 1995. The stock of debt and its composition at the end of these two years is placed at Annexures XII.1 and XII.2. Loans from the Central Government account for 54.31 and 53.74 per cent of the outstanding debt, for 1994 and 1995 respectively. The shares of market loans and bonds, and those of provident funds, etc. come to 13.4 and 15.7 per cent for 1994 and to 17 and 15.8 per cent in 1995.

12.6 In assessing the overall debt position of States, previous Finance Commissions have followed the practice of excluding the short-term components of debt. In keeping with this practice, for purposes of comparison, the profile of estimated debt of State Governments, excluding ways and means advances from the Reserve Bank of India and reserve funds, is drawn in Table 1.

12.7 Loans for State plans and small savings account for 97.6 per cent of the total central loans to States during 1989-1994 as at Table 2. The Statewise position of outstandings with respect to loans in the above period and the repayments during 1995-2000 is at Annexures XII.3 and XII.4.

Table 1
Outstanding Long Term Debt of State Governments

	1989		1994		1995 Estimates	
	Amount	%	Amount	%	Amount	%
1. Internal Debt						
a) Market Loans	10839	13.43	24629	15.69	35585	19.66
b) Loans from Banks	1759	2.18	3774	2.40	(*)	(*)
2. Loans from Centre	55648	68.93	99867	63.58	112395	62.09
3. Provident Funds etc.	12487	15.46	28791	18.33	33029	18.25
Total	80733	100.00	157061	100.00	181009	100.00

Table 2
Outstanding Central Loans Advanced to States during 1989-94 and Repayments in 1995-96 to 1999-2000

Items	(Rs. crores)	
	Outstandings as on 31.3.1994	Repayments due during 1995-2000
1. Plan Loans		
(i) State Plan	28786.89	6481.00
(ii) Drought Loans	14.35	6.28
(iii) Others	141.49	61.71
(iv) Central Sector	162.97	43.97
(v) Centrally Sponsored schemes	659.59	256.63
Total Plan Loans	29765.29	6849.59
2. Small Savings Loan	26462.56	4392.20
3. Modernisation of Police	29.93	6.75
4. Housing for All India Services	23.84	13.99
5. Others	305.28	55.80
Total (2 to 5)	26821.61	4468.74
Grand Total	56586.90	11318.33

* Details not available

12.8 The share of Central loans in the total debt of State Governments has been steadily declining as may be seen at Annexure XII.5. In 1979 the share of Central loans was 71.7 per cent of the total long-term debt of the States. By 1995, this share is estimated to decline to about 62 per cent, which is reflected in the increasing share of internal debt and that of provident funds, the relative increase of the latter category being somewhat higher. On the whole, therefore, for their long-term debt State Governments have been gradually shifting towards higher-cost sources.

12.9 The high income States (Punjab, Maharashtra, Gujarat, Haryana and Goa) currently account for slightly more than a quarter of the outstanding debt for all States as shown at Annexure XII.6. Their share has been increasing steadily over time. The share of low income States has held steady at just above 38 per cent. As such, the increase in the share of debt of the high income States is reflected basically in decreases in the shares of middle income States and special category States. Looking at the movements of the shares of individual States in each category, four out of five in the high income group, Haryana being the exception, have increased while among the low income States, the share of four has declined, Uttar Pradesh being the exception.

12.10 Financing plan outlays continues to constitute the core of the borrowing requirements of States, although in recent years many States have been forced to borrow even to meet part of their revenue expenditure. To the extent borrowed funds are not utilised for productive investments, a future stream of income cannot ensue from them, enabling the States to meet servicing liabilities arising from the debt. States have resorted to loans in order to finance investments in social and economic infrastructure, where the returns are not necessarily direct or immediate and are characterised by considerable externalities. The disturbing features of the debt profile of States and its management appear to be the following :

- i) diversion of borrowed funds for meeting revenue expenditure;
- ii) use of loans in unproductive enterprises, or enterprises which are potentially productive but are beset by poor performance, and currently yielding low or even negative returns;
- iii) non-provision for depreciation or amortisation funds in respect of government owned assets, leading to repayments out of fresh borrowing.

12.11 With growing repayment obligations, the ratio of fresh loans taken on a gross basis, and funds that actually become available net of repayments, is bound to move adversely with smaller and smaller amounts being available as net borrowed funds. Central loans, whether for plan assistance or otherwise, are determined on a gross basis, leading to a gradual decline in the net amounts on account of the heavy repayment burden, because other sources for these repayments are not generally available. On the other hand, gross market borrowing by a State has been so managed by the Reserve Bank of India as to ensure availability of predetermined amounts for the States net of repayments.

12.12 With the outstanding internal and external debt and other liabilities of the Government of India estimated at Rs.5,32,753.22 crores at the end of 1994-95, which by itself represents a 12.96 per cent increase over the revised estimates for the previous year, the debt/gdp ratio for the Centre and the States works out to nearly 69 per cent.

Views of States on Debt Relief

12.13 With respect to the existing liabilities, States have generally been asking for write-off of their debt, extension of maturity periods and reduction in interest rates. In relation to fresh borrowing, they have advocated a larger ratio of grants in the Central plan assistance, changing the grant to loan ratio from 30:70 to 50:50 for non-special category States and from 90:10 to 100:0 for the special category States.

12.14 States have also reiterated their long-standing demand that loans based on small savings be converted into loans in perpetuity and that 90 to 100 per cent of the net collections of small savings be given to the States as loans. It is also suggested that States be allowed to raise small savings and retain them. Treating loans from Central financial institutions as loans in perpetuity, has also been asked for.

12.15 Among the other suggestions of the States, the following may be highlighted:

- that the grant component for externally aided projects be 70 per cent ;
- that Central loans used directly for non-productive purposes (e.g. public works, roads, bridges, education) be written off;
- that loans used for semi-productive purposes like housing, multi-purpose river schemes, power projects, be made repayable in 30 years;
- that loans for natural calamity and socially desirable but financially unremunerative schemes be written-off;
- that differential rates of interest be charged according to the purpose of the loan and the economic backwardness of a State;
- that previous loans be consolidated as on 31st March, 95 and then 50 per cent of these be written-off, and a fresh interest rate of 8 per cent be charged on the remaining balance after determining a new maturity period allowing for an initial grace period; and
- that relief be especially provided for the backward States.

12.16 The issue that there exists now a reverse flow of funds from the States to the Centre, and that this should be stopped has also been raised. In this context, it has been urged that the non-plan capital gap be considered while making an assessment of the debt position, and that a ceiling be fixed so that repayment of principal and interest does not exceed 20 per cent of own revenues.

12.17 States which have been formed more recently, i.e. Goa, Mizoram, and Arunachal Pradesh, have urged that their pre-Statehood loans be written off entirely. Many of the special category States want all of their outstanding loans written off. States have asked for greater latitude in raising loans. In particular, it is suggested that like the Centre, States should be allowed to issue tax-free bonds.

Views of the Central Government

12.18 Considering the fiscal system as a whole any debt relief measures for the States would automatically affect the Centre. In its memorandum, the Central Government has stated that re-scheduling of debt and write-offs of interest recommended by the earlier Commissions have at least partly been responsible for the rise in Central debt and consequently the burden of increased interest payments. In our meeting with the Ministry of

Finance, it was pointed out that the burden of interest payments must be appreciated with reference to i) the difference in the rates at which the Centre borrows and lends, ii) administrative expenses and iii) implicit costs of tax incentives.

12.19 The memorandum notes that the resources of States have grown on both the revenue and capital account. Revenues accruing to the States have gone up from 8.2 per cent of GDP to 12.7 per cent over the period 1974-75 to 1991-92. A large part of the increase in the combined Central and State revenues over this period has accrued to the States. Their gross capital receipts as well as fiscal deficit have grown fairly fast. It calls for a plan to bring down the ratio of debt of State Governments to GDP which includes reduction of fiscal deficit, retirement of debt out of the proceeds of loan recoveries, and sale of equity holdings of States in public enterprises.

12.20 The Central Government has urged us not to reschedule the debts of State Governments as it is no longer in a position to bear any additional burden and rescheduling would inevitably lead to a reduction in future lending by the Centre.

12.21 There is merit in the argument that with both tiers of government under considerable fiscal strain, the transfer of burden from one channel of the fiscal flows would sooner or later be adjusted through another. It is futile merely to shift the debt from one to the other since it will make no dent on the aggregate fiscal deficit of the system. Any relief given to the States should thus be so formulated as to make an impression on the basic fiscal malaise of revenue expenditures persistently exceeding revenue receipts.

Corrective Measures

12.22 The constraints on the fiscal system put limits on the extent of debt relief that can be organised in the medium-term perspective. In the long run there is no escape from the rule that the rate of return on borrowed funds must be greater than the rate of interest at which they are held. The appropriation of a part of borrowing for consumption makes the need for earning an adequate return on investments in productive enterprises that much greater.

12.23 At the same time, States which are under severe fiscal pressure, need to be helped. Similarly, several specific problems relating to debt management and relief need to be addressed. In general, we have considered relief measures keeping in view the following objectives viz.

- i) that the quantum of relief is limited ;
- ii) that priority is given to States under severe fiscal strain ; and,
- iii) that incentives are given for better fiscal management.

12.24 We now consider the following :

Plan Loans;

Small Savings Loans; and

Amortisation Funds.

12.25 Loans advanced by the Centre by way of assistance to finance State plans constitute the bulk of Central loans to States. The burden of debt servicing of States on this account has gone up with the progressive increase in plan outlays and the rise in interest rates as indicated in Annexure XII.7

12.26 States have reiterated their demand that loans against small savings be treated as loans in perpetuity. The present arrangements entitle States to a 75 per cent share of the net

collections under various small savings schemes, to be given to them by the Central Government as a loan for use for development purposes. A State may also get an additional 2.5 per cent share provided the net collections in the State as a percentage of gross collections exceed the corresponding percentage for the country by more than 5 per cent. States are also entitled to a 50 per cent share of the net collections under the deposit scheme for retiring employees of Government and Public Sector Undertakings. The repayment period for small savings loans advanced to the States is 25 years inclusive of an initial moratorium period of five years towards repayment of the principal. The current rate of interest on the small savings loans is 14.5 per cent. We note that the rate of interest on small savings loans to the States has been increasing steadily over time, as indicated in Annexure XII.8

12.27 States argue that since their entitlement to a loan against small savings is worked out on the basis of net collections under the small savings scheme, the Union government should not insist on repayments. The loan should be treated as a loan in perpetuity, as the Central Government is able to make the repayments from the gross collections. It is argued that the small savings actually belong to States and the role of the Centre is only to ensure economies of scale through Central management.

12.28 On the other hand, the Central Government has argued that :

- i) while State Governments make the repayment in 25 years, the Central Government repays to the investor in 5 to 6 years;
- ii) while the Central Government services the repayments out of gross fresh borrowings, it does so at increasing costs; and
- iii) the effective interest costs to the Centre are much higher when administrative costs and tax losses due to incentives for small savings provided in the tax statutes are also taken into account.

12.29 According to the Sixth Commission, these loans have been given to the States largely as inducement to join the Centre in a cooperative effort to mobilise small savings, and that treating them as loans in perpetuity would confer disproportionately larger benefits on some of the advanced States and defeat the crucial objective of any properly designed scheme of debt relief.

12.30 The Seventh Commission had recommended that the small savings loans outstanding against each State at the end of 1978-79 may be consolidated into one loan and treated as a loan in perpetuity. This recommendation was not accepted by the Government of India although it did concede that the States would not be required to make any repayment during 1979-84 on account of small savings loans outstanding at the end of 1978-79. Apart from waiving repayments for 1984-85, the Eighth Commission did not recommend any further relief or change in the arrangements with respect to the small savings loans. The Ninth Commission also did not recommend any change in the terms and conditions relating to these loans.

12.31 We have examined this question afresh. We find that net amounts available under small savings schemes have been falling in recent years. From a peak of 50 per cent, net collections as a percentage of gross collections have fallen to about 25 per cent. The amounts retained by the Centre net of interest payments and administrative charges indicate that this source contributes only marginally to its funds.

12.32 Small savings schemes have to be run jointly by the Centre and the States in order that the benefits of economies of scale are reaped, that all States are able to participate and that investors feel protected. It follows that the liability of repayment ought to be shared. Further, if the small savings loans were to be treated as loans in perpetuity, it may mean a rising burden of interest on States in perpetuity. For all these reasons, we do not favour these loans being treated as loans in perpetuity.

12.33 The burden of repayments can be much better borne if amortisation funds at the State level are set up in respect of investments in the government sector. Otherwise the present situation of borrowing to meet repayment obligations would continue since recoveries of loans and advances and net miscellaneous capital receipts of the State Governments can contribute only marginally towards repayments.

12.34 The Ninth Commission had recommended an arrangement for amortisation in respect of market borrowings, and the Reserve Bank of India was asked to work out the modalities. While no final decision has been taken on the recommendation, in its Annual Report for 1992-93 (page 115), the Reserve Bank of India observed that : "Consideration could be given to setting up a States' Funding Corporation which would raise funds at market related rates of interest and pass on the funds at fixed rates to the states..." and further, "...with the shortening of the maturity structure of Governmental borrowing, the repayment schedules can give discomfort and, therefore, the restoration of the erstwhile system of a consolidated sinking fund for redeeming the debt has been long overdue...". Although, the context in which the Reserve Bank of India has considered this issue is that of market loans to the States, a similar situation would appear to have arisen about Central loans . Establishment of sinking funds now appears to be desirable as a part of overall fiscal discipline. Such funds would, however, not be able to serve their purpose unless the amounts appropriated to them are held separately by the Reserve Bank of India, and are not available as a Ways and Means resource to the State. We recommend that the modalities should be worked out by the Reserve Bank of India expeditiously.

Quantum and Forms of Debt Relief

12.35 Debt-related relief to States may be provided in many forms, e.g., write-off of the loan or of repayments falling due during a specified period, rescheduling of the loans with a view to shifting the timing of repayments, consolidation of past loans on common terms and reduction of interest rate. The Eighth Commission had recommended a debt relief of Rs.2,285 crores for the period 1984-89 . The Ninth Commission recommended a relief of Rs.494 crores for the period 1990-95. The Commission argued that since they were not dealing with the non-plan capital gap, their focus was narrower than that of the Eighth Commission. Also, their overall approach was to discourage the periodic write-off of debt. For all debt relief measures taken together, the quantum of relief recommended by the Ninth Commission was Rs.975.62 crores. In view of the fact that many of the relief measures recommended by the previous Finance Commissions continue to be operative, any further relief should be viewed as only incremental in nature, and the amounts involved would necessarily be limited.

Relief and Corrective Measures

12.36 Our scheme for debt relief, has two parts :

- i) a scheme for general debt relief for all States linked to fiscal performance ; and
- ii) specific relief for States with high fiscal stress, special category States and States with debt problems warranting special attention.

12.37 This is in addition to a scheme for encouraging retirement of debt from the proceeds of disinvestment of equity holdings of State Governments (Chapter III para 3.20). Relief, in this scheme, is linked to the use of funds for the reduction of outstanding debt. We believe that this would make a tangible impression on the debt burden of the States.

12.38 As an incentive to better fiscal management, we have designed a scheme which links debt relief to the fiscal performance of a State. We measure improvement of fiscal performance by comparing the ratio of revenue receipts (including devolution and grants from the Centre) to total revenue expenditures in a given year (r) with the average of corresponding ratios (r*) in the three immediately preceding years. Thus each State would be considered against its performance in the past. We suggest that generalised debt relief may take the form of a certain percentage of repayment falling due in each year of the period of our recommendations being written off. Only those repayments as pertain to fresh central loans to the States during 1989-95 and as outstanding on 31st March, 1995 would be covered. This percentage (R) should be twice the excess of (r) over (r*) as defined above. The details of this scheme are given in Appendix 6.

12.39 We now come to specific relief for all special category States, and three other States, viz. Orissa, Bihar and Uttar Pradesh, which are characterised by high fiscal stress as indicated by an average ratio of interest payments to revenue expenditure exceeding 17 per cent during 1989-90 to 1993-94. For these States we recommend writing-off of 5 per cent of repayment due with respect to fresh central loans given during 1989-95 and outstanding on 31st March, 1995.

Special Loans to Punjab

12.40 An amount of Rs. 1471.90 crores is due for repayment during 1995-2000 by the Punjab Government on account of special term loans which were advanced to it to fight militancy and insurgency. These repayment liabilities refer to an outstanding amount of Rs.5522 crores as on 31st March,1994 as indicated to us by the State Government. In view of the special circumstances when these loans were advanced, and the need for the State to re-invigorate its development efforts, it is recommended that one third of the repayment of principal falling due during 1995-2000 on these special term loans be waived. The estimated amount of relief would be Rs. 490.63 crores.

Loan Liabilities of Union Territories Graduating to Statehood

12.41 The Union Territories of Arunachal Pradesh, Mizoram and Goa graduated to the status of Statehood in 1987. As Union Territories they received loans to cover their capital gap and grants for their revenue gap. Arunachal Pradesh and Mizoram are special category States receiving plan assistance by way of grants and loans in the ratio 90 : 10. In their case, the Ninth Commission had recommended that the excess of the central loans received by each of these three States for its plans, upto 1986-87 as Union Territories (and outstanding as on 31st March,1990) over what it would have received had it been a full-fledged State be written off. Outstanding loans remaining after this write-off, as on 31st March 1990, of each State were then to be consolidated into one loan. These States have requested for further specific relief on loans given to them as Union Territories. We recommend that the scheme of special relief in Para 12.39 should cover the consolidated loans as well.

12.42 Arunachal Pradesh has requested that loan for payment in respect of helicopters purchased under special

arrangement be written off. The Rangarajan Committee set up by the Planning Commission in 1991 to suggest durable solutions for the financial problems of special category States has recommended this earlier. We also recommend that this be done.

12.43 The Government of Goa has stated that the loan liability of the erstwhile Union Territory of Goa, Daman and Diu has been placed entirely on Goa when it became a State. The State Government pleaded that the loan liability of Daman and Diu should be separated from the accounts of the State. We recommend that this matter may be examined and settled by the Government of India as quickly as possible.

12.44 Our estimates of debt relief relate to fresh central loans during 1989-94 and as outstanding on 31st March, 1994. However, central loans given to the States given in 1994-95 should also be covered by the schemes of debt relief recommended by us. We suggest that before granting debt relief, the Ministry of Finance may ascertain the exact amount due for repayments in the period 1995-2000 with respect to fresh central loans given during 1989-95 and outstanding as on 31st March, 1995.

12.45 We have estimated the quantum of relief on account of special debt relief schemes suggested by us as in Table 3. The

quantum of relief with respect to the incentive scheme suggested by us cannot be estimated at this juncture, as it depends on the future performance of the States. Should the States improve their performance by, say, 2.5 percentage points, the relief would come to Rs.565.51 crores, as explained in Appendix 6. Further relief could accrue to the States from the scheme relating to disinvestment of equity as stated earlier in Para 12.37. However, this would depend on the action taken by States and is not amenable to precise estimation by us.

Table 3

Summary of Special Debt Relief to States

	<i>(Rs. crores)</i>
	Relief for 1995-2000
1. High Fiscal Stress States	
(i) Bihar	44.54
(ii) Orissa	17.50
(iii) Uttar Pradesh	104.33
(iv) Special Category States	44.14
2. Punjab	490.63
Total	701.14

DEVOLUTION : AN ALTERNATIVE SCHEME

13.1 We have indicated earlier in our approach that we favour a system of vertical resource sharing in which central taxes are pooled and a proportion devolved to the States. In the context of the current economic reforms, this new arrangement is likely to have distinct advantages over the present system. We now set out our alternative scheme of devolution.

13.2 The main benefits resulting from this new arrangement may be listed as below:

- a) With a given share being allotted to the States in the aggregate revenues from central taxes, States will be able to share the aggregate buoyancy of central taxes.
- b) The Central Government can pursue tax reforms without the need to consider whether a tax is shareable with the States or not.
- c) The impact of fluctuations in central tax revenues would be felt alike by the Central and State Governments.
- d) Should the taxes mentioned in articles 268 and/or 269 form part of this arrangement, there will be a greater likelihood of their being tapped.

13.3 In the framework of cooperative federalism, the Constitution currently provides for sharing of two taxes, income tax and Union excise duties, with the States. India's economic space is occupied in common by the Centre and States. Recent economic reforms including tax reforms, have underlined this fact. The progress of reforms will be greatly facilitated if the ambit of tax sharing arrangement is enlarged so as to give greater certainty of resource flows to, and increased flexibility in tax reform for, the two layers of government. The Indian tax system, heavily dependent on indirect taxes, with Union excises and State sales taxes comprising the core of the domestic trade taxes, suffers from many deficiencies like high and multiple tax rates, taxation of inputs and cascading, exclusion of services from the tax base, multiplicity of exemptions and concessions through notifications and lack of harmony in the tax systems of States. The country needs a climate in which there is greater harmonisation of State taxes in terms of their rates, structure and procedures as also greater Centre-State harmonisation in domestic trade taxes.

13.4 The relevant ratios determining the vertical allocation in tax devolution have remained at 85 per cent in the case of income tax and at 45 per cent for Union excise duties for the past ten years. As the share of the Central Government in income tax is only 15 per cent it has often been claimed that the Centre has shown lack of interest in tapping this source of revenue fully. A similar lack of interest is adduced as a reason for the tax sources under articles 268 and 269 remaining unexploited or underexploited. Similarly, it is believed that the large share of Union excise duties accruing to the States has reduced the flexibility of the Centre in the choice of tax measures. The Ministry of Finance itself has said in its memorandum: "If the Central Government raises more through personal income tax... as much as 85 per cent of the increase will go to the States. Similarly, in the

case of the Union excise duty, 45 per cent of any increase in the yield will accrue to the States. Hence, if the Central Government wishes to raise Rs. 100 crores for itself, through Union excise duties, it would have to raise around Rs. 182 crores. To get the same Rs. 100 crores through a rise in the personal tax yield, the Central Government would have to raise Rs. 667 crores!"

13.5 Of the major Central taxes, the two taxes presently shareable seem to be less buoyant than the other two as is evident from **Table 1**. An advantage of pooling these Central taxes would be that both the Centre and the States would share in the buoyancy of aggregate revenues. This would be of particular advantage in a period of tax reform, when relative buoyancies undergo changes.

Table 1

Revenues from Major Central Taxes: Growth Rates

	Average Annual Growth Rates		
	70/71-79/80	80/81-89/90	70/71-89/90
Corporation Tax	14.42	17.15	15.79
Income Tax other than Corporation tax	12.76	14.83	13.80
Customs Duties	20.96	20.03	20.49
Excise Duties	14.10	14.31	14.20

Source: *Interim Report of the Tax Reforms Committee, Ministry of Finance, Government of India, page 24*

13.6 In their memoranda to us, States have generally urged us to move towards a larger pool of revenues from which they can be assigned a share. Many States have urged that corporation tax and income tax should be pooled together and then distributed. Orissa has suggested the inclusion of receipts from penalties, interest recoveries and surcharges on income tax in this pool. Rajasthan has suggested that capital receipts accruing from pre-emptive purchases and sale of immovable properties should form part of the income tax proceeds. Tamil Nadu has suggested that proceeds from the pre-emptive purchase of properties, penalties and interest recoveries, tax on Union emoluments, cost of collection and miscellaneous receipts should be included in the pool. Karnataka and Uttar Pradesh have suggested that all Central taxes should be made shareable.

13.7 The Ministry of Finance, Government of India, at one stage, made the suggestion that in the longer term context, we may wish to examine the desirability of changing the pattern of tax sharing such that the entire tax revenues of the Centre (except Union surcharges) become shareable. It also said, however, that the percentage may be pitched at 22-23 per cent and that it should remain fixed for 20 years.

13.8 Notwithstanding the present Constitutional position, Finance Commissions in the past have noted, with concern, that a share was not being assigned to the States in the proceeds of the corporation tax. The Third and Fourth Commissions took this factor into account for raising the States' share in income tax from

60 to 66 2/3, and to 75 per cent, respectively. The Third Commission had also raised the number of items of excise to be shared to compensate for the loss. The Sixth Commission had suggested a review of this issue by the National Development Council and the Seventh Commission had also suggested that the Centre may hold consultations with the States in order to settle the point finally. The Eighth Commission had expressed the view that since the corporation tax had shown a high elasticity, it would seem only fair that the States should have access to such a source of revenue.

13.9 The Sarkaria Commission had also examined this issue at length. It favoured bringing the corporation tax into the divisible pool as part of permissive participation like that of the Union excise duties. It suggested that this may be accomplished by a suitable Constitutional amendment.

13.10 The Chelliah Committee on Tax Reforms (1991) has expressed the view that the present Constitutional provisions regarding tax sharing need to be re-examined. In this context, the Committee observed in its Interim Report (p. 45) as follows: "The task of fiscal adjustment at the Centre has been rendered more difficult because of the compulsions arising from the formula of tax sharing with the States. ... The percentages of the taxes to be shared with the States are not specified in the Constitution, but are left to be decided by the President after he considers the recommendations of the Finance Commission in this regard. At present tax devolution to the States constitutes around 24 per cent of gross Central Government tax revenues. With the consent and cooperation of the States the relevant constitutional provisions could be amended to the effect that 25 per cent of the aggregate tax revenues of the Centre shall be shared with the States. There would be certainty then for the States and the Union regarding what revenues would accrue to their respective budgets and the Centre would not have to distort its pattern of taxation by being virtually compelled to raise non-shareable taxes."

13.11 The Constitution provides for the division of functions and sources of revenue between the Central and State Governments vide three lists contained in the Seventh Schedule, viz. Union List, State List and Concurrent List. Article 270 makes it mandatory to share income tax with the States. Article 272 provides for a discretionary sharing of Union excise duties. The sharing of corporation tax has, however, been excluded by a specific provision in Article 270. In addition, the following proceeds of income tax are excluded from being shared with the States:

- i) proceeds attributable to the Union Territories;
- ii) taxes payable in respect of Union emoluments;
- iii) surcharge.

Duties set out in article 268 are such as may be levied by the Centre but the States collect and appropriate the proceeds within their respective areas. Article 269 specifies taxes that are to be levied and collected by the Government of India but the proceeds are wholly assigned to the States.

13.12 Assigning a share in the total proceeds from central taxes to the States would require suitable amendments to the Constitution. While doing so, the power of the Union to levy and collect all taxes in the Union list should not be qualified by the proposal to transfer a certain percentage of specified central taxes to the States. In other words, while all List I taxes remain Union taxes and the proceeds of no particular tax shall be deemed 'divisible', the States will be entitled to a prescribed percentage of the tax receipts of the Union.

13.13 We are proposing a share of the States based on the amounts currently accruing to the States. For this purpose we have distinguished between shares in income tax, basic excise duties and grants in lieu of tax on railway passenger fares as a proportion of central tax revenues (s1) on the one hand and the share of additional excise duties on the other (s2). The share of the States in these taxes is given in Table 2.

Table 2

Share of States in Aggregate Central Tax Revenues

	S1	S2	S
1979-80	25.66	2.92	28.58
1980-81	26.00	2.94	28.94
1981-82	24.11	3.00	27.11
1982-83	23.57	2.78	26.35
1983-84	22.27	3.16	25.43
1984-85	21.15	3.56	24.71
1985-86	23.26	3.20	26.46
1986-87	22.85	3.25	26.10
1987-88	22.53	3.20	25.73
1988-89	21.29	2.91	24.20
1989-90	22.77	3.04	25.81
1990-91	22.60	2.90	25.50
1991-92	22.90	2.85	25.75
1992-93	24.69	3.01	27.70
1993-94 (RE)	26.20	2.98	29.18
1994-95 (BE)	25.15	3.02	28.17
Average:			
1979-84	24.32	2.96	27.28
1984-89	22.22	3.22	25.44
1990-95	24.31	2.95	27.26

Notes: S1 = Share of States in income tax, Union excise duties, estate duty, and grant in lieu of tax on railway passenger fares as percentage of total Central tax revenues (incl. AED).

S2 = Revenue from additional excise duties transferred to the States as percentage of total Central tax revenues.

S = S1 + S2

Source: Finance Accounts, Government of India.

Receipts Budget, Central Government, 1994-95.

13.14 It will be noticed that during the period covered by the reports of the Seventh, Eighth and Ninth (1990-95) Commissions, the average value of s1 has been 24.32, 22.22 and 24.30 per cent and that of s2 2.96, 3.22 and 2.95. Having regard to these values, and the fact that we are recommending inclusion of some taxes under article 269 in the central pool, we recommend that the share of States in the gross receipts of central taxes shall be 26 per cent. We further recommend that the tax rental arrangement should be terminated, and additional excise duties merged with basic excise duties. These three commodities should not be subject to States sales tax. Having done so we recommend a further share of three per cent in the gross tax receipts of the Centre for the States in lieu of additional excise duties. These shares of twenty six and three per cent respectively should be suitably provided for in the Constitution and reviewed once in 15 years. We have used the criterion of revenue equivalence only for the initial fixing of the

above ratios. We are not recommending revenue equivalence as a principle. It would not be relevant to consider in future what the share of the States would have been had they been getting shares individually in income tax and Union excise duties as at present.

13.15 The proceeds of taxes under articles 268 and 269, except in so far as they relate to the Union Territories, do not form part of the Consolidated Fund of India, and are wholly assignable to the States. There is a distinction between articles 268 and 269 in so far as this assignment is concerned. In article 268, the Constitution provides that the proceeds of taxes leviable within any State shall be assigned to that State. Article 269 provides that: "The net proceeds....shall be assigned to the States within which that duty or tax is leviable in that year, and shall be distributed among those States in accordance with such principles of distribution as may be formulated by Parliament by law". Among the taxes covered by article 269, estate duty has now been abolished. The tax on railway passenger fares was also repealed in lieu of which the States are given a grant. The important taxes, from the viewpoint of revenue, are the central sales tax, and the consignment tax.

13.16 With the Central Sales Tax Act, 1956, the power to levy the tax on inter State sales has been effectively delegated to the States. A State levies tax on inter-State sales originating in its territory and retains the proceeds. The maximum rate of tax, currently 4 per cent, is prescribed by the Central Government. Such a tax is viewed as fragmenting the national market, and may be considered as an inefficient source of raising revenues. The consignment tax raises similar problems. The very reason why the power to levy these taxes was vested in the Centre was to avoid their misuse or overuse at the cost of fragmenting and distorting the domestic market.

13.17 We believe there is some advantage in retaining a system such as in article 268, where a tax is levied by the Union

Government but collected and retained by the States, in the interest of uniformity of rates. Because Central sales tax, already being levied, and consignment tax, if and when levied, are similar to the taxes under article 268, we have decided to keep them out of the pool of central taxes. All other taxes in article 269 shall form part of the central pool.

13.18 In recommending that these taxes form part of the pool, we are guided by the consideration that this will induce the Centre to exploit these tax bases which are not currently being tapped. States will also benefit from such exploitation of tax bases. We are of the view that while article 268 taxes may be kept out of the arrangement of fixing a common share for all central taxes being suggested here, all article 269 taxes except Central sales tax and consignment tax should be brought within the purview of these arrangements.

13.19 There has been occasion in the past when the Centre had to augment its revenue for meeting emergent but temporary needs. In such circumstances a surcharge on income and corporation tax was imposed. Such occasions may arise in future also. The Centre should, therefore, continue to have the power to levy surcharges for the purposes of the Union and these should be excluded from the sharing arrangements with the States which are recommended above.

13.20 We have recommended the share of States in income tax, Union excise duties, additional excise duties and grants *in lieu* of tax on railway passenger fares in accordance with our terms of reference. However, we would recommend that the alternative scheme of resource sharing suggested by us may be brought into force with effect from 1st April, 1996 after necessary amendments to the Constitution. This should not affect the inter-se shares and grants recommended by us.

NATIONAL SECURITY

14.1 Our terms of reference require that in making our recommendations we should have regard, among other factors, to the resources of the Central Government and the demands thereon, in particular, on account of expenditure on civil administration, defence and border security, etc. Earlier Commissions were also required to take into account the demands of defence while assessing the resources of the Central Government. Defence expenditure, like interest payment, is major component of the central expenditure. Both however, display rigidity to any downward adjustment.

14.2 We felt that our Commission, tenth since the commencement of the Constitution, should give more than an incidental attention to the assessment of defence and security related expenditure. We, therefore, decided early on in our deliberations to carry out a detailed study of the requirements of defence expenditure so as to accord it a proper weight while assessing the resources of the Centre.

14.3 The in-house study on defence expenditure is, for reasons of confidentiality, being forwarded separately to the Ministry of Defence. We expect the Ministry to take full advantage of the findings. Here we would only like to state that the estimates emerging from the study are broadly in line with the over-all projection of defence expenditure made by the Ministry of Finance in its forecast. We have, therefore, accepted the forecast of the Ministry of Finance but adjusted it to neutralise the year-by-year inflation rate, as assumed by us for the period 1995-2000.

14.4 We would like to highlight some of the broad conclusions prompted by the review. These are :

- i) A large part of the allocations for defence are pre-empted by manpower costs and related expenditure. Since 1986-87, these have grown at an average rate of 13.4 per cent per annum. As against this the total defence budget during the last five years has grown annually only at an average of 11.9 per cent. It is important to protect the availability of funds for the purchase of hardware, particularly spares and equipment.
- ii) The expenditure on defence pensions has risen from Rs.479.88 crores in 1984-85 to Rs.2706 crores in 1994-95. There is an urgent need to contain the rising bill on pensions.
- iii) Linked with the reduction in expenditure on pensions is also the consideration of reducing the age profile of combatant troops.
- iv) There is a need to examine the possibilities of optimal utilisation of available resources by prioritising defence expenditure. A pattern of inter-service allocation of resources best suited to obtain a balanced force

structure, the need for adequate funding for spares replenishment and for training purposes, a cost-effective mix of weapon systems, the balance between new acquisitions and upgradation of the existing hardware and facilities, more economical alternatives to current structures and capabilities, etc. are some of the factors which need to be evaluated in the context of a comprehensive assessment of threats and security requirements of the country.

- v) Since the defence and para-military forces have been quite often utilised on the maintenance of law and order duties in States, a revised balance should be evolved between the roles of local police, on the one hand, and that of the defence and para military forces on the other. If a holistic view of the internal and external security scenario is taken, it would suggest that the local law and order problems are best left to be dealt with by a strengthened local police force, suitably supplemented by the State's own armed police. It would reduce the strain placed on the resources of the para-military and defence forces.
- vi) Common recruitment and training of para-military forces engaged on the borders and combatant troops serving in the army would facilitate soldiers moving over to the para-military formations after an initial period of, say, seven years service. A certain percentage of vacancies in various government organisations in the States and at the Centre are already reserved for ex-servicemen. Full use should be made of these quotas to facilitate the absorption of servicemen. The defence ministry and the armed forces, who have a large number of non-combatant posts, should take a lead in this matter. This would not only enable the army to maintain a youthful profile of its combatant troops but also reduce its pensionary commitments in future.
- vii) The present budgetary system for defence is not conducive either to yielding relevant management information regarding the cost of a job or service done or utilisation of resources. A less opaque and feasible two part-budgetary scheme, involving inputs and outputs (mission/function) should be adopted.

14.5 What is stated above illustrates the kind of action that is needed to evolve an integrated, cost-effective system of national security. It is not possible for us to go into the myriad aspects of national security which, to our way of thinking, would also involve the States. We, therefore, recommend that a High Powered Committee should be set up to review the entire security scenario - both external and internal - and determine the role, organisation equipment and funding requirements of various agencies involved in meeting the present and emerging threats to the country's peace and integrity.

GENERAL OBSERVATIONS

Introduction

15.1 We have, through our reassessment and recommendations, tried to evolve a certain vision of the overall fiscal profile of the economy by 2000 A.D. In approaching our task and working out a design of resource sharing we have been guided by considerations of equity and efficiency. Our recommendations ranging from devolution to distribution and our method of balancing of revenue account take cognizance of the influence on and effect of macro-economic variables operating on the real and monetary sides of the economy. As indicated in Chapter II, to the extent possible, we have taken an integrated view of the finances of the country. If the fiscal profile envisaged by us is to be fully realised, the Centre and States would have to devote attention to certain areas which we have chosen to highlight in this Chapter. These areas relate to fiscal discipline; reform of the tax system; planning process and institutional changes in the context of economic reform; decentralisation of development. Each of these requires far-reaching changes in policies and attitudes and some of them point in the direction of changes in the relevant constitutional provisions. We now turn to a brief discussion of these issues.

Fiscal Discipline

15.2 The previous chapters of our Report have clearly brought out the sad story of rapid deterioration in the financial position of the Central and State Governments. While the potential for raising resources is inadequately utilised, expenditures have continued to mount. The report of the National Development Council Committee on Austerity contains many useful recommendations which still deserve consideration. We think it is of the utmost importance that the growth of expenditure on revenue account is curbed and a serious attempt made to contain it within revenue receipts so that governments do not incur additional debt, as they have been doing, to meet current expenditure which does not generate a return to service the debt. While borrowing for capital expenditure is in order, the projects for which such debts are incurred must earn adequate returns. It is a matter of serious concern that investments in irrigation, power and road transport, which constitute the bulk of State Government investments do not yield enough returns. A shortsighted perception of political necessity, perhaps, has persuaded State after State to fix user charges in irrigation and power at levels which do not cover even the operation and maintenance expenditures in irrigation and generate meagre surpluses, if at all, in power. Several State Electricity Boards are over-staffed and run at substantial losses. The artificially depressed user charges result in a criminal waste of water and electricity - both very scarce resources. Several studies have shown that the marginal benefit of irrigation to the farmer far exceeds what he currently pays for water and even if the rates were raised to yield an adequate return on capital, they would still constitute only a small percentage of the additional production generated by irrigation. There is no justification that can be reasonably adduced for power and irrigation rates to be so heavily subsidised. We would recommend that a national consensus on irrigation and power rates should be

evolved sooner rather than later to stem the rot in these sectors. No society can move forward if its citizens are encouraged to believe that costs of services do not have to be borne by those who benefit from them, especially when capacity to pay is not a constraint. Other central subsidies need to be phased out as quickly as possible, and those on food better targeted.

15.3 Fiscal discipline does not stop at bridging the revenue deficit, which in itself would be a very major step forward. Our forecasts do not suggest that this can be achieved by the year 2000, but every effort must be made to do so within the subsequent five years. This will require a careful look at both plan and non-plan expenditures. Equally important is to ensure that resources are not diverted from the purposes for which they are allocated. We came across a case of money meant for flood relief being used for building a sports stadium which exemplifies the extent to which fiscal discipline is eroded. The poor state of accounts in some States and the failure to complete accounts of State enterprises, for several years on end are other examples of such erosion. We would recommend that the Comptroller and Auditor General should constitute a task force to identify lapses from the prescribed norms and procedures and initiate corrective action. The report of the task force should be made public.

15.4 More generally, expenditure control should involve questioning every item of expenditure every year, rather than giving automatic approvals on the basis of continuity of schemes or projects. Over the years employment in government has grown manifold. There is scope for Central and State Governments to shed many an activity and absorb the staff rendered surplus in other activities and to encourage them to avail of retirement with attractive benefits. Viable methods of reducing the strength of government employment must be explored, otherwise, economic reform may lose its way in a new bureaucratic maze.

15.5 Economies in expenditure have many dimensions and we do not wish to deal with the matter in great detail. It is well known that there are leakages in many departments and schemes and only a part of the expenditure reaches the ultimate beneficiary. Accessibility to funds must be linked to performance. And a machinery must be established for close monitoring detecting leakages and punishing the guilty.

15.6 Selective privatisation of public enterprises will relieve the Governments of the burden of recurring losses while at the same time giving them the benefit of a one-time accretion to their resources. Privatisation should be viewed as a method of providing the same service in a cost-effective manner and raising resources which can be deployed to reduce the accumulated debt.

15.7 In the area of Centre-State relations, there is one specific matter to which we would like to draw attention. It is the persistence of a large number of centrally sponsored schemes. Although a number of them have been closed down following a review by a committee set up by the National Development Council, these were relatively small, representing an annual provision of only about Rs.200 crores, as against a total for all

centrally sponsored schemes of about Rs. 14,000 crores. Central intervention through such schemes is presumably acceptable to the States because they carry with them additional resources. Their continuance makes for large and sprawling bureaucracies at the Centre dealing with what are primarily State subjects - e.g. agriculture, rural development, education and public health. Given adequate decentralisation, it should be possible to effect considerable economies in such Ministries.

Reform of the Tax system

15.8 Centre-State financial relations will necessarily undergo a change with the progress of tax reform at the Centre and in the States. At the Centre, a major structural change which has occurred is the decline in the importance of customs as a source of revenue. This is a consequence of the opening up of the economy and the policy of progressively reducing customs duties on capital goods, raw materials and components. The policy of further liberalising imports, if necessary with a high customs tariff on sectors like consumer goods, will, apart from inducing greater efficiency in production, ensure that the growth in customs revenue does not decline rapidly. The reassessment of the Centre's revenues made by us (see Chapter IV) makes an implicit assumption that this will be the case.

15.9 As for excise duties, the Centre has adopted the policy of moving over to ad valorem rates and extension of MODVAT. Several variants of introducing a full-fledged value added tax (VAT) have also surfaced in discussions. One such is that the Centre would levy VAT upto the wholesale stage, leaving it to the States to move over from sales tax to VAT beyond the wholesale stage. Another is a comprehensive VAT levied by the Centre but collected by both the Centre and the States, the proceeds to be shared with the States. Whichever of the various versions is adopted eventually, it is clear that the system of indirect taxation comprising excise duties and sales taxes requires an overhaul in order to remove the deleterious impact it has on economic activity and exports through cascading and lack of transparency. Meanwhile, the widely varying sales tax rates and numerous exemptions and incentives announced by the State Governments to attract investment distort investment and production and result in an avoidable loss of revenue for the States. Harmonisation of rates and incentive structures should be brought about through agreement among the States. One possibility would be to evolve two or more broad bands for sales tax uniformly in all states.

Planning Process and Institutional Reform

15.10 We were considerably handicapped in our work by the fact that the period of our Report does not coincide with the period of the plan. The Eighth Plan runs from April 1992 to March 1997 whereas the period for which we are required to make our recommendations runs from April 1995 to March 2000, with an overlap with the Eighth Plan of two years. In the existing scheme of things, expenditures on plan schemes completed at the end of a plan are treated as committed non-plan expenditures in the subsequent plan period. Our terms of reference specifically require us to have regard to maintenance expenditure on plan schemes to be completed by 31st March, 1995. Since it is not the practice of the State Governments to move expenditures on completed schemes to the non-plan category until the end of the plan period, we have perforce had to take recourse to a broad estimation of such expenditures. In the absence of a common time-frame, we have not been able to take a view of the total revenue expenditure of the Centre and the States, both plan and non-plan, which would have been necessary for dealing fully with para 4(i) of our terms of reference. We believe it is important to synchronise the period of recommendations of a Finance

Commission with that of a Five-Year Plan. In the past, due recognition was given to this factor and up to the Seventh Commission the periods were synchronised. The issue is urgent and should be dealt with while determining the period for the next plan.

15.11 It is becoming quite clear that the planning process will have to undergo a material change in the wake of the economic reforms now underway. The Planning Commission itself is conscious of this and has taken an initiative to start a debate on the subject. The greater market orientation of the economy and the enhanced role for private and foreign investment will put additional responsibility on the public sector to strengthen the economic and social infrastructure and reinforce the legislative, legal and judicial processes which make for good governance. In particular, public outlays on education and health will need to be increased substantially. This means a greater responsibility for State Governments whose resource base will have to be correspondingly augmented. Since the bulk of such outlays are on revenue account, we think that it should be the responsibility of future Finance Commissions to deal with them along with revenue receipts. It follows that the present artificial distinction between plan and non-plan expenditures, which runs across revenue and capital budgets shall be replaced by the simpler and conventionally well recognised distinction between revenue and capital. Future Finance Commissions may be required to examine the aggregate requirements on revenue account and recommend means to bridge the revenue gaps.

15.12 We are conscious that the current distinction between plan and non-plan expenditures serves the purpose of demarcating new from old schemes. We think, however, that the distinction may have had the perverse impact, as explained in an earlier chapter, of resulting in the neglect of maintenance of capital assets. The crucial point is the criterion of borrowing; it should be for activities which generate adequate return to service debt. Other activities must be a charge on current revenue or such funding as may be created from revenues from time to time to finance lumpy expenditures.

Decentralisation

15.13 Because of the 73rd and 74th amendments to the Constitution, Finance Commissions will be required in future to suggest measures in the light of the recommendations of the State Finance Commissions. We believe it is important that the panchayati raj institutions are firmly established and strengthened. Equally, we think it is necessary to guard against generation of dependency for resources at each sub-national level. The three-tier structure, with two layers of Finance Commissions, may generate expectations that in the end it will be the responsibility of the Centre to channel resources through the State Governments to the panchayats and urban local bodies. The fiscal system can scarcely meet such expectations. Panchayats and urban local bodies need to have well-defined sources of income and taxing powers. They must be encouraged to exploit them to the full, relying on transfers from the above only at the margin and preferably on a matching basis. Decentralisation of the development process is a desirable objective. But it can prove effective only if local resources are mobilised for local development, thus ensuring minimum leakage and cost-effective deployment.

15.14 We are of the view that in order to ensure continuity and advance preparations, a permanent Finance Commission Division may be created in the Ministry of Finance with an officer-oriented composition. We endorse the recommendations of the Eighth Finance Commission in this regard contained in para 16.12 of their report which reads:

"16.12 The Division, which we propose, should have the

following functions:-

- (i) to watch the implementation of the recommendations of the Finance Commission;
- (ii) to watch closely and analyse the trends in the receipts and non-plan expenditure of the State Governments and identify the reasons for variation between actuals and estimates made by the Finance Commission ;
- (iii) to monitor and evaluate the utilization of upgradation grants;
- (iv) to preserve the records of the previous Commissions, and take such necessary action to obtain future information as might be of use to the future Commissions;
- (v) to conduct studies and publish papers and data having a bearing on State finances.

The Division should be actively associated with the annual plan exercises of the Planning Commission so that the maintenance of assets already created does not suffer from either lack of attention or lack of resource-allocation because of the anxiety of the States to have progressively larger Plan."

15.15 We have noted that there is already a Finance Commission division in the Ministry of Finance. It is, however, no more than a cell. We are in full agreement with what the Eighth Commission had recommended and would urge that a full-fledged Division, appropriately staffed, and with adequate technical expertise, be created at the earliest under a senior officer and made to function within the Ministry of Finance so that it can discharge the functions indicated above. State Governments may also be asked to designate officers whose duty it would be to liaise with the Division to ensure continuity of contact and updating of information.

SUMMARY OF RECOMMENDATIONS

16.1 Our important recommendations to the President are set out below.

Income Tax

16.2 We recommend that for each financial year in the period 1995-96 to 1999-2000 :

(a) Out of the net distributable proceeds of income tax, a sum equal to **0.927 per cent** shall be deemed to represent the proceeds attributable to Union Territories.

(b) The share of the net proceeds of income tax assigned to the States shall be **77.5 per cent**.

(c) The distribution among States of the share assigned to them in each financial year should be on the basis of the percentages shown in the **Table** below :

Income Tax : Shares of States 1995 - 2000

State	Per cent
Andhra Pradesh	8.465
Arunachal Pradesh	0.170
Assam	2.784
Bihar	12.861
Goa	0.180
Gujarat	4.046
Haryana	1.238
Himachal Pradesh	0.704
Jammu & Kashmir	1.097
Karnataka	5.339
Kerala	3.875
Madhya Pradesh	8.290
Maharashtra	6.126
Manipur	0.282
Meghalaya	0.283
Mizoram	0.149
Nagaland	0.181
Orissa	4.495
Punjab	1.461
Rajasthan	5.551
Sikkim	0.126
Tamil Nadu	6.637
Tripura	0.378
Uttar Pradesh	17.811
West Bengal	7.471
TOTAL	100.000

(Para 5.47)

Union Excise Duties :

16.3 We recommend that **40 per cent** of the net proceeds of Union excise duties during each financial year in the period 1995-96 to 1999-2000 should be distributed as per the shares in the **Table** below :

40 per cent of the net proceeds of Union Excise Duties :

Shares of States 1995 - 2000

State	Per cent
Andhra Pradesh	8.465
Arunachal Pradesh	0.170
Assam	2.784

Bihar	12.861
Goa	0.180
Gujarat	4.046
Haryana	1.238
Himachal Pradesh	0.704
Jammu & Kashmir	1.097
Karnataka	5.339
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Madhya Pradesh	8.290
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Sikkim	0.126
Tamil Nadu	6.637
Tripura	0.378
Uttar Pradesh	17.811
West Bengal	7.471
TOTAL	100.000

(Para 5.48)

16.4 We also recommend that the remaining **7.5 per cent** of the net proceeds of Union excise duties be distributed among the States in accordance with the shares specified by us for each financial year in the period 1995-96 to 1999-2000 as given in the **Table** below.

Shares of States in 7.5 per cent of the net proceeds of Union Excise Duties

State	(per cent)				
	1995-96	1996-97	1997-98	1998-99	1999-2000
(1)	(2)	(3)	(4)	(5)	(6)
Andhra Pradesh	12.069	7.988	0.000	0.000	0.000
Arunachal Pradesh	3.410	4.300	5.871	6.224	6.667
Assam	8.543	9.836	11.849	10.748	9.290
Bihar	6.434	2.965	0.000	0.000	0.000
Goa	0.973	1.058	1.161	0.917	0.604
Himachal Pradesh	8.816	10.744	14.057	14.230	14.338
Jammu & Kashmir	13.366	16.491	21.985	22.741	23.700
Manipur	3.930	4.891	6.602	6.917	7.348
Meghalaya	3.590	4.403	5.815	5.994	6.130
Mizoram	3.676	4.628	6.278	6.784	7.074
Nagaland	5.818	7.417	10.247	11.072	12.025
Orissa	4.815	5.248	4.934	2.773	0.680
Rajasthan	0.835	0.000	0.000	0.000	0.000
Sikkim	1.199	1.473	1.938	1.982	2.055
Tripura	5.465	6.807	9.263	9.618	10.089
Uttar Pradesh	17.061	11.751	0.000	0.000	0.000
TOTAL	100.000	100.000	100.000	100.000	100.000

(Para 5.49)

Devolution : An Alternative Scheme

16.5 Having regard to the share of States in income tax, Union excise duties, and grant-in-lieu of tax on railway passenger fare in total central tax revenues (including additional excise duties), and the fact that we are recommending inclusion of some taxes under article 269 in the central pool, we recommend that the share of States in the gross receipts of central taxes shall be **26 per cent**. We further recommend that the tax rental arrangement should be terminated, and additional excise duties merged with basic excise duties. These three commodities should not be subject to States sales tax. Having done so we recommend a further share of **three per cent** in the gross tax receipts of the Centre for the States in lieu of additional excise duties. These shares of twenty six and three per cent respectively should be suitably provided for in the Constitution and reviewed once in 15 years.

(Para 13.14)

16.6 We believe there is some advantage in retaining a system such as in article 268, where a tax is levied by the Union Government but collected and retained by the States, in the interest of uniformity of rates. Because Central sales tax, already being levied, and consignment tax, if and when levied, are similar to the taxes under article 268, we have decided to keep them out of the pool of central taxes. All other taxes in article 269 shall form part of the central pool.

(Para 13.17)

16.7 The Centre should continue to have the power to levy surcharges for the purposes of the Union and these should be excluded from the sharing arrangements with the States.

(Para 13.19)

16.8 We would recommend that the alternative scheme of resource sharing suggested by us may be brought into force with effect from 1st April, 1996 after necessary amendments to the Constitution. This should not affect the inter-se shares and grants recommended by us.

(Para 13.20)

Additional Duties of Excise

16.9 The share of Union territories amounting to **2.203 per cent** should be retained by the Central Government. We recommend that the balance should be distributed among the States as shown in the Table below.

State	Percentage share
Andhra Pradesh	7.820
Arunachal Pradesh	0.104
Assam	2.483
Bihar	7.944
Goa	0.232
Gujarat	5.995
Haryana	2.366
Himachal Pradesh	0.595
Jammu & Kashmir	0.856
Karnataka	5.744
Kerala	3.740
Madhya Pradesh	7.236
Maharashtra	12.027
Manipur	0.197
Meghalaya	0.188
Mizoram	0.079
Nagaland	0.137
Orissa	3.345

Punjab	3.422
Rajasthan	4.873
Sikkim	0.053
Tamilnadu	7.669
Tripura	0.286
Uttar Pradesh	14.573
West Bengal	8.036
TOTAL	100.000

(Para 6.19)

Grants-in-lieu of tax on Railway Passenger Fares

16.10 We recommend that :

- The quantum of the grant in lieu of the Railway Passenger Fares Tax for 1995-2000 should be Rs.380 crores annually.
- The shares of States in the grant would be as in the Table below :

State	Percentage share
Andhra Pradesh	8.345
Arunachal Pradesh	0.005
Assam	1.368
Bihar	9.326
Goa	0.194
Gujarat	6.901
Haryana	1.917
Himachal Pradesh	0.108
Jammu & Kashmir	0.728
Karnataka	3.388
Kerala	3.495
Madhya Pradesh	6.882
Maharashtra	17.548
Manipur	0.018
Meghalaya	0.034
Mizoram	0.001
Nagaland	0.145
Orissa	1.715
Punjab	3.280
Rajasthan	4.445
Sikkim	0.010
Tamil Nadu	6.458
Tripura	0.039
Uttar Pradesh	15.568
West Bengal	8.082
Total	100.000

(Para 7.12)

Upgradation Grants

16.11 We recommend a total sum of **Rs 2,608.50** crores as grants for upgradation and special problems for the period 1995-2000.

(Para 8.15)

Financing of Relief Expenditure

16.12 The amount worked out for all the States for the period of our Report is **Rs.6304.27** crores. Out of this, the Centre will be required to contribute **Rs.4728.19** crores (**75 per cent**) and the States **Rs.1576.08** crores (**25 per cent**). We recommend the continuation of the current scheme of the Calamity Relief Fund with modifications suggested by us.

(Para 9.15)

16.13 We propose that in addition to the Calamity Relief Funds for States, a National Fund for Calamity Relief should be

created to which the Centre and the States will contribute and which will be managed by a National Calamity Relief Committee on which both the Centre and the States would be represented.

(Para 9.18)

16.14 The size of the National Fund for Calamity Relief would be **Rs.700 crores**, to be built up over the period 1995-2000, with an initial corpus of **Rs.200 crores** to which the Centre would contribute **Rs.150 crores** and the States **Rs.50 crores** in the proportion of 75:25. In addition, for each of the five years from 1995-96 to 1999-2000 the contributions of the Centre and the States would be **Rs.75 crores** and **Rs.25 crores** respectively. The contribution by both the Centre and the States would be made annually in the beginning of the financial year. Contribution of States *inter-se* would be in the same proportion as their estimated total tax receipts after devolution.

(Para 9.20)

Grants for Local Bodies:

16.15 A total grant of **Rs 5,380.93** crores should be made available to the States in four equal instalments commencing from 1996-97.

(Para 10.20)

Grants-in-Aid

16.16 We recommend grants-in-aid, to be given to the States under the substantive portion of Article 275(1), equal to the amount of the deficits as estimated for each of the years during 1995-96 to 1999-2000. These amounts have been specified in the **Table** below:

	1995-96	1996-97	1997-98	1998-99	1999-00	1995-2000
Andhra Pradesh	483.47	202.98	0.00	0.00	0.00	686.45
Arunachal Pradesh	136.60	109.26	45.63	16.11	0.00	307.60
Assam	342.20	249.94	92.08	27.81	0.00	712.03
Bihar	257.72	75.34	0.00	0.00	0.00	333.06
Goa	38.98	26.88	9.03	2.37	0.00	77.26
Himachal Pradesh	353.11	273.00	109.25	36.82	0.00	772.18
Jammu and Kashmir	535.39	419.05	170.85	58.84	0.00	1184.13
Manipur	157.43	124.28	51.31	17.90	0.00	350.92
Meghalaya	143.83	111.89	45.19	15.51	0.00	316.42
Mizoram	147.25	117.60	48.79	17.55	0.00	331.19
Nagaland	233.04	188.46	79.63	28.65	0.00	529.78
Orissa	192.87	133.35	38.34	7.18	0.00	371.74
Rajasthan	33.45	0.00	0.00	0.00	0.00	33.45
Sikkim	48.05	37.45	15.06	5.13	0.00	105.69
Tripura	218.92	172.98	71.99	24.89	0.00	488.78
Uttar Pradesh	683.40	298.60	0.00	0.00	0.00	982.00
Total	4005.71	2541.06	777.15	258.76	0.00	7582.68

16.17 We recommend that in case the actual realisation of the concerned States from royalty is higher than that assumed in our estimates, it would be open to the Central Government to make suitable adjustments in the grants-in-aid under **Article 275** recommended by us for meeting their non-plan revenue deficits.

(Para 3.22)

Debt Relief

16.18 We have recommend a scheme for debt relief in two parts :

- a scheme for general debt relief for all States linked to fiscal performance; and
- specific relief for States with high fiscal stress, special category States and States with debt problems warranting special attention.

(Para 12.36)

16.19 In addition we recommend a scheme for encouraging retirement of debt from the proceeds of disinvestment of equity holdings of State Governments.

(Para 3.20)

16.20 We recommend specific relief for all special category States, and three other States, viz. Orissa, Bihar and Uttar Pradesh, which are characterised by high fiscal stress. For these States we recommend writing-off of 5 per cent of repayment due with respect to fresh central loans given during 1989-95 and outstanding on 31st March, 1995.

(Para 12.39)

16.21 We recommend the waiver of one third of the repayment of principal falling due during 1995-2000 on special term loans to Punjab in view of the special circumstances when these term loans were advanced and the need for the State to re-invigorate its development efforts.

(Para 12.40)

Monitoring of Maintenance Expenditure

16.22 We recommend that the presentation of accounts should be redesigned in such a way that the expenditure on the works component and the establishment expenses get reflected separately and are easily accessible. We recommend that the Ministry of Finance, in consultation with the State Governments and with the concurrence of the Comptroller and Auditor General of India, should introduce appropriate changes in the accounting and reporting system in accordance with the scheme outlined by us.

Para 3.62)

16.23 We also recommend that the State Governments should ensure that the provisions for maintenance are made in accordance with our recommendations. We further recommend that a high powered committee chaired by the Chief Secretary and with secretaries of the State Governments concerned in the departments of Finance, Planning, Irrigation and Public Works and the concerned chief engineers of the works departments should review every quarter the allocation and utilisation of funds provided for maintenance.

(Para 3.63)

Finance Commission Division

16.24 We recommend that a full-fledged Division, appropriately staffed, and with adequate technical expertise, be created at the earliest under a senior officer and made to function within the Ministry of Finance so that it can discharge the functions assigned to it. State Governments may also be asked to designate officers whose duty it would be to liaise with the Division to ensure continuity of contact and updating of information.

(Para 15.15)

(Krishna Chandra Pant)
Chairman

(Debi Prosad Pal)
Member

(B.P.R. Vithal)
Member

(Manu R. Shroff)
Member

(Arun Sinha)
Member Secretary

New Delhi
25th November, 1994

We wish to place on record our appreciation of the help we have received from our two Member Secretaries, Shri M.C. Gupta and Shri Arun Sinha. Shri Gupta was with us till January 1994 by which time the painstaking work of organising the office, collecting the requisite material and arranging discussions with several groups as well as State Governments was completed. His initiative and drive during this phase greatly facilitated our work.

Shri Sinha's patience, perseverance, tact, and leadership helped him get the best out of the team working with him. He coordinated their efforts effectively in the final stages of our work and during the preparation of our report. We were fortunate in having an officer of his calibre and experience at this juncture. We wish to record our gratitude to him.

(Krishna Chandra Pant)
Chairman

(Debi Prosad Pal)
Member

(B.P.R.Vithal)
Member

(Manu R. Shroff)
Member

New Delhi
25th November, 1994