

## 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.