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

per cent of GDP

	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 Ist 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 agggregate 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-government 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 acount 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 expendiutre.

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.