NOTE BY SHRI H.N.RAY, OUTLINING HIS VIEWS ON THE RETURNS FROM STATE ELECTRICITY BOARDS ETC. TO BE TAKEN INTO ACCOUNT FOR THE PURPOSES OF THE FORECASTS OF THE STATE GOVERNMENTS, AND THE TARGETS OF ADDITIONAL RESOURCE MOBILISATION.

1. I have not been able to agree with the decision of the majority of the Commission that in projecting the returns from State Electricity Boards, a rate of 6 per cent per annum on the total investment should be stipulated, including the revenue obtained from the electricity duty levied by the State Government and the Central excise duty levied by the Central Government on the generation of the State undertaking. It has been further decided by the majority of the Commission that the return should be calculated on the total investment of the State Government till the end of 1978-79, and ignoring any fresh investments during the period of our Report.

2. Annex (1) to this note prepared by the Secretariat of the Commission /_ except the percentage calculations in Columns 4(b) and 5(b) _/ shows separately the electricity duty and the Central Excise duty for 1978-79 collected from "own generation" as a percentage of the total Government investment in the undertaking for each State.

3. I find it difficult to accept the proposition that the amounts collected by the Central Government as excise duty should be set off against the stipulated return of 6 per cent. In law, the Central excise duty accrues to the Central Government. When imposing the duty, the Finance Minister in his Budget Speech of February 1978 stated as follows:—

> "I feel that with our enormous investment in power, there is ample justification for claiming a contribution from those who benefit from these investments. I am, therefore, proposing to levy a duty of 2p. per Kilowatt hour on electricity generated".

The intention, presumably, was to levy the duty so as to increase the return from the investments in electricity undertakings and to realise a higher amount from the consumers, so that the overall resources of the Central and State Governments would increase, and would be available for developmental and other essential purposes. Our information is that most of the States have taken steps to pass on the Central excise duty burden to the consumer Whatever justification there might or might not be for setting off the electricity duty (which accrues to the State Government), there appears to be no justification for setting off the Central excise duty accruing by law to the Central Government from the returns which the State Government is assumed to derive during the forecast period from its investments in electricity undertakings. In fact, setting off the amounts collected as Central excise duty from the stipulated return, as decided by the majority of the Commission, would frustrate the purpose for which the duty was imposed in the first instance. That the Central Government has recently decided to make over the non-shareable portion of the duty from 1979-80 onwards to the various State Governments and that we are recommending the transfer of the entire Central Excise duty levied on electricity generated to the concerned States does not, in my view, vitiate the legal point. This money is now un-doubtedly available to the State Government for various purposes - but this factor by itself whould not absolve the State Electricity Board from earning a reasonable cash return on the State Government's investment through efficient operation of the system.

4. The combined effect of setting off both the electricity duty and the Central excise duty is somewhat anomalous in respect of the following States as the aggregate set off is in excess of 6 per cent:—

States	Percentage of total investment		
	Electricity duty	Central excise duty	Total percentage
Gujarat	4.922	2.512	7.434
Kerala	3.444	4.297	7.741
Orissa	3.325	3.011	6.336

The would mean that according to the Commission's decision, no further return as such need be expected from the State Electricity Boards of these States as the stipulated return and more is already being earned by way of electricity duty and Central excise duty. On the contrary, the excess amounts over 6 per cent have been set off against the other receipts of these 3 States, so as not to "penalise" them for their better management compared to the other States. For some other States, the set off of these duties against the stipulated return of 6 per cent would be quite significant as shown below:—

State	Percentage of total investment		
	Electricity duty	Central Excise Duty	Total percentage
Haryana	3.59	1.92	5.51
Karnataka	1.88	2.25	4.13
Madhya Pradesh	2.35	1.65	4.00
Maharashtra	0.93	2.51	3.44
Punjab	1.84	1.01	2.85

5. My distinguished colleagues have argued that the Central Excise duty on electricity generation, has inhibited tariff revisions, and additional resource mobilisation in this sector. Central excise duties are levied on a vast number of commodities, and it could be similarly argued that these duties have inhibited State Governments from levying Sales tax etc. at higher rates, and generally hindered their additional resource mobilisation efforts. For all other commodities also, the Central excise duty is being shared with the States. Nevertheless, it is not the practice, whether in a public sector enterprise or in the private sector, to set off the Central Excise duty paid to the Central Government, when computing the return on the investment in a commercial organisation (which the State Electricity Board is meant to be). What is really sought is a genuine cash return from the investments made. The principle implicit in the majority recommendation of the Commission, if conceded, could lead to unsound practices in various undertakings both in the Central and the State spheres for determining returns on the investments made. The principle adopted may thus blur the line of demarcation between what is a cost of production, and what is a return on the investment made. Taking the case of the State Electricity Boards a step further, there is no logical reason why the arrangement should cover only the Central Excise duty on electrical energy, and not the excise duty on coal (levied in the same budget) or the duty on furance oil, which also raised the cost of generation to a corresponding extent. It is significant that inclusion of the Central excise duty in the stipulated return would have widely disparate results so far as different States are concerned. Even if we were to omit the atypical States, the incidence of the Central excise duty is only 0.84 per cent in Assam and 1.03 per cent in Uttar Pradesh, but is as high as 4.30 per cent in Kerala. Thus, in making the projections, although the stipulated rate of return taken as a whole is 6 per cent, Kerala would have a substantial advantage as compared with Assam or Uttar Pradesh. Such discrimination to my mind appears to be unjustified. Again, it is open to the Government of India to withdraw or modify the rates of the Central Excise duty on electricity. There is no assurance that this will not be done in the next 5 years. Any such decision would thus cause deviations from the State forecasts, beyond the control of the State Government. This consideration would suggest that the recommended linkage is wrong in principle and should be avoided.

some cases, and the returns we ourselves are stipulating for Central and State enterprises, I am of the view that an unadjusted 6 per cent rate of return on the massive capital sunk in electricity undertakings is not an unfair proposition. I would also suggest that for the relatively weak units, the stipulated return need be achieved in gradual stages only during the final year, 1983-84. The financial effects of doing so are indicated in Annex 2 prepared by the Secretariat of the Commission at my instance. If a 6 per cent rate of return on Government investments is stipulated for each year, the credit to be given to the State Government budgets in the aggregate would be Rs.2211 crores over the forecast period (col.2 of Annex 1 x 5). If, however, State Electricity Boards are gradually expected to achieve a return of 6 per cent in the final year with progressive improvement in their working, then the contribution in aggregate terms during the forecast period would be Rs.1449 crores (Annex 2). According to the majority recommendations of the Commission, however, after setting off the electricity duty and the Central excise duty, the total contribution to the State budgets by these undertakings would be Rs.1101 crores (Col. 7 of Annex I). This would suggest that the return proposed by me is feasible, calling for only a moderate improvement over what the majority has assumed but with the advantage that unsound practices for computing returns need not be introduced. It will be recalled that these investments do not include fresh investments during the forecast period, and also have a fair proportion of investments made when prices of plant and equipment were such lower.

9. My impression is that there is enormous scope for improving the efficiency of most State Electricity Boards and certain reports on the functioning of particular bodies are highly disconcerting. There is also scope for fixing tariffs in a more business-like manner, specially in the agricultural sector where heavy losses are being incurred. The increases in procurement prices of first wheat and now paddy and coarse grains should enable revisions to be undertaken without causing hardship. The nation is entitled to a proper return from the massive investments made in the power sector, which will continue to grow rapidly, specially when such a return is achievable with more efficient management and economic tariffs. The assumption made by a body such as the Finance Commission, and its general attitude in financial matters, has effects spreading well beyond the transfer of funds from the Centre to the States. Having regard to the overall national interest, this Finance Commission should not, in my view, adopt too relaxed an approach to the question of the rate of return expected from investments in State Electricity Boards.

10. In making these comments, I would like to clarify that the intention is not to modify in any way the existing terms and conditions as between the State Government and the State Electricity Board. The purpose of laying down a particular rate of return is merely to arrive at a notional figure of the likely returns during the forecast period and thereafter to assess the financial position of the State Governments on a uniform basis and in a normative manner.

11. Our terms of reference require us to have regard amongst other considerations to the revenue resources of the States for the five years ending with 1983-84 on the basis of the levels of taxation likely to be reached at the end of 1978-79 and the targets set for additional resource mobilisation for the Plan. In arriving at these targets, it has been decided by the majority of the Commission that the revenue from the Central excise duty on electricity generated by the State Electricity Boards and by the departmental undertakings of the State Government should be excluded also from this target. This has resulted in a reduction of the target for all the States combined from Rs.452.17 crores to Rs.326.84 crores after adjusting the Central excise duty on electricity amounting to Rs.125.33 crores per annum. In my view, the preceding arguments for not adjusting the Central excise duty against the stipulated return, have equal validity for not making a corresponding adjustment in the target of additional resource mobilisation adopted by the State Government. This tax having

6. A return of 6 per cent without adjustment of duty, to be achieved in gradual stages by 1983-84 does not appear to be too onerous a task. In Cols. 1 and 2 of the table below are given some figures* showing the net surplus for certain State Electricity Boards as a percentage of the cumulative block capital in completed works at the middle of the year for 1977-78 and 1978-79. The net surplus has been arrived at from the gross operating surplus by deducting subsidy from the Government, interest to institutional creditors, and transfers to Depreciation Reserve Fund and General Reserve Fund. For the same Boards/ Mysore Power Corporation, the return on Government's investment for 1978-79 have been tabulated in Col. 4.

Table

State	Percentages 1977-78	1978-79	Return on Govt. investment in 1978-79
1	2	3	4
Andhra Pradesh	2.90	2.93	4.7
Gujarat	2.02	0.81	1.3
Karnataka	2.75	15.19	4.2
Maharashtra	5.09	4.44	5.0

Our Report shows that the World Bank has obtained undertakings that the electricity Board concerned should achieve a return of 9½ per cent on what was termed as the average capital base. While this concept, of course, took note of the net value of assets in use, it also added 1/6th of the operation and maintenance expenditure (excluding depreciation). This return, exclusive of electricity duty, was more than achieved in several States during 1976-77 e.g. Assam, Gujarat, Karnataka, Madhya Pradesh, and Maharashtra, as detailed in the body of our report. The Venkataraman Committee laid down a norm of 6 per cent interest, 3 per cent profit and ½ per cent appropriation to reserve - exclusive of a notional 1½ per cent on account of electricity duty.

7. For road transport undertakings, we are stipulating a return of 6.5 per cent on the capital as a general rule, though lower rates have been adopted for the weaker units. The point worth emphasising is that for these undertakings we have NOT taken note of either the motor vehicles tax or the tax on passengers and goods, which also accrue to the State Government. By the same token, we should treat electricity undertakings similarly. Again, we are stipulating that over and above the interest on the loan component, other State Government enterprises should earn by 1983-84 a return of 5 per cent on the equity capital as it stood at the end of 1978-79. This return has been adopted despite the fact that in 1976-77 the return on share capital was only 1.15 per cent averaged out for the enterprises of all States. The return for all State Electricity Boards was higher at 1.5 per cent. Further, out of 434 State Government enterprises, as many as 121 were promotional enterprises and therefore could not be reasonably expected to yield high profits. All State Electricity Boards by statute are meant to be commercially viable. It may be recalled that we are stipulating a return of 7.5 per cent on equity investments by the Central Government in its undertakings, besides interests on loans, again to be achieved during the last year of our forecast period.

8. Having regard to the returns already achieved by the better-run State Electricity Boards as indicated above, the recommendations of the Venkataraman Committee, the undertaking to earn a return of 9½ per cent given to the World Bank, and its over-fulfilment in

* Source: Secretariat Compilations.

been imposed by the Centre should not count as a resource mobilisation effort by the State Government. When the target was initially fixed in consultation with the State Government concerned, and accepted by it. Even if it is contended that the levy of a Central Excise duty on electricity generation has inhibited State Governments from raising additional resources, this consideration would apply only with respect to a very limited field, namely, the electricity tariff, and not over the entire field of State taxation. Further, as pointed out in paragraph 5 above, the Government of India can withdraw or modify the Central Excise Duty on electricity at any time. This would effect the State budget, but not the target of additional resource mobilisation adjusted for the present rates of duty. Thus, an element of uncertainty is injected by the linkage into the State forecasts, over which the State Government has no control. Finally, I would add that the decision of the majority to set off the Central Excise duty on electricity generation once against the stipulated return of 6 per cent on the capital invested by the State Government in its State Electricity Board, and again by lowering the target of additional resource mobilisation by an amount equivalent to the duty, confers a double benefit on the State. This arrangement appears to me to be unduly liberal, especially when the Government of India and the Finance Commission are transferring the entire proceeds of the Central Excise duty on electricity back to the States, as against the general ratio of about 40 per cent for the devolution of Central Excise duties.

H.N. Ray
25.10.1978

Annex 1

Statement showing net returns from State Electricity Boards and departmental undertakings during 1979-84 on the basis of Commission's decision

(Rs. lakhs)

STATES	Government investments as on 31. 3. 79	6% of Col. 2	Excise Duty on own generation @ 1. 8 paise per unit	% to Col. 2	Electricity Duty from own generation	% to Col. 2	Net return after deducting Excise Duty and Electricity Duty to be adopted for reassessment for each year 1979-80 to 1983-84 Col. 5-(4+5)	Net return in (Col. 6 x5)during 5 years 1979-84	Interest receipts from SEBs as given in the State forecasts for 1979-84 (K)
(1)	(2)	(3)	4(a)	4(b)	5(a)	5(b)	(6)	(7)	(8)
1. Andhra Pradesh									
State Electricity Board	41458	2487	830	2. 002	-	-	1657	8285	11057
Departmental	19850	1191	96	0. 484	-	-	1095	5475	792
2. Assam	13858	831	117	0. 844	43	0. 310	671	3355	Nil
3. Bihar	30913	1855	400	1. 293	275	0. 889	1180	5900	Nil
4. Gujarat	35835	2150	900	2. 512	1764	4. 922	(-) 514	(-) 2570	934
5. Haryana	25726	1544	494	1. 920	925	3. 595	125	625	8125
6. Himachal Pradesh	7128	428	85	1. 192	10	0. 140	333	1665	Nil
7. Jammu & Kashmir £	19043	1143	94	0. 494	54	0. 283	995	4975	Nil
8. Karnataka	38535	2312	866	2. 247	725	1. 881	721	3605	3547+7102 MPC
9. Kerala	18875	1133	611	4. 297	650	3. 444	(-) 328	(-) 1640	2644
10. Madhya Pradesh	52299	3138	865	1. 654	1228	2. 348	1045	5225	88
11. Maharashtra									
State Electricity Board	79214	4753	1668)						11084
Departmental	20385	1223	828)	2. 506	924	0. 928	2556	12780	9612(LM)
12. Manipur £	1446	87	4	0. 276	-	-	83	415	Nil
13. Meghalaya	3241	194	43	1. 326	15	-	136	680	Nil
14. Nagaland £	1460	88	1	0. 068	-		87	435	Nil
15. Orissa									
State Electricity Board	18525	1111	529)		584		-	(-) 10	605
Departmental	571	34	46)	3. 011	51	3. 325	- 65	(-) 315	-
16. Punjab	64849	3891	656	1. 011	1195	1. 842	2040	10200	9366
17. Rajasthan	28396	4704	594	1. 775	263		937	4685	3789
18. Sikkim £	366	22	1	0. 273	-		21	105	Nil
19. Tamil Nadu	33062	1984	660	1. 996	196		1128	5640	Nil
20. Tripura £	2746	165	4	0. 145	-		161	805	Nil
21. Uttar Pradesh	155025	9302	1590	1. 026	584		7128	35640	3425
22. West Bengal	24181	1451	441	1. 824	175		835	4175	Nil
All States	736987	44221	12533		9465)		22934 *) (-) 907)	114670 * (-) 4535	71470

(K) In this col. the figures represent interest receipts assumed for 1979-84 in the State forecast. In the case of departmental undertakings, figures represent surpluses after meeting working expenses. If there are no surpluses, nil has been shown. In the State forecasts, if no interest receipts are assumed from the SEB's "Nil" has been shown.

£ Departmental schemes

*Excludes surplus returns in excess of prescribed returns for 3 States Gujarat, Kerala and Orissa.

[illegible]

Progressive returns to [illegible]
Boards and [illegible]
[illegible]

(Rs. lakhs)

States	Investment as on 31.3.1979*	[illegible]	[illegible] Col. 3 to Col. 2	[illegible]	[illegible]	[illegible]	1982-83	1983-84	Total 1979-84
1. Andhra Pradesh	[illegible]	[illegible]	1.7	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. Assam	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	436	[illegible]	[illegible]	[illegible]
3. Bihar	[illegible]	[illegible]	[illegible]	[illegible]	149	718	[illegible]	[illegible]	[illegible]
4. Gujarat	[illegible]	[illegible]	1.3	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5. Haryana	[illegible]	-	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6. Himachal Pradesh	7125	-		[illegible]	[illegible]	257	[illegible]	[illegible]	[illegible]
7. Jammu & Kashmir	19043	[illegible]	0.1	[illegible]	[illegible]	677	[illegible]	[illegible]	[illegible]
8. Karnataka ([illegible])	38535	[illegible]	[illegible]	[illegible]	[illegible]	2043	[illegible]	[illegible]	10711
9. Kerala	18875	[illegible]	2.6	642	764	[illegible]	1020	[illegible]	4436
10. Madhya Pradesh	32299	[illegible]	1.6	[illegible]	[illegible]	2083	2910	[illegible]	[illegible]
11. Maharashtra	79214	[illegible]	5.0	[illegible]	[illegible]	1443	[illegible]	[illegible]	[illegible]
12. Meghalaya	[illegible]	[illegible]	1.3		17	[illegible]	[illegible]	[illegible]	[illegible]
13. Orissa	[illegible]	[illegible]	[illegible]	[illegible]	591	[illegible]	[illegible]	[illegible]	[illegible]
14. Punjab	[illegible]	1500	2.5	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
15. Rajasthan	[illegible]	-150	-0.5	[illegible]	[illegible]	[illegible]	1037	[illegible]	[illegible]
16. Tamil Nadu	33362	-15	-0.05	284	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
17. Uttar Pradesh	[illegible]	1165	0.8	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
18. West Bengal	24181	-937	3.9	-459	18	456	[illegible]	[illegible]	[illegible]
All Boards	696163	[illegible]	1.5	16567	[illegible]	28587	35157	41412	144923

Source: Net returns shown for 1978-79 are from Secretariat's compilations.

Note: Excludes all departmental schemes.

*Loans advanced and outstanding on 31.3.1979 with State Electricity Boards and MPC.

OBSERVATIONS ON THE NOTE OF SHRI H.N. RAY

We have adopted a normative return of six per cent every year on the investments of State Governments in electricity boards and departmental electricity undertakings, effective from 1979-80 onwards. We consider this realistic, since we have kept in mind the actual achievements in 1976-77 and the estimates thereafter in States which have shown good results as well as the States at the other end of the scale. We also feel that as Commission it would be incorrect for us to stipulate lower normative returns than the last Commission did. Any States which achieve better returns than the norms would thereby augment their resources for their plans. Having decided upon a norm we feel it would be fair, and a recognition of good performance, if we ignore additional returns earned by any State over the norm for the purpose of estimations of the receipts of the State Government. This is what we have done.

2. Shri Ray has observed that the inclusion of the Central excise duty in the normative return leads to disperate results in the different States, in that the Central excise duty element in the return is different in different States. This will be so, for reasons like the different load patterns and varying transmission and distribution losses in the States. Even more important, since our calculation is on the investment of the State Government, and not the total investment, the results are bound to be different. The proportion of State Government investment in the total investment in electricity boards varies widely between the States.

3. Apart from the above, our view basically is that the levy of the Central excise duty definitely is a factor which inhibits the freedom of the States to adjust electricity tariffs, in the same manner as electricity duty levied by the State Government does. We have to recognise that there are limits at any point of time to the levels of tariffs for the consumers, irrespective of whether additional earnings from them are retained by the electricity boards or given to the State Government or to the Central Government. This position stands irrespective of the merits of the much wider question raised by Shri Ray in para 5 of his note. We also note that the Central Government has decided in effect that the revenue from its Central excise duty on electricity should go back to the States.

4. Shri Ray feels that it is not correct to set off the Central excise levy on electricity both against the additional resource mobilisation targets of the States for 1978-79 and against the return on investments in electricity. This, we are afraid, misses a crucial point, namely, that when the targets were fixed there was no knowledge that there would be a Central levy on electricity of the order of 1/3rd of the total resource mobilisation targets of the States. It is well known that electricity tariffs and duty are an important areas for States to raise resources for their plans. We, therefore, consider it would be impractical to maintain for our purposes the original resource mobilisation targets for this year. We note that the Central Government's decision to retransfer the Central excise should ease to some extent the States' mobilisation effort.

J. M. Shelat

Raj Krishna

C. H. Hanumantha Rao

V. B. Eswaran

New Delhi,
October 28, 1978.