Chapter 11

NON-PLAN CAPITAL GAP OF STATES

Under paragraph 8 of the Presidential Order constituting the Commission the Commission may make an assessment of the non-Plan capital gap of the States on a uniform and comparable basis for the five years ending with 1983-84. In the light of such an assessment, the Commission may undertake a general review of the States' debt position with particular reference to the Central loans advanced to them and likely to be outstanding as at the end of 1978-79 and suggest appropriate measures to deal with the non-Plan capital gap, having regard inter alia to the overall non-Plan gap of the States, their relative position and the purposes for which the loans have been utilised and the requirements of the Centre. The Sixth Commission, which was the first Finance Commission to be asked to undertake a comprehensive review of this aspect of the finances of the States, had similar terms of reference. There is however a significant difference between our terms of reference and those of the Sixth Commission in that whereas that Commission was asked to suggest changes in the terms of repayment of the Central Loans, we are required to suggest "appropriate measures" to deal with the non-Plan capital gap of the States in the period covered by our report.

Assessment of non-Plan capital gap

2. The capital transactions of the State Governments are brought to account under the various heads of account prescribed in the Consolidated Fund, Contingency Fund and the Public Account. A summarised list of these heads is given in Appendix VI. 1. As indicated earlier, we obtained from the States their forecasts of receipts and disbursements on capital account for the five years from 1979-80 to 1983-84. We re-assessed these forecasts on a uniform and comparable basis for estimating the gap of each State on capital account arising out of non-Plan transactions. We might observe in this connection that we have benefited considerably from the pioneering work of the Sixth Commission in this exercise. We have kept in mind certain general considerations, for instance, the current practice that some types of net receipts on capital account are taken as resources of the States for their Plans and so are not available for meeting non-Plan liabilities and the fact that capital outlays and loans advanced by the States generally represent investment expenditure and should form part of their Plans.

3. The capital outlay in the general services Sector in the States is mainly incurred for construction of non-residential buildings, other than those exclusively relating to a function included in the sectors 'social and community services' or 'economic services'. Outlays for stationery and printing, including purchase of machinery for printing presses, are also accounted for in this sector. Several States have proposed sizeable provisions for these purposes in their forecasts. These outlays would create new assets or new capacity and therefore should properly form part of the Plan. We have not, therefore, allowed any provision for non-Plan capital outlay in this group for computing the non-Plan capital gap of the States. However, we have provided elsewhere for their requirements on account of construction of buildings which we considered essential together with provisions on revenue account for upgrading the standards of administration of certain services in many States.

4. Capital outlay brought to account under the heads in the social and community services sector is mostly on buildings, both residential and non-residential, and other construction work like townships. These outlays basically create assets in the developmental

Upgradation of Treasury and Accounts administration, as earlier described and set out in Appendix V. 1, may be monitored by the Ministry of Finance.

(ii) Judicial Administration: Additions of a specific number of courts, attaining the minimum norms of disposal per court based on past trends, and construction of court buildings and of residential accommodation for all the new Presiding Officers, as set out in Appendix V. 5, can be conveniently monitored by the Department of Justice.

(iii) Revenue, District and Tribal Administration: The implementation of specific schemes for which provisions have been allowed as listed in Appendix V. 7 may be monitored by the Ministry of Home Affairs.

(iv) Police Administration: The norms adopted for making provisions for upgradation of strengthening of police administration have only been stated in financial terms as far as revenue expenditure is concerned and the State Governments should finalise their plans of operation in consultation with the Ministry of Home Affairs. For the provisions made for Police housing, the Ministry of Home Affairs may draw up a suitable monitoring system to ensure that the funds provided are utilised for the construction of quarters/barracks in accordance with the norms adopted by us. Appendix V. 10 (ii) lists the provisions we have allowed.

(v) Jails: Provisions for incurring of minimum of expenditure of Rs.3 per day on the diet of prisoners and Rs.1 for medicines, clothing, etc. within the total provision of Rs.6 per day for direct expenditure on prisoners (including overheads), which should be monitored by having suitable sub-heads under the major head of account. For additions to overall capacity also we have specifically indicated the amounts provided to the States where such capacity needs to be augmented, and the progress made against these schemes should be monitored by the Ministry of Home Affairs. All the items, including amenities and improvements in Jails, and the provisions allowed by us are listed in Appendix V. 14. This should be utilised for the purposes of preparing plans of action, releases of grants and monitoring of progress.

47. We have examined the question of the mode of regulation of releases of grants. These grants should be made so as to cover the actual expenditure on the approved plans of action. An initial on-account grant may be released in the first year and the second year's grant on the basis of performance and expenditure reported by the State Government. By the third year, the audit report for the first year should be available and should also be taken into account while making the subsequent annual releases of grants. The grants we have recommended are for five years, and any shortfalls in actual expenditure in a year should remain available for utilisation in the subsequent years till 1983-84.

48. We expect that the provisions for upgradation of administration made by us will have a substantial impact on the effectiveness of the States' administration, and enable them to overcome the deficiencies that have come to light. We trust that the provisions will be purposefully utilised by the States.

sectors. In a few cases, the outlays under this group are in connection with purchase and sale of commodities by the Food and Civil Supplies Departments of the State Governments. We have not allowed any non-Plan capital outlay under the heads in this sector, except a provision of Rs. 20 crores in the case of Assam towards construction of a new capital for the State. Following the formation of Meghalaya as a separate State the project of the Government of Assam to build a new capital has been given non-Plan aid by the Government of India. We have assumed that of a total outlay of Rs. 40 crores in the five years from 1979-80 to 1983-84, half would be covered by grants from the Central Government and the other half by non-Plan loan assistance. The grant portion and the corresponding amount of capital outlay have been omitted from the forecast of the State Government for convenience.

5. Capital outlay under the heads in the economic services sector are essentially of a developmental nature and should therefore be in the Plan. In certain cases, however, the transactions are of a trading nature, like purchase and distribution of fertilisers, pesticides, etc. In such cases the entire outlay ought to be fully recovered within a short period. The capital account forecasts of some State Governments include provisions for payments provided by their land ceiling laws. The practice is not uniform in all the States. In many States the expenditure has been included in their forecasts on revenue account. We also found that there is no uniformity among the States in the categorisation of such expenditure as Plan or non-Plan. We are not in a position to make correct estimations of the extent of surplus land likely to be acquired during the period covered by our Report in each State and the amounts of payments involved. We noticed that in some States the provision proposed on this account is based on phasing of acquisition of surplus land, which is too optimistic in the light of the achievements in recent years. It is not feasible to make a realistic and fair assessment of the pace of acquisition of surplus land in each State, and estimate on a uniform and comparable basis the payment liabilities likely to devolve on each State. We are of the view that the requirements of the States towards payments for surplus land acquired under the ceiling laws should be provided in their Plans, and that, for this purpose, the realisations from the allottees of such surplus land should be set off against such requirements. In this connection we have noted that the new Draft Five Year Plan for 1978-83 contemplates an outlay of Rs. 350 crores for land reforms and consolidation of holdings. The Planning Commission has also informed us that the Plans of many States for 1978-79 include outlays for payments under the land ceiling laws. Payments of compensation on the abolition of Zamindari, however, stand on a different footing. Hence, where the State Governments have proposed non-Plan expenditure for such payments we have allowed them in our assessment of the non-Plan requirements on revenue or capital account in which the provisions have been proposed by the States.

6. We now turn to the internal debt of the State Governments. Receipts from open market loans, net of repayments, are earmarked for financing the Plan. We have, therefore, excluded from the assessment of non-Plan capital gap both the receipts and repayments on account of open market loans of the State Governments. The States also obtain loans from the Life Insurance Corporation of India, the Agricultural Credit (Long-term Operations) Fund of the Reserve Bank of India and other financial institutions for financing Plan schemes. We have not, therefore, assumed capital receipts by way of loans from these sources. We have, however, fully provided for the repayment liability during the five years 1979-84 in respect of loans from these sources as are likely to be outstanding at the end of 1978-79. But we have not included either receipts or repayments on account of loans from commercial banks and ways and means advances from the Reserve Bank in our computation of the non-Plan capital gap of the States.

Compensation Bonds

7. We have assumed credit for such part of the estimated payment of compensation towards abolition of Zamindari and Jagirdari as may be made in the form of Bonds according to the information furnished by the respective State Governments. We have also allowed for disbursements on the Bonds issues as and when repayments become due during the five-year period from 1979-80.

Loans and Advances from the Central Government

8. We have not assumed credit in our assessment for any non-Plan loans from the Central Government to the States during the five years 1979-84 except in the case of Assam's capital earlier referred to. On the repayment side, however, we have fully provided for the repayments that may be due on Central loans, both Plan and non-Plan, which are likely to be outstanding against the States at the end of 1978-79.

9. We have found that the States' forecasts of receipts on account of recoveries during 1979-84 against outstanding amounts of loans advanced by them do not conform to any uniform pattern. It appears that the estimates of receipts are not based in all cases on the terms of the loans. In very many cases the recoveries assumed are so low that they point to the need for improvement in this important area of fiscal management. It is also noticed in a few cases that loan accounts take very long to prepare, even years, with the result that recoveries are bound to become difficult. It also appears that there is no centralised monitoring of loan recoveries in many States. Greater attention must be paid to these matters. Some of the State Governments have also included recoveries against fresh loans likely to be advanced during the quinquennium 1979-84.

10. A detailed analysis has been made of the loans advanced by the State Governments and likely to be outstanding at the end of 1978-79. In order to estimate on a normative basis the recoveries against the outstandings, which the State Governments should be assumed to make in the period 1979-84, we have categorised the loans as follows:-

(a) loans for social and community services;
(b) loans for general economic services;
(c) loans for agriculture and allied purposes;
(d) loans for other economic services; and
(e) advances to Government servants and miscellaneous loans.

11. We are not in a position to make close estimates of loans likely to be advanced by the State Governments during the five years 1979-84 and have not assumed any recoveries against such loans except in the case of fresh advances to Government servants for purposes other than house building. We have not also assumed recovery against loans advanced to the State Electricity Boards and likely to be outstanding against them at the end of 1978-79, as most of these loans by their terms are not usually repayable by the Boards. For the rest of the loans advanced by the State Governments and likely to be outstanding at the end of 1978-79, we have adopted normative percentages of recovery uniformly for all States, on a broad consideration of the purposes for which the loans are usually advanced. The percentages of recoveries during the five years 1979-80 to 1983-84, as adopted by us, are:-

(a) Loans for social and community services	-	30%
(b) Loans for general economic services	-	45%
(c) Loans for agriculture and allied purposes	-	45%
(d) Loans for other economic services	-	56.25%
(e) Advances to Government servants and miscellaneous loans	-	50%

We have also taken credit for recovery of 60 per cent of the fresh advances to Government servants for purposes other than house building for the five year 1979-84 corresponding to the provisions we have allowed in this period.

Inter-State Debt Settlement (Net)

12. We have adopted in our assessment the forecasts furnished by the Governments of Assam and Meghalaya under this head. Meghalaya has also included in its forecast a provision for repayment to the Centre of a part of Assam's pre-reorganisation debt liability. We have not provided for this repayment since it has not been possible for us to verify that this liability has been correctly assumed by the Government of Meghalaya.

Transfers to the Contingency Fund and transactions under the Fund

13. These transactions, of a book-keeping nature, have been ignored.

Provident Funds

14. It appears to us that it would be proper to treat the net realisations under State Provident Funds as a draft on the savings of the community of Government servants, which should be available for creation of new assets in the Plan, and should not be set off against the non-Plan capital gap liabilities of the State Governments. Several States have also urged that net accretions in State Provident Funds should be let out of account in the assessment of the non-Plan capital gap account. We have also noted that a number of State Governments have been compulsorily diverting into the provident fund substantial portions of benefits in emoluments sanctioned by them to their employees. It would be inequitable to take these accretions to set off non-Plan capital liabilities.

Other heads in the Public Account

15. In regard to the transactions in the Public Account other than State Provident Funds, the Sixth Commission reckoned the net accretions on account of civil deposits as capital receipts available to the States for meeting their non-Plan disbursements on capital accoont. Civil deposits include deposits in civil and criminal courts, earnest money and other deposits by contractors, public works deposits and a variety of other deposits made for short periods. The accretions to these deposits fluctuate considerably from year to year. It is no doubt to be expected that with the increasing volume of Government transactions there should usually be a net accretion to such deposits from year to year. On the other hand, it also happens that large deposits in a particular period would be followed by large refunds later, thereby causing a strain on State Governments' finances. There are also inherent difficulties and imponderables in estimating accurately the transactions under civil deposits, and that too for a full 5-year period. In the light of these considerations, we have considered it expedient to leave out such deposits from the assessment of the non-Plan gaps of the States on capital account. To the extent the States have net accretions of these deposits during the forecast period, the resources will therefore become available to them for financing their Plans.

16. The non-Plan capital gaps of the State Governments for the five years ending with 1983-84, assessed as set out above, add up to a total of Rs. 3512. 18 crores. The State-wise details are given in Appendix VI. 2.

Review of the States' Debt Position

17. We have estimated the total outstanding debt of the State Governments at the end of 1978-79 at Rs. 18,785 crores, comprising the following:-

	(Rupees in crores)
I. Internal Debt	
(a) Market loans	2,572
(b) Other negotiated loans and Compensation Bonds etc. (excluding W&M advances from RBI, cash credit accommodation from commercial banks, etc.)	776
II. Loans by the Central Government	13,463
III. Provident Funds and other unfunded debt	1,974
	18,785

18. In estimating the debt position of the States as at the end of 1978-79, we have not included the Ways & Means Advances from the Reserve Bank, which are of a short-term nature, or cash credit accommodation from commercial banks, that may be outstanding against some of the States at the end of 1978-79. Similarly, we have also not taken the outstandings of short-term Central loans. Appendix VI. 3 gives the State-wise estimated debt likely to be outstanding at the end of 1978-79.

19. We indicate below the All-States' debt position since 1951, estimated as above:

(In crores of Rupees)

	As on 31st March of -						
	1951 Accts.	1956 Accts.	1961 Accts.	1966 Accts.	1969 Accts.	1974 Accts.	1979 Estimated
Debt Liability							
I. Internal debt -							
(a) Market loans	111	222	410	720	950	1543	2572
(b) Other loans	12	45	182	458	539	612	776
II. Loans from Central Government	196	943	2014	4103	5569	8578	13463
III. Unfunded debt	56	86	133	231	367	857	1974
Total debt liability	375	1296	2739	5512	7425	11590	18785

20. Obviously, the States' indebtedness has increased manifold during the 28 years from the commencement of the era of planned development. However, such a situation is inherent in a developing economy and so long as the money is raised or utilised towards achieving social and economic goals of national priority, one need not feel unduly

perturbed over the mounting debt burden of the State Governments taken together. We have also found that the progressive figures of capital outlay and outstandings of loans advanced by the State Governments, both for Plan and non-Plan purposes, have consistently been more than the outstanding debt. The table below would be of interest:

(In crores of Rupees)

	Upto 31st March of						
	1951 Accts.	1956 Accts.	1961 Accts.	1966 Accts.	1969 Accts.	1974 Accts.	1979 Estimated
Assets represented by –							
(i) Capital Outlay	369	1135	2365	4281	5743	9330	17362
(ii) Loans Outstanding	93	309	846	2246	3197	5163	9511
Total	462	1444	3211	6527	8940	14493	26873

This is a welcome feature, indicative of the States taken together having financed a part of their capital outlay and lendings from revenues and from net receipts under public account.

21. The States' indebtedness to the Centre has always constituted a predominant component of their total debt burden. A major part of the mounting debt burden of the States to the Centre is attributable to the large loan assistance being provided by the Centre to the States for financing the Plan. Till the beginning of the Fourth Plan the bulk of such assistance was linked to individual schemes. The pattern was changed to block assistance from the Fourth Plan onwards, not linked with particular schemes, with the result that a direct nexus between the loan funds and their utilisation cannot be established.

Utilisation of the monies borrowed by the States from the Central Government

22. Our terms of reference require us to take into account the purposes for which the Central loans have been utilised by the States.

As in the case of the Central loans which form part of the block assistance for State Plans, the small savings loans advanced by the Centre to the State Governments have all along never been ascribed to any specific purpose. The same applies to Central loans given from time to time to many States in order to sustain their resources for the Plans. These categories of loans constitute the largest bulk of Central loans to the States. It is clear that it is not possible to determine the purposes for which the States utilised the major part of the loans from the Centre merely by reference to the designations given to the loans.

23. We have, therefore, evolved an empirical approach, by which we can estimate sufficiently for our purposes the manner in which States have used the loans from the Centre and the return flows of funds to their budgets. For each State, we have computed the receipts from various sources of funds that became available on capital account during the period of 12 years from 1967-68 to 1978-79. We have also worked out the capital outlays and the loans advanced by the State Governments during the same period. We have categorised the capital funds available to the State Governments into the following four broad

categories, in the ascending order of the cost involved to the States in procuring these funds on capital account:-

Category (i) - no-cost funds, which include broadly the surplus on revenue account, recoveries of loans and advances by the States, and deposits and reserve funds not bearing interest;

Category (ii) - loans from the Central Government, net of repayments;

Category (iii) - market loans, net of repayments; and

Category (iv) - loans from the Life Insurance Corporation and other financial institutions, net accretions in the provident fund, deposits bearing interest and overdrafts.

Likewise, we have worked out the capital outlay and the loans and advances made by the State Governments during the same period of 12 years into three broad categories, namely -

(a) those which are not likely to yield to the State budgets any return sufficient to cover interest charges, much less repayments of the loans used, and can, therefore, be termed as non-productive purposes - such as capital outlay on public works, roads and bridges, education, social security and welfare;

(b) outlays which ought to yield sufficient direct returns, assuming good management, to meet interest charges, but which do not yield enough to enable States to meet the repayment liabilities of the principal - these which could be termed semi-productive purposes include capital outlay on housing, a part of the outlay on agriculture and allied services, outlay on multi-purpose river schemes etc., and, more importantly, loans for power projects; and

(c) utilisation towards productive purposes, which we take as including mainly loans to various parties, where the States ought to be able to make recoveries sufficient to meet their interest and repayment liabilities.

24. Having thus categorised the funds available to the States, in the capital account during the 12 years from 1967-68 to 1978-79, as also the capital outlays and loans made by the States during the same period, we have assumed that the funds used for non-productive purposes would be the no-cost funds. If the non-productive purposes are not fully covered by the no-cost funds, Central loans have been taken as financing the balance. If in any case there is a balance of the no-cost funds, after meeting non-productive purposes, the amount has been taken as used for semi-productive purposes. To the extent that the use for semi-productive purposes is not covered by the balance of the no-cost funds, we have taken it that Central loans would have been used. In cases where the Central loan funds are larger than necessary for this purpose, they have been attributed to productive purposes. It appeared to us that it would be logical to assume, as we have done, that the requirements of capital expenditure, categorised into non-productive, semi-productive and productive uses should be properly met first from funds on which the State Governments have to bear no-cost and then progressively from funds which bear increasing costs.

25. We have thus estimated the amounts of Central loans which may be deemed to have been utilised towards non-productive, semi-productive and productive purposes. The percentage utilisation of Central loans accordingly has been shown in the Table

below (the percentages have been rounded to the nearest multiple of 5):-

(Percentages in nearest multiples of 5)

Sl. No.	States	Non-Productive purposes	Semi-productive purposes	Productive purposes	Total
(1)	(2)	(3)	(4)	(5)	(6)
1.	Andhra Pradesh	-	90	10	100
2.	Assam	45	50	5	100
3.	Bihar	-	75	25	100
4.	Gujarat	-	100	-	100
5.	Haryana	-	70	30	100
6.	Himachal Pradesh	60	40	-	100
7.	Jammu & Kashmir	40	60	-	100
8.	Karnataka	-	30	70	100
9.	Kerala	25	75	-	100
10.	Madhya Pradesh	-	90	10	100
11.	Maharashtra	-	70	30	100
12.	Manipur	50	50	-	100
13.	Meghalaya	80	20	-	100
14.	Nagaland	100	-	-	100
15.	Orissa	10	90	-	100
16.	Punjab	-	-	100	100
17.	Rajasthan	5	95	-	100
18.	Sikkim	-	90	10	100
19.	Tamil Nadu	-	25	75	100
20.	Tripura	70	30	-	100
21.	Uttar Pradesh	-	70	30	100
22.	West Bengal	5	60	35	100

26. We have taken, for the analysis above, the Central loans to the States for the last 12 years i. e. from the year following the re-organisation of the erstwhile State of Punjab. The period is long enough to provide sufficiently reliable results for our exercise. There is no reason to assume that an analysis for a longer period would give substantially different results. We find that in the period we have taken, Central loans to States net of repayment by the States were two-thirds of the total outstandings at the end of 1978-79.

Measures to deal with the States' non-Plan capital gap during 1979-84

27. As aforesaid, our terms of reference require us to suggest appropriate measures to deal with the assessed non-Plan capital gap of the States for the five years ending with 1983-84. Obviously no such measure can be devised which would be confined to the five years from 1979-80 and which would have no impact on the debt burdens of the States in the years after 1983-84. Also, it is not possible to devise measures in relation to borrowings by the States from lenders other than the Central Government. Whatever measures we recommend have consequently to be in relation to the outstanding Central loans.

28. In their memoranda submitted to us, some of the State Governments have urged that we should recommend scaling down or writing off a part of the outstanding Central loans, more particularly those whose utilisation is for non-productive purposes. We agree with the approach of the Sixth Finance Commission that write-off of the States' debt burden to the Centre, as a general measure, may not be desirable. Writing off

loans, except on a carefully selective basis, could well discourage conscious efforts on the part of the State Governments for mobilising tax and other resources sufficient to meet their requirements. Instead, measures aimed at linking the repayment period suitably with the purposes for which Central loans have been used by the State Governments, are likely to command greater acceptability in all quarters and would not also be questioned as arbitrary.

29. The total amount of Central loans likely to be outstanding against the States at the end of 1978-79 has been estimated at Rs. 13,463 crores, including Rs. 82 crores against Orissa on account of the Hirakud Project, Stage I, the repayment of which commences in 1988-89. Of this estimated amount of loans likely to be outstanding at the end of 1978-79, Rs. 2,133 crores have been estimated as relating to loans advanced to States as their shares of the net collections of small savings. Some of the State Governments have suggested that these loans should be converted into 'loans in perpetuity'. The reason adduced is mainly that what the Central Government lends to a State in a year is two-thirds of the 'net' collections in that State in that year. In other words, the Centre's repayment liability on account of small savings is, in each year, fully met from the fresh collections in that year and it is only from the balance that a share is paid to the States by way of loans. The suggestion for converting these into irredeemable loans had been made by many State Governments to the Sixth Finance Commission as well. The Government of India in a communication to that Commission, had agreed with the view that the small savings loans stand on a different footing from other Central loans to the States and might be considered on merits irrespective of the non-Plan capital gap of the States. It cannot be ignored that in mobilising small savings collections, the State Governments play a vital role, barring the portion attributable to deposits of provident funds, e.g. under the Employees' Provident Fund Act. On a full consideration, we see considerable force in the plea that small savings loans, being a part of 'net' collections, should be converted into 'loans in perpetuity'. Accordingly, we recommend that in the case of each State the small savings loans outstanding against the State at the end of 1978-79 may be consolidated into one loan as on 1st April, 1979, and such consolidated loans may be then converted into 'loans in perpetuity', in respect of which the States need not make any repayment of principal with effect from 1979-80. They should however continue to pay annual interest at the existing rate. Shri H. N. Ray has reservations on this recommendation, and thinks that "loans in perpetuity" is a novel concept. Also, he has emphasised that while the Centre's liability to repay the individual depositors remains unchanged, the cover in the form of repayments of the principal on account of small savings loans advanced to the States is now withdrawn by virtue of this recommendation.

30. It appears logical that the Central loans applied to unproductive purposes, as we have derived in the manner explained above, should not be expected to be repaid, for the State Government cannot get any return which would enable them to meet their interest liabilities, let alone repayment of the capital. It is not as if the States had the choice to use the Central loans only for purposes other than unproductive ones. This is clear from the analysis which we have done. The amount involved, out of the total outstanding of Rs. 13462.84 crores against all the States at the end of 1978-79 is Rs. 942.82 crores as presently estimated by us without taking into account the rehabilitation loans referred to in paragraph 31. We recommend that this component should be written off.

31. We have referred earlier to the outstandings of Rs. 82.42 crores against Orissa at the end of 1978-79 on account of Central loans advanced to that State for the Hirakud Project, Stage I. Since the repayment of this loan is due from

1988-89, and therefore does not affect the non-Plan capital gap of the State in the period covered by our Report, we do not recommend any modification of the terms of this loan. We have noticed that there are small outstandings against States on account of Central loans advanced upto 31st March 1974 for rehabilitation of displaced persons and repatriates, etc. in respect of which the position is that States are now required to pay only half of such recoveries as they are able to effect. We feel that this position need not be distrubed. In respect of loans advanced to the States by the Central Government from 1st April 1974 for the same purposes, we understand that the terms allow States to repay only what they are able to recover against their lendings from these advances. We do not propose to disturb this arrangement either.

32. In regard to the balance of the Central loans outstanding against the States at the end of 1978-79, we consider that the States should repay these loans over periods related to the purposes for which they have been used as estimated by us. It seems reasonable that the outstanding loans attributed to semi-productive purposes should be repayable in 30 years from 1979-80, and the balance of outstanding loans attributed to productive uses over a period of 15 years from 1979-80.

33. We recommend accordingly that -

(a) the balance of the Central loans, other than small savings loans, the loans referred to in paragraph 31 and short-term loans, outstanding at the end of 1978-79 may be consolidated into one loan, as on 1.4.1979, outstanding against each of the States;

(b) out of the consolidated loans, amounts equivalent to the percentages shown against the respective State in column 4 of the Table in paragraph 25 should be recovered in 30 equal annual instalments, commencing from 1979-80; and

(c) the balance of the outstanding Central loans against the States, as consolidated on 1.4.1979, amounting to the percentages shown against the respective State in column 5 of the Table in paragraph 25, should be recovered in 15 equal annual instalments, commencing from 1979-80.

34. As estimated by now, the amounts to be consolidated in these two categories will be Rs.7613.64 crores and Rs.2690.79 crores respectively for all the States taken together, not taking into account the rehabilitation loans mentioned in paragraph 31, for which the estimates of outstandings at the end of 1978-79 are not available. When these are also allowed for our estimates of the amounts to be consolidated are likely to be marginally smaller.

35. We have considered what the rates of interest should be on these two categories of consolidated loans, in the light of the preferential rates of interest normally prescribed by the Central Government for the loans to the States. We have also kept in mind the fact that these outstandings relate to loans advanced by the Centre over a very long period. It appears to us that the rates of interest at 4.75% and 5% respectively would be just and appropriate for the consolidated loans relatable to semi-productive purposes and for productive purposes. We recommend that the rates of interest should be refixed accordingly.

36. As mentioned earlier, the Central loans likely to be outstanding against the States at the end of 1978-79, as estimated by us, do not include any outstandings on account of

the short-term advances, such as these for agricultural inputs, for tiding over temporary ways and means difficulties, etc. Should there be any such short-term advances remaining outstanding against any State at the end of 1978-79, the repayments thereof should be effected in accordance with the existing terms applicable to such advances.

37. These recommendations will reduce the estimated total debt burden of all the States to the Centre as at the end of 1978-79, by an estimated amount of Rs.3075.99 crores. This is the result of conversion of small savings loans into 'loans in perpetuity' (Rs.2133.17 crores), and the write-off recommended (Rs.942.82 crores) in respect of 11 States. Further, for the 5 years ending with 1983-84, the repayment liability of the State Governments to the Centre will get reduced by Rs.2155.80 crores, as estimated by us, comprising Rs.388.14 crores on account of small savings loans, and Rs.1767.66 crores due to write-off as well as conversions into 30-year loans and 15-year loans. The estimated relief, during the 5 years 1979-84, accruing to each State as a result of these recommendations, is as follows:-

(In crores of rupees)

S.No.	State	Estimated relief in repayment of loans to Central Government during 1979-84 on the basis of our recommendations.
1	2	3
1.	Andhra Pradesh	135.63
2.	Assam	112.20
3.	Bihar	182.65
4.	Gujarat	108.02
5.	Haryana	38.29
6.	Himachal Pradesh	30.37
7.	Jammu and Kashmir	133.79
8.	Karnataka	39.53
9.	Kerala	115.09
10.	Madhya Pradesh	147.34
11.	Maharashtra	160.78
12.	Manipur	11.85
13.	Meghalaya	5.94
14.	Nagaland	18.59
15.	Orissa	96.48
16.	Punjab	60.57
17.	Rajasthan	137.98
18.	Sikkim	0.66
19.	Tamil Nadu	49.93
20.	Tripura	10.55
21.	Uttar Pradesh	367.63
22.	West Bengal	191.93
	Total:-	2155.80

These estimates, as mentioned earlier, do not allow for the treatment we have proposed for rehabilitation loans in paragraph 31.

38. The estimated relief of Rs. 2155.80 crores in the States' loan repayment liability to the Centre during the five years 1979-84, in accordance with the above recommendations, will convert the non-Plan capital gaps of Nagaland and Tripura assessed by us for that period into surpluses amounting to Rs. 4.96 crores taking both the States together. The other 20 States will have their non-Plan capital gap for the five years 1979-84, as assessed by us, reduced to a total of Rs. 1361.34 crores, which is about 39.03 per cent of the assessed gap in relation to those States.

39. This position cannot be compared to the relief given by the Sixth Commission in regard to the non-Plan capital gaps of the States for the quinquennium 1974-79. As mentioned earlier, unlike that Commission, in our computation of the non-Plan capital gap, we have left out net accretions to provident funds and civil deposits, and have also provided for repayments of loans fully, including repayments of small savings loans to the Centre. Since we have recommended coversion of small savings loans into loans in perpetuity, the States' efforts at small savings collections should receive a great fillip and augment their capital receipts.

40. Our recommendations in relation to loan repayments to the Centre as well as the rates of interest to be charged on the 30-year and 15-year loans into which the loans outstanding at the end of 1978-79 would be converted, would also increase the interest liability in the case of 10 States by an amount of Rs. 158.52 crores in all, but will reduce the liability of the remaining 12 States, by a total of Rs. 172.19 crores during the five years 1979-84. These modifications in the States' liability towards payment of interest to the Centre, during the five years 1979-84, have been taken into account in our assessment of their surplus or gap on non-Plan revenue account. We have ignored, in these calculations, the changes in the amounts to be consolidated into 30-year and 15-year loans consequent on the treatment we have proposed for the rehabilitation loans.

41. Finally we would urge, as the Sixth Finance Commission did, that our recommendations for debt relief should be viewed in their totality and accepted as a 'package' both by the Government of India and the State Governments. Simultaneously we strongly recommend that while making financial assistance available to the States from 1979-80, whether for Plan or for non-Plan purposes, the Government of India and the Planning Commission should determine the loan and grant components thereof with due regard to the end-use to which the assistance is likely to be put by each State, and that, having so determined the loans component, the terms of repayment thereof should be prescribed consistently with the terms that we have recommended in relation to the loans that would be outstanding against the States at the end of 1978-79.

CHAPTER 12

GENERAL OBSERVATIONS

During our discussions with the State Governments, other non-official bodies and academics interested in the work of the Finance Commission, a view was expressed in emphatic terms that the Finance Commission, to fulfil its role effectively as contemplated by the Constitution, should be a permanent body instead of one constituted once in five years. This view was sought to be fortified by more than one consideration. Some thought that a permanent Finance Commission would reduce the scope for the Central Government to make discretionary transfers in an ad hoc manner to the States. It was pointed out that with the diversities which have emerged in the political complexion of the Governments at the Centre and in the States, it would be in consonence with sound and smooth Centre-State fiscal relations if there was a permanent Finance Commission to advise continuously on fiscal transfers, taking note of developments in the finances of the States from time to time. It was urged that this was not possible if the Finance Commissions were appointed once in about five years. In consequence of the Finance Commission coming into existence at intervals of five years the scope for making discretionary grants by the Centre automatically grew. It was suggested that if the Central Government had a large scope for discretionary fiscal transfers, there was scope for some States being favoured unduly, and their improvidence or lack of effort in the matter of good fiscal management condoned or even rewarded. Those who held such a view believed that the Finance Commission, being an impartial body, would be able to ensure that Central transfers were not made to particular States on considerations which may not be fair or acceptable to the rest of the States.

2. Another consideration put forward was that when a Finance Commission is appointed, it has to start on a clean slate, collect the material required for its work from the State Governments and the Central Government, and then initiate such studies and analyses as it requires. The feeling is that within the time available to a Commission it is often handicapped in its work. It has been urged that if the Finance Commission were permanent, like the Australian Grants Commission, its task would be easier, since it would be able to keep under continuous review various aspects of the finances of the Central and State Governments, special features of particular States, and the factors which affect their finances. An alternative suggestion in this context has also been made that there should be a permanent agency with functions similar to those of the Commission's Secretariat, which would act as the Secretariat for a new Commission as and when that is constituted. Similar suggestions have also been made by the Commissions in the past.

3. One of the most important advantages of the present system, under which the entire Finance Commission is constituted afresh, is that all the Members can be expected to function impartially. One might doubt whether it would be possible to preserve this cardinal feature if the Commission were a permanent body. If it were, there might well be a tendency for Members to be regarded as full-time employees of the Central Government, and this would be unhealthy from the point of view of the Commission's functions vis-a-vis the State Governments. Besides, we see advantage also in the present system which allows for the induction of persons with a fresh approach and unbiased minds as Members. We would not, therefore, favour the idea that the Finance Commission needs to be permanent. In regard to the discretionary transfers of fiscal resources by the Central Government to the States, we cannot conceive of a system which can altogether eliminate such transfers in the widely varying conditions and circumstances in which the State Governments may find themselves from time to time. The scope for