State Finances and the Fourth Plan

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When the Central Government is so concerned with curbing inflationary pressures, the States have made no attempt whatsoever in their Budgets for 1965-66 to aver even their revenue deficits.

This [act cannot but have its impact on the Fourth Plan,

The Planning Commission may be compelled to revise downwards its estimates of revenue surpluses at current tax rates and, correspondingly, raise its estimate of the 'resources gap'.

This, in turn, will naturally affect the size of the Fourth Plan,

In this context a major responsibility rests on the Finance Commission now nearing the end of its labours. It will have to evolve a system of financial assistance from the Centre to the Slates which will meet the genuine needs of the States while requiring the States to make reasonable efforts to raise revenues.

IN what is obviously an attempt to secure enhanced devolutions from the Centre, the States have vied with one another in leaving large deficits uncovered in their budgets for 1965-66. While it may be conceded that States have certain genuine difficulties in imposing new taxation for meeting their deficits, it would be wrong to condone their comphcency at a time when the county is about to embark on a crucial phase of its economic planning. When the Central Government is concerned with raising larger internal resources for financing huge investments in the Fourth Plan, the States have not made reasonable efforts even to eliminate or reduce their revenue deficits. If this attitude continues, it may seriously jeopardize the stability and growth of the economy.

Rise in Deficits

The State Government's tendency to seek the easy way out by relying on the Centre's doles, despite the buoyancy of their own revenues, is clearly brought out by a comparison of the budget estimates for 1964-65 with those for 1965-66. In the current year the States total revenue receipts have shown an increase of 21 per cent, from Rs 1,553 crores in 1964 65 to Rs 1,878 crores (Table 1). But expenditure has increased by 26.5 per cent from Rs 1,548 crores in 1964.65 to Rs 1,959 crores. Accordingly, whereas last year revenue receipts at the existing level of taxation more or less matched revenue expenditure and there was a marginal surplus of Rs 5 crores, receipts in the current year are estimated to fall short of expenditure by Rs 80.13 crores. Added to the revenue deficit is the deficit on capital account and other miscellaneous expenditure aggregating Rs 36.76 crores, bringing the total deficit of the States to Rs 116.89 crores.

Within this consolidated picture for all States, the performance of individual States varies considerably. On revenue account, only three States, namely, Assam, Bihar and Punjab have shown surpluses of Us 6.38 crores, Rs 5.71 crores and Rs *2.32* crores, respectively, and in the other States, deficits range between Rs 0.35 crores in Madhya Pradesh and Rs 17.83 crores in West Bengal. On capital account, surpluses occur in the budgets of Jammu and Kashmir (Rs 1.33 crores), Kerala (Rs 1.38 crores), Rajasthan (Rs 4.34 crores) and West Bengal (Rs 10 78 crores); the rest of the States show deficits varying from Rs 1.60 crores in the case of Andhra Pradesh to Rs 26.34 crores in Maharashtra. The overall position or ail the States –; one of deficit which ranges between Rs 0.82 crores in the case of Kerala to Rs 35.69 crores for Maharishter.

In certain States the deficits, are actually larger than what the budget figures reveal — a lot of window-dressing has been resorted to. For instance, in Bihar though the overall deficit has been kept down to Rs 4.29 crores, the Finance Minister slated in his budget speech that it excluded certain inevitable expenditures such as those *on* revised pay scales and that, provisions *under* certain heads were inadequate, The real deceit, he estimated, might be around Rs 9.18 crores.

Apart from Madhya Pradesh and Rajasthan which nave proposed mild doses of taxation to the tune of Rs 1.71 crores and Rs 1.55 crores, bone of the States has proposed any new taxation, though some States have promised to bring forth tax proposals during the year. The Hilar Pradesh Finance Minister, *(or* instance, stated his intention to submit in due course tax proposals calculated to yield Rs 7.5 crores.

'Memoranda' to the Finance Commission

The Finance Ministers of some of the States used their budge, speeches to appeal to the Finance Commission for a belter deal for their respective States. The Madras Finance Minister, for example, desired that the Commission should evolve a formula under which financial assistance would become available for covering additional expenditure which the States are obliged to incur on upward revision of dearness allowance consequent on similar increase sanctioned by the Central Government. The dominant theme of the speech of the Maharashtra Finance Minister, too, was the need for the Centre to take a more liberal attitude towards a State like his which had done its utmost to mobilise resources by fresh taxation and open mark el loans and had tightened up fiscal administration. Similarly, the West Bengal Finance Minister pointed out that his State which occupied third place in 1957-58 in respect of per capita share is Central taxes had been reduced to ninth place in 1962 63. The budgets of these States were virtually addinonal memoranda to the Finance Cornmission

The performance of some of the States in the matter of raising additional taxation has been depressing in earlier years of the Third Plan also (Table 2). Bihar shove, the poorest performance as it is estinated that it will achieve only about 40 per cent of the target of additional taxation. In fact, Bihar has the distinction of taking no steps, to raise additional lesources by way of taxation during the last five years, with the exception of 1962-63 when additional lax of Rs 1 crore was imposed. It was against the background of this deplorable performance that the Bihar Finance Minister declared in his Budget speech that "the execution of the development plan is a problem of life *and de*ath for us and is the final purpose of all our efforts"! Next to Bihar are Uttar Pradesh and Madhya Pradesh which are expected to raise additional taxation only to the extent of two-thirds of their tagets for the Third Plan. Amongst others, Jamma and Kashmir, Andhra, Mysore, Assam and Rajasthan are expected to achieve their respec- targets to the extent of 71, 87, 89, and 94 per cent.

Seven Stales have exceeded their targets of additional taxation for the Third Plan, Maharashtra shows the best performance, having exceeded the target by about 50 per cent — additional taxation during the Plan being about Rs 77.47 crores as against the target of Rs 52 crores. Gujarat and Orissa are expected to exceed their targets by about 40 per cent Then follow Punjab, Kerala, Madras and West Bengal which are expected to exceed their targets by 21, 18, 17, and 1 per cent, respectively. The picture of additional taxation as it emerges is that the measures taken by the States during 1961-65 will yield about Rs 572.42 crores which is below the third Plan target of Rs 610 crores by Rs 37.58 crores. It will be seen from Table 2 that Madhya Pradesh and Rajasthan are the only States which have distributed additional taxation over the five years. Most of the other States concentrated their efforts in 1962-63 and 1963,64.

Central Assistance

What is as much cause for concern as the tax performance of the States is the sharp rise in the States, expenditure as a result of which even to cover their revenue deficits the States have to look to the Centre. The total resources transferred from the Centre to the States during the First Plan, it will be seen from Table 3, totalled Rs 1,413 crores, representing 42 per cent of the total expenditure of Rs 3,352 crores by States. This proportion increased to 49 per cent during the Second Plan period, as the amount transferred aggregated Rs 2,868 crores as against total expenditure of Rs 5,843 crores. In the current Plan the annual transfers from the Centre have risen from Rs 847 crores in 1961-62 to Rs 1,037 crores in the budget estimates for 1965-66. ft has been estimated by the Planing Commission that the Centre would provide Rs 5,478 crores, or 54 per cent of the Slates' total expenditure of Rs 10,205 crores in the Third Plan period.

Of the total devolutions, loans from the Centre to the Stales which showed an increase of 75 per cent from Rs 799 crores in the First Plan to Rs 1,411 crores in the Second Plan are expected to be doubled in (he Third Plan period to reach the figure of Rs 2,985 crores. In the Third Plan, loans account for about 55 per cent of the total transfers from the Centre to the States. Loans are followed by Starts, share of divisible taxes and duties and grants met from revenue which have increased about four-fold and five-fold, respectively, since the First Plan and today account for 22 per cent and 20 per cent of total devolutions.

In respect of Plan expenditure, the dependence of States on the Centre is almost complete, though in the Third Plan the percentage shows a little decline as compared with the Second Plan. Out of the States' total Plan expenditure of Rs 1,427 crores in the First Plan, the Centre provided Rs 982 crores or 69 per cent; this percentage is expected to reach 93 in the Third Plan as the Centre will provide as much as Rs 3,649 crores out of the States, total Plan outlay of nearly Rs 3,922 crores. In the Second Plan, the percentage of Central assistance was 97, the share or the Centre bring Rs 1,931 crores out of a total expenditure of Rs 1,981 crores. As data on the share of the Centre In Plan outlays in individual States is not yet available, only the total figure for all the States has been given in Table 1. It will be seen that the proposed Plan outlays range from Rs 23.30 crores *In* Jammu and Kashmir to Rs 141.00 crores in Uttar Pradesh; the other two States with big Plan outlays are Maharashtra and Andhra Pradesh which have fixed their figures at Rs 137.60 crores and Rs 100.33 crores, respectively.

Impact on Fourth Plan

The string of defict State budgets has naturally had its impact on the preparation of the Fourth Plan. The calculations of the planners in regard to the internal resources for the Fourth Plan have been upset and consequently meetings of the sub-cominittees of the National Development Council have had to be postponed. The Planning Commission has expressed its concern at the inability of the States to effect economy and keep down non-essential expenditure. It has sought to impress upon the States the need to restrict expenditure on tax collection and general administration, etc, to 5 per cent per annum and non-Plan expenditure on revenue account to 3.3 per cent per annum. The Commission has suggested that representations from States to the Finance Commission should be based on this restticted level of expenditure so that resources for the Fourth Plan would not be unduly curtailed.

But all this notwithstanding it becomes clear that the increased expenditure of the States on revenue accounts is at variance with the assumptions *of* the planners and would cut into resources available for The Fourth Plan. The Fourth Plan memorandum, it will be remembered, had put the revenue gap to be met through increased taxation, better collection and pricing adjustments at nearly Rs 3,000 crores. On the basis of the 1965 66 State budgets as well as the Central Budget, however, the resources gap is now expected to be around Rs 4.500 crores. in fact, even at the time of earlier discussions, whereas the planners assumed the balance available from current revenues of the States at 1964-65 rates at *Rs* 870 crores, the States had maintained that this balance would be no more than Rs 333 crores. The Planning Commission was then of the view that the Strips were deliberately inflating their revenue expenditure, but in view of the 1965,66 State

Table 1: States' Budgets, 1965-66

(Rs Crores)

	Revenue Receipts	Revenue Expenditure	Net Position on Revenue Account	Net Position Outside Revenue Account	Overall Position	Plan Outlay as Fixed by States
Andhra Pradesh	154.53	161.23	6.70	—1.60	—8.30	100.33
Assam	70.78	70.40	+0.38	—4.63	—3.25	30.90
Bihar	119.34	113.63	+5.71	—10.00	—4.29	77.58
Gujarat	106.63	110.31	—3.68	—1.99	—5.67	58.45
Jammu and Kashmir	30.17	35.94	—5.77	+1.33	—4.44	23.30
Kerala	85.50	87.70	—2.20	+1.38	—0.82	41.60
Madhya Pradesh	120.46	121.19	—0.73	—4.21	—5.94	64.65
Madras	163.63	170.60	—6.97	—	—6.97	78.55
Maharashtra	215.47	224.82	—9.35	—26.34	—35.69	137.60
Mysore	121.52	125.43	—3.91	—	—3.91	56.16
Orissa	81.35	91.38	—10.03	—	—10.03	63.38
Punjab	129.65	127.33	+2.32	—5.82	—3.50	62.00
Rajasthan	79.68	86.14	—6.46	+4.34	—2.12	46.90
Uttar Pradesh	247.74	262.65	—14.91	—	—14.91	141.00
West Bengal	152.00	169.83	—17.83	+10.78	—7.05	75.28
Total	**1,878.45**	**1,958.58**	**—80.13**	**—36.76**	**—116.89**	**1,057.68***

*** As some of the States have fixed Plan outlays at levels higher than those approved by the Planning Commission, the aggregate figure is higher than States' total approved outlay of Rs 1.027 crores in 1965-66.**

Budgets the Planning Commission's estimate seems to have been rather optimistic.

This setback is likely to delay the finalisation of the Fourth Plan because, unless the resources sub-committee of the N D C meets and settles on the resources targets and allocations to different sectors, the other sub Committees would not be able to finalise their schemes. Presumably, a detailed review of the resources position by the resources sub-committee will be followed by some generalised recommendations to the States. Some *vague* suggestions about raising resources in the States are already in circulation. For instances, it has been suggested that the States might be asked to levy a surcharge on land revenue, ranging from 50 to 150 per cent to narrow the gap in resources. But the possibility of any really effective steps by the States is generally discounted. The States, it is felt, will not take the political risk, of antagowsing the peasantry.

Light Burden on Rural Sector

It was ten years ago that the Taxation Enquiry Committee recommended the introduction of the agricultural income tax bur the response from the States has been most disappointing The vast scope that exists for taxing agriculture is evident from the fact that of the total tax revenues of the country of Rs 2,400 crores in 1964-65, revenue from the rural sector was only Rs 700 crores. In other words, 80 per cent of the population of the country contributed only 29 per cent of total revenues The rise in agricultural prices has raised incomes in the rural areas and this is, indeed, the opportune time to seek an upward adjustment in and rationalisation of rural taxation.

There has been almost no change in land tax for a long time and in most of the Stages land revenue settlements are as old as 30 to 40 years. Over these years, it is common knowledge, there has been a radical change in incomes from agriculture — per acre yields have risen and agricultural production has been boosted. But the land revenue and agricultural income tax taken together constitute hardly two per cent of the total value of agricultural production Of the total tax revenue of the States during 1,64-*65* amounting to Rs 695.96 crores land revenue accounted for Rs 118.55 crores and the agricultural income tax for Rs 10.26 crores If an element of progression is introduced in the land revenue system the yield from this source can be multiplied since it is relatively difficult to evade. As regards agricultural income tax, only in Assam, Kerala and Madras is it reckoned as a source of income, though it is levied in nine States at present.

Finance Commission's Responsibility

The whole problem of State finances clearly needs careful review. While the States should have some fret dorr. in allocating their own resources, so far as the Central assistance is concerned, there must be an assurance that a major portion of it is related to capital expenditure on projects which are part of the plan. The consequences of frittering away Central assistance on non-essontial expenditure can be seen in the burgeening debt servicing burden on the States against which few income-yielding assets have been created. Interest charges payable by the States have risen from Rs 84 crores in 1961-62 to Rs 210 crores in 1964-65!

As a postscript it may be added that the Rajamannar Commission which is now nearing the end of its labours should devise a system of financial devcolutions that meets the genuine needs of the States but also insists on resoluble efforts by them. In particular, the Commission should take into account Election of arrears of taxes, additional taxation measures during the last five years and efforts to economise expenditure. The revenue gap and the budgetary needs to be met by financial devolution from the Centre should accordingly be based not entirely on the States' own estimates of revenue and expenditure for the coming years but on these esimates as adjudged by the Finance Commission on the basis of criteria of efficiency and responsibility The Commission might measure budgetary gaps with reference to some sort of "optimum" taking into account the States' efforts in raising resources.

Table 2: Additional Taxation by States in Third Plan

(Rs Crores)

	Target	1961-62 Accounts	1962-63 Accounts	1963-64 (R E)	1964-65 (B E)	1965-66 (B E)	Total (Estimated)	Surplus + or Shortfall (—)
Andhra Pradesh	53.00	—	5.00	6.00	—	—	46.50	— 6.50
Assam	16.00	0.15	1.58	1.60	0.86	—	14.19	—1.81
Bihar	50.00	—	1.00	..	—	—	20.32	—29.68
Gujarat	29.00	0.80	2.23	2.90	0.08	—	40.53	+11.53
Jammu and Kashmir	8.00	—	1.10	1.00	0.75	—	5.71	—2.29
Kerala	23.00	2.13	—	5.50	—	—	27.22	+4.22
Madhya Pradesh	48.00	3.00	5.00	1.90	1.45	1.71	31.16	—16.84
Madras	45.00	—	7.14	—	1.00	—	52.52	+7.52
Maharashtra	52.00	1.00	5.71	0.90	.	—	77.47	+25.47
Mysore	42.00	1.70	4.00	—	—	—	36.48	—5.52
Orissa	23.00	0.69	1.57	0.70	—	—	32.01	+9.01
Punjab	40.00	1.31	3.80	5.30	.	—	48.33	+8.33
Rajasthan	32.00	1.35	0.15	4.50	0.58	1.55	29.98	—2.02
Uttar Pradesh	109.00	5.21	0.13	0.30	—	7.50*	69.50	—39.50
West Bengal	40.00	—	—	6.50	1.90	—	40.50	+0.50
Total	**610.00**	**17.33**	**38.41**	**37.00**	**6.62**	**10.76**	**572.42**	**—37.58**

, To be proposed during the current financial year.

Table 3: Devolutions from the Centre to the States

(Rs Crores)

	First Plan	Second Plan	Third Plan (Estimated)
States ' Total Expenditure	3,352	5,843	10,205
Devolution from Centre	1,413	2,868	5,478
(i) Share of Divisible Taxes and duties	327	711	1,191
(ii) Grants (Statutory and Others) met from Revenue	248	668	• 1,148
(iii) Grants from Central Road Fund	16	19	17
(iv) Grants met from Capital	24	59	137
(v) Loans	799	1,411	2,985
States' Total Plan Outlay	1,427	1,981	3,922
Devolution from Centre for Plan Outlay	982	1,931	3,649