CHAPTER 5

BUDGETARY TRENDS AND FISCAL POLICY

5.1 The events of 1971-72 and the setback in agricultural production in 1972-73 continued to cast their shadow on Government finances in 1972-73 and 1973-74. The actual outturn of the budgetary transactions of the Central and State Governments in 1972-73 revealed a disconcerting picture. Thus despite the fact that actual receipts, especially the domestic capital receipts, exceeded the budget estimates, the overall gap which had to be covered by recourse to borrowings from the Reserve Bank amounted to Rs. 848 crores in 1972-73. In the background of strong inflationary pressures in the economy, the major emphasis in the Central budget for 1973-74 was on restraint in the growth of public expenditure, though without affecting investments in the vital core sectors of the economy. As an anti-inflationary measure, the budget sought to reduce considerably the reliance on budgetary deficits for financing public expenditure. However, it appears that because of unexpected subsequent developments, the actual budget deficit this year is likely to be much higher than originally anticipated.

Budgetary Developments in 1972-73

5.2 The combined revised estimates of the budgetary transactions of the Central and State Govenments for 1972-73 reveal that the gap between the total outlay and current revenues turned out to be of the order of Rs. 3426 crores as compared to the budget estimate of Rs. 2272 crores, thereby showing a deterioration of Rs. 1154 crores. As against a modest increase of Rs. 146 crores in current revenues, the increase in Government outlay in the revised estimates over the budget estimates of 1972-73 was Rs. 1,300 crores. The improvement in the current revenues of Government in the revised estimates for 1972-73 occurred mainly under customs duties (Rs. 90 crores), corporation tax (Rs. 65 crores), income tax (Rs. 19 crores) and state excise duties (Rs. 12 crores) offset partly by a decline in union excise duties (Rs. 37 crores) and land revenue (Rs. 14 crores). On the other hand, of the increase in Government outlays over the budget estimates, as much as Rs. 728 crores (56 per cent) was on account of developmental expenditure and the balance of Rs. 572 crores was due to non-developmental expenditure. The increase in non-developmental expenditure was mainly the result of increased outlays on defence (Rs. 192 crores), drought relief (Rs. 250 crores), assistance to the government of Bangladesh (Rs. 24 crores), food subsidy (Rs. 17 crores) and take over of general insurance, copper and coal mines (Rs. 56 crores). As regards the increase in developmental expenditure, this was to a substantial extent accounted for by the Central assistance to States for the emergency agricultural production programme (Rs. 150 crores), the step up in the provision for fertiliser loans (Rs. 40 crores) and also larger assistance for State plans (Rs. 55 crores). The remaining amount of the increase in developmental expenditure was spread over a number of items, such as railways, industries, irrigation, education and medical and public health (including family planning).

TABLE 5.1

Budgetary transactions of the Central and State Governments

(Rs. crores)

	1971-72 (Accts.)	1972-73 Budget estimates	1972-73 Revised estimates	1973-74 Budget estimates
I. *Total Outlay*	**9,789**	**10,273**	**11,573**	**11,838**
(a) Developmental	5,498*	5,981	6,709*	7,024
(b) Non-developmental**	4,291‡	4,292	4,864	4,814
II. *Current Revenues*	**7,009**	**8,001**	**8,147**	**8,853**
III. *Gap (I-II)*	**2,780**	**2,272**	**3,426**	**2,985**
Financed by:				
(i) Draft on voluntary domestic private savings	1,531	1,589	2,396	2,224
(ii) Draft on foreign savings	378	380	336	452
(iii) Foreign assistance earmarked for refugee relief	133	10	14	—
(iv) Budgetary deficit	738	293	680 (852)†	309

* Excludes notional entry of Rs. 212 crores in 1971-72 and Rs. 48 crores in 1972-73 (RE) on account of conversion of loan capital into equity capital in respect of Public Undertakings.

** Excludes Contingency Fund transactions of the Central and State Governments [(Rs. 67 crores in 1971-72, Rs. (—) 68 crores in 1972-73 (BE), Rs. (—) 50 crores in 1972-73 (RE) and Rs. (—)12 crores in 1973-74 (BE)].

‡ Includes Rs. 295 crores on account of expenditure on refugee relief.

† As per accounts. For different concepts of deficit financing, refer to footnote on page 25.

5.3 A major part of the gap between total outlays and current revenues as revealed by the revised estimates for 1972-73 was met by a marked increase in draft on voluntary domestic private savings. The net market borrowings by the Central Government at Rs. 478 crores in 1972-73 set a new record and showed an improvement of Rs. 263 crores over the budget provision of Rs. 215 crores. This sharp step-up in market borrowings was aimed at mopping up excess liquidity in the banking system and at keeping the budget deficit under control. In addition, net market borrowings by the States aggregated Rs. 134 crores in 1972-73, and net collections from small saving at Rs. 300 crores were also higher by Rs. 70 crores as compared to the budget estimates. The draft on foreign savings, however, declined by Rs. 40 crores as compared to the budget estimates. According to the revised estimates, the budgetary operations of the Central and State Governments taken together resulted in 1972-73 in an overall deficit of Rs. 680 crores as compared to the budget estimates of a deficit of Rs. 293 crores.

5.4 The budgetary outturn for 1972-73, however, disclosed a further increase in the deficit when the actuals became available after the close of the year; this was mainly due to further shortfalls in revenues from excise duties and receipts of external assistance, larger outlays on defence, railways, and transactions with the Food Corporation of India in respect of food imports. While for States, the actuals showed a surplus of Rs. 14 crores as against a deficit of Rs. 130 crores as indicated by the revised estimates; at the Centre, the budgetary deficit widened from Rs. 550 crores (RE) to Rs. 866 crores (Actuals). The combined budgetary deficit of the Centre and States thus amounted to Rs. 852 crores in 1972-73 ; this figure works out to Rs. 848 crores if deficit financing is interpreted in the wider sense*.

Budgetary Developments in 1973-74

5.5 In view of strong inflationary pressures operating in the economy, the 1973-74 budget provided for only a modest step-up in developmental outlays while simultaneously trying to keep down to a minimum the outlays of non-developmental nature. As such, the total developmental expenditure of the Centre and States at Rs. 7024 crores in 1973-74 showed an increase of 4.7 per cent only as against a step-up of about 22 per cent in 1972-73. The provision for Plan outlays in the Central budget for 1973-74 was kept at Rs. 2844 crores, showing a modest increase of 8.4 per cent, as against the increase of about 17 per cent in the preceding year. Of this total, Rs. 1924 crores were for the Central Plan and centrally sponsored schemes and Rs. 920 crores were earmarked for plan assistance to States and Union Territories. However, including the resources raised by the State Governments, non-departmental undertakings and financial institutions, etc., the Plan outlay in the public sector as a whole worked out to Rs. 4364 crores which showed over the preceding year's budgeted level, a step-up of 10 per cent only as against the increase of 27 per cent in 1972-73. As regards the non-developmental expenditure of the Central and State Governments, the budgeted provisions were expected to show a small decline of one per cent in 1973-74 in sharp contrast to an increase of 13 per cent in 1972-73.

*Budgetary deficit as per accounts referred to in the Economic Survey comprises Centre's deficit as measured by net increase in the holding of treasury bills by the RBI and variation in cash balances, and States' deficit as measured by ways and means advances (net) from the RBI and variation in their cash balances. The Centre's deficit so defined is a measure of the net variation in the Central Government's short-term indebtedness to the RBI and differs from the concept in the budget documents according to which the budgetary deficit equals net increase in floating debt (i.e. net sale of treasury bills not only to RBI, but also to all other parties such as State Governments, commercial banks etc.) and variation in cash balances.

In a wider sense, deficit financing includes, besides the overall budgetary deficit as referred to in the Economic Survey, the RBI's transactions in the long-dated securities and is broadly equivalent to the net increase in Government's total indebtedness to RBI as revealed by monetary data. The two magnitudes may however differ due to the fact that the final accounts of Government are closed about three weeks after the end of the fiscal year and as such the change in cash balances as emerging from budget documents includes end-year fiscal adjustments whereas no such adjustment is made in monetary data.

5.6 As a result of the massive additional tax effort undertaken in 1971-72, the ratio of tax revenue to GNP at market prices had risen from 12 per cent in 1970-71 to about 14 per cent by 1972-73. On top of it, fresh taxes were levied by the Central and State Governments in 1973-74; these together with the normal growth in revenues, were expected to result in an increase of about 12 per cent in total tax revenues during the current year. The additional tax efforts of the Central Government during 1973-74 were estimated to yield Rs. 290 crores (after allowing for post-budget concession of about Rs. 2 crores). Of this, as much as Rs. 154 crores were to come from customs duties and Rs. 117 crores from excise duties. Direct taxes were to yield Rs. 18.6 crores only. Increases in Railway fares and freights were expected to add another Rs. 44 crores (after post-budget concession of about Rs. 1 crore). The States' own tax efforts (as per their budgets) in 1973-74 were to yield Rs. 41 crores and the share of the States in the Centre's tax effort was estimated at Rs. 40 crores. Taking the Fourth Five Year Plan period as a whole, the total yield from measures of additional resource mobilisation undertaken by the Centre alone (before deducting States' share) works out to a striking figure of Rs. 3900 crores.

5.7 Following the recommendations of the Committee on Taxation of Agricultural Wealth and Income headed by Dr. K. N. Raj, a step of far reaching significance was taken in the current year's budget proposals by making a provision for the partial integration of both the agricultural and non-agricultural components of a tax payer's income for purposes of determining the rate of income tax on his non-agricultural income. Simultaneously, efforts designed to plug the loopholes in income-tax law were intensified. With a view to curbing the use of the institution of Hindu Undivided Family for avoiding tax liability, higher rates of income-tax were prescribed in the case of such families having one or more members with independent income or wealth exceeding the exemption limit. A comprehensive legislation embodying such of the recommendations of the Direct Taxes Enquiry Committee (headed by Shri K. N. Wanchoo) as were acceptable to the Government awaits approval by the Parliament. The tax proposals of the 1973-74 budget also provided enhanced incentives for long-term savings through life insurance and provident fund contributions. In order to provide stimulus to investment in backward areas, Government announced a decision to accord preferential tax treatment to industries to be set up in these areas in the form of a deduction of 20 per cent of the profits in computing their taxable profits. Further, the ceiling on investment eligible for subsidy was raised from Rs. 50 lakhs to Rs. 1 crores, and the amount of subsidy was also raised from 10 per cent to 15 per cent of investment. Also, after May 31, 1974 selected industries will start enjoying the benefit of an initial depreciation allowance equivalent to 20 per cent of the cost of machinery and plant. The existing fiscal incentives for promoting research and development and exports are also proposed to be enlarged. A bill giving effect to these provisions as well as that relating to the concessional treatment of industrial profits in backward areas is now before Parliament.

5.8 In the field of indirect taxation, the thrust towards simplification and rationalisation was continued. The tax base of excise duties was enlarged by bringing in more items and the rates of duty on several luxury items were enhanced. The 1973-74 tax proposals also provided for the replacing of regulatory duties by auxiliary duties, both on excisable and imported goods. Further, in order to fulfil the commitment to the States to raise the additional duties of excise on sugar, tobacco and textiles so as to achieve an overall incidence of 10.8 per cent of the value of their clearances by the end of 1973-74, excise duties on cigarettes were raised and also the basis of charge changed in order to prevent loss of revenue. The import duty proposals included an increase in the rate of duty on machinery and raw cotton as further impetus to import substitution.

5.9 As a result of the budget proposals, the gap between total outlays and current revenues of the Central and State Governments in 1973-74 was estimated to have narrowed to Rs. 2985 crores from Rs. 3426 crores in 1972-73 (RE). This gap was to be financed by a draft of Rs. 2224 crores on voluntary domestic private savings, and of Rs. 452 crores on foreign saving as compared with a draft of Rs. 2396 crores on domestic private savings and Rs. 350 crores on foreign saving in the revised estimates for 1972-73. The overall budgetary deficit of the Central and State Governments for 1973-74 was estimated at Rs. 309 crores—Rs. 87 crores for the Centre and Rs. 222 crores for the States. The Centre's deficit, however, even at the time of the presentation of the budget was expected to be larger than Rs. 87 crores because no provision could be made for the impact of the Third Pay Commissions' recommendations, as the Report had not become available by then. On the other hand, the deficits as revealed in the States' budgets were without reckoning several items of receipts; strictly speaking, States' deficit under the revised procedure is restricted to running down of their cash balances and normal ways and means advances from the Reserve Bank of India. The overdraft facility having been stopped, the only way open to States for bridging the gap between their receipts and expenditures is the resort to the Centre for assistance under some form or the other. Thus at the end of the year, Centre's deficit now also includes a part of what previously appeared as deficit in States' accounts.

5.10 The principal magnitudes emerging from the Economic and Functional Classification of the Central Budget are presented in the following table and are indicative of the modest increases in both Government consumption and provision for capital formation as postulated in the 1973-74 budget. A salient feature of the financing pattern as revealed by this presentation is that gross saving of the Central Government and its departmental undertakings which increased from Rs. 269 crores in 1971-72 to Rs. 572 crores in 1972-73 (RE) was likely to rise further to Rs. 983 crores in 1973-74 (BE). Expressed as a ratio of the Central Government's disposable income*, the net saving was estimated to rise from 1.9 per cent in 1971-72 to 13.5 per cent in 1972-73 and further to 23.7 per cent in 1973-74.

*Tax revenues plus non-tax revenues minus current transfer payments.

TABLE 5.2

Capital Formation by the Central Government and its financing

(Rs. crores)

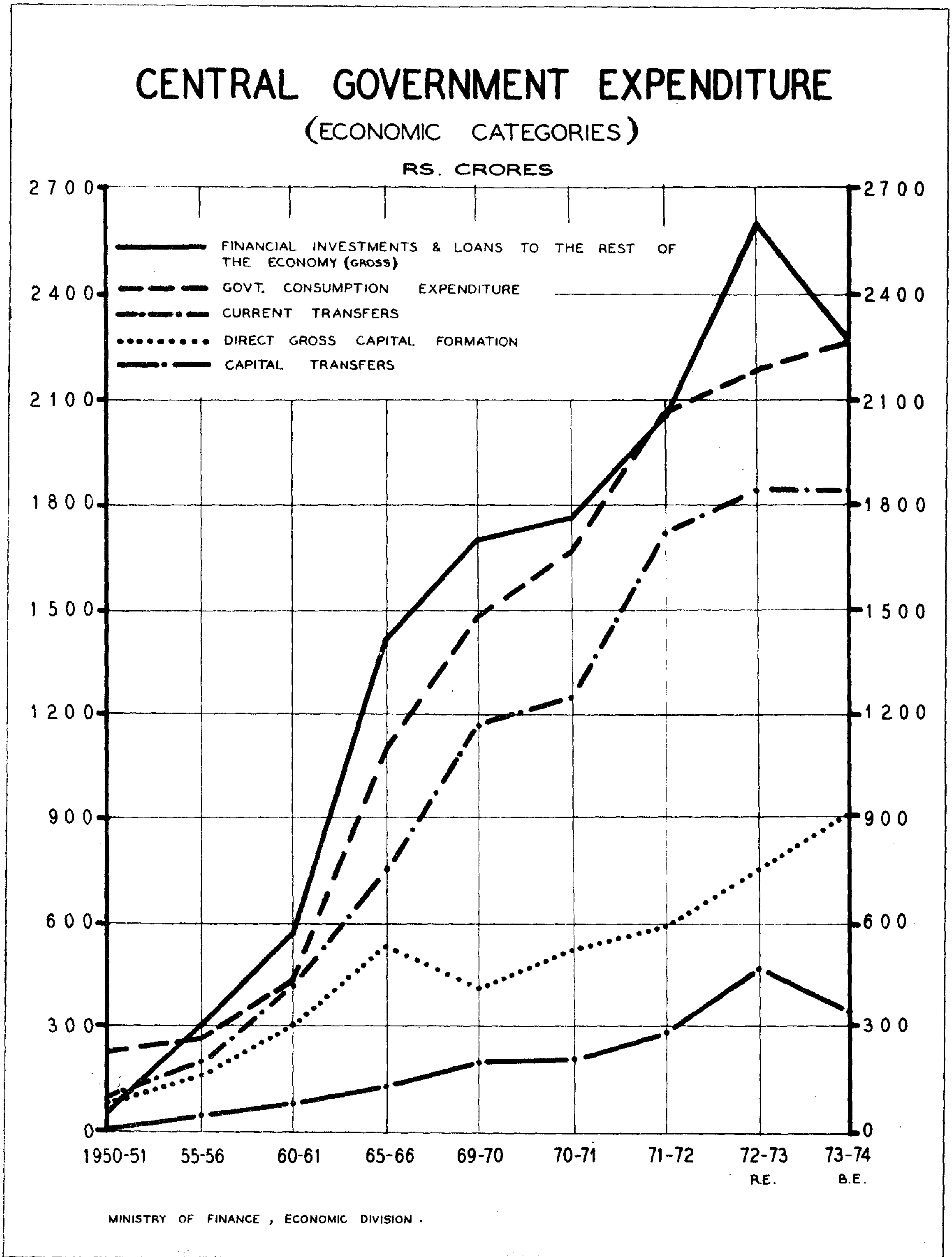
	1971-72 (Accts.)	1972-73 (RE)	1973-74 (BE)
I. Gross capital formation out of budgetary resources of the Central Government	**2,161**	**2,718**	**2,883**
(i) Gross capital formation by the Central Government	597	749	897
(ii) Financial assistance for capital formation to the rest of the economy	1,564	1,969	1,986
II. Gross savings by the Central Government	**269**	**572**	**983**
III. Deficit (I-II)	**1,892**	**2,146**	**1,900**
Financed by :			
IV. Draft on other sectors of the domestic economy	**1,514**	**1,810**	**1,448**
(i) Domestic capital receipts	1,054	1,260	1,363
(ii) Budgetary deficit	460	550 (831)†	85
V. Draft on foreign savings	**378**	**336**	**452**

† As per accounts. Does not include RBI's transactions in long-dated securities.

Note : Gross capital formation in this table includes loans given for capital formation on a gross basis. Consequently domestic capital receipts include loan repayment to the Central Government.

5.11 Apart from capital formation, the Central Government outlays on development include current expenditure on social and economic services; these two categories of expenditure taken together correspond broadly to the total developmental outlay on both plan and non-plan accounts. According to the Economic and Functional Classification of the Central Government budget for 1973-74, the provision for social and economic services on both revenue and capital accounts is estimated at Rs. 4056 crores out of a total expenditure of Rs. 7642 crores budgeted for 1973-74. Although in absolute term, it shows only a marginal step-up of Rs. 31 crores over the 1972-73 level, yet significantly, it accounts for 53 per cent of the total expenditure as against 51 per cent in 1972-73 and 47 per cent in 1971-72.

5.12 As stated earlier, the budget for 1973-74 was framed with a view to imparting a measure of stability to the economy, while making at the same time sufficient provision for achieving a reasonable degree of growth. However, in the post-budget period, it became evident that the originally envisaged budgetary deficit of Rs. 87 crores was likely to be substantially exceeded. The assistance for carrying relief operations in drought affected areas, for instance, is likely to be much larger than visualised earlier. In addition, despite the increase in the issue



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prices of wheat and other foodgrains announced in October and November, 1973, the burden of food subsidy is expected to be about twice the budget provision of Rs. 130 crores. Also, with the improvements made in the Third Pay Commission's recommendations, the impact of its implementation on the current year's budget is expected to be much higher than originally anticipated. In addition, the Central Government has already sanctioned to its employees three instalments of dearness allowance in the current year and together with one more instalment that is likely to fall due in January 1974, these would increase government expenditure by about Rs. 200 crores annually (about Rs. 100 crores in 1973-74).

5.13 In a major move to contain the budgetary deficit, a decision was taken in August 1973 to cut Government expenditure by Rs. 400 crores. Although a large part of this cut was to be on Plan outlays, care was taken that the core sector and projects in an advanced stage remained unaffected. Simultaneously, further economy measures were initiated to restrict the growth of expenditure of non-developmental nature. The States were also requested to review their budgetary position and effect economies, in addition to the reduction of Rs. 100 crores of Central Plan assistance to them. A certain relief to the exchequer is also expected to accrue as a result of measures taken in the wake of world-wide energy crisis. In order to secure a reduction in the consumption of motor spirit in the country, the rate of excise duty on motor spirit was doubled in November 1973. It is estimated that the effect of the doubling of the rate of duty (after allowing for 25 per cent reduction in the off-take of motor spirit) would boost Government revenues by Rs. 50 crores in the current year and by about Rs. 120 crores in a full year. The other changes made in the excise duties on kerosene and diesel oil were of no revenue significance, as their main aim was to prevent the misuse of kerosene for purposes of adulteration of diesel oil.

5.14 The trends in the collections of major central taxes in the first nine months of the current fiscal year reveal that while realisations from income and corporation tax and customs duties may be in conformity with budget expectations, some shortfall in revenue from excise duties cannot be ruled out, given the current pace of industrial production. The revenues of Railways are also expected to show a marked deterioration. On the other hand capital receipts are expected to exceed the original budget anticipations; net realisations of market borrowings by the Central Government are now placed at Rs. 472 crores and show an improvement of about Rs. 146 crores over the budget provision of Rs. 326 crores. Like last year, the Central Government entered the market several times in 1973-74 with a view to mopping up the excess liquidity in the economy. The receipts by way of net collections of small savings are also expected to be higher than the budgeted level of Rs. 325 crores. Even then, taking all factors into account, the overall deficit in the current year is expected to be substantially larger than the original anticipation at the time of the presentation of the budget.

Finances of States : 1973-74

5.15 The budgets of the State Governments for 1973-74 were presented against the background of severe strains on their financial resources caused by drought in 1972-73 and stoppage of overdraft facilities by the Reserve Bank. Technically speaking, States are now required to keep their total disbursements within the availability of their own resources and what they can get from the Centre by way of their share in taxes, grants and loans plus the cushion of the facility of normal ways and means advances available to them from the Reserve Bank of India. It may be recalled that the effective limit of these clean advances from the Reserve Bank of India was raised to four times the earlier limit when the overdraft facility was stopped in May 1972.

5.16 The State Governments' expenditure for 1973-74 as per the budget estimates shows only a modest increase of 5 per cent over the revised estimates in 1972-73 as against an increase of over 20 per cent revealed in the preceding year. While the developmental expenditure at Rs. 4631 crores shows an increase of 5.5 per cent in 1973-74 as against a marked step up of 21.5 per cent in 1972-73 (RE), the non-developmental expenditure at Rs. 1965 crores is higher by only 2.7 per cent as compared to the sharp increase of 18.7 per cent recorded in 1972-73.

5.17 The aggregate current revenues of the States (including additional resource mobilisation) budgeted at Rs. 5056 crores for 1973-74 show an improvement of 8.4 per cent over the revised estimates for the preceding year as against the improvement of 12.4 per cent recorded in 1972-73 (RE). While the tax revenues are expected to increase by 9.2 per cent as against an increase of 11.7 per cent recorded in the preceding year, the non-tax revenues (excluding the surpluses/ deficits of States' non-departmental commercial undertakings) show a marginal decline of 1.9 per cent in contrast to a rise of 11.2 per cent in 1972-73. If the States' own tax reveunes (i.e. excluding their share in Centre's taxes) alone are taken into account, the budgeted level for 1973-74 shows an increase of 9.9 per cent over the revised estimates for 1972-73 and may be compared to the growth of 12.6 per cent expected to be registered by taxes collected by the Centre (before deducting States' share) in the same period.

5.18 An analysis of the pattern of growth in the various items of revenues indicates that States' efforts to augment their own tax and non-tax revenues, particularly the latter, have not been commensurate with the resources required for developmental purposes. The deterioration in the non-tax revenues has primarily been caused by the mounting losses of their departmentally-run undertakings. While the net contributions, as measured by excess of revenue over non-plan working expenses and interest on capital employed, by forests and road and water transport schemes show a decline of about Rs. 6 crores during 1973-74 (BE), the net losses by commercial irrigation and multipurpose river schemes at Rs. 170 crores in 1973-74 are expected to be higher by Rs. 17 crores. On the other hand, some evidence of better performance is provided by the estimated decline in the losses incurred by the departmentally-run industrial enterprises of State Governments.

5.19 The grants from the Centre to the States for both plan and non-plan purposes continue to show a rising trend; in the budget estimates for 1973-74 the States have taken credit for Rs. 1152 crores on account of these grants as compared to Rs. 1006 crores in 1972-73 (R.E.) showing an increase of 14.5 per cent in 1973-74. The share of Central grants in the States' total revenue receipts has increased from a little over 20 per cent in 1968-69 to nearly 23 per cent in 1973-74. Taking into account States' share in Central taxes, total transfers, excluding loans from the Centre to States account for 46 per cent of the latter's total revenue receipts in 1973-74 as against 38 per cent five years ago.

5.20 The measures proposed in the 1973-74 budgets are expected to bring an additional yield of Rs. 41 crores to the State exchequers. During the Fourth Plan period, the State Governments are expected to mobilise additional resources of Rs. 1058 crores as against the target of Rs. 1098 crores. Although this performance appears to be satisfactory, there is a disconcerting aspect also, in that the mobilisation of additional resources from the agricultural sector in the form of land revenue and agricultural income-tax shows a negative figure of Rs. 30 crores. The additional resource effort by States for 1973-74 indicates that only one State (viz. Haryana) has taken some steps by way of further taxing the agricultural sector. There is, thus, an urgent need for mobilisation of additional resources from the agricultural sector not only through speedy implementation of the recommendations of the Raj Committee, but also through other measures such as cesses on commercial crops and imposition of betterment levy as suggested in the Draft Fifth Five-Year Plan.

5.21 The gap between the total outlays and the current revenues of the States is estimated to decline from Rs. 1639 crores in 1972-73 to Rs. 1540 crores in 1973-74 (RE). This gap is expected to be financed to the extent of Rs. 1318 crores by way of capital receipts (including loans from the Centre and repayment of loans by third parties), leaving a deficit of Rs. 222 crores† as compared to the deficit of of Rs. 130 crores in 1972-73 (R.E.)*.

† If credit is taken of Rs. 13 crores of market borrowing by Maharashtra and of Rs. 40 crores as the share of the States in the Centre's additional taxation, the States' deficit would come down to Rs. 169 crores in 1973-74.

* After excluding Rs. 421 crores transferred by the Centre to States for clearing their overdrafts with the R.B.I. The accounts for 1972-73 showed an overall surplus of Rs. 14 crores for all the States taken together; this was mainly the result of larger transfer of resources from the Centre; otherwise the trends in the budgeted figures of State Governments continued to present a disconcerting picture of their finances.

5.22 In the past two decades, the States' liability to the Centre has grown considerably, going up from Rs. 196 crores at the end of March 1951 to Rs. 8,536 crores by the end of 1973-74. Their debt servicing to the Centre (repayment of principal plus interest payments) which was only Rs. 12 crores in 1950-51 has now grown a hundred fold to over Rs. 1200 crores by 1973-74. It was in this context that the Sixth Finance Commission was asked to go into the question of providing debt relief to the States.

Centre-State Relations

5.23 In last year's Economic Survey mention was made of the chronic fiscal imbalance from which several of the State Governments were suffering, measures taken to stop the facility of overdrafts which the States could obtain from the Reserve Bank of India and the constitution of the Sixth Finance Commission, with terms of reference far wider than in the past.

5.24 A most significant development in the field of the Centre-State financial relations during the current year was the Government's acceptance of the recommendations of the Sixth Finance Commission. The financial implications of the Sixth Finance Commission are of far reaching character since they affect the total availability of resources for the plan (in so far as the larger transfer of resources from the Centre to States is for meeting the non-plan needs of State Governments as assessed by the Finance Commission) and add to the task of additional resource mobilisation in the course of the Fifth Plan. Thus, for the first time, a Finance Commission was asked to go into the question of the non-plan capital gap of the States and also to review their debt position. Accordingly, it has recommended changes in the existing terms of repayment of Central loans outstanding at the end of 1973-74; this will provide the States with a debt relief of about Rs. 1,970 crores over a period of five years ending 1978-79 and would cover the bulk of the non-Plan capital gaps of most States during the Fifth Plan period. Added to this is the big step-up in the quantum of grants-in-aid recommended by the Commission under Article 275; this takes into account not only the Commission's assessment of the normal non-plan revenue gap but also—as enjoined by its terms of reference—the needs of backward States for the improvement of standards of essential administrative and social services. The grants-in-aid to States are thus to rise from Rs. 711 crores during the five years ending 1973-74 to Rs. 2,510 crores during the coming five-years, subject to a further proviso that the amount of grants-in-aid should be suitably raised after taking into account the net interest liability of the States on account of fresh borrowings and lendings during the Fifth Five-year Plan period. As regards the share of the States in Central taxes and duties, the Commission has made no major departure except raising States' share in the income tax pool from 75 per cent to 80 per cent and recommending States' sharing in auxiliary union excise duties also from 1976-77 onwards, their share being 20 per cent of the net proceeds as in the case of the basic excise duties. It is estimated that during the Fifth

Plan period, the transfer of resources to States by way of their share in Central taxes and duties would amount to Rs. 7,099 crores, as against Rs. 4,605 crores during the preceding five-year period. All in all, the recommendations of the Sixth Finance Commission would have the effect of transferring to the States (by way of rise in the quantum of grants-in-aid, increase in their share in Central taxes over what they would have got under existing arrangements, and debt relief) an additional amount of over Rs. 4,000 crores over the five-year period.

5.25 The Commission's terms of reference also enjoined on it to review the policy and arrangements in regard to financing of the relief expenditure by the States affected by natural calamities and to examine *inter alia* the feasibility of establishing a National Fund to which the Central and State Governments may contribute a percentage of their revenue receipts. On the question of the establishment of a National Fund, the Commission came to the conclusion that the establishment of such a Fund fed by Central and State contributions was neither feasible nor desirable. The Commission has recommended complete overhaul of the present pattern of financing of relief expenditure. It has urged that instead of incurring large scale expenditure on relief on an *ad hoc* basis, provision should be made on a much larger scale for development of drought and flood-prone areas in the Fifth Plan both in State and Central sectors and accommodated within the overall ceiling of the Central assistance for the Plan period as a whole. The implication of these recommendations of the Commission is that the present pattern of arrangements for Central assistance to States to meet the natural calamities relief need not continue. It would be significant to note that expenditure on famine relief in State budgets was more than Rs. 300 crores in 1972-73 and for some States, the Central assistance for drought relief far exceeded the assistance for their development plans.

Performance of Public Sector Undertakings

5.26 The provisional information in regard to the performance of non-departmental commercial undertakings of the Central Government reveals that the total net profit (after tax) of the 101 public sector undertakings in operation on March 31, 1973 will be of the order of Rs. 18.1 crores in 1972-73 as compared to a net loss of Rs. 18.9 crores incurred by 93 running concerns in 1971-72. While 67 enterprises earned a net profit of Rs. 105 crores during 1972-73, 34 enterprises sustained a loss of Rs. 87 crores. The profit-earning enterprises included Indian Oil Corporation, Bharat Heavy Electricals, Shipping Corporation of India, Heavy Electricals India Ltd., Oil and Natural Gas Commission, and Madras Refineries; and those sustaining losses included Hindustan Steel, Heavy Engineering Corporation, Neyveli Lignite Corporation and Bokaro Steel Ltd. The main reasons for the losses are lower utilisation of installed and developed capacities and the capital intensive nature of these enterprises. During 1972-73, 30 enterprises declared dividends amounting to Rs. 18 crores at rates varying from one per cent to 20 per cent as against a total dividend of Rs. 16 crores declared by 32 enterprises during 1971-72. The return on capital employed i.e. ratio of gross profits (after providing for working expenses and depreciation but before deducting interest and tax liability) to capital employed (net fixed assets plus working capital) in 1972-73 is, however, estimated at around 6 per cent i.e. about the same as in 1971-72 due to a large increase in capital employed.

5.27 According to the perspective view of the performance of the public sector enterprises during 1973-74, 87 running enterprises are expected to earn a net profit of Rs. 34 crores. Hindustan Steel Ltd., which anticipated a net loss of Rs. 14.52 crores during 1973-74 is now expected to earn a net profit of Rs. 22 crores in view of the additional revenue arising from higher prices of steel allowed from October 15, 1973. The provisional operating results reported by the public sector enterprises for the first half of 1973-74 are quite encouraging. A number of major public sector enterprises are likely to achieve substantially the targets set for the year and the overall performance of the public sector as a whole for 1973-74 is expected to show considerable improvement over 1972-73.

5.28 The finances of Railways which have been under severe strain since 1966-67 showed some improvement in 1971-72 and 1972-73 (RE) primarily on account of the relief provided by the Railway Convention Committee. The surplus was estimated at Rs. 17.84 crores for 1971-72 and Rs. 12.40 crores for 1972-73 (RE), the decline in the surplus for 1972-73 as per revised estimates being attributable to the increase in the Railways' working expenses accompanied by the non-realisation of anticipated additional revenue earning traffic. The Railway budget for 1973-74, after taking into account the relief of Rs. 22 crores accruing as a result of the recommendations of the Railway Convention Committee and the effect of enhancement in fares and freights amounting to Rs. 44 crores, had anticipated a surplus of Rs. 24 crores. However the prospects are that the railways would be running into a huge deficit as a result of a number of factors. Their working expenses during the current fiscal year have gone up considerably following the implementation of the recommendations of the Third Pay Commission and the grant of three instalments of dearness allowance to employees. Frequent strikes by a section of the railwaymen and coal shortages during the year have caused a considerable loss of traffic receipts. The failure of economy to pick-up during the greater part of the current year has also resulted in upsetting the original calculations of the volume of traffic likely to be handled by the Railways. The financial position of the Posts and Telegraphs, on the other hand, continues to show considerable improvement mainly on account of a marked buoyancy in their revenues from telephone services. The net profits of Posts and Telegraphs have improved from Rs. 37 crores in 1971-72 to Rs. 40 crores in 1972-73 (RE) and are expected to go up to Rs. 51 crores in 1973-74 (B.E.).

5.29 The financial position of State Governments' departmental undertakings continues to be a source of great concern. The net losses by irrigation (commercial) and multipurpose river schemes continue to rise and as stated elsewhere in this chapter, these may amount to Rs. 170 crores in 1973-74 (BE) as against Rs. 153 crores in 1972-73. The distressing fact is that most of these departmental undertakings of State Governments have even failed to cover their working expenses and interest on capital employed. Similarly, the financial position of State Electricity Boards reveals that the rate of return on capital employed (after meeting working expenses and depreciation) declined from 4.8 per cent in 1971-72 to 4.3 per cent in 1972-73 and is expected to remain at the same level in 1973-74 as against the norm of 11.0 per cent (including 1.5 per cent of electricity duty) recommended by the Venkataraman Committee. In this context, the need for adoption of appropriate pricing policies and for ensuring a high degree of operational efficiency can hardly be overemphasised.

Fiscal Policy, Growth and Stability

5.30 The growth strategy enunciated in the draft Fifth Plan envisages a significant increase in the rate of domestic savings over the plan period. The Plan relies heavily on public savings to achieve the target rates of aggregate savings. Thus, while private savings are expected to go up from 9.4 per cent of GNP in 1973-74 to 9.7 per cent in 1978-79, public savings are expected to rise from 2.8 per cent of GNP to 6 per cent over the same period. Given our past experience, this is no doubt an ambitious target, but in the interest both of stability and growth, fiscal policy has to assist in the process of mobilising public savings. Given the fact that in the absence of a certain degree of price stability, the attainment of both accelerated growth and greater social justice may become elusive, utmost emphasis has to be laid on extracting savings from the economy in a non-inflationary manner. For the same reason, a growth oriented fiscal policy cannot neglect the objective of short term economic stability even though the reconciliation of the two objectives is not always easy. This is particularly so in the case of agrarian economies experiencing significant fluctuations in output on account of weather conditions. In these countries, because of a narrow tax base and persistent demands for additional expenditure, it becomes difficult to pursue an effective countercyclical fiscal policy. Nevertheless, fiscal policy has to be employed as a potent instrument of demand management so as to offset, as far as possible, the inflationary impact of fluctuations in agricultural output. In addition, fiscal policy has also an important role to play in curbing non-essential consumption and in re-directing investible resources in accordance with planned priorities.

5.31 It is obvious that in order to achieve the savings targets of the Fifth Plan, it will be necessary to mobilise significant amounts of resources by way of additional taxation. Both direct and indirect taxes will have to contribute to the additional tax effort. However, it has to be recognised that rates of direct taxes in our country are already very high even though the effective progression of our system of direct taxes is greatly reduced by large-scale evasion and avoidance. As such, additional resources from direct taxes have to come largely through prevention of evasion and avoidance. Besides, as the Raj Committee has recently pointed out, there is considerable scope for increasing the yield from direct taxes by more effective taxation of agriculture.

5.32 An important feature of the Indian fiscal system is the heavy reliance that has traditionally been placed on indirect taxes, particularly excise duties, for raising revenue. Indirect taxes today account for about 80 per cent of the total tax revenue of the Centre as against 70 per cent in 1962-63. This heavy reliance on indirect taxes has been a subject of considerable criticism both in Parliament as well as among some fiscal experts. However, since agricultural income is not subject to Central income-tax and also because of administrative difficulties involved in collecting direct taxes, the heavy emphasis on indirect taxes is perhaps inevitable. At the same time, it has to be recognised that indirect taxes need not be inherently regressive as is sometimes supposed. A well conceived structure of indirect taxes can be an effective means for mopping up a part of the high incomes earned by relatively well-to-do sections of society. Through a careful choice of taxable commodities and of rates of commodity taxation, it is possible to impart a considerable element of progression to the system of indirect taxes.

5.33 It has also been argued that heavy reliance on indirect taxes has accentuated inflationary pressures. For example, it has been suggested that a growing emphasis on *ad valorem* duties in our system has intensified inflationary pressures in the economy. There is not much substance in this argument since food articles and industrial raw materials, which have contributed most to the rise of the wholesale price index in the last two years, bear little or no indirect taxes. As for the choice of *ad valorem* rather than specific duties, it is necessary to bear in mind that in a situation where an important part of Government expenditure increases autonomously, it would seem desirable to maintain the elasticity of the tax structure with respect to rising money incomes. In the field of indirect taxes, this can be more effectively secured through a system of *ad valorem* rather than specific duties. If duties were specific rather than *ad valorem,* inflation itself would call for frequent changes in the rates of specific duties in order to raise revenue as expenditure rose as a result of price rise. While in particular industries *ad valorem* duties may no doubt constitute an excessive burden in a period of rising prices, in general there would seem to be a strong case in favour of the shift witnessed in recent years in the direction of *ad valorem* duties in place of specific duties.

5.34 At the same time it is no doubt necessary to ensure that the tax system, particularly with regard to customs duties, should be sufficiently responsive to the changing domestic and international situation. Duties that may have been imposed for protective, or for revenue reasons, for example, sometimes tend to stick even though the basic situation with respect to the particular dutiable commodities may have changed drastically. It is therefore important that the duty structure of imports is kept under a constant watch and is varied in the light of changing requirements of domestic and international situation.

5.35 Taking all factors into account, it would appear that the potentialities of commodity taxation have by no means been exhausted. There is, for example, considerable scope for using excise duties to curb the consumption of luxury and semiluxury items, mopping up excess profits in the case of commodities in short supply and for encouraging exports. However, the untapped potential is not as large as is sometimes assumed. For example, because the public sector itself is a major consumer of many excisable products and a part of customs and excise duties is paid by the Government itself, the gross yield of these taxes is not a true indicator of net additional resource mobilisation. For this reason, when levying indirect taxes for purposes of raising revenue, it is necessary to distinguish between gross yield and net yield to Government from such taxes. Moreover, as the proportion of industrial output accounted for by the small-scale sector increases, this also affects the yield from indirect taxes since both for administrative and other reasons, it is not always easy to bring the small-scale sector effectively within the network of excise taxation.

5.36 In view of the limited potential of additional taxation at the Centre, it is most important that public sector enterprises should make a significant contribution to the growth of public savings. Our past performance in this matter is far from satisfactory and in the interest of both growth and social justice, it is essential that the heavy investments that have been made in the public sector are made to yield an adequate rate of return. This would require not only more determined efforts to make fuller use of the capacity of these enterprises but also suitable modifications in their pricing policies.

5.37 The experience during the Fourth Plan shows that an increase in tax revenues is not a sufficient condition of higher public savings. Thus, while targets for additional resource mobilisation were more than fulfilled, the expected savings did not materialise on account of much faster growth of non-development outlays. If the same experience is not to be repeated in the Fifth Plan, it will be necessary to exercise more effective control on growth of non-developmental expenditure.

5.38 Given the Fifth Plan objectives of fostering both growth and self-reliance, the task of additional resource mobilisation will call for special effort on the part of State Governments. In this context, taxation of agricultural incomes, increases in irrigation rates and revision of electricity tariff appear as three major areas holding prospects for substantial contribution to the State exchequers. The inadequate taxation of the agricultural sector remains one of the most serious anamolies of the Indian fiscal structure and reference has been made earlier in this chapter to lack of any progress so far with regard to the implementation by State Governments of the recommendations of the Raj Committee. Similarly, having regard to the huge losses being incurred by irrigation works, the revision of irrigation rates is another measure which calls for immediate action. In view of huge further investments required for bringing irrigation to more and more farmers, it is clear that these losses cannot be allowed to continue from year to year. This is particularly true since the benefits available from irrigation are not distributed equally among farms of all sizes. Extensive subsidisation of irrigation, therefore, amounts to subsidising farmers who enjoy irrigation facilities at the expense of those farmers and areas which do not now enjoy irrigation facilities but could be provided with these facilities in the future if larger resources were available.

5.39 Today, a number of electricity boards are not even in a position to pay their current dues of interest on loans taken from State Governments. Total investment of electricity boards is expected to reach or exceed Rs. 5000 crores by the end of the Fourth Plan period and a further investment of about Rs. 6200 crores is contemplated in the course of the Fifth Plan. An appropriate tariff structure would, apart from yielding considerable additional revenue, go a long way towards an efficient use of electricity and eliminating its wasteful consumption. Since the benefit from electricity consumption varies from user to user, it is only appropriate that those who derive greater benefit from electricity should pay for it, rather than have this burden transferred to the tax resources of the State Governments.

5.40 According to the draft of the Fifth Plan, one-third of the total domestic savings will have to be generated within the public sector; besides, the public sector will have to divert to itself about one-half of the savings which will emerge in the private sector. The policy mix will have thus to embrace taxation, borrowings and appropriate pricing by public undertakings. It should also be emphasised that the task of fiscal management does not end with mobilisation of resources; what is even more crucial is their efficient utilisation. It is here that proper control of expenditure and efficient plan implementation become integral parts of the same process.