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ORISSA ECONOMIC JOURNAL

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ORISSA ECONOMICS ASSOCIATION
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SECRETARY'S REPORT

I take this opportunity to welcome you all to this XVII Annual Conference of the Orissa Economics Association. The XI Annual Conference of the Association was held here under the auspices of the Post Graduate Department of Economics, Berhampur University. We are grateful to the university authorities to host this Conference again after a gap of only five years. In fact, if this gesture in emulated by the three Post Graduate Centres and the four Universities of the state, the Association would find no difficulty in organising the Annual Conference.

For the first time in the history of the Association, the Association was entrusted with the responsibility by the Government of Orissa to make an assessment of Rural Poverty in all its dimensions in different parts of the state and also to evaluate the various projects under the ERRP programme. A Seminar, for this purpose, was held in collaboration with the OUAT, Bhubaneswar, on the 10th and 11th March 1984. A sum of Rs, 50,000/- was sanctioned by the Government for this Seminar and I take this opportunity to express my thanks to the government for this kind gesture. The report of the Seminar has been sent to the government for its perusal and necessary action.

We have chosen two subjects for discussion in this conference : (1) Keynesian Economics and (2) Centre-State Financial Relations with special reference to Orissa. The first subject assumes great significance in the context of the Birth Centenary of J. M. Keynes. The second was selected in anticipation of the 8th Finance Commission Report to be available for study by this time. But the Report is still in the anvil and our discussion on the subject has to centre round the Seventh Finance Commission Report. It is a strange coincidence, that in 1978, we also had a discussion on the same subject here.

We have also two symposia : One is on a controversial issue related to Sales Tax, particularly its abolition and the second is 'Marx and Marxism. The second subject has been deliberately chosen to commemorate the death centenary of the socialist luminary, Karl Marx.

The life-membership of the Association has increased beyond one hundred and the annual membership has also increased to a great extent.

The journal for 1983 has been distributed to the members. But if the members could send their papers at least two months before the conference the Conference number of the journal could be ready for the Annual Conference. I request the members to consider this.

The Association receives recurring grants in-aid from two sources : (1) the Director, Higher Education Orissa provides a grant in-aid of Rs. 3000/- and (2) The State Youth Welfare Board sanctions Rs. 4000/- annually. Our thanks are due to the Director, Higher Education, Orissa and the Secretary, State Youth Welfare Board for their sympathy and goodwill for this Association.

The Association is completing seventeen years of its existence. During these years it has been nurtured by the blessings of the old guards and unstinted cooperation of its members. Since the Association is young, I look forward for your guidance, sympathy and good will so that your Association can march forward.

Let me take this occasion to express my thanks to the President, Vice President and members of the Executive of the Association for their ungrudging help to me in all matters of the Association. Thanks are due to Dr. G. N. Das for getting the accounts of the Association audited without taking audit fee. Thanking you.

B. P. DASH
Secretary

Esteemed Chief Guest, distinguished delegates to the 17th Annual Conference of the Orissa Economics Association, Ladies and gentlemen !

I am indeed very much beholden to the Orissa Economics Association for the honour it has bestowed on me by electing me its President. With deep sense of gratitude and humility I take this opportunity of addressing you on "Perspective on Industrialisation : An alternative approach". The address is divided into three parts. Part-I deals with the nature of industrial development of some leading countries in their historical perspective, part-II discusses the issue of industrial development in national perspective and part-III focuses attention on the problems of industrial development in Orissa.

(I)

Industrialisation has a broader sepctrum. It does not simply mean establishment of manufacturing industry but involves a change in the whole economic structure of a country. This change implies an extended division of labour contemplated by a system of distribution and exchange of goods functioning in a developed "money economy".[1] According to Peikang-Chang the process of industrialisation involves, apart from the building of a new industry, those basic changes that accompany the mechanisation of an enterprise, the opening of new territory.[2] To Prof. Harry Johnson industrialisation is the organisation of production in business enterprises characterised by specialisation and division of labour both within and among themselves; specialization is based on application of new technology motivated by the objectives of minimizing costs per unit and maximising returns to the enterprise.[3] To be more precise industrialization implies :

a) the use of power machinery, modern technique and organisation,

b) Capital investment on a large scale,

c) division of labour and exchange and distribution of goods with the help of a developed monetary system,

d) transformation of the whole economy.

It has been rightly observed by U. N. "Industrialisation is a process of economic development in which a growing part of the national resources is mobilised to develop a technically up to date diversified domestic economic structure characterised by a dynamic manufacturing sector having and producing means of production and consumer goods and capable of assuring a high rate of growth for the economy as a whole and of achieving economic and social progress.[4]

Defining industrialisation is not easy. The purposes vary with socio-economic conditions and methods, forms, sequence and stages of this process are highly diverse. Notwithstanding the diverse experiences of countries the essence of industrialisation consists in the extensive introduction of the latest scientific and technological achievement in production, in the comprehensive technical requirement of the national economy .. Ultimately it is the key manufacturing industries that hold the central place in the industrialisation process".[5]

Industrialisation in the modern age requires mobilisation of huge resources. Further the modern work can function properly only if there are a number of allied sectors which provide raw materials, power and semi-manufactures, process the by.products, transport the goods and so on. Thus, capital has to be invested in a complex of things. It must be remembered that the techno economic difficulties can be overcome only by socio-economic factors. Industrialisation in fact encompasses the reconstructions of all sectors and presupposes the transformation of the social structure, a change in the place and role of the developing countries in the world economy, their conversion from agrarian raw material appendages to a handful of imperialist powers into equal partners in the world economy.[6]

The choice of development strategy, specifically industrialisation is an intricate process which requires not only a detailed analysis of the diverse trends in the national economy as a whole but also consideration of tendencies of both economic and social development, their interaction and at times contradictions. The priorities given to the different sectors of the economy, agriculture and industry, particularly the timing and degree of stress on various subsectors of industry: capital goods, intermediate goods and consumer goods sectors are questions of importance which have to be seriously considered to plan for the long run balanced growth of an economy. Consideration of these questions leads us to have a perusal of the theory and practice of industrial development in the major industrial countries of the world.

PATTERN OF INDUSTRIAL DEVELOPMENT–A HISTORICAL PERSPECTIVE:

Growth economists have invariably observed that economic development involves (a) shift of resources from primary production to industry, (b) rise in ratio of capital to labour, (c) change in composition of import and export, (d) movement of population from rural and urban location.

The process of change occurs and moves step by step. Income elasticities of demand for the product of different industries are different and therefore development of some industries are commensurate with a particular level of income. Chenery speaks of 'early 'middle' and 'late' industries and pleads for the developments of 'early' industries like, food-processing and textile industries when income level is low. With rise in income, consumption pattern changes and this brings about changes in industrial structure. Change in consumption pattern along with import substitution and growth of industrial exports account for the change in industrial pattern. Size of the economy, natural resources, growth of capital and skill, level of the population have also a bearing on the structure of industrial production. At lowest level of income contribution of the primary sector to employment exceeds its contribution to output. But as income rises, fall in its share of output is more rapid than fall in employment reflecting concentration of investment and technological progress in industry and accumulation of surplus labour in agriculture. [7]

It was observed by Chenery that continuous structural change is related to growth of income. Statistical analysis didn't support the hypo. thesis that different structural relations characterise developed and developing economies. The productive structures of large and small countries do not differ significantly at the lowest income level and they also appear to converge at highest income level. [8]

Surveying the industrial patterns of the cross-section of countries Chenery found four principal patterns of resource allocation, primary specialisation. The countries in each classification followed some what different sequences of development stemming partly from initial differences on size, resource endowments and access to external capital and partly from differences in social philosophy and organisations.

W. G. Huffman analysing time series data of leading industrial countries proved the propositions that (a) in early stage industrialisation is weighted in favour of consumer goods industries like food, textile, leather, furniture and (b) in later stage capital goods industries like ferrous, non-ferrous metals, machinery, vehicles, chemical industries assume signifi. cance. [9] He observed that with the rise in level of economic development, the ratio between consumer and capital goods and capital goods industries declines. For example in Great Britain the ratios between consumer goods and capital goods industry were 4.7:1 in 1850, 1.7:1 in 1907, 1.1:1 in 1935 and 0.7:1 in 1948. In U.S.A. the ratios were 2.4:1 in 1850, 1.7:1 in 1970, 0.8:1 in 1925, 0.7:1 in 1947. It was found that transition from one stage to another was quicker in case of the late starting countries as they could borrow the technique.

Notwithstanding pitfalls and arbitrary ratio marks demarcating various stages of growth, the overall trends in relationship between consumer goods and capital goods industries over the years were found correct. Arnodo Lago too found the changing relative importance of output of heavy and light industries with the change in level of economic develop-in U.S.A., Canada and Australia. [10]

The process of industrialisation in leading countries of the world has been interpreted differently by different economists. Rosten thought that all countries pass through a uniform course of development. 'The process of industrialisation repeated itself from country to country lumbering through his pentametric rhythm''. He observed abolition of primitive agriculture, creation of an entrepreneurial elite and adequate infrastructure are essential for industrialisation of all countries, small or big. Gerschenkron, on the contrary found different processes in different countries. Some factors that constituted pre-requisites for industrialisation of England were absent in other European countries. At the threshhold of industrialisation so called prerequisites could be substituted. There may be capital accumulation from the past or capital can be provided by banks and the state. Gerschenkron observed that there is bigger discontinuity in industrialisation when the country is backward. The backward country adopts advanced technique to counter foreign competition and meet the shortage of skilled labour which result in greater degree of capital itensity.[11]

S. L. Bursby found out positive correlation between relative backwardness and subsequent rate of growth and backwardness and share of producer goods industry in spurt period.

H. Roscsky analysing Japanese industrialisation marked the dependence of Japan on imported technology and the big role of the state. Russia had a different experience, ideology and factor endowment played key role in Russian industrialisation. Now that the poor countries stand in different relation to the advanced ones from what was in the past Gerschenkron's analysis appears to be more cogent that of Rostow. The former approach is more convincing because "it is only by comparing industrialisation process in several countries at various levels of backwardness that we can hope to separate what is accidental in a given industrial evolution from what can be attributed to the historical lags in a country's development and that it is only because a developing country is part of a larger area which comprises more advanced countries that the historical lags are likely to overcome in a specifically intelligible fashion".

From the above review emerge three facts :

i) That the process of industrialisation varies from country to country. The pattern of development is conditioned by the size of the country, resource development, access to external capital, state's role etc.

ii) In most of the countries early stage of industrialisation has been marked by the preponderance of the early consumer goods, or light industries. The ratio between light and heavy industry declines with rise of income level. The pattern of industrial development has been linked with income level of the country.

iii) The late starting countries have experienced quicker transition from one stage to another stage of industrialisation. Capital intensity has been found to be higher in case of large and backward countries facing foreign competition, and lacking in skilled labour.

II

INDIAN EXPERIENCE :

Historical account throws light on the appropriateness of a particular pattern of industrialisation at a particular phase of country's economic development.

Taking the prevailing economic condition of India in early fifties into account enlightened by the theoretical frame woven on historical facts we may assess the merit of industrial planning in India.

Judging the growth of industries in terms of absolute values India's record since independence appears impressive. In terms of value-added, India ranked 14th in the list of 91 countries in 1978, in terms of employment in manufacture (5.8 millions) in 1979, it was 6th in the list of 92 countries and in terms of the scientific and technical manpower (with 1.17 million) it stood 11th in the list of 72 countries.[12]

At the time of independence the industrial base was characterised by predominance of small industries, a few large consumer goods industries in private sector. The pattern of development since independence has been guided by the Industrial Policy Resolutions of 1948 and 1956, and five-year-plans. The outstanding success of planned effort in the field of industrialisation is reflected by the following statistical facts.

(i) Industrial production grew at the trend growth rate of 6.1 per cent per annum during 1950-79 as against 2.0 per cent during 1900-46.

(ii) Industry's importance in the gross domestic product (1970-71 prices) increased from 15 p.c. in 1950-51 to 23 p.c. in 1978-79.

(iii) The registered manufacturing units increased their share from 55 p.c. of G.D.P. in manufacturing (1970-71) prices in 1950-51 to 65 p.c. in 1978-79.

(iv) The weights of basic and of capital goods industries in the index of industrial production increased from 22.33 and 4.71 in 1956 to 32.28 and 15.74 respectively in 1970. The weights of the intermediate and consumer goods industries declined from 24.59 and 48.37 in 1956 to 21.95 and 31.03 respectively in 1970. Consumer goods accounted for over two thirds (68%) of the value added in Indian factory sector in 1950 51, their share declined to 37 p c. in 1977-78.

(v) Public sector accounted for 8 per cent of value-added in organised industry and mining in 1960-61. Its share increased to 29 per cent in 1977-78.

(vi) The share of the four industrially developed states Maharastra, West Bengal, Gujrat and Tamilnadu in the value-added in factory sector in India declined from two-thirds in 1960 to 57 per cent in 1977-78.

Despite this achievement India remains one of the poorest and the slowest growing countries of the world and its gross manufacturing output per capita is U.S Dollar 91 and with this it ranks 38th in the list of 49 countries.[13]

This is because industrial growth rate has not been sustained at its initial high rate. The high growth period that covered 1950-51 to 1965-66 (7.7 p.c per annum) was followed by a declining growth rate period 1965-75 (3.6 p.c. per annum). Gross capital formation as a percentage of gross domestic product increased from 10% in 1950-51 to 18% in 1965-66, net aid as percentage of plan expenditure moved up from 9% in the first plan to 27% in the 3rd plan. The share of household sector saving rose from 10% in 1950-51 to 31% in 1965-66 and that of public sector saving rose from 19% to 23% of the net domestic saving. Public sector out-lay in industry rose from 5% in the 1st plan to 24% of the total in the 3rd plan. Investment in metallurgical engineering and chemicals formed 74% and 70% of the total investment in industry. This high industrial growth rate in the first three plans was due to (a) emphasis on industrialisation in economic policies (b) heavy industry-oriented strategy of industrialisation and the persuit of industrial growth as a supreme objective in the industrial policy and planning and (c) the substantial investments made and capacity created in industrial sector as a follow-up of the first two decisions. [14]

In the years following 1965, deceleration in industrial growth occurred and with this flaws in the strategy and policies of industrialisation get exposed. Viewed from socialist and welfare stand points, industrial planning seems to have less creditable achievements. The reconciliation approach of David Apter, reconciling the compulsions of the public sector with claims and cravings of the private sector has helped the growth of monopolies which have prevented capitalism from below and held back transformation of the entire economy. The industrial policy has tended to emphasise heavy industries to "construct and create a modern base of reproduction primarily for the capitalist developed sector of economy, not transforming all sectors on modern technical basis". Policy proclamations regarding development of village and small industries and decentralisation of economic power have not been matched by real performance. Rather, some small industries have been drawn into the capitalist reproduction process. There has been growing concentration of wealth in the hands of a few industrial magnets. 20 top houses account for 24 p.c of the assets of the private corporate sector over the years 1964-76. An increase of 23.73 p.c. inequality was noticed. [15]

Regional disparity in the industrial sphere continues to exist. Of the total manufacturing output, Maharastra accounts for 26.4 p.c., West Bengal 11.4 p.c., Gujrat 10.2 p.c., Tamilnadu 9.5 p.c., U.P. 6.9 p.c., Bihar 6.6 p.c., Andhra Pradesh 5.00 p.c., M.P. 44 p.c. and Karnataka 4.00 p.c. The above 9 states together account for 78.8 p.c. of factories, 76.7 p.c of fixed capital and 8.3 p.c. of employment in factory sector.

Industrial growth has not made a significant dent in the problem of unemployment. The growth of employment has lagged far behind the growth in productive capital employed. The compound annual rate of increase in percentage in respect of employment in manufacture was 3.46 between 1959 and 1970 against corresponding rate of 18.36. in respect of productive capital in the period. Between 1960 and 1973, production of capital goods rose by 174 p c that of intermediate goods by 75 p.c. and that of consumer goods by only 62 p.c.[16] Workers' real earning increased marginally by 4 p.c. between 1951 and 1970 and declined there after. Thus, the growth in aggregate industrial output and diversification of production have been overshadowed by industry's failure to promote employment. equity and welfare. Declaration couped with distortion now causes great concern.

Many an alibi are put forth to explain the slackening of industrial activities. Some attribute it to the change in emphasis in planning and stress on prevention of concentration of economic power and reduction of regional imbalances. Really, there has been no lessening of the emphasis on industrialisation except for the period 1977-80. The controls and restrictions were there since 1951 and slackening stared only from 1965.

Though gross capital formation as percentage of gross domestic product rose from 20 p.c. in 1973-74 to 24 p.c. in 1978-79, there occurred a decline in capital formation in industry since 1965-66 from 5.07 p.c. downward. Public sector outlay on industry which was 25 p.c. of the total in Annual Plans came down to 20 to 22 p.c. in later plans. The public sector investment which was 64 p c. in the Third Plan declined to 60.58, and 56 percentages in the 4th, 5th and Rolling Plans respectively. This too partially explains declining industrial growth.

Mounting cost of the projects due to price and underutilisation of capacity may be considered responsible for the slump in the industrial sector. Potential utilisation ratio (peak month) for all manufactured goods that stood at 87.9 in 1965 slidedown to 79.l in 1977. Of the 118 products for which capacity utilisation has been presented in the Sixth plan 77 showed cahpacity utilisation of less than three fourth.

Random factors like wars of 1962, 65 and 71, droughts of 1965-66, 66-67, 71-72 and 72-73, supply constraints of late sixties, infrastructural bottlenecks and oil crisis of 1973 are said to be the causes of deceleration. Really they cannot explain persistent stagnation.

Similarly the contention of Bhagwati and Desai (1970) and Bhagwati and Srinivasan (1975) that the complex bureaucratic system of licensing, restrictions and controls creating inefficiencies and misallocation of resources has led to the declining industrial growth does not appear tenable because the same bureaucratic system operated in 1951-65, the period of accelerated industrial growth.

Sluggishness of investment is considered as the main cause of industrial deceleration. The Draft Five-Year-Plan, 1978-83 (p. 184) observes—"There does appear to be a close relationship between the trends in total investment and particularly public investment and industrial growth. The period 1961-62 to 1963-64 when a 9 p.c. growth rate was achieved, the slum to 1.6 p.c. during 1966-69 and the recovery to about 6 p.c. during the 5th plan period broadly follow the trends in total and public investment during the corresponding periods." The decrease of public investment and the consequent loss of stimulus to private investment were the consequences of the earlier growth process. The increasing public investment provided basic inputs and increasing public expenditure promoted demand for goods upto 1965. Import substitution guaranteeing market stimulated private investment in the period 1960-61, 65-66, gross fixed capital formation rose at the rate of 9.1 per cent per annum and the Governmental expenditure rose at 13.2 p.c. per annum at constant price. In the period, 1964-65 to 73-74, the rates dropped to 0.7 per cent and 2 per cent respectively. In the succeeding years the Government failed to mobilise resources and the private sector channelled resources to speculation, luxury goods and construction. The stagnation of public investment alone doesn't explain the sluggishness of private investment. The private investment is governed by the consideration of profitability which depends among other factors on the pattern of consumption expenditure and demand in the home market.

Industrial growth hinges on (i) performance of agriculture and (ii) level of investment in the economy.

Agricultural development affects industrial growth through (a) creation of surplus wage goods investible resources, (b) supply of agricultural raw materials and (c) demand for industrial products through income-rise.

The agricultural development as such may not promote industrial growth. If intersectoral terms of trade move in favour of agriculture and if the increasing incomes do not accrue to the poor, agricultural development may not promote industry.

The quantum of public investment alongwith its composition provides policy variable for creation of employment and consumer demand. Hence, investment-mix in the public sector matters as much as the rate of investment.

Income distribution is a crucial factor in the nature and pattern of industrial growth. In an economy where the bulks of consumption, production, investment decisions, are made through market mechanism, income distribution determines consumption expenditure and hence, the composition of industrial output.

The National Sample Survey shows that in 1963-65, in rural sector, the richest 10 percent of population was responsible for 32.2 percent of total consumption of industrial goods whereas the poorest 50 percent accounted for 22 percent of the total. In urban sector the top decile purchased 39.3 percent of industrial goods and the bottom 5 decile, absorbed only 19.9 percent of the total. Sav points out that in 1974 the richest 20 percent of population accounted for 48.4 percent of the total consumption of industrial goods in rural India and 55 percent of the same in urban India. It is further reported that the proportion of private financial consumption expenditure in economy devoted to cereals and cereal substitutes rose from 27.4% in 1965-66 to 32.7% in 1974-75 while the proportion spent on industrial goods fell from 23.1 percent to 19.3 percent in the period.[17]

The successive bumper crops in the years 1975 to 1978 did not add to the income of the poor. The policies adopted in the period such as reduction of indirect tax on luxuries, cut-back in income tax and delicensing of industries added to the income of the rich.

The increasing terms of trade for agricultural production was due to the Government's higher procurement price and lack of comprehensive public distribution system. Slow growth of agriculture was due to failure to diffuse gains of income growth or increased public patronage. With similar agricultural growth Japan and China could have higher industrial growth because price and incomee lasticities of demand food-grain could be controlled by rationing. Such was not done in India.

The simultaneous launching of projects in the Second and Third Plans did not raise natural rate of growth because of (a) absence of suitable innovation in industry and of suitable organisational change and change in agrarian relation (b) the Government's failure to keep up the increasing public development programmes.

The retention of the same bureaucratic structure led to the sacrifice of equality and dynamism. The distribution of wealth and economic power was the cause of extreme maldistribution of incomes. "It is the failure to assess the importances of the production relations aspect of economic dynamics that is by and far responsible for so little achievement in development". [18] Limitations of the market and inadequate control by the capitalist class over the forces of production have been responsible for depressing the long-term rate of industrial growth in India. [19]

In short slow growth of agriculture after mid sixties and terms of trade for agriculture coupled with the mal-distribution of income reduced the rate of industrial growth. The unequal distribution of income did not check industrial development earlier because there was assured domestic market, the size of which was determined by the level of imports and the state of excess demand for importables. This guaranteed sources of demand was exhausted once import substitution in consumer goods was virtually completed and the capacities in capital goods and intermediate goods sectors transcended the prevalent needs of the final goods sector.

The distortion in development is rooted in the very political compulsion of our country after independence. India was influenced by the principle of socialist industrialisation and placed priority on heavy industries to accelerate industrial expansion. But there remain some fundamental differences between the principle of socialist industrialisation and the Indian thought. First, social and economic ideologies of the communist states and India differ. Second, though attempt was made to industrialise on modern line in the capitalist sector attention was also paid to the employment of more manual labour in the rest of the economy. The dual policy was a necessity to solve the acute unemployment problem. In fact industrialisation was regarded as a method of reconstruction and creation of modern base of reproduction primarily for the capitalist developed sector of the economy. [20]

This tasks of gaining economic independence and eliminating economic backwardness elevated the role of the state, the public sector to a qualitatively higher level. The social economic direction of the State intervention was determined by the needs of developing that sector which is represented by the ruling class i.e. the private capitalist sector. In the framework of the given socio-economic course the development of the public sector assuming the form of state capitalism substantially promoted the private capital sector even in lagging areas disregarding extra financial cost. "The public sector in the frame work of the capitalist evolution promotes the growth of the private capitalist sector not only by creating the necessary external conditions for the latter's development but also by influencing the state of various groups of private capital, its internal structure facilitating the removal of its inherent obstacles to development". 21

This has resulted in substituting foreign capitalists by indigenous capitalists. The spectacular growth of the big industrial houses in India stands testimony to it.

The public sector under the political domination of the national bourgeoise is subordinated to the needs of the private capitalist sector. Its overall scale and sectoral sphere have been determined by the needs of the development of national private capital. The servicing role of the state capitalism in regard to private capitalism has restricted the financial base for the former's development and has influenced the methods of mobilising state revenues. The growth of public sector too depends on the demand coming from the private sector, retardation of the latter's growth retards the former. This in turn renders a reverse containing influence on growth rate in the private sector. The stagnating influence is rooted in the contradictions in the capitalist way of transforming the economy. Stagnation of the pre-capitalist sectors, growing unemployment and the related preservation of semi feudal and usurious methods of exploiting direct producers continue to blunt and vitiate the effect of public sector. The consequence is perpetuation of widespread poverty and grave inequality.

Rightly the conference of the ministers of industry of Asian and Pacific countries in Nov. 1977 expressed "concern at the fact that economic growth in the developing countries though impressive by conventional and historical standards has done little for the poorer mass of the population and that income distribution has tended to become more skewed in the developing societies". As a result "not only has agriculture stagnated, but also continued poverty in rural areas has inhibited the growth of demand for industrial goods"[23] retarding the development of industry and the economy as whole. The growing incomes of the capitalising uppercrust of the population give rise to a structure of production which is determined by the demand of the urban elite while "the basic needs of the poor remain unsatisfied." The conference stressed the need to make industrial production "more relevant to the lives of the vast masses without blunting the edge of progress".

Gf late the policy makers in our country seem to have realised their follies and are trying hard to promote growth with equity through target group oriented and minimum needs programmes which entail necessary modification in industrial planning.

(III)

ORISSA'S ZEALOUS STRIDE :

In light of the experiences of the national economy we feel tempted to critically examine the progress of industrialisation in our State.

Notwithstanding the rich heritage of art and architecture the State of Orissa during the British regime was reduced to state of static agriculture. Orissa became a colony within colony subject to the exploitation by the rich Zamindars and industrial magnets belonging to other States. Consequently despite its huge mineral and forest resources very few large scale industries could come up in the State before independence. All the constraints on industrial development like lack of entrepreneurial ability, infrastructure, technical and managerial personnel and above all low purchasing power were present and are still prevalent in the State.

Surface road length per 100 kms. is only 7 km. in Orissa, against 19 km in the country. The state has only 13 km of Railway line per 100 sq. km as compared to 18 kms. all India, 43 kms. West Bengal and 31 kms. Bihar. Inspite of the spectacular increase in electricity generation in the State the per capita consumption is only 91.30 kw as against all India average of 98.99 kw. Percentage of village electrified in the State is only 33.13 against all India average of 40.42 and almost 100 in Punjab, Haryana and Tamil Nadu. Bank offices per lakh of population number 3 in Orissa against 4.9 in India and per capita bank deposit stands at Rs. 102 in Orissa against Rs. 415 in the country.

Orissa remains one of the poorest States of India. Its per capita income at current prices stands at Rs. 860 against All India average of Rs. 1267. Low purchasing power of the people can be inferred from the consumption data. Between 1960-61 and 1973-74, the per capita consumer expenditure in rural Orissa at 60-61 prices came down from Rs. 18.76 to 17.22 and that in urban Orissa declined from Rs. 31.95 to Rs. 26. 43. Orissa's per capita expenditure (Rural) at current prices stood at Rs. 42. 66 in 1973-74 against the all India figure of Rs. 53. Percentage of population below the poverty line in Orissa is 66.40 against 48.13 in the country, 24. 84 in Haryana, 15.13 in Punjab, 21.69 in West Bengal and 42.18 in Andhra Pradesh. Engel's ration has stood almost static at 68. percentage since 1960—61. In the percentage of gross irrigated area to gross cropped area in Orissa (18.3% in 77-78) is much below the Indian average (26.6%). Average yield of rice, the major crop in Orissa during 1975—76 to 1977—78 stood at 9.0 quintals per hectare against the all India average of 12.7 quintals. The yield remained almost constant in 70.

The linear growth rates per annum of the State income declined from 4.6% in the Third plan to 2.5% in the Fourth plan and 2.8% in the Fifth plan. The per capita income growth rates in the last two plans were marginal (0.2 and 0.3 percentage). The rates of growth were less than the Indian averages.

The above statistics point out (a) that the majority of the population of Orissa is steeped in abject poverty (b) that there exists very low purchasing power of the people constraining local demand for industrial goods (c) that agriculture in the state has remained exposed to the vagaries of nature causing negligible change in productivity and (d) that infrastructural facilities are not well developed to promote and sustain modern industrialisation.

Against the above socio-economic setting we can hardly expect either a virile entrepreneurial class to grow to take up industrial programme on a substantial scale or a sufficient number of outsiders to start industries in the State. Whatever progress has been made in the industrial field has been mostly due to the State aid and the State Policy which of course needs careful examining.

Thanks to the plan efforts, the industrial landscape of Orissa has undergone a visible change. The number of factories working increased from 563 in 1964 to 938 in 1970 and 957 in 1977-78. Productive capital increased from Rs. 298 crores in 1964 to Rs. 497 crores in 1970 and Rs. 802 crores in 1977-79. Employment in the period increased from 6.9 lakhs in 1964 to 9 lakhs in 1970 and 11 lakhs in 1977-78. The value of output in the organised factory sector increased from Rs. 299.5 crores in 1973-74 to Rs. 564.2 crores in 1977-78.

The shares of the small scale industries and medium and large scale industries in the total manufacturing units in 1977-78 stood at 89.5 percent and 10.5 percent respectively and that in capital investment were 3.4 percent and 96.6 percent.

The shares of public sector, private sector and joint sector in manufacturing units stand at 11.3 percent, 77.3 percent, 11.4 percent respectively. The corresponding shares in productive capital are 83.4 percent, 13.6 percent, and 29 percent. The values of outputs produced by the public sector, private sector and joint sector in 1977-78 stood at Rs. 366.15 crores, 233.46 crores and 54 62 crores respectively. The value-added by large and medium industries forms 93 percent of total value-added. The value-added by public sector forms 62 percent of total value-added. Thus though in number small units are preponderant, in terms of productive capital and output the medium and large units and that too in public sector appear over-whelmingly dominant.

So far as the small scale and artisan sectors are concerned it is revealed that up till 1973-74, there were 2776 units with an investment of Rs. 29.66 crores employing 32030 persons. In 1979-80 there were 9119 units with Rs. 68.96 crores employing 75789 persons. In 1982-83 there were 16902 units with an investment of Rs. 127.49 crores employing 131309 persons. There appears to be spectacular growth during the period 1980-81 to 1982-83.

Cuttack, Koraput, Puri, Sambalpur and Sundargarh districts account for 67.3 percent of factories and 96.5% of total productive capital. The share of these districts recorded a rise during 1973-74 to 1977-78. These districts account for 91 percent of total factory employment.

The shares of different districts in the total of S.S.I units in non factory sector stand as follows : Balasore 8.27%, Bolangir 4.6%, Cuttack 18.4%, Dhenkanal 5.7%, Ganjam 10.2%, Kalahandi 4.2%, Keonjhar, 5.0%, Koraput 7.3%, Mayurbhanja 6.6%. Phulbani 2.4%, Puri 7.8%, Sambalpur 9.0%, Sundargarh 9.0%. The corresponding percentage shares in investment are 7.2, 4.8, 23.2, 4.4, 6.9, 4.0, 2.47, 4.2, 4.1, 1.2, 10.6, 10.2, 16.3 respectively.

In the total 16902 small scale industry units in non-factory sector the share of different category of industries are as follows; Agro and marine based, 28.3 percent, chemical based 8.9 percent, Engg and metal based 13.2 percent, glass and ceramic based 9.9 percent, electrical and electronics 1.1 percent, textile based 9.7 percent, livestock and leather 0.9 percent, Misc and servicing 14.7 percent and forest and wood based 12.9 percent.

In the factory sector the percentage of shares of Industry groups are as follows

Industry Group	Workers		Fixed capital		Value added	
	1965	1977	1965	1977	1965	1977
1. Agro-based	33.65	28.62	5.39	6.55	21.28	16.49
2. Fertilisers, chemical & chemical based	0.25	2.53	0.01	1.84	0.13	4.02
3. Cement and Non-metallic mineral product	7.29	8.97	1.45	3.51	5.84	11.48
4. Iron & Steel and Metal products	36.61	26.01	50.04	38.05	51.41	50.26
5. Machinery Mfg.	14.14	28.67	19.33	48.11	11.58	10.00
6. Other Industries	0.06	5.20	23.78	1.94	9.76	7.75

Source : Calculated from the A.S.I. (Orissa) 1965–77-78.

The State Government in early sixties, late seventies and in recent years evinced keen interest for industrialisation and adopted promotional measures like pilot project schemes, formation of I.D.C, IPICOL and D.I.C. The New Industrial Policy providing feasibility report through promotional agencies and subsidising the cost of preparation of the feasibility report and facilitating financial flow has created a fervour for industrialisation. Nucleus industrial complex at Chandka has been constructed and such complexes at Kalahandi, Bolangir, Dhenkanal and Mayurbhanja are proposed to be setup. Some giant projects like NALCO are being set up.

For provision of infrastructural facilities, Infrastructure Development Corporation has come up. Bank expansion has been rapid, though credit deposit ratio is not as high as in India 56.1 against 65.3 percent.

With massive investment and corporations springing up' one is easily swayed by a wave of optimism that blinds him to deeper malaise in the system. It behoves an economist to probe deep into the problem and discover the truth.

From the cursory survey of the progress of industrialisation in the state, some disconcerting facts emerge. They are : (a) that the private sector does not hold an important place in industry (b) that the contribution of small industry to total output is very small (c) that regional imbalance in industrial development continues. It is a matter of great concern that all out efforts at industrialisation resulted in a marginal increase in the share of income originating in mining and manufacturing in the total state income during the last two decades. The share rose from 14-3 p.c. to 16-5 p.c.

All that matters is not simply setting up an industry, but ensuring its survival through efficient functioning. Industry has to act as a prime mover of growth. We have, therefore, to look to the performance of industry and the congeniality of the environment in which it operates.

In Orissa the Index of value added per worker, marked a rise of 17 percent and that of value added per fixed capital rose by 31 p. c. during 1970-71 and 77-78. This no doubt speaks of efficiency in aggregate sense.

A disaggregated study shows that many units do not fare well and encounter numerous constraints in respect of marketing, management and procurement of raw materials. For example, the percentage of net profit to net worth for IPICOL units is very low and decreased from 2.27% in 1975-76 to 0.66 percent in 1980.81. During 20 years of its functioning IDC had 10 loss years.

Studies made about the industrial estates show that the units on an average worked upto 53.25 percent of their productive capacity. Only 70 percent of the sheds were functioning in 1977-78 and 18 percent of the firms incurred loss. It is discovered that the older units declined after

10th year. The poor performance is attributed to (a) lack of demand (b) poor management (c) non availability of finance (d) shortage of raw materials. 80 percent of the units faced the problem of demand and 77 percent encountered the shortage of raw materials. There is hardly any correlation between the level of development of industrial estates and the level of agricultural development.

The above facts urge us to consider industrialisation in its broad and long-run perspective and caution us against quantitative increase without qualitative change.

AN ALTERNATIVE APPROACH

We have all along conjured up a pattern of industrialisation prevailing in the West under the spell of cultural and intellectual dominance of the developed countries. Is this pattern inevitable and unavoidable for India ?

The pattern of technology and industry is shaped by and in turn shapes the society in which this pattern is generated and sustained. In untampered market economies only wants which can be backed up by purchasing power become articulated as demands upon the research and development of institutions and the remaining wants are by-passed.

The old international economic order, with developed countries dominating the developing ones, has resulted in capital intensive energy profligacy reckless with regard to non-renewable natural resources and labour saving character of the western pattern technology and industry. The technological innovations emanating from the basic driving force of capitalism i.e. maximisation of profit and accumulation spawned the western pattern of industrialisation. This pattern has the following intrinsic tendencies. :

i) amplification on inequalities between and within countries.

ii) increase in alienation of men from each other and from their work and diminution of social participation and control and

iii) degradation of the environment.

The developing countries like India can ill afford this pattern of industrialisation as very few of them have the necessary range and quantity of raw materials within their frontiers and they do not have captive external markets for manufactured goods. The western pattern has buttressed polarisation of India into dual societies of the richest 10 percent and the poorest 90 percent of the population. The affluence of the elites has been preserved at the expense of the misery of the masses. Thus the pattern is not only infeasible but also immoral.

The alternative pattern that lends itself for acceptance is obviously one which does not aim at maximising the volume of goods and services but promotes a process of socio-economic change for (a) satisfaction of basic human needs (b) self-reliance growing from within through social participation and control c) harmony with environment. The pattern of industrialisation to be pursued has to be need-based rather than demand oriented. The technology-mix has to be appropriate to the industry-mix created in response to the social needs. The criteria have to interepreted in a dynamic perspective as a heuristic leading to the generation of new technology.

The problem of industrialisation is linked up with the problem of total development which entails due emphasis on agricultural development. In the conditions prevailing in India and particularly Orissa, relatively much greater priority has to be assigned to agriculture. But more growth of agriculture can not provide sufficient condition for sustained industrial development. It has to be seen that the terms of trade do not move in a way discouraging industrial development and the increase in income of the farm sector is not appropriated by the rich farmers and landlords.

Generation of demand is crucial "in an economy where bulks of the consumption, production and investment decisions are made through the market mechanism. It is income distribution which determines the pattern of consumer expenditure as well as demand and hence the composition of industrial output. Ashok Mitra suggests that the shifting terms of trade have been instrumental in eroding the level of real incomes of the majority of the population in both urban areas and the country side. This implies income in farm sector has to be generated in a way benefiting the poor. Brahmananda reveals the declining share of wages in income. The share of wages in agricultural income was 80 percent in 1950-51, and in 1960-61, 79 percent in 1970-71 and 74 percent in 1980-81. The share of wages in secondary sector declined from 62.4 percent in 1960-61 to 52.0 percent in 1980-81. Wage's share in total national income which hovered around 75 percent during 1950-51 to 1970-71, slumped to 71 percent in 1980 81.

It is now necessary to increase mass domestic demand for industry goods. This requires channelling increments to income to the poor. Public sector investment may be stepped up, but it would not suffice unless adequate attention is paid to the composition of investment so that it leads to employment creation and incomes for the poor, if not directly at least as a second order effect.

The tendency of stagnation or sluggishness in industry requires deep probing. The foregoing account suggests that "for sustained industrial growth it is essential not only to mobilise savings of rich for investment but also to channel increments to income to the poor which in turn would generate a broad-based demand for industrial goods". Sustaining industrial growth requires tackling the problems of agriculture in comprehensive and through fashion recognising the differences from region to region and even within each region. "It would require explicitly linking the future pace and pattern of industrial development with the growth of incomes from agriculture, the needs of agricultural development and the resources available for the purpose locally. This would imply paying much more attention to small scale industry catering to rural needs. It would require restricting certain kinds of technological change in the large scale sector. It requires a different kind of planning much more aware of inter-regional differences, hence more decentralised". It has been found that the rates of growth of small scale industries have been higher in states such as Punjab, Haryana, Karnatak, Tamilnadu and Kerala where the rates of growth of agricultural output have been higher and where agricultural output is not subject to year to year fluctuation.

The above discussion irresistibly leads to the following suggestions.

i) Agriculture has to develop fast and more equitable distribution of the incremental income has to be effected to ensure sustained growth of industrialisation;

ii) The consideration of social needs should determine the industry-mix to be adopted and appropriate combination of capital and labour-intensive techniques for different industries has to be applied.

iii) Resource and demand potentials on regional basis have to be estimated and industrialisation needs to be planned as an integral part of the overall regional planning.

iv) Inter-firm contracting and common facilities, and services are to be developed. The concept of industrial complex is to be given a real shape. The ancillary parent relationship on the basis of direct contact as in Japan has to be developed.

v) The extent of industrialisation at any time has to be determined by the availability of the infrastructural, technical and marginal facilities. The rate and nature of industrial expansion have to be determined in consideration of the rate of depletion of the non-renewable resources and the social and ecological effect of industrialisation.

On the face of it I am persuaded to conclude on the humanist note as struck by 'Alfred Marshall : The question is not whether all men will ultimately be equal—that they certainly will not be—but whether progress may not go on steadily, if slowly, till by occupation at least every man is a gentleman."

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UNION DEBT BURDEN ON STATES WITH SPECIAL REFERENCE TO ORISSA

Trilochan Kanungo

Debt from the Centre has been accepted as a part of federal transfer of resources to the States. Article 293 (2) of the constitution of India empowers the Union Government to grant loan to the States under this constitutional provision read with Article 282, the Union Government has been providing loans to the States (1) at the discretion of the Union Ministries and (2) on the advice of the Planning Commission, which is an extra-constitutional body. As to loans provided to the States at the discretion of the Union Ministries, most of the loan assistance is provided to non-development programmes like, flood, drought and cyclone relief works, rehabilitation works and non-plan programmes of both development and non-development nature. On some occasions, loan assistance was given for non-plan revenue expenditure also. Plan assistance on the advice of Planning Commission consists of grants and loans. Till 1969 grant and loan components of plan assistance to States are not uniform, from where under the name of Gadgil Formala (named after Prof. V. R. Gadgil, Deputy Chairman of Planning Commission from 1969-74) the loan component to each State except Jammu and Kashmir, Assam, Nagaland and Meghalaya has been fixed uniformly at 70 per cent.

A debt from the Centre cannot stand on the same footing with a loan from the open market or from a foreign body. In the latter cases there exists a creditor-debtor relationship, whereas between Centre and the States, there ought to exist a mutual partnership in economic development and co-ordination and harmony for unity and order. A debt does not involve any burden either on the people or on the economy if it is used to generate sufficient additional income. From the purpose-wise distribution of Union loans among States, it is revealed that a part of Central loan is meant for unproductive purpose, another part may be socially necessary but economically unproductive. A good portion of the productive loan does not yield the desired dividend for various reasons whereas the rest portion of the loan has been invested in very long gestation projects. The States have been complaining that the economic returns of the loans invested are much less than the accepted norm of cost benefit rates. An in-depth study of the nature of the Central loans to States, the additional income generated by each loan and the reason of the short-fall of the targeted result have not been conducted so far by any expert body.

Total outstanding debt has been estimated in Orissa Budget for 1983-84 to be Rs. 1503 crores out of which outstanding loan from Central Government is Rs. 1203.6 crores. Debt retirement has caused serious financial and economic problem for the State. Interest payment and servicing of debts are met from the revenue account and repayment of capital, is made from capital account. During 1979-80— 1983-84 period the annual average interest payment and debt services are 66.8 crores of rupees and average capital payment during the same period is 50.96 crores of rupees. The annual average of State's own tax receipt during this quinquennium is 166.8 crores of rupees. Thus the debt services are calculated to be 39.5% of State's own tax. Both capital repayment and interest payment account for 70% of State's own tax revenue and 18.5% of State's average revenue expenditure of the said quinquennium. The development endeavours of Orissa or in that matter of other backward States are hamstrung owing to such persistent huge drafts made on the budgets of the backward States. During fourth plan period (1969-70 to 1973-74) the Central Plan Assistance was Rs. 160 crores (including 70% loan according to Gadgil 'Formula) to Orissa where as Orissa had to pay back to the Centre an amount of Rs. 120.5 crores towards interest and Rs. 170.7 crores towards capital repayment.

The matter of debt burdens on the States has been referred to second, fourth, sixth, seventh and eighth Finance Commissions to provide some relief. The Commissions did not have sufficient time at their hand if not the necessary machinery and expertise to delve into the problem let alone recommend permanent solutions. Fourth Finance Commission had, however, suggested to refer the matter to an expert body—"A survey of the soundness of the present system of intergovernmental borrowing is necessary as much in the interests of the States as that of the Government of India". This sound suggestion was not even accepted by the Government of India.

Sixth Finance Commission which had made to some extent a systematic study and tabulated some purpose wise loans declined to write off the unproductive loans on the ground that (a) it would reduce the pool of resources of the centre for financing new plan, (b) it would help the economically advanced States to a greater extent (c) it would be like pursuing will-0-the wisp if one tries to strike a distinction between the productive and unproductive loan. Because, "on a closer look at the working results of the so called productive schemes (such as Road Transports, power and Irrigation Projects and Industrial Enterprises) the proposed classifications between productive and unproductive debt would seem to have almost a touch of irony about it. There are transport schemes which do not cover even working expenses let alone depreciation and interest" (Sixth Finance Commission page 84) and so on. This however is a national phenomenon. Central Government undertakings have not even escaped the demerits of running on losses. Delhi Transport Corporations which is a public undertaking of Government of India runs on loss of more than Rs. 15 crores of rupees a year. Shipping Corporation of India Ltd. and Coal India Ltd. had incurred loss to the extent of Rs. 37 crores and Rs. 202 crores respectively in 1978-79. Thus these dismal failures are common to both State undertakings and Public undertakings.

Sixth Finance Commission recommended some debt relief to the States in order to mitigate the mounting debt liabilities of the States after assessing non-plan capital gap by rescheduling and consolidating various loans of different States. By such debt relief the Commission thought that weaker States would get some respite. But during the subsequent quinquennium between 1974-75 and 1978-79 (Fifth Five Year Plan) the period covered by the recommendation of the Sixth Finance Commission, the reverse flow of resources from the exchequer of Orissa, one of the most backward States to the Central fund towards interest payment and capital repayment was Rs. 244. 42 crores, whereas during fourth plan period the total reverse flow was Rs. 267.25 crores of rupees. In concrete terms the annual relief was only about Rs. 4.5 crores.

Seventh Finance Commission was also referred to undertake a general review of the State's debt position with particular reference to the Central loans advcnaed to them and likely to be outstanding at the end of 1978-79 and to suggest appropriate measures to deal with the non-plan capital gap of the States. Sixth Commission did not appreciate the idea of writing off Central loan, the reasons of which have been mentioned above. Seventh Commission on the other hand in their wisdom thought it prudent to write off some unproductive loans. The Commission had divided the Central debt into three categories which might be deemed to have been utilised for unproductive, semiproductive and productive purposes. The unproductive loans which they had decided to be Rs. 942. 82 crores, were written off. They had also recommended to convert small savings loans into debt in perpetuity. This was not accepted by the Central Government but the Government of India granted a moratorium on the small savings loan for the period covered by the recommendation of this Commission which benefited the advanced States more than the weaker States. Maharastra and Gujrat received relief of Rs. 160 crores and Rs. 108 crores respectively during 1979-84 period where as Orissa received a relief of Rs. 96 crores only over the same period.

The reverse flow of resources from the exchequer of Orissa to that of the Central Govt. during the five year period covered by the recommendation of the Seventh Commissions rose to 589 crores of rupees from Rs. 306 crores during the previous quinquennium covered by Sixth Commission. The decline in the percentage of interest payment and capital repayment to the States tax revenue during 1979-84 period is due to the increase of States' own tax revenue. A debt is not a burden if it generates a flow of income sufficient enough to defray the debt services including capital repayment. The Financial burden of Union loans on the States refers to the annual burden of interest charges and capital-repayments imposed on the budgets of the States. During third plan period the annual average burden i.e. interest and repayment was 25% of annual average of ravenue expenditure over the same period. Similarly during fourth plan period i.e. from 1969-70 to 1973-74 it rose to 37.7% of the revenue expenditure. Moreover the severity of the debt burden can be well understood during the period by measuring the ratio of interest charges and repayments to States own tax revenue. The annual average of interest and repayments during the period 1961-62 to 1965-66 was 163% of the States annual average own tax revenue. This burden was, However, substantially reduced by the relief granted by the recommendation of the Sixth Commission.

Apart from having adverse financial impact on the States budget, by the reverse flow in terms of interest and repayment, the Central debt while failing to generate sufficient income leaves serious economic impact which is known as the economic burden of the debt. The economic burden of the debt is measured in terms of the ratio of interest charges and repayments to State income. During third plan period the percentage of interest and repayment of Central loan to State income was about 4%, during annual plan period of 1966-67 to 1969-70 the annual average percentage was about 5%. During fourth plan period it rose to 5.6%. After the recommendation of the Sixth Finance Commission the percentage declined to 3.59. These figures are quite high in comparison with the corresponding figures for other States excepting Rajasthan in some years.

From fourth plan period the plan allocation to the States from the Centre, under Gadgil Formula contains 70% of loan element which is the single largest factor to raise the debt burden of the backward States. A graded loan content is therefore warranted in place of the present formula. The debt burden of the States has been referred to successive Finance Commissions only because of this Gadgil Formula. The plan allocation for more prosperous States should therefore contain higher proportion of loan and the less developed States should have lower proportion of loan content in the plan allocation.

We are of the view that the central loan should be so rescheduled that the financial and economic burden of the State should be least felt. If R is the reverse flow of resources in way of interest and capital repayment in a particular year from the State to the Centre, P is the net State domestic product of the same year and Q is the total revenue of the State for the said year, then R/P is the economic burden and R/Q is the financial burden of the State and R^2/PQ is termed as income-economic burden. While measuring the financial burden of Union-debt on Orissa in terms of the ratio of reverse flow of resources to the Centre (R) to State's total revenue (Q) it has been observed that though the percentage of reverse flow of resources to total revenue is declining with successive plan period still the burden continues to be quite substantial. Taking the ratio of the average reverse flow (R) to the average State's own tax (T) and total revenue (Q) of the years 1980-81, 1981-82 and 1982-83, it is found that in former case (R/P) Orissa occupies the second place after Assam and in the latter measurement (R/Q), it occupies the fourth position after Assam Rajasthan and West Bengal. We like to suggest that the outstanding loan and interest of a State should be so rephased that in each financial year the capital repayment and interest payment and debt services (R) shall help keep R^2/PQ below 0.001. We are sure no State shall have any objection to the above formula. The above derivative (0. 001)- the whip line (Lakshman Rekha) is the product of empirical analysis of debt burden of states over quite a number of years, beginning from the first plan period.

SUGGESTIONS :

1. Graded loan content is warranted as against the present practice under Gadgil Formula. More prosperous States should have higher

proportion of loan and the less developed States should have lower proportion of loan content in their respective plan assistance.

2. Central assistance for non-development purpose, for relief, rehabilitation and restoration works to economically backward States should not have any loan content.

3. Capital-repayment and interest-payment of outstanding Union loans on individual States should be so rephased that in each financial year the capital repayment and interest payment and debt services of a State (R) shall help keep R^2/PQ below 0.001.

   Where R = Capital repayment + interest payment and debt charges.

   P = Net State Domestic Product

   and Q = Total revenue of the State of a particular year

4. Planning machinery should be armed with necessary expertise for continuous monitoring of the end-use of the loans and concurrent evaluation of the loan schemes in order to ensure desired result.

DISTRIBUTION OF INSTITUTIONAL FINANCE AND ITS REPERCUSSION ON CENTRE-STATE FINANCIAL RELATIONS

Prof. B. C. Parida

Centre-State Financial relationship has three aspects so far as fiscal transfers are concerned. The statutory fiscal transfer or budgetory fiscal transfer which is determined on the basis of the awards of the Finance Commission constituted at an interval of five years. The second type of fiscal transfer relates to the plan allocation which is financed by the planning commission on the basis of Gadgil formula. This formula remains the core formula for the distribution of major central assistance and market borrowing though a sum of Rs. 2000/- crore was taken out to distribute among states on the basis of Income Adjusted Total Population which gives due weightage to poverty. Even after this, one does not find any marked difference in terms of assistance to advanced and poor states.

The third fiscal transfer which flows from the centre to the States is through the mechanism of Institutional Finance. By Institutional Finance we understand National level financial institution and the banking sector which help in mobilisation of resources and provison of finance for the economic development of the State and for reducing inter-state backwardness. For the constraint of data it is not possible to cover the grants made by U.G.C., Central Social Welfare Board, Housing and Urban Development Corporation, National Co-operative Development Corporations and various commodity boards which have been excluded. We have only to review the flow of assistance through special financial institutions and commercial banking sector.

According to some the flow of institutional fund is more important for correcting inter-state fiscal imbalances, because the budgetory imbalances go to cover the states' current consumption expenditure. Almost all the institutional funds go to finance production and investment. So from the point of view of correcting the imbalances in inter-states development, the importance of institutional finance is far greater than their budgetory or plan transfer. The focus in this paper has been to study the inter state distribution of institutional funds and its role in correcting the fiscal imbalances among the states.

When we look at the State Per Capita Income (1975-76) and share in SFIs disbursements cumulative to 31st March 1981, we find that states like Orissa, Bihar, U.P, and M.P, have not only less state per capita income, their per capita disbursement of institutional finance is also low. States like Orissa, Bihar, M.P. have got 1.97%, 3.22%, 2.79%, respectively as a percentage of disbursement of institutional finance. U.P. has got 7. 21%, Gujrat and Maharashtra have topped the list. So assistance from SFIs have gone in favour of richer states. Therefore, the study of Gulati & Geoge that "Inter state distribution of institutional finance has had a very pronounced regressive bias against low income states and in favour of high income states still holds good today".

THE COMPONENTS OF INSTITUTIONAL FINANCE :

Commercial Banks:

The above analysis of institutional finance has not covered commercial banks. Commercial banks disburse more than 60% of institutional finance. Therefore, we have to find out, how comercial banks have provided benefit to the states in general and poor states in particular. If we take credit deposit ratio according to sanction and utilisation of credit we find that the states like Haryana, Punjab, Maharashtra, Gujrat, Tamilnadu and West Bengal have got more credit than the poorer states.

In Bihar, Orissa, U.P, and M.P, there is one bank branch office per 20,000 population but in case of Punjab,West Bengal, Gujrat and Maharashtra there is one bank per 10,000. 10,000 13,000 and 15,000 people respectively. So far as per capita bank deposits are concerned, Orissa, Bihar, U. P, and M. P, have got Rs. 163/-, Rs. 222/-, Rs. 321/-, and Rs.224/- respectively whereas in case of Punjab, Haryana, Maharashtra and West-Bengal, they are Rs. 1165, 1506, 1103 and 755 respectively. So far as per capita bank credit is concerned in Orissa, Bihar, U.P. & M.P, it is Rs. 96/- Rs. 91/-, Rs. 136/- and Rs. 125/- respectively whereas in case of Gujrat, Haryana, Karnatak, Kerala, Maharashtra, Punjab, Tamilnadu and West Bengal it is Rs. 435/-, Rs. 363/-, Rs. 389/-, Rs. 385/- Rs. 869/-. Rs. 504/-, Rs 490/- Rs. 457/- respectively and all India average figure is Rs. 360. This clearly shows that the bank credit has flown more to richer States than to the poorer States.

If we analyse the co-operative banking sector, we find that the richer states have got more of deposits and loans than the developed states. Orissa has got 17 Central Co-operative banks with 142 offices and deposits of Rs. 2,769 lakhs whereas Maharashtra has got 26 Central banks, 1524 offices and Rs. 38,272 lakhs deposits. Similar is the story of state co-operative and urban co-operative banks.

So bank finances go to richer states more than to the poorer states and those aggravate inter-state inequality. Some people advance the argument that bank credit can only be given on demand and on the absorbing capacity of the state or the region. But the idea of absorption has undergone considerable change in case of investment by banks in Governmental securities, corporations and shares of different companies. Bank finance can serve as an instrument of reducing inter-state fiscal imbalance if properly designed. One suggestion has been made that at least the ratio of credit plus investment to bank deposits in low income states should not fall below the all India average.

TERM LENDING INSTITUTIONS :

Report on Development Banking in India 1980-81 at page 14 has calculated the cumulative assistance of I.D.B.I., I.F.C.I., I.C.I.C.I., L.I.C., U.T.I. and G.I.C. up to March, 1981. This shows that states like Bihar, Orissa, U.P. and M.P. have received Rs. 229.92 crores, Rs. 125.39 crores, Rs. 508.91 crores, Rs. 192.33 crores respectively whereas states like Gujrat, Maharashtra, Karnataka, Tamilnadu and West Bengal have got Rs. 917.51 crores, Rs. 1529.56 crores, Rs. 556.81 crores, Rs. 706.11 crores, and Rs. 501.45 crores respectively. It is needless to mention that U.P. is much bigger state in comparison to the other developed states who have got more. Therefore, the term lending institutions have benefited the rich states progressively and the poor states regressively.

ASSISTANCE TO BACKWARD AREAS BY ALL INDIA FINANCIAL INSTITUTIONS :

All India Financial Institutions have got concessional finance schemes for backward states. In pursuance of Wanchoo Committee Report, the Government of India notified 44 districts eligible for special concessional assistance for industrial development of units whose assets do not exceed Rs. 50 lakhs. The scheme has been liberalised from time to time. Now it is extended to industries having investment of Rs. 1 crore. Wanchoo Committee pointed out that the distribution of assistance by various financial institutions have not served the cause of industrial dispersion in any appreciable manner. 62% of their total credit has gone to metropolitan cities. The distribution system is faulty. Therefore industries should be set up on preferential basis and on a concessional rate of interest. Their lending policy has to be reoriented so that they finance not only the viable but also the potentially viable schemes in these areas.

The package of concession included concessional rate of interest, longer initial grace period, amortization period depending upon the merits of each case, reduced margin of security, lower contribution by the promotor to finance the cost of the project, larger participation by these institutions in the equity and preference capital of projects and a 50 percent reduction in their normal charges in respect of commitment charges, under writing commission etc. The All India institutions such as I.D.B.I., I.C.I.C.I. and I.F.C.I., L.I.C , U.T.I., G.C.I. provide financial assistance to backward areas. Report on development banking in India 1980-81 (P.15) has discussed about the cumulative assistance to backward areas by all India financial institutions. The total assistance sanctioned has been Rs. 9758.46 crores of which Rs. 6731.30 crores have been disbursed. Backward area assistance Rs. 3631.51 crores sanctioned and Rs 415.49 crores disbursed. So far as has been sanction is concerned it is 37.2 percent of the total assistance and disbursement is 36 percent.

INTER STATE VARIATION IN BACKWARD AREA ASSISTANCE

The statewise institutional finance to backward areas shows skewed distribution of funds in favour of industrially developed states, such as, Gujrat, Maharashtra, Haryana, Punjab Karnatak, Kerala, Tamilnadu and West Bengal. These States accounts for 71 percent of total assistance sanctioned by the term lending institutions. The backward states only utilised the rest of the finance. In the industrially developed states the backward areas have got only 24.8 percent of the total assistance. The share of the backward areas in the industrially backward states is only 13 percent of the total assistance sanctioned.

Among the developed states Gujurat and Maharashtra with 14.2 percent of population have got 36.8 percent of assistance where as other states have got less percentage, of assistance. Bihar. U P, Andhra Pradesh, M P. and Rajsthan having 49 percent population have got 23.4 percent of assistance. Orissa having 4 percent of population have got 2.2 percent of the assistance. Further three districts in each state enjoy financial assistance i.e. from 50-70 percent in the backward states. This suggests there has not only been concentration of industrial finance in the developed states but also concentration of industrial finance in the developed districts of the backward states. The state-wise and districts-wise distribution of institutional finance have shown that regional imbalances have increased.

SUMMARY AND SUGGESTIONS

Institutional finance flow has a positive role in correcting or accentuating the regional imbalances like the devolution of resources through Finance Commission and Planning Commission.

2. Per capita cumulative disbursement of these SFIs by 1981 reveals that the institutional finances have gone more in favour of advanced states than in favour of poorer states even though one of the professed objectives of these institutions are balanced regional development.

3. More than 50% from institutional finance are channelised through the commercial banks. A study of their credit deposit ratio shows that they have provided more benefit to the advanced states than the poorer ones on the ground that credit cannot be advanced without any absorbing capacity. But though it is a fact that the utilisation of bank credit depends to a large extent on the level of economic development of a state, the banks should have consciously attempted through the distribution of their investment that the credit-deposit-ratio in the low income states do not fall below the national average.

4. So far as concessional finance and backward area developments are concerned more assistance has gone to the backward districts of the developed states than to the backward districts of poorer states. In each state also 3 backward districts which are comparatively advanced have got 50% of concessional finance in comparison to other states. Imbalances in the distribution of concessional finance become more acute because of the way they define backward districts. The advanced districts of backward states are much below the backward districts of advanced states. Therefore most populous under developed states like Andhra Pradesh, Rajsthan, Bihar, U.P. and M.P. having 47% of population have got 23% of the total concessional finance, whereas most populous developed states of the country like Gujrat, Maharashtra, Karnatak, Tamil Nadu, and West Bengal have got 62% of concessional finance with 34% of population. In this connection if one analyses the criteria followed by the Panda Committee and the Planning Commission, will find that if a particular district has got per capita

income, factory employment, surfaced roads. agricultural output, electrification and many such indicators below the state average and the district is 50 Kms. away from the metropolitan city, then the district is said to be a backward one. But it does not take into account national averages and as such the procedure of identification of a backward district contributes more to regional imbalances than the end use of concessional finance which flows to these districts.

6. Some people have observed that the term financing institutions while selecting projects do not find projects to finance. These institutions have been complaining of a glaring lack of application for projects located in less developed states or areas viable technically and financially. In this connection two suggestions can be examined. In the first place, absence of infrastructural facilities stand on the way of enterpreneurial skill and financial accommodations, Orissa for example has got 10 Kms. of surfaced road length for 100 Kms. of area as against the all India average of 19 Kms. Similarly in case of railways Orissa has got 13 Kms of railway lines against the all India average of 18 Kms. per 100 Kms area. Similarly in case of other infrastructural facilities poorer states fall behind the advanced states. Unless infras tructural facilities are developed institutional finance will not find proper projects. Prof D. T. Lakadawala in his article 'Centre State Financial Relation, I. E. J. Dec-1972 has pleaded for equalisation of basic public services among different states specially the social over-heads, like health, medicine and education and to a large extent economic overheads like transport, irrigation and power. These disparities must be compensated by larger central transfer to weaker states, otherwise the finances will not yield the same level of results in all the states.

7. Neither institutional finance nor statutory plan can help a **state in attaining higher levels of economic development unless the people of the state help themselves.** I.D.B.I. as the apex industrial development bank of India has started TCOs for identification of the projects, preparation of project profiles and helping entrepreneurs in training and initiating industrial ventures in the state. ORITCO is one of them and poorer states like Orissa should take full advantage of it.

In the absence of the corrective measures to arrest the trend of unequal institutional finance, the regional fiscal imbalances will aggravate and the pressure on budgetary transfer will become more and more for correcting the imbalances in inter-state distribution of fiscal transfer. This will also give new dimension to centre-state financial relations.

FISCAL FEDERALISM IN INDIA.

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I

In a unitary State the central problem of public finance pertains to the achievement of optimum revenue-expenditure patterns at given revenue-expenditure levels. This becomes difficult to solve because the 'social welfare function' which it is the objective to maximise, cannot be specified in a quantitative manner, even if the effects of the fiscal operations on the various elements of the function can be fairly accurately ascertained.[1] When we switch over to a federal form of government the problem assumes added dimensions. Even if a federal government is considered superior in providing a mechanism for realisation of the paretian optimality in resource allocation through the operation of the principle of conflict, bargain and mediation ([2,3]) and even if it is seen to be economically more efficient than an alternate situation with a host of small unitary governments in providing for better security against external threats and internal insurgencies and in ensuring a unified market by doing away with avoidable vexations in the free movement of trade and commerce throughout the length and breadth of the territory,[4] the best revenue-expenditure levels and the most beneficial way of spending a given amount or the least harmful way of raising a given amount of resources continue to tax the best ingenuity in this field.

The federal set up adds to the problem in three ways, viz; First, there are two sets of governments not subordinate but coordinate to each other with well defined distribution of functions and sources of revenue. Problems of intergovernmental fiscal relations arise due to non-correspondence between functions and resources in a perpetual way since exact correspondence is hardly possible in any federal system, however water-tight the division of functions and distribution of taxing powers may be. This is essentially due to the fact that the process of adjustment is a dynamic one.

The second factor which aggravates this problem, as in case of India, is the introduction of planning. Planning, by its very nature, rests on the thesis of centralisation. Reconcilation of the decentralised federalist point of view with centralist planning principle is the crux of the problem of centre-state financial relations in India. Social and economic planning has made the states the focus of all developmental activities for which huge amounts of funds are necessary. But the states find themselves in an unenviable position in this regard as the resource gap for them is increasing year after year.

Third, which is plaguing the centre-state financial relations in India is that there exists a big chasm between the rationality of the central planning authority and that of the authority which is in charge of the state planning activities in many cases. The rationality of the two authorities in deciding the strategy and technique of planning may itself be subject to question. But even with this shortfall also the basic strategy seems to be not in conformity with each other.[5]

II

The constitution of India provides for various ways of adjustments and financial transfers for correcting the imbalance in the resource position of the states. The transfers from the centre to the states are of three broad categories, viz,

i) through Finance Commission, mainly in the non-plan sector
ii) through Planning Commission, in the plan sector and
iii) other transfers. Where as the first category of transfers is statutory in nature, the other two are basically discretionary in nature.

Even though the framers of the constitution expected the statutory transfers to take the pride of place in the scheme of devolution, the position till recently has become just the opposite in actual practice. The transfers through the recommendations of the Finance Commission have been relegated to the second grade position due to the emergence of the Planning Commission transfers under Art. 282 and the central loans under Art. 293. The Sixth Finance Commission has drawn our attention to the anomalous position in their report.[6] They have analysed the relative position of transfers of the different categories from the centre to the states, during the period 1951—1974. They have come to the conclusion that out of the total transfers during this period, those through the Finance Commissions accounted for 31.5%, Planning Commission transfers had been 31.1% and other transfers 33.4%. Of late, however, the relative position between the Finance Commission and Planning Commission in matters of resource transfer has undergone substantial changes. But plan transfers and other transfers taken together still continue to weigh heavier than Finance Commission transfers taken in isolation.

Another dimension of the scheme of transfers is worthnoting in the context of the operation of the federal principle. When one looks at the magnitude of transfers from the centre to the states one is simply at a loss to find that there is a glaring and heavy dependence by the states on the central resources which does not speak well of the operation of the federal spirit of our constitution. The position can be read from the table below.[7]

Total current transfers from the central govt. to the states as % of own resources of states.

Year	Transfers as % of state resources.
1961 - 62	57.57
1966 - 67	63.88
1967 – 68	62.11
1968 – 69	62 96
1969—70	64.19
1974 – 75	62.18
1978 – 79	87.99
1979—80	77.83
1980 – 81 (R E)	79.98

This might mean the very collapse of the fabric of the federal system in our country due to heavy dependence of the states on the Government of India for meeting their requirements.

III

The states have become critical of this situation. They ventilate their grievances on all possible platforms to attract the attention of all concerned. They claim that the central government has become niggardly in transfer of tax revenue to the states. The following table indicates the position.[8]

Devolution of taxes to the states as % of gross Central Tax Revenue

Year	Devolution as %
1961—62	16.98
1966—67	16.16
1967—68	17.50
1968—69	19.44
1969 - 70	22.15
1974—75	19.43
1978—79	18.55
1979 —80	28.46
1980— 81	28.22
1982—83	26.00
1983—84	25.10

The claim put forward by the states is much higher, 75% proposed by West Bengal and 60% by other states. Of couse the commitment of expenditure by the central govt. has to be considered simultaneously when the demand for transfer of more of tax proceeds to the states is taken into consideration. The outlay on civil administration, defence, border security, debt servicing and other social and community services claim a major portion of the tax proceeds of the central government and it may not be possible on its part to accede to the demands of the states in this regard. The two major exclusive sources of revenue for the central govt. in the fiscal year 1982—83 yielded 8266 crores—customs duties 5880 crores and corporation tax 2386 crores. This was even short of the committed expenditure of the central govt. of 9800 crores – Defence expenses (net) 5364 crores, interest payments of debt (net) 2000 crores and Administrative services pensions etc 2436 crores. But in some other respects the discrimination introduced by the central govt. does not seem to be justified.

The administration of the Income Tax has become slack in recent years in view of the fact the major portion of the proceeds (85%) are distributed among the states. There have been large amounts of arrears, reduction of basic rates while increasing surcharges (meant exclusively for the central government), ploughing back the evaded amounts through special Bearer bonds whose proceeds are appropriated by the central govt. alone. — All these have created discontentment among states as their shares have been reduced consequently.

In matters of overdrafts state govts. are put to a disadvantage. A state government is entitled to overdrafts upto 2% of its annual expenditure at 13% rate of interest wheres the central govt. can resort to unlimited amounts of overdrafts at 6.5% interest.

The central government having superior financial strength is increasing the emoluments of its employees from time to time and is able to compensate them fully for rise in prices. The states are seriously handicapped in this respect as they do not have adequate resources to meet the demands of the employees. Such a situation urgently calls for an immediate formulation and strict implementation of a rational wage-income policy for the country as a whole.

The working of the Finance Commission has been one-sided, since it lacks authority to critically examine the financial requirements of the central govt. and to allocate funds to it accordingly. In other words the central govt. forces the states to accept a discipline from which it is completely free. This underscores the need for an Expenditure Commission in order to subject the central govt. expenditures to scrutiny. The example set by the central govt. is no better in this regard. In 1973-74 the central revenue receipts were 5072 crores whereas revenue expenditure was 4835 crores resulting in a surplus of 237 crores. But in 1982-83 the receipts increased to 17900 crores whereas expenditures were of the tune of 18277 crores resulting in a deficit of 377 crores. These short falls are made good, among other measures, by deficit financing which the states have no authority to take resort to. Even in matters of public borrowing also the states depend upon the clearance from the central government. Thus the states are made to stand at the doors of the central govt. for doles to keep their budgets balanced.

The conclusion that emerges is that the central govt. has to be more liberal towards the states on a uniform basis so as to set an example as a willing partner in the overall game of economic development of the country. As the 7th Finance Commission pointed out the tax efforts of the states during 1969-79 has been creditable.[9] Therefore the devolution of resources from the centre should be so fashioned that it follows a set of uniform rules and is statutory in nature.

But this need not obsecure us from the fact that the state governments must improve the standards of their financial house keeping so as to improve their image in this respect. In spite of the fact that the tax efforts of states have been recorded as creditable, much remains to be done by them in this regard to rationalise their tax structure. Through Green Revolution substantial gains have accrued in the agricultural sector, particularly to the big farmers. But the direct tax load has remained at a very low level. More surprisingly some state governments have abolished or drastically reduced the land revenue pertaining to their jurisdiction. Massive irrigation schemes have been undertaken with the help of loans whereas irrigation rates are far below the level which cannot even meet the operation costs of the schemes. Such cases of non-tapping of potential sources of revenue by the state governments is considered unpardonable by any standard of sound fiscal management.

Public undertakings of the state governments consider it criminal to work on a principle of breakeven, let alone earn profits to contribute to general revenue. The total loss incurred by State Road Transport Corporations is 62.35 crores in 1979-80 and is likely to rise to 1340 crores, by the end of 1983-84. State Electricity Boards, commercial undertakings, cooperative institutions all run with huge losses year after year. These institutions cater to the needs of particular groups of consumers. Any loss incurred by them is charged on the consolidated fund and the common taxpayer bears the burden in ultimate analysis. He is denied equity in so far as fiscal burdens and benefits are concerned because of this unsound financial management by the state governments. The states can definitely improve their own resource base through more efficient and strict financial management in these fields. But unfortunately they have developed an attitude of blaming the central government for anything that goes wrong with them for paucity of resources.

In a situation of confrontation, cooperative federalism cannot advance an inch at all. We have the example of United States and Australia before us, where they have crossed the stage of confrontation with experience that conflicts do not lead to advancement. At some point the two tiers of government have to cooperative through a synthesis of their seemingly antagonistic approaches. The key factor is partnership, linking the federal government in joint endeavours to pursue common and shared goals. This spirit was rightly emphasised by Mr. Palkiwala in the historic Bangalore seminar when he pointed out that the present state of bickerings in the financial relationship between the centre and the states is basically due to gradual incursion of mistrust and erosion of the fundamental spirit of the framers of the constitution.

Therefore he suggests a return to the basic spirit of the constitution and the fundamental values with strict standards of discipline so that the financial arrangements would work in a satisfactory manner. Both the states and the centre must be true to their own task and function with the right purpose so as to further the cause of economic development of the country. Any conflict among them would make their efforts a zerosum game without any advancement for either tier of the government.

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5. This might seem to be having a political overtone associated with it. As a matter of fact the way social welfare function is defined by Bergson, it is basically a decision to be taken by the political functionaries of the society. But when the two authorities are of the same political wave length the non-identity of the rationalities remain inexplicable.
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FISCAL FEDERALISM IN SEARCH OF A "FEDERAL TAX"

Kishor Samal

Though India is a federal state in theory, the working of its constitution has been on unitary lines, along with a steady encroachment of the Centre on the powers of States.

Three important tendencies are apparent : tendencies of further concentration of economic and political power at the hands of the Centre, the growth of autocratic rule and concentration of capital in big business houses. The last two tendencies require concentration of power.

It should also be kept in mind that development of capitalism necessitates, as one of its conditions, the formation of larger market for commodity production. This necessity plus the requirement of big capital demand growing centralism.

The Indian constitution, accordingly provides in built mechanism to the centre to encroach upon and curtail the powers of states.

If one looks at the division of power under the Seventh schedule of the Constitution, one can safely conclude that virtually states have no exclusive power on any subject. As per the Seventh schedule, the Parliament has exclusive power of legislation with regard to items mentioned in the Union list and State Legislatures over every subjects in the state list. In case of concurrent list, both Parliament and State Legislatures have concurrent power. But once Parliament does enact a law on such items mentioned in the Concurrent list, Parliamentary Law shall prevail over any state law in this regard. Thus in real sense, states have no power to enact law independently in case of concurrent list. Even under Articles 249 and 250, the Parliament has also over-riding power to enact law on subjects mentioned in the state list. Again, Article 200 empowers the Governor to reserve the Bill passed by the Assembly for President's assent. Thus, even in case of state list, the powers of states is not exclusive.

In many cases, by withholding presidential assent to Bills passed by state legislatures, the centre has succeeded in sabotaging progressive legislation passed in the interest of the people. Thus, for proper decentralisation of power, Articles 200 and 201 should be done away with. Further the Article 249 giving power to the Centre to legislate on a subject in the state list should be deleted. The residual powers of the federation should lie with the states and not with the centre. These steps are required, because, if there is no decentralisation in power of legislation, there will be no proper financial decentralisation.

The economic imbalances and deprivation and backwardness of many states are the consequences of the over centralisation of economic powers and resources with the centre. About 60 percent of the total resources raised in the public domain is retained by the Central Government. The more elastic sources of taxation are with the centre. In the recent past, there has been a tendency towards the concentration of more financial powers with the centre, particularly through taxation measures. States do not get any share from the yield from the surcharge on Income Tax. Since 1959, the income from the company became non-sharable with the states by describing it as "Corporate Tax". Again, since 1956, the centre, through the introduction of the scheme of Additional Duties of Excise on textiles, sugar, tobacco, has eroded the power of the state governments to levy taxes on the sales of commodities. The Union Government has of late been endeavouring to extend further the orbit of operation of the scheme on some more items like cotton' yarn, cement, crude, iron, steel, ingots, paper and paper board products and petroleum products.

A number of other arrangements, such as fixing a ceiling on the rate of Sales Taxation for goods 'declared' to be of national importance, prohibiting the states from imposing Sales Tax on exportable goods to some extent have deprived the states of their due share of revenue. The unwillingness of the Union Government to pay the states the appropriate royality for the exploitation of their mineral wealth is a further source of encroachement upon resources of the states.

In recent years, the states heve been victims of a particular strategem of inequity indulged in by the central government. Though, due to strong pressures from different states the Seventh Finance Commission raised the share of states from 80 to 85 percent in case of Income Tax and from 20 to 40 percent in case of Excise; the centre is taking certain steps to nullily the Finance Commissions recommendations. For instance, in case of Income Tax, in 1979 budget instead of raising income tax rate, the surcharge on Income Tax was raised from 15 to 20 percent which is not sharable with the states. Similarly in 1984 budget, instead of reducing the surcharge on Income Tax, income tax rate has been reduced by 5 percent on all slabs of incomes. Again, the centre has been raising additional resources by raising the administered prices of commodities like petroleum products, coal, iron and steel and so on, instead of adjusting the excise duties on them. As a consequence the states have been deprived of their due share of revenues. In a similar way, many examples can be cited.

To check these tendencies of centralisation, suggestions with regards to taxation are made from different circles to bring some changes in the existing financial arrangements like sharing the proceeds of the corporation tax with the states, abolition of surcharge of Income Tax or alternatively sharing of its proceeds with the states, removal of the scheme of additional duties of excise, and a review of the principles guiding decisions regarding "declared" goods and the rates of sales taxation with respect to such goods and so on. But all these measures, if implemented, may not solve the problem of centralisation.

There must be some amendments in the constitution to give more financial autonomy to the units. The states should be financially fully independent without any string attached by the centre. The centre should not impose any tax. All types of taxes may be imposed by the states. And states may be regarded as legal persons and be taxed by the centre in a graduated rate like personal income taxation, with the provision of negative rates of taxation taking the criteria of per capita income and the number of people living below poverty line in a state. Because the true federalism is that in which the primary responsibility for looking after the well-being of people together with the primary sources of revenue and primary authority is located in the states; the Central Government meeting its obligations with the surplus of the revenues of the units.

At last, it can be mentioned that since bourgeois – landlord rule in India cannot solve the basic economic and political problems of the people, simply granting more autonomy to states makes no fundamental difference. Without the removal of the class rules of the bourgeoisie— landlords combination there cannot be any solution to the people's problem by ensuring greater decentralisation of power.

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TREND OF TAX TRANSFERS IN INDIA

A CASH STUDY OF ORISSA

R. K. Choudhury

INTRODUCTION :

There is raging controversy all over the country on the issue of the Centre-State financial relations. Indian federation has two levels of Government with distinct division of powers and sources of revenue between the national and the State Governments. Under such a system, each federating unit frames its own budget within the ambit of its own resources and the transfered resources from the centre.

The Constitution of India provides for the assistance to States under Article 275 (1) and Article 282. The central assistance to states can be broadly classified into statutory and discretionary. The statutory assistance is in the process of transfer of shared taxes and grants-in-aid under the substantive portion of Article 275 (1) of the Constitution. The statutory transfers are in accordance with the recommendation of the Finance Commissions provided for under Article 280. The discretionary devolutions are in pursuance of the provisions of Article 282 of the Constitution which are granted on the basis of an executive order and are not compulsory under the Finance Commission awards, generally provided for financing the implementation of state plans. The quantum of such transfers under the aforesaid Articles are determined by negotiations between the Central Government, State Governments, Finance Commission, and the Planning Commission.

Article 268 and Article 281 of the Constitution deal with the distribution of revenue between the Union and the States. In the Seventh Schedule, item 82 to 92 (a) in the Union List and item 45 to 63 in the State List refer to the sources of taxation. Taxes under the Union List can be broadly classified into the taxes which wholly accrue to the Union Government, the divisible taxes, and taxes imposed by the Union Government but collected and appropriated by the States. The divisible taxes include Income Tax other than agricultural income, excise duty on tobacco and other goods manufacture in India except alcoholic liquors and narcotic drugs, Additional Duties of Excise in lieu of Sales Tax on sugar, tobacco and textiles, Tax on Railway passenger Fares and the Estate Duty.

SCOPE & OBJECTIVE OF THE STUDY :

Economic development requires a balanced regional development. Under the federal financial set up, the Centre has to help the States through transfer of funds with a view to removing such disparities. This article intends to examine the nature and impact of Central devolution of taxes to the States with particular emphasis on Orissa and suggest suitable linkage in the financial relations between the States and the Union in the interest of the nation at large. However, the study is confined to a study of the transfer of divisible taxes to the States since independence upto the end of the Fifth Five Year Plan in 1977-78.

SHARED TAXES

Taxes like Income Tax, Central Excise Duty, Additional Excise Duty, Tax on Railway Passenger Fares, Estate Duty are divisible among the Union and the States. The division of such taxes are effected to in accordance with the recommendation of the Finance Commission. The Commission is the sole arbiter for the transfer of resources from the Centre to the States. The First Finance Commission was appointed in 1952 and by 1978, seven Finance Commissions were appointed, primarily to facilitate a periodical review of the fiscal needs and formulate proposals for transfer of resources. But an incidental and by no means insignificant advantage of the appointment has been to rekindle interest in issues pertaining to financial relations between the Centre and the States, and to promote an enlightened national debate on the several facets of our federal fiscal set up.

INCOME TAX SHARE

In accordance with the provisions of the Constitution of India under Article 270, the Finance Commission were required to make recommandation in regard to the percentage of the net proceeds of Income Tax to be assigned to the States, the distribution of the divisible pool among the States *inter se* and the percentage of the net proceeds which shall represent the proceeds attributable to Union Terrotories. Different Finance Commissions have recommended varying percentages of the shareable pool of Income Tax to be distributed among the States. The main basis of distribution has been population and collection or assessment of income Tax in the State.

An anilysa's of receipts shows that in 1960-61 the States like Gujarat. (16.6 percent), West Bengal (11.8 percent), and Uttar Pradesh (10.5 percent) covered more than the other States of their respective total revenue from the share of Income Tax. Orissa covered 9.5 percent of its total revenue during the same period. In 1970-71, the share of Income Tax in the total revenue of all the States was increased. Bihar covered the highest percentage (16.5) as against 4.6 percent in 1960-61. The share of Orissa was increased when it covered 11.1 percent of its total revenue by the share from Income Tax in 1970-71, but the position of Orissa was reduced from fourth in 1960-61 to fifth. in 1977-78, the share of Income Tax in the total revenue was decreased for all the States. Bihar maintained its first position but was reduced to sixth and Rajasthan from seventh to nineth.

The share of Income Tax in the total tax revenue of the States reveals that the percentage share of the tax increased in 1970-71 but decreased in 1977-78 for the States like Andhra Pradesh, Assam, Bihar, Kerala, Madhya Pradesh, Maharastra, Rajasthan, Uttar Pradesh and West Bengal. But it had a decreasing trend throughout for the States like Orissa, Gujarat. Jammu & Kashmir, Karnataka and Punjab. The trend of the share of Income Tax in the tax revenue of Orissa is not in line with the poorer States in India.

A comparison of the percapita devolution of Income Tax and the percapita Income of the States reveals the fact that the percapita devolution of Income Tax has considerably increased in line with the per capita income of the States. This indicates that the States in the higher income bracket have been receiving more than the States in the lower rank. The position of Orissa was rather reduced from eleventh to fourteenth. Thus the way Income Tax is distributed goes against the principle of natural justice and reduction of regional disparity, even though the Commissions have recognised the principle of need of the States.

In view of the significance of Income Tax sharing, the principle of distribution should take into account the need of the States. The policy of distributing Income Tax on the basis of population and collection or assessment will fail to serve the purpose. The divisible pool of the Income Tax should include the Corporation incomes. The basis of distribution should include population—its size, composition, percentage of scheduled castes and tribes and other backward classes and the reverse order of the per capita income.

SHARE IN CENTRAL EXCISE

The question of division of Union Excise Duty for the first time was initiated by the First Finance Commission. The emergence of Planning caused to a greater degree of concentration of financial resources with the centre, there by reducing the financial position of the States and ultimately increasing dependence on the Centre. The Union Excise Duty have now become an expanding source for the Central Government and in view of the low elasticity of Income Tax, the need for greater devolution of Central Excise was recognised by the States and the Finance Commissions. The Third Finance Commission emphatically observed that, "a more extensive use of Article 272 for awarding assistance to the States is not only justified but is even necessary". It was thought that the viability of the States could best be secured by a larger devolution of the Union Excise Duties and it would give a great deal of psychological satisfaction and dissipate any suspicion among the States that the Union is pursuing a policy of excessive centralisation of resources. The successive Finance Commissions have worked out principles for distribution of Union Excise Duties among the States. Orissa shared 4.22 percent and 4.46 percent from the award of the First and Second Finance Commissions respectively. It was increased to 7.07 percent during the Third Commission. But it was decreased to 4.82 percent, 4.72 percent and 4.06 percent during the Fourth, Fifth, and Sixth Finance Commission respectively. Orissa obtained Rs. 74.12 lakhs in 1952-53, which increased to Rs. 1704.98 lakhs in 1970-71 and Rs. 4379.48 lakhs in 1977-78. Central Excise Duty covered only 9.1 percent of the total revenue of the State of Orissa in 1960-61. This went upto 26.8 percent in 1970-71 and 28.6 percent in 1977-78. Orissa has been benefited significantly.

The per capita devolution of Central Excise Duty also reveals that the poorer States have secured more benefit in the process of devolution than the richer States. It was higher for the richer States upto 1965-66 but there after it changed in favour of the poorer States.

In view of the increasing needs of the States and limited scope for further upward revision of the share of Income Tax, the Union Excise Duty should become the main instrument for transfer of resources from the Centre. If at all the Central Government desires to transfer more resources to the States, the shareable percentage of the tax should be increased from 20 percent to atleast 50 percent of the net proceeds of the Union Excise Duty. The basis of distribution need to be increased to 60 : 40 ratio when 60 percent is distributed on the basis of population and 40 percent on the socio-economic condition of the State.

ADDITIONAL EXCISE DUTY

Additional Excise Duty in lieu of Sales Tax on sugar, tobacco (including manufactured tobacco), and mill made textiles was imposed by the Central Government in May, 1957 consequent upon the decision of the National Development Council in December, 1956 in the interest of convenience to trade and avoidance of tax evasion. The Government of India on its part decided to transfer the entire proceeds to the States for compensating the loss on the basis recommended by the Finance Commission.

The Second Finance Commission recommended certain amount as guarantee for the States and the balance was to be distributed partly on the basis of population and partly on consumption. The Third Finance Commission accepted the guaranteed amount of the Second Commission with slight alteration but followed a different policy as regards the basis of distribution of the balance amount. The Commission recommended percentage distribution based on the percentage increase in the collection of the Sales Tax in each State since 1957-58 and partly on the basis of population without mentioning the weightage to be given. Orissa received as guaranteed amount of about Rs. 85 lakhs both in the Second and the Third Finance Commissions. The Fourth Finance Commission agreed with the guaranteed amount but stated that, "the balance amount over the total guaranteed amounts may be made on the basis of the proportion of the Sales Tax revenue realised in each State to the total Sales Tax collection in all the States taken together." This affected the interest of the poorer States but benefited the States like Kerala, Tamil Nadu, Maharastra, Gujarat and West Bengal.

The Sixth Finance Commission did not set apart any guaranteed amount. The commission recommended 1.41 percent of the net proceeds to be retained for Union Territories and the balance be distributed among the

States on the basis of population, State Domestic product at current price and the production in 70 : 20 : 10 ratio. Accordingly Orissa's share was increased to 3. 59 percent. The net amount transfered to Orissa went up from Rs. 102. 14 lakhs in 1959-60 to Rs. 1083.49 lakhs in 1977-78. However, the percentage share of this transfer varies around 3 percent all along.

In view of the economic significance of the goods under the additional excise duties in the country and the revenue receipts from this source being elastic, the existing practice may be continued with further stepping up of the incidence to practicable extent. However, the coverage of the additional excise duty should not increase to the disadvantage of the States.

ESTATE DUTY

The Estate Duty was first imposed by the Government of India in 1953. Estate duty on property other than agricultural lands is another shareable tax visualised under Article 269 of the Constitution. The collection of this tax upto March 1957 was distributed provisionally among the States in the same ratio as the share of the States from Income Tax. The Second Finance Commission after retaining one percent of the net proceeds for the Union Territories, allocated the balance between immovable property and other property in proportion to the gross value of such property brought into assessment every year. Thus, the share allotted to the immovable property was to be distributed in proportion to the gross value of such property located in each State and the balance in proportion to the population to the population of the State. All the Finance Commissions appointed so far agreed to the basis of location when apportioning Estate Duty on immovable property and the population as the basis of apportionment of the movable property. However, the share attributable to the Union Territories was increased to two percent and three percent by the Fourth and the Fifth Finance Commission respectively but was reduced to 2.5 percent by the Sixth Finance Commission.

The revenue receipts of this tax by Orissa was Rs. 0.11 lakh in 1960-61 which went upto Rs. 0.38 lakh in 1977-78, This tax covers a very insignificant portion of the total revenue of the State. As has been pointed out earlier, the successive Finance Commissions insisted on the fact that it is a State tax to be returned to the States of its origin. But the objective of the imposition of the Estate Duty being reduction and ultimately equalisation of the inequal distribution of the wealth in the country, the basis of distribution does not seem to be rational. In the interest of social justice the proceeds of the tax has to be transferred on the principle of need reflected in the degree of backwardness of the States.

TAX ON RAILWAY PASSENGER FARES

Tax on Railway Passenger Fares was for the first time levied under the Railway Passenger Fares Tax Act, 1957. This is another instance of a tax levied and collected by the Government of India but distributed among the States in accordance with the provisions under Article 269 of the Constitution. But consequent upon the difficulties experienced in breaking down the inter-State collection and sharing of the tax, the Railway Passenger Fares Tax was repealed in 1961 and was merged in the basic railway fares. The Government of India, however, decided to make an adhoc grant of Rs 12.5 crores per annum payable to the States in lieu of the tax. This was calculated on the basis of the average collection of the passenger fares. The grant was raised to Rs. 16.25 crores in 1966-67.

The Third Finance Commission recommended a principle of compensating the loss in revenue and allowing the States to be as before. The Commission without determining the percentage distribution, fixed the amount attributable to States. As a result, the share of Orissa was reduced from Rs. 25 lakhs to Rs. 22 lakhs. The Fourth Finance Commission while retaining the basis of distribution fixed the share of Orissa at 2.12 percent. The percentage share of Orissa was increased to 2.36 percent. The Sixth Finance Commission agreed to the principle followed by the Second Commission but reduced the share of Orissa to 2.24 percent. The total amount transfered from this tax by all the Finance Commissions from 1957-58 to 1978-79 amounted to Rs 6.62 crores.

In view of the balanced regional development the importance of the transfer of funds from this tax cannot be over emphasized. A balanced regional development requires a discriminating treatment. This principle seems to be seriously ignored by the various Finance Commissions while recommending grants in lieu of such tax. More grants should be sanctioned to the States with inadequate railway development. The railway statistics shows that at the end of March, 1976, as against railway route length per thousand square kilometers which was 18 in all-India, it was 13 for Orissa, Madhya, Pradesh and Manipur, 5 for Himachal Pradesh. It was

43 for West Bengal and Punjab. But the States with railway route length higher than that of the all-India ones have received more grants in lieu of such a tax than Orissa. The principle should reflect the need of the States in the broader economic interest of the nation at large.

CONCLUSION

The analysis of the transfer of shared taxes, in general, clearly reveals that the principles adopted by various Finance Commissions have weighed heavily in favour of the prosperous States. The poorer States could have been benefited more had the Finance Commissions determined the basis of distribution according to the need and ability of the States. The share of the States could have been directly related to the proportion of their population to the national population, the principle of need, and inversely related to the proportion of income to the national income of India, the index of ability. It is seen that the industrially prosperous States have received higher shares in comparison to the backward States. Any move in the interest of the nation must face dissociation between what is legal and what is legitimate and the legitimacy to work out its own legal expressions, a new concensus is necessary.

Under the federal financial set up the Centre is to help the States through transfer of funds with a view to removing regional disparities. However, all tax transfers through different Finance Commissions with a strong bias against the poor and the economically backward States have resulted in a fiasco. The gulf between the rich and the poor States have rather sharpened mainly due to the going principle of 'as you sow, so you reap'. The principle of 'as is where is' have added fuel to the growing dissatisfaction and discontentment among the States. Unless a drastic change into the principle of federal fiscal transfers is resorted to with top priority, it would act as a serious to national integration.

ECONOMIC BACKWARDNESS AND THE NEED OF ORISSA

AND

THE DEVOLUTION OF CENTRAL TAXES UNDER THE EIGHTH FINANCE COMMISSION

Sri B. C. Behera

The constitutional division of financial powers in the Indian federation has made the States heavily dependent upon the centre. The Union Govt. has been empowered to raise revenue by imposing taxes like the Income Tax (other than agriculture income), Excise duties, Wealth taxes, Estate duties (other than Taxes on agricultural lands) gift taxes, etc. These taxes are not only elastic in nature, but they have also a great scope for expansion. Besides, the Union Govt. have wide sources of non-tax revenues and unlimited powers of borrowing. In contrast, the States are assigned the spheres where the taxes are more or less inelastic in nature. Some of the State taxes such as Land Revenue, Agricultural Income Taxes, Entertainment Taxes and the like are quite inelastic in character, with the single exception of Sales Taxes. So, the constitutional provisions have resulted in a financially strong Union and a comparatively weaker federating units. Consequently, there arises the necessity of financial adjustments between the Centre and the States. The net proceeds of some of the important taxes are to be distributed among the Union Govt. on the one hand and the different State Govts. on the other. In India, this is done by the successive Finance Commissions appointed by the President of India in every five years. In fact, there is no controversy regarding the division of Central Taxes between the Centre and the States. The controversy centres round the "criteria" adopted by the Finance Commissions for the distribution of the States' share among themselves. It is therefore proposed to make an assessment of the "criteria" adopted by the Finance Commissions so far and suggest certain alternative "criteria" for consideration.

Let us take a brief look at the criteria adopted by the Finance Commissions (First to Seventh) for the devolution of central taxes among the States. In almost all cases, the criteria adopted are two fold, i e.

"population" and "collection" with varying degrees of emphasis on either. It is proposed to be proved here that due to the adoption of the twin criteria mentioned above the devolution of central taxes has become discriminatory against the poorer State of the Union. Particularly, collection as one of the "criteria" seems to have no justification at all. The Expert Committee on the Financial Provisions of the Constitution has stated that, "Origin or the locus of income is no doubt relevant, but in the complex industrial and commercial structure of modern times, when a single point of centre often regulates a vast net work of transactions, when the raw materials come from one place, are processed in another, manufactured in a third, marketed in whole-sale in a fourth and ultimately sold in retail over a large area, the assignment (on the basis of origin) can only be emperical or arbitrary". So, it is in view of this, the Memorandum presented by the Govt. of Orissa to the Eighth Finance Commission pleads for the total dicontinuance of collection as one of the criteria. The other basis, i.e. population does not seem to be much meaningful unless the quality of the population is also taken into consideration. The Memorandum of the State Govt. pleads that atleast 50% emphasis should be given to the percentage of S.C. and S.T. in the State. But in any case, the traditional basis, i.e. population and collection do not seem to reflect real need of the State and they have gone more or less in favour of the prosperous States. further widening the disparity in resources among the States of the Indian Union.

The main reason for the federal transfer of resources to the states in India is the necessity for a balanced regional development of the entire country. The "spread effects being weaker in poor countries", the developed centres will not automatically promote growth in the other underdeveloped regions and hence " a special attention is necessary to initiate the process of economic development in the backward regions of the country. There are vast economic disparities between the different States of the Indian Federation. This is so because "they had different starting points in the beginning of planning and the different rates of economic growth recorded by them" in the planning process. These regional economic imbalances should be corrected by transferring more of financial resources to the less developed States of the country. So, the task before the Finance Commission is to make an objective assessment of the comparative economic inequalities of different States and to recommend the criteria for the devolution of central taxes accordingly.

ALTERNATIVE CRITERIA

The analysis so far has shown that the criteria adopted by the successive Finance Commissions (From first to Seventh) are not in keeping with the constitutional objective of the reduction of interstate economic disparities through the machanism of the federal transfer of resources to the states. So, there is a necessity of suggesting a set of alternative criteria for the consideration of the Finance Commission for the devolution of central taxes among the states. The "criteria" suggested are two fold i e, the relative economic backwardness of the States and the actual financial need of the state govts. The Central taxes distributed among the states on the basis of the above two criteria would not only result in reducing the inter state economic disparities but would also be helpful to the individual state in undertaking various economic and social service measures more efficiently.

The next question to be answered in this regard is how to determine the relative economic backwardness of the states and their actual financial needs. Let us select four indices to determine the relative economic backwardness of the states. They are (i) Per capita income (ii) The percentage of population below the poverty line, (iii) The percentage of S. C. and S. T. population and (iv) The rate of literacy. Similarly four other indices may be selected for the assessment of actual financial needs. They are (i) The budgetary positions of the States (ii) The debt position of the States (iii) The extent of natural calamities in a state and (iv) Miscellaneous needs. An inter state comparison of these indices would present a true socio economic picture of the states, on the basis of which devolution of Central Taxes can be made easily.

On the basis of relative backwardness (taking the four indices given above), Orissa, Bihar, Assam, Madhya Pradesh are some of the states, which deserve special consideration. Orissa's case is the worst. It has a per capita income of Rs. 931 whereas All India average is Rs. 1316 (1979-80). The percentage of people below poverty line is maximum-66.40 in Orissa compared to the All India average of 48.13 (1977-78). The percentage of scheduled caste and scheduled tribe in Orissa is 38 whereas All India average is 22 (1971 census). The percentage of literacy in Orissa is 26.2 compared to the All India average of 29.5 (1971 census). All these justify increased transfer of resources to Orissa to reduce regional disparity.

THE BUDGETARY POSITION OF THE STATE:

The Budgetary position of a State includes the total revenue receipts (both tax and non-tax) and total expenditure of the State and the adjustment of Revenue and Capital accounts to find the over all picture. In the first place, let us analyse the revenue receipts and the total expenditure of

Orissa over the last decade. Table No. 1 below shows total revenue receipts and total expenditure of Orissa for the year 1974-75 and 1983-84.

Table – I

State's own tax and Non-tax revenues and expenditures (Rs. in crores)

Year	Total own tax revenue	Per capita State's own tax (in Rs.)	Total own non tax	Total revenue expenditure	Index of growth of expenditure	Per capita expenditure (in Rs.)
1974-75	50.5	21.0	31.0	206.5	100	86.0
1983-84	235.2	84.0	114.7	780.2	378	278.6

Source : Orissa budget in brief, 1983-84 Bureau of Statistics and Economics Orissa,

The informations obtained from Table No. I are as follows. The total own tax revenue has increased from 50.5 crores in 1974-75 to Rs. 235.2 crores in 1983-84, an increase of about more than four times over the decade. But the bulk of these tax revenue comes from Sales Tax and Taxes and duties on electricity. Together they constitute 73% of the total State's own tax revenue and the remaining 27% is expected to be contributed by remaining seven taxes. It is further revealed from Table I that the percapita State's own tax revenue has increased from Rs. 21.0 in 1974-75 to Rs 84.0 in 1983-84. So, the per capita expenditure has far outstriped the per capita tax effort in Orissa.

Further, the rise in total expenditure under revenue account from Rs. 206.5 crores in 1974-75 to Rs. 780.2 crores in 1983-84 is mostly due to the enormous rise in the non-plan expenditure of the State. About 75% of the total expenditure under revenue account is expected to be spent for non-plan schemes.

Lastly, the overall budgetary position (Revenue and Capital accounts) may be examined to get a correct picture of the State's finances. A brief survey of the budgetary data of the State for first 38 years (from 1936-37 to 1973-74) show that the revenue account was continuously surplus up to 1947-48. Thereafter it became uneven. The years 1951-52, 1952-53, 1958-59, 1966-67 and 1969-70 were exceptional years, which witnessed surplus but in all other years, expenditure of the State were more than the receipts. The revenue account during these 38 years produced a total deficit of Rs. 159.92 crores. In all these years, the capital budget of the State came to the rescue of the revenue budget and the next out come was the transfer of resources from capital account to fill up the void created in revenue account. But after 1973-74, there is a different story altogether. From the year 1974-75 the revenue account was continuously surplus except in the year 1982-83, and in most of these years the Capital account remained in the negative. The foregoing review of the budgetary provision of the State right from the beginning reveals the weakness of the State's financial position. This is particularly true in view of the fact that the State's tax efforts seem to lag behind its growing expenditure requirements.

DEBT POSITION OF ORISSA

Another index of Orissa's financial position is its indebtedness. Table II below gives a picture of the Public debt of Orissa for the year 1974-75 and 1983-84.

Table - II

Debt Position of Orissa

Year	Total debt burden Rs. in crores	Index	Per capita debt burden in Rs.
1974-75	661.3	100	276.3
1983-84	1503.0	227	536.8

Source : Orissa Budget in brief, 1983-84 Bureau of Statistics and Economics, Orissa.

In 1974-75 the total debt of the Govt. of Orissa was Rs. 661.3 crores which increased to Rs. 1503 crores in 1983-84, showing an increase of 227% during the 10 year period. The per capita debt burden also increased from Rs. 276.3 in 1974-75 to Rs. 536.8 in 1983.84.

NATURAL CALAMITIES

The abnormal rise in non-plan expenditure in Orissa in recent years is due largely to the recurrence of natural calamities like floods, cyclones and droughts in the State. These natural calamities have almost became a part of life of the State. In the event of any natural calamities effecting either, the whole or a part of the State a huge amount of funds is necessary for relief and rehabilitation work. Table III below shows the actual amount of money spent on relief and restoration work and the amcunt of money made available to the State under the recommendation of the Seventh Finance Commission.

Table – III

Expenditure Incurred on natural calamities in the State

(Rs. in crores)

Year	Type of natural calamities	No. of blocks affected	Margin money available	Total Plan and Non-plan expenditure incurred on relief
1978-79	Tornado Flood Drought	2 161 33	3.58	7.29
1979-80	Flood Drought	91 272	8.71	16.64
1980-81	Flood Drought	127 34	8.71	60.50
1981-82	Tornado Flood Drought	3 50 76	8.71	6.04
1982-83	Cyclone Flood	110 114	8.71	170.80
	Flood in Sambalpur drought pro-monsoon			
	Total			261.27
	Annual average			52.25

Source : Memorandum presented to the Eighth Finance Commission, Finance Department, Govt. of Orissa 1983. Vol, I p-22.

It appears from table III above that the expenditures incurred by the State Govt. for the relief and rehabilitation work due to natural calamities are far in excess of the margin money recommended under the Seventh Finanance Commission to Orissa.

THE MISCELLANEOUS NEEDS

The miscellaneous needs include the cost of the measures for the upgradation of the standard of administration, maintenance of the capital assets of the State like irrigation works and others and the various other social and economic services. They also include the cost of pay revision of the Govt. employees and grant of A.D As to them. They are summarised in the Memoranda presented by the State Govt. to the Eighth Finance Commission. In the Vol. I page-6 of this Memoranda, a forecast has been worked out in respect of various financial requirements of the State for the period of 1984 to 1989. They are re-produced below.

1.	Requirement of funds for upgradation of administrative and other services.	Rs. 324.42 crores
2.	Cost of Revision of Dearness allowances	Rs. 256.50 crores
3.	Cost of Pay revision	Rs. 125.00 crores
4.	Equation of retirement benefits of the employees of aided educational institutions with the retirement benefits of the State Govt. employees.	Rs. 11.30 crores

The analysis of the four indices above shows the extent of the need of Orissa in terms of money. This enormous financial need of the State ought to be recognised at the time of central assistance.

THE FINANCE COMMISSION AND INTER-STATE DISPARITIES WITH SPECIAL REFERENCE TO ORISSA.

Sri L. M. Sahoo

A lot is being said these days on Centre-State financial relations. The nature of Centre-State financial relation has been a matter of lively debate right from the days of the framing of the Indian Constitution. The Constitution of India actually makes its incumbent upon the govt. at the Centre to appoint a Finance Commission under Article 280 of the Indian Constitution, once at least in every five years to examine the problems arising out of the gaps between the needs for expenditure and the availability of revenue of the different states of India and other related and similar issues.

First, devolution of financial resources by the Finance Commission needs to be looked into as an integral part of the national effort for development carried out by the States.

Second, it should be used as an effective mechanism for bringing about a reduction in inter-regional disparities in the levels of development among different regions.

Third, the criteria for allocation of resources should reflect the needs of the respective states in terms of strategy set for development and efforts needed in different states to implement the accepted scheme of priorities.

In view of the fact that inter-state disparities in India have not declined during the last three decades, a study is called for, of the extent to which the Finance Commission has tackled the problem of inter-state disparities.

Reduction of inter-state disparities has always been one of the major objectives of planning in India. But the machanism for mobilisation of resources, allocation and transfer of resources has not been conducive to a progressive reduction of regional disparities. In fact, disparities have grown over the years. Indicators of inter-state disparities can be conveniently grouped into six categories.

1. Indices of income, poverty and unemployment;
2. Agricultural indicators;
3. Industrial indicators;
4. Infrastructure indicators;
5. Social service indicators and
6. Resource allocation indicators;

On the basis of data available, it can be said that percentage of population below the poverty line is very high in Orissa. It was 68.6% in 1972-73 and now about 66%. The poverty ratio is very high, that is more than 50% in Assam, Bihar, M.P., Orissa, Tamil Nadu and U.P. So far per capita income is concerned it is very low in Orissa, U.P., M.P. and Bihar. The unemployment rates too are very high in Andhra Pradesh, Tamil Nadu, West Bengal Bihar, Kerala and Orissa. The poverty ratio of Orissa is three times the poverty ratio in Punjab. The firm output per head in U.P., West Bengal, Orissa, M.P , Kerala, Bihar and Assam is also very low. In the field of manufacturing, the states like Bihar, Orissa, Rajasthan and U.P. are very much lagging behind in comparison to other states of India. In respect of ,nfrastructure, Orissa is also in a very low position. As regards rural electrification and drinking water, in Rajsthan, U.P., Bihar, M.P., West Bengal and Orissa, less than one third of the villages have been electrified so far when it is almost 100% in Punjab, Haryana, Kerala and Tamil Nadu. In respect of road length Kilometre, the states like M.P., Orissa, Rajsthan are at a very low level. The position of social services, the picture is the same. Orissa alone has 21% of India's Iron Ore, 39% of Manganese, 86% of Chromite, and 50% of Buxite. But yet, there is very high poverty ratio in Orissa. What keeps Orissa poor is not the paucity of national resources but insufficient investment.

It is worth enquiring first as to whether the reduction of inter-state disparities in the levels of living has been included as one of the terms of reference provided to the different Commissions. It may of course, be argued that irrespective of terms of reference, the Finance Commission could recommend measures to reduce inter-state-disparities. The extent to which this has been done by the Finance Commission, hence also needs going into.

The paper will therefore examine (a) The terms of reference of the Finance Commission; (b) the extent to which the Finance Commission has given weightage to the existence of the problem of regional disparities in making their awards; (c) Whether the awards of these commissions have been such, as to reduce inter-state disparities in the levels of living.

Over the period since 1951, the transfer of resources from the Centre to the States has tremendously increased. The transfers are effected through the mechanism of the Finance Commission, Planning Commission and "other transfers", and the importance of the three mechanisms has been more or less equal. In recent years, transfer through Finance Commission has been larger than that of the Planning Commission. Along with divisible taxes accruing to the Centre and to the States as well as the share going to the States and grants-in-aid of revenue to the States, other matters like debt position of the states have been referred to the Finance Commission from time to time. None of the seven Finance Commissions appointed so far have ever, being specifically asked to make recommendation for the reduction of inter-state disparities in the levels of living.

WEIGHTAGE FOR REGIONAL DISPARITIES:

But this does not mean that, the Finance Commissions have not taken the existance of inter state disparities in levels of living in making their recommendations. Different criteria have been used to distribute among the states. In regard to some of these, attention has been paid to the fact that, the needs of the expenditure of different states are different.

Income tax constitute 33.6% of the total devolution to the states as per Finance Commission recommendations between the years 1951-52 and 1978-79. In these transfers, the needs of the states as calculated by their population have been the main critarion. The weight given to population in this regard was 80% in 1st, 3rd, and 4th Finance Commission and 70% in 2nd Finance Commission and 90% in case of 5th, 6th, and 7th Finance Commission. In between 1951-52 and 1978-79 the distribution of Union Excise constitutes 31.9% of the total devolution due to the award of Finance Commissions. Here also population seems to have the main criterion. The weight for population being 100%, 90% and 80% in the 1st, 2nd and 3rd Commission respectively. But from the Fifth F.c onwards the degree of backwardness of the States has been taken. The Fifth Finance Commission has given 20% weightage to the degree of backwardness of the states and 80% to population of the states. Out of the 20%, 2/3rds of it were assigned to the states with per-capita income below the national average, with 1/3rd on the basis of backwardness. The Sixth Finance Commission reduced the weightage of population to 75% and 25% to the degree of backwardness. The per capita income is taken as the sole indicator of backwardness. In the 7th Finance Commission, the degree of backwardness gets the top priority with a weightage of 50%. It took two indicators; the percentage of poor people in the state and inverse of the per capita state domestic product. The recommendation of 7th Finance Commission is far reaching. Finance Commission also grants for schemes to promote the welfare of S. T. and to raise the level of administration in states along with communication, medical and public health. The 7th Finance Commission took into account the need for upgrading purely administrative service ignoring social services. So it is only through more grant-in-aid to the less developed states like Orissa, Bihar, Assam, M.P. and U.P. etc. by the Finance Commission that development can be maintained and inter-state disparities reduced.

In Orissa in between 1952-53 and 78-79 there is always a deficit in the non-plan revenue account. Of course except 5th Finance Commission all other Finance Commissions have treated Orissa sympathetically. The deficit of non plan revenue account of Orissa in the 1st, 2nd and 4th Finance Commission was 3.79, 8.97 and 14.88 crores respectively. The recommendation of the 2nd Finance Commission was very favourable to Orissa due to surpluses in non-plan revenue account to the extent of 13.39 crores but deficit increased to 126.83 crores at the end of the fifth plans. So far 7th Finance Commission is concerned, Orissa was very much ignored. The Seventh Finance Commission could not take a realistic picture of Orissa. It underestimated the non-plan revenue account and also interest in respect of different types of loans.

It appears, therefore, that the correction of regional imbalances has only a marginal features in the recommendation of the F.C. Collection base as a criterion contributes to the perpetuation rather than correction of disparities; and does not seem to have any measure force of argument behind it except the bargaining position of the states with larger contribution to the tax; it amounts to more rewards to better off states and punishment to states like Orissa with a low tax base. Population is again a basis which can at best prevent increase in disparities. The expenditure receipt gaps provide a static criterion and seem more of a philanthropic gesture than a rational criterion for positive approach towards development of backward states. So, for the devolution of resources the Finance

Commission will have to evolve multiple criteria like the extent of poverty, unemployment, illiteracy and debt position to work the needs of the different states for financial resources, particularly in determining the grants-in-aid under article 275. The Commission may first assess the total resources available with the Centre for transfer to the states by way of grant-in-aid and allocate according to the priorities like eradication of poverty, unemployment and illiteracy as a national economic policy.

Natural calamities like flood, cyclone and drought are recurring features in Orissa and they affect economic development of a backward state very adversely. There is maximum poverty, unemployment, illiteracy and a vicious circle of insufficient infrastructure, income and market growth. Finance Commission can take a right approach to uplift Orissa and other backward states to a comfortable socio-economic take off and reduce regional disparities in India. The Finance Commission should keep 10% of the Central Revenue apart to give relief to the states in case of natural calamity. Both the Finance Commission and the Planning Commission should aim at regional balance in making their recommendations.

FINANCE COMMISSION AND REGIONAL DISPARITY.

Sri Saroj Kumar Panda
Dr. Manoranjan Das

In the federal set up of India, the Union Government has been assigned with greater financial powers. The potential revenue yielding taxes have been kept under the jurisdiction of the Union Government. This has reduced the capacity of the States to mobilise large resources and due to this they have been thrown at the mercy of the Center. The States on their own are not able to collect adequate funds to meet the developmental and administrative expenditures. It seems that the framers of the Constitution of India have created such a problem deliberately to make the Centre more strong. But while they have intended to do so, they have not done this with the purpose of creating poor and backward states. They have made provisions for transfer of a share of the major taxes to the States, in addition to it there is the provision of grants-in aid. To prescribe the manner of devolution of the productive taxes like Income Tax, Excise duty and Estate duty and to fix the quota of grants-in-aid. Article 280 of the Constitution of India has authorised the President of India to appoint Finance Commissions in every five year.

The Finance Commission, while giving their recommendations take two problems into account: firstly the vertical fiscal imbalance created due to assignment of productive sources of revenue to the Centre which has resulted in a surplus fund always with the Centre and meagre resources with the states and secondly the regional disparities (i.e. inter-state disparities) in fiscal capacity and standards of public service. The Finance Commission is supposed to give its recommendations regarding federal transfers to the State Governments with the intentions of both redressing overall vertical fiscal imbalance and reducing inter-State disparities in fiscal capacity and standards of public services [1].

Let us examine how far the Finance Commissions have succeeded in reducing the regional disparities through their recommendations. (We do not intend to touch the problem of vertical fiscal imbalance). Let us also examine if this job can be done by the Finance Commission alone because another body called Planning Commission has emerged which is also involved in transfer of resources to the States. The Planning Commission makes allotment regarding plan investments. Development Plan covers a wide range of government services and plan assistance consists of both grants and loans. The Planning Commission while making recommendations about grants inevitably encroaches on the field of Finance Commission. It has been pointed out "since the former is supposed to deal with all aspects of development, the Finance Commission feels inhibited in making recommendations regarding measures to narrow down disparities in standard of important public services". [2] But the problem of overlapping jurisdiction between the Finance Commission is yet to be solved. At present, the sphere of non-plan expenditure has been demarcated as belonging to the Finance Commission and the Planning Commission keeps under its purview the whole plan expenditure. Thus, Planning Commission as an agency is equally important in eradication of regional disparity.

It has been felt that even the limited role of the Finance Commission as the agency concerned with the non-plan side of the budget, has not been satisfactorily performed as the criteria adopted for devolution of shared taxes have gone against the backward states. Here, the case of Orissa a backward state may be examined. An analysis of the memorandum presented by the State Government of Orissa to the different Finance Commissions regarding the adoption of principles for allocation of shares of different taxes and recommendations made by the Finance Commissions highlight how the formulae of distribution of the taxes have gone against the interest of the poorer states. The Finance Commissions in their recommendations have allocated the net income tax proceeds assigned to the states chiefly on the basis of population. Eighty to ninety percent of allocation is based on population and the rest on the basis of tax collection or assessment. The states like Orissa have been demanding before different Finance Commissions for omission of tax collection as a criterion as it goes against the poor states. They have been also demanding from time to time for allocation either on the basis of population weighted for scheduled tribes, scheduled castes and other backward classes or on the basis of the inverse ratio of per-capita income of the states. As backwardness has been completely ignored by the Finance Commissions (particularly first six) as a criterion the poorer states like Orissa have received relatively less shares from net income tax proceeds. In the sharing of central excise duties State's population remains the main basis with limited weightage given to the backwardness. This assignment of weightage to backwardness has not at all been applied in the sharing of income tax. As unweighted population figure has been the main basis, in case of Excise duty also the relative position of Orissa as regard to receipt of the share as compared to other states is discouraging. In case of Estate duty Orissa's position remains same. [3]

Even though the adopted criteria have gone against the poorer states like Orissa, their continuance has been justified by a person no less than Justice J. M. Shelat, the Chairman of the Seventh Finance Commission. His view was that no state would be denied a share in the obligatory tax shares and hence the origin of collection as a criterion was justified. But his argument loses ground because with population as the main basis of devolution every state would get a share from the obligatory taxes. It has been pointed out by Thimmaiah that if the intention is to see that no state is denied a share from the obligatory taxes, this can also be achieved with greater justice by taking population below the poverty line as the sole criterion because poverty is an all India phenomenon with varying degrees.[4] Similar views have been expressed by Prof. Raj Krishna. [5]

The selection of wrong criteria, instead of bridging the gap has been partially responsible for further inter-state disparities. However, this gap is taken into consideration by the Finance Commissions while giving recommendations regarding grants-in-aid. The First Finance Commission recommended grants-in-aid taking the budgetary needs of the state as the important criterion. In doing so appropriate allowances were made on the basis of a number of considerations. These considerations were : (a) reduction of the budgets of the states to a standard form after eliminating non repetitive items, (b) tax efforts of the states and the extent to which the state itself has made efforts to raise resources in relation to its tax potential, (c) scope for economy in expenditure, (d) avoidance of large disparities in the standards of basic social services, (e) special burdens of states if such burdens were of national concern and if they caused undue strain on the states finances and (f) emphasis on broad national purpose with a view to furthering any beneficient service of primary importance in regard to which it is in the national interest to assist the less advanced states to go forward.[6] These principles with marginal modifications were also followed by the subsequent Finance Commissions.[7]

Backwardness which is a major consideration in the provision of grants in-aid is not given due importance in the devolution of the taxes.

The poorer states which get relatively lower share from the taxes are provided with large amount of grants-in-aid to compensate for the huge shortfall in their non-plan revenue budgets. If backwardness would have been taken as the main criterion in the devolution of taxes huge budgetary deficits of the poorer states could have been avoided. The mechanics of devolution and grants-in-aid only place the states at the mercy of the Centre.

The points discussed above clearly indicate that the criteria adopted by the Finance Commissions for sharing taxes have been regressive in nature. It seems, Planning Commission which is another vital agency for transfer of resources to the States has also not worked to the full interest of the poor states. Gulati and George have empirically found out that during the period 1956-77, the total transfer of resources to the States has been regressive as the low income States have received relatively less as compared to the higher income States. [8] The National Institute of Public Finance and Policy has also reached a similar conclusion. [9]

In the light of the study made, it is suggested that backwardness of a State should be taken as the main criterion either for devolution of taxes or grants-in-aid. To check the tendency of States to demand higher shares on the plea of 'false backwardness', proper investigations may be made regarding the progresses in various fields. If there are genuine lapses on the part of the States either in implementing projects, or in raising tax efforts or in observing economy, the State may be taken to task. There must be also some coordination between the Finance Commission and Planning Commission as both are agencies to transfer resources to the States and it is the total transfer of resources which matters to the States.

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TREND OF CENTRAL RESOURCES TRANSFER TO ORISSA THROUGH
The Finance Commission (1953-54—1973-74)

Sri Bholeswar Sahu

INTRODUCTION

Federalism is an optimal form of government because it represents a compromise between unitary government and extreme decentralisation. [1] Yet federal-state financial relations are a perennial source of controversy in all federations. This is more so in India.

There are vertical as well as horizontal fiscal imbalances in Indian Federation. The Finance Commission is instituted every five years to study the fiscal needs and capacities of the states and determine quantum of resources transfer to the states.

The scheme of resource transfer through the Finance Commission envisaged under the provisions of the Constitution of India involves broadly the following two devices :

1) Sharing of net proceeds of the Taxes and Duties under chapter I of part XII of the Constitution between the Centre and the States and the allocation among the states of such proceeds; and
2) Grants-in aid from the Centre under article 275 (1) of the Constitution to the States, who are in need of assistance.

OBJECTIVE OF THE STUDY

This paper aims at throwing light on the trend of resource transfers to Orissa from the year 1952-53 to 1973-74 through the Finanace Commissions.

METHODOLOGY

It is a time series study which analyses data from the First Finance Commission to the Fifth Finance Commission. In a time series study, time is the independent variable. It is plotted along the OX-axis. In our study shared taxes, grants-in-aid and percentage of share of the aggregate resources transfer to Orissa through these channels, to the aggregate revenue and other receipts of the State are the dependent variables. These are plotted along the OY-axis.

The time series data are a product of trend (t), seasonal (s) cyclical (c) and other fluctuations (i).

In order to obtain the trend value, the ideal method is to eliminate all these types of fluctuations. Since our data are annual data, the seasonal fluctuations are automatically eliminated. We seek to neutralise cyclical fluctuations which may have occurred during the time span of a Finance Commission, by using simple average.

DATA SOURCES

We deal with secondary data. We have obtained the official data from the published sources, Conspectus of Orissa Budgets, 1936-37 to 1973-74.

DATA ANALYSIS

The first Finance Commission covers a period of five years from 1952-57. The award of the First Finance Commission with regard to shared taxes increased to some extent except in the years 1952-54 and 1954-55 where it declined. But the grants-in-aid during these five years period has increased year after year as also the revenue and receipts of the State in an upward trend. The increase in grants-in-aid may be due to the budgetary needs of the States which being the criteria adopted by the First Finance Commission. The ratio of total resources transferred to Orissa from the Centre declined during the last phase of the first Finance Commission although it went up in the second year (1953-54).

The second Finance Commission awards cover a period of five years from 1957-62. The amount of shared taxes during the second Finance Commission increased in successive years starting from 1957-58 to 1961-62. The total grants-in-aid almost remained constant for the years 1957-58 to 1959-60 and increased for the years 1960-61 to 1961-62. The constancy in grants-in-aid during the above period may be due to the fact that the second Commission treated grants as residuary assistance to the States for meeting their adjusted budgetary needs after taking into account devolution of revenue in other forms, e.g. share from Central taxes. The total share of shared taxes and grants-in-aid increased during the period of Second Finance Commission but again the ratio of total shared taxes and grants-in-aid to the total revenue and receipts of the state declined.

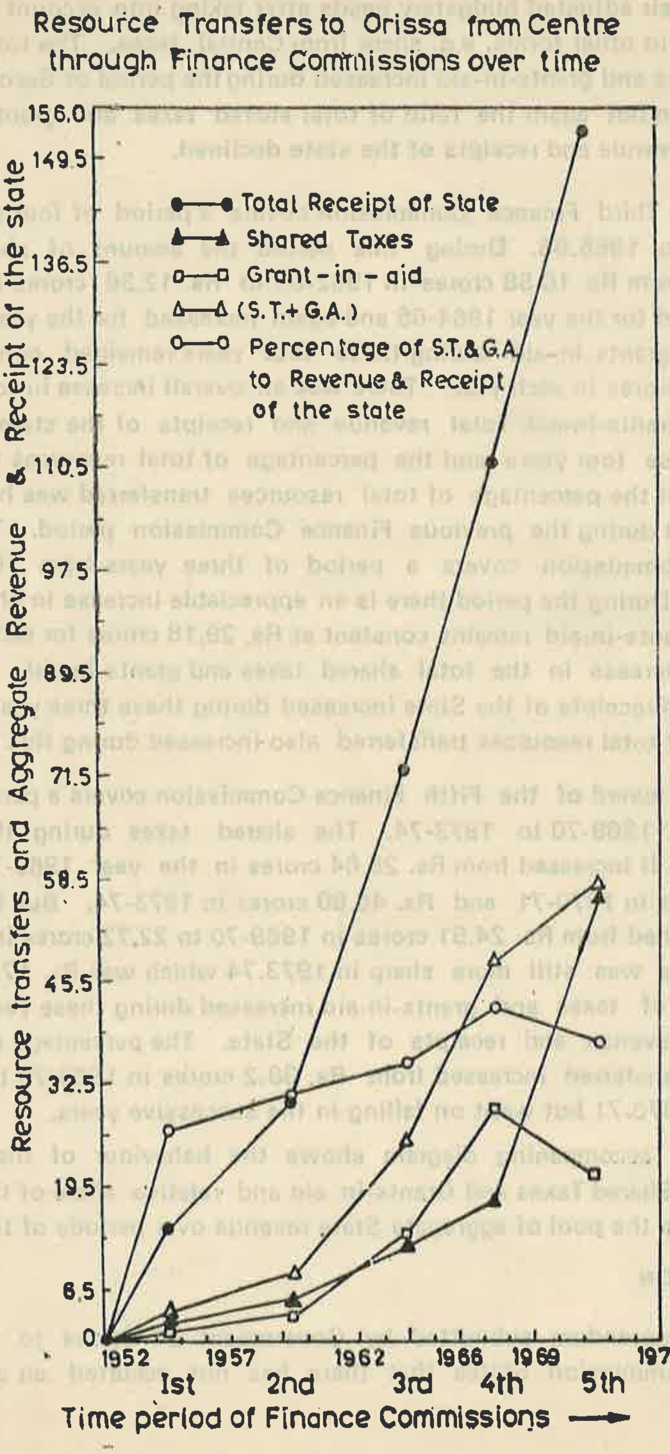
The Third Finance Commission covers a period of four years from 1962-63 to 1965-66. During this period the amount of shared taxes increased from Rs. 10.58 crores in 1962-63 to Rs. 12.36 crores in 1963-64 but declined for the year 1964-65 and again increased for the year 1965-66. The total grants-in-aid during these four years remained constant, i.e. Rs. 13.25 crores in each year. There was an overall increase in total shared taxes and grants-in-aid. Total revenue and receipts of the state increased during these four years and the percentage of total resources transferred declined but the percentage of total resources transferred was higher than what it was during the previous Finance Commission period. The Fourth Finance Commission covers a period of three years from 1965-66 to 1968-69. During the period there is an appreciable increase in shared taxes but the grants-in-aid remains constant at Rs. 29.18 crores for each year and there is increase in the total shared taxes and grants in-aid. The total revenue and receipts of the State increased during these three years of time. The ratio of total resources transferred also increased duing this period.

The award of the Fifth Finance Commission covers a period of five years from 1969-70 to 1973-74. The shared taxes during this period increased. It increased from Rs. 25.64 crores in the year 1969-70 to Rs. 30.85 crores in 1970-71 and Rs. 46.80 crores in 1973-74. But the grants-in-aid declined from Rs. 24.51 crores in 1969-70 to 22.72 crores in 1970-71, the decline was still more sharp in 1973-74 which was Rs. 17.76 crores. Total share of taxes and grants-in-aid increased during these years so also the total revenue and receipts of the State. The percentage of total resources transferred increased from Rs. 38.2 crores in 1969-70 to Rs. 39.4 crores in 1970-71 but went on falling in the successive years.

The accompaning diagram shows the behaviour of the absolute amount of Shared Taxes and Grants-in-aid and relative share of the federal resources in the pool of aggregate State revenue over periods of time.

CONCLUSION

Memorandum submitted by Government of Orissa to the Eighth Finance Commission States that there has not occurred an appreciable


Resource Transfers to Orissa from Centre
through Finance Commissions over time
Resource transfers and Aggregate Revenue & Receipt of the state
156.0
149.5
136.5
123.5
110.5
97.5
89.5
71.5
58.5
45.5
32.5
19.5
6.5
0
Total Receipt of State
Shared Taxes
Grant-in-aid
(S.T.+G.A.)
Percentage of S.T.&G.A. to Revenue & Receipt of the state
1952
1957
1962
1966
1969
1974
1st
2nd
3rd
4th
5th
Time period of Finance Commissions

increase in the percentage of total revenue receipts of Government of India transferred to the States. But leaving aside the period covered by the Fifth Finance Commission, there seems to have occurred an increase in dependence of the State of Orissa on the Centre. A study by Thimmaiah [2] reveals that Finance Commission's transfers have not been distribted more in favour of needy, less developed States. He classifies Orissa among these less developed States. So special assistance should be provided to Orissa to reduce inter-state economic disparities by linking the assistance with infra-structure support for development and socio-economic welfare.

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TRANSFER OF NON-PLAN RESOURCES FROM THE CENTRE TO THE STATES:

WITH SPECIAL REFERENCE TO ORISSA

Smt. Sandhyarani Mohanty.

INTRODUCTION:

Center-State financial relations have been an area of controversy since a long time. The States always complain that in the context of their great and growing developmental responsibilities in both social and economic fields, they are given less elastic revenue sources whereas the Central Government is assigned high yielding revenue sources like the excise duties, custom duties, corporation tax, earnings from railways etc. Besides the Centre has access to internal and external borrowing.

TRANSFER OF RESOURCES FROM THE CENTRE TO THE STATES:

In 1981-82, the Centre's tax revenue amounted to Rs 14,734,00 crores out of which Rs. 4200.00 crores were tranferred to the States as their statutory share. Besides this the Centre also transferred Rs. 2234.00 crores as grants-in-aid to States for development and Rs 533,00 crores as non-development grants, the transfer amounting in all to about Rs 7067.00 crores which formed about 38 percent of total tax and non-tax revenues.

The table below indicates the resource transferred from Centre to States from 1969-83.

(Rs in crores.)

Year	Total gross revenue receipts of the Centre	Shared tax of all States	Non-plan statutory grants to States	Total devolution to all States (col.3 to col.4)	Percentage of devolution of TR
1969-74	24649	4562	859	5421	22.0
1974-79	52672	8268	2826	11094	21.0
1979-83	72861	16188	1349	17537	24.1

Source: Mamorandum Vol I to 8th F.C (1983) Finance Dept, Govt. Orissa.

It was mentioned in the Memorandum of WB govt. (1983) to the 8th FC that in the course of last three years the Centre had raised new taxes cumulatively yielding Rs 1430.00 crores per annum, out of which the share of States was only Rs 80.00 crores. Income tax, which was shared by the Centre with the States has remained stagnant, while the corporation tax and surcharge on income tax, appropriated by the Centre wholly, has been expanding. Grant in lieu of Repealed tax on Railway Passenger Fares was stagnant at Rs 16.25 crores from 1966-67.

CRITERIA FOR ALLOCATION OF RESOURCES:

To determine suitable criteria for resource transfer in a federal set up like India is an intricate problem. The Seventh F.C. has raised the States' share of income tax to 85% of the divisible pool, giving 90% of weightage to 'population' and 10% to 'collection'. It has also increased States' share of excise duties to 40% of the entire proceeds. It has made a significant departure from the norms of the past by assigning equal weightage of 25% to each of the four factors, i.e., the population of a State in 1971; the inverse of per capita State domestic product multiplied by the projected population of a State as on March 1, 1976; the percentage of poor in the total population of each States and a formula for revenue equalisation worked out by the Commission. It is found that in their computation of inter-State allocations, successive Finance Commissions have given over whelming importance to population.

REVENUE POSITION OF THE STATES:

The States do not have enough and elastic sources of revenue. Because of inherent disadvantages, agricultural sector providing 42% of GNP contributes only Rs. 250.00 crores in direct taxes, the tax base has remained very narrow in the States. In contrast to their increased and social obligations, the States have to depend on a few taxes like sales tax, stamp duty, entertainment tax, octroi and the like. The States finances were under great strain as seen from the unauthorised overdrafts which engulfed many States.

THE NON-PLAN FINANCIAL NEED OF THE STATE OF ORISSA:

A financially weaker State like Orissa has to encounter formidable constraints on its resourcse to meet the growing expenditure commitments. With nearly 67% of population living below poverty line, 38.2% consisting of SCs and STs. revenue from agriculture being nil, the tax has remained very narrow in the State. Besides the loss of revenue in major departments is considerable. For example, in all the major, medium, flood control and minor irrigation projects, the net receipt was (–) 706.16 lakhs in 1980-81; in Road Transport Corporation it was (–) 307.95 lakhs in 1981-82; in State Electricity Board the profit was (–) 1.82 crores in 1981-82. Therefore the financial need of the State is higher than any other State.

The following table shows the tiansfer of non-plan resources from the Centre to the State of Orissa.

(Rs. in lakhs)

	1976-77	1977-78	1978 79	1979.80	1980-81	1981-82
1. Share of Central taxes	6522	6936	7568	14436	15997	17387
2. Non-Plan Grant	6503	7525	8355	4637	7459	4627
3. Non-Plan Loans	1090	1255	2487	1697	2385	2090
Total	14115	15716	18410	20770	25841	24104

Source : Memorandum to 8th F. C. Vol III. 1983 Finance Deptt , Govt. of Orissa.

Orissa has theoretically left with zero deficit in the non-plan revenue account after the award of the 7th Finance Commission. The Commission did not allow adequate provision for some expenditure commitments like expenditure on revision on DA and ADA, relief expenditure on account of natural calamities etc. The 7th Finance Commission had allowed a provision of Rs. 47.42 crores for two instalments of DA after the 1st January, 1977. But the State Government had already sanctioned 14 instalments of ADA upto 1st April, 1982; the net financial liability of which is Rs. 351.37 crores during the period 1979-84. The situation would become worse after the recommendation of the Pay Commission, the minimum financial implication of which was tentativly assessed at Rs. 256.50 crores. If the employees of aided educational institutions would be paid pensions, gratuity etc. at the same level as the State Government employees, it would cost Rs. 11.30 crores for the period 1984-89 Meagre resources are also a great road block on the way of adequate maintenance of capital assets like roads, buildings, embankments, irrigation works, etc. It has been assessed that taking both revenue and capital account together Rs. 75,170.91 lakhs would be required during 1984-89 for upgrading standards of administration.

As the State is always prone to natural calamities like flood, cyclone, drought etc., the annual average expenditure to meet natural calamities was of the order of Rs. 52.25 crores for 1978-83, whereas the 7th F. C. had recommended margin money of only Rs. 8-71 crores per annum for financing natural calamities.

The outstanding loans and advances obtained from the Centre constitute 70% of the total indebtedness of the State. During 1984-89, excluding fresh borrowing, repayment of all loans to the Centre would be of the order of Rs 338.85 crores at 1983-84 level of liabilities. As a result of this there is a chronic gap in the non-Plan capital account of the State over the years.

SUGGESTIONS ESPECIALLY FOR THE STATE OF ORISSA

1. Improving the performance of State Electricity Board, Road Transport Corporation, irrigation projects, so that available resources can be utilized for other purpose like education, health facilities, tribal welfare and other public services.

2. Criteria for allocation should not be 'population' and 'collection' only but along with these, tax effort, backwardness, percentage of SCs and STs, percentage of people below poverty line, percentage of rural population to urban population should be taken into account.

3. To leave adequate surplus in the non-Plan Revenue Account so that assistance required for financing relief expenditure, revision of pay scales, grant of DA, grant of terminal benefits to the employees of aided educational institutions at par with the State Govt. employees, repayment of debt, maintenance of capital assets can be met.

4. To reduce the chronic gap in the non-Plan capital account of the State.

5. Special grant should be given for the population below poverty line.

6. Grants-in-lieu of repealed tax on railway passenger fare which was Rs. 36.00 lakhs per annum in 1974-79, and reduced to Rs. 28.00 lakhs in 1979-84 should be increased to a larger amount.

7. Corporation tax and surcharge on income tax should be included in the basic income tax rate.

8. The additional duties of excise on cloth, sugar, tobacco etc. should be distributed on the basis of population.

CONCLUSION

In a federation like India, there exists vertical fiscal imbalance between the Centre and States on the one hand and on the other, horizontal fiscal imbalances among the States. The strength of the federation depends on the balanced development of constituent units. For this the backward States may be given adequate financial aid in order to maintain their public services at par with higher income States.

"SCHEME OF DEVOLUTION OF RESOURCES— SOME BASIC ISSUES"

Sri Surendra Nath Behera

The federal system of the Government of India spelt out in detail a provision of division of financial powers and allocation of resources between the Centre and the States.

There are basically three streams of transfer of resources.

a) Statutory transfers, mandatory is nature, which include shared taxes, made under the recommendations of the Finance Commission. It also includes grants-in-aid to the States.

b) Plan transfers, relate to the assistance given to the States on the recommendations of the Planning Commission. The Gadgil formula, originally introduced in 1969 and revised in the sixth plan, reveal the objective criteria of plan transfer, the components of which are (i) population 60 percent (ii) percapita income, if below national average 20 percent (iii) tax effort 10 percent (iv) special problems 10 percent. It is relevant to the states excluding lumpsum assistance to the special category states, such as, Assam, Jammu and Kashmir and Nagaland.

c) Non-statutory and non-plan transfers in the form of grants and loans, provided for flood and drought reliefs and non.plan programmes.

Eight Finance Commissions have been setup so far, and seven of them have already submitted their reports, over the past thirty three years. The recommendations of the Seventh Finance Commission extend from 1st April 1979 to March 31st 1984. In the light of the assessment of these Commissions, we have yet to receive the recommendations of the Eighth Finance Commission headed by Y. B. Chavan appointed on 20th June 1982.

The Seventh Finance Commission recommended to increase the share of income tax by states from 80% to 85%, the proceeds of excise duties doubled from 20% to 40%. Regarding the share of income tax, 90% weightage was given to population and 10% to collection. Its further recommendations are, 100% of the proceeds of Wealth Tax on agricultural land are passed on to the states as grants, using the mechanism of grants-in-aid as a residual item to fill the non-plan-capital gap, and providing substantial relief in the States debt obligations.

In 1982-83, the total tax revenue of the Centre, stood at Rs. 17,900 crores, out of which Rs. 4,600 crores, i.e. 26% has been transferred to the States, which was 18.6% in 1978-79. It was the highest in 1980-81, i.e. 28.8%. Beginning from the 70's to the mid of 80's the tax revenues of the States has been two-third of their total revenue.

The recommendations of the Seventh Finance Commission were welcomed, since they involve a generous transfer of funds to the tune of Rs. 23,062 crores during 1979-84. During the sixth plan there is a provision to extend plan assistance of Rs. 15,350 crores, to the State Governments. Moreover the debt relief and the grant of relief to States affected by natural calamities have been liberal.

Though the Seventh Finance Commission has performed its task admirably, the approach of the Commission has been to ensure that, their fiscal transfer scheme leaves as many as the less affluent States, as possible with surpluses on revenue account which could be purposefully utilised towards fresh development. Though, some of the States demand were ignored, liberal transfer facilities will involve a considerable strain on Centre's finances. It is highly imperative, therefore, that some methods should be devised to streamline the process of resource mobilisation in the country as a whole, and the efficient utilisation of resources. But the liberal flow of funds should not prevent the States from raising additional resources from the un-taxed areas.

Between 1951–52 to 1982-83, about more than Rs. 90,000 crores, were transferred from the Union Government to the States through Planning Commission and Finance Commission. The pattern, types, and trends of resource transference do not take note of the widening gap between resources and responsibilities of the less developed States, with any basic change since the beginning of planning era. The present system of non-inclusion of the proceeds of corporation tax and surcharge on income tax in the divisible pool has resulted in centralisation of resources in favour of Union Government. The existing State of affairs, thus defeats the federal objective of removing regional disparities between States, and the gap between affluent States and poor States has actually widened in these years. It is evident from the following Table.

Table Showing Regional disparities.

States	Percentage be-low the poverty line (1978-79)	Infrastrutcure Index (100)	Percapita income (1978-79)	Percapita plan expenditure (1950-51 to 1984-85).	Percapita resou-rces transference (1982-83)
1	2	3	4	5	6
1. Andhra Pradesh	42	96	1092	1147	148
2. Assam	51	106	1017	1136	309
3. Bihar	57	109	765	940	189
4. Gujarat	39	147	1530	1988	179
5. Haryana	25	169	1800	2325	187
6. Karnataka	48	118	1170	1294	135
7. Kerala	47	143	1074	1244	142
8. Madhya Pradesh	58	72	900	1307	153
9. Maharashtra	48	138	1820	1835	153
10. Orissa	66	94	841	1180	192
11. Punjab	15	238	2111	2582	154
12. Rajasthan	34	85	1052	1196	147
13, Tamilnadu	52	168	1438	1241	130
14. Uttar Pradesh	60	113	974	1079	139
15. West Bengal	52	144	1282	1115	180
All India including other states and Union Territories	48	1100	1255	1267	172

The States having more population below the poverty line, infrastructure facilities at a very low ebb and per capita income far below the national average, get the less per capita plan expenditure, as well as minimum share in resource transference. The per capita plan expenditure of Orissa, is far below the developed States of Punjab, Haryana, Gujarat and West Bengal.

It is due to a sense of indifference, apathy and non-involvement among States. The States have become mostly spending agencies. Since more than one-third of the total aggregate expenditure and fifty percent of the plan expenditure of the States are controlled by Central government, operational efficiency at the State governments level has been badly effected. The present system of resource transference is adversely affected fiscal autonomy, democratic set up and administrative efficiency of State governments. The widening regional disparities in the federal structure leads to financial indiscipline. It is the direct outcome of the regressive nature of the tax devolution, the richer states benefited more than the poor. Another flaw of the existing practice of transfer of resources is, mounting debt obligation of the States which has increased from Rs. 445 crs., is 1950-51 to Rs. 17,320 crs., in 1980-81 raising incidence of interest charges, putting heavy strain on the revenue budget causing a serious concern to the states.

Orissa, a backward State, deserves more Central assistance on the following grounds.

(a) It has got nearly about 38 percent of Scheduled Caste and Scheduled Tribe population. The people below the poverty line are the highest, i.e. 66 percent of the total population and percapita income is far below the national average. Additional funds are required to meet the special problems as Tribal development.

(b) Orissa is frequently visited by natural calamities like, flood and drought every year.

(c) It has immense potentiality for development in the form of abundant mineral and forest resources.

It is suggested for setting up a permanent Finance Commission. But there should be periodical examination of the division of resources, and suitable modifications should be made to impart a degree of flexibility in the planned era of changing needs, and resources. In the light of our past experiences the States' demand for equalisation or progressivity should be an accepted creed of the Eighth Finance Commission, as a promising line of advance. A re-orientation of the Planning Commission and Finance Commission is called for reordering financial and economic relations between Centre and the States. The Union Government cannot function on the usual assumption of a very strong Centre and highly dependent States.

At the same time, the States may not be so correct in demanding complete financial autonomy and independence. We have witnessed a simmering controversy and an intense debate for sharing the cake off and on. It is not the conflict, rather a compromise, which will have to be worked out, so that there is a powerful Centre on the one hand, and more or less autonomous States on the other, which do not depend upon the generosity of the Centre. The Union Government has appointed the Sarkaria Commission to study the problem of Centre-State relations. The need of the hour, is vigorous co-ordinated efforts of the Central Government and State Governments which will bring about 'unity in diversity'.

CENTRE— STATE RELATIONS— AN APPRAISAL

M. V. Raman Murty

Financial resources of the states are inadequate to meet their expenditure liabilities. They should be provided with more financial powers so that they need not be subordinate to the Centre and can act independently. Further, the Planning Commission grants are discretionary. Political factors are more important in allocating plan grants than economic needs. Transfer of resources from the Centre to the States should take place through a single body to avoid such conflicts.

CENTRE— STATE FINANCIAL RELATION WITH SPECIAL REFERENCE TO ORISSA

Gopal Chandra Chaudhury

The constitutional provision does not provide adequate resources to the States. The resources provided to the State of Orissa through different Finance Commissions are not adequate to meet its financial obligations. In order to improve the economic standing of different States and particularly of Orissa, it is recommended that the States should (i) tap all the resources to mobilise additional resources (Land Revenue and Agricultural Income Tax are some of the important taxes which can be tapped), (ii) ensure financial discipline in their expenditure priorities, and (iii) develop a national outlook so as to strengthen the economic and political base of the country.

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AN EMPIRICAL TESTING OF CONSUMPTION—INCOME RELATIONSHIP

A CASE STUDY OF INDIA

Sri P. K. Raj
Sri K. P. Mohanty

The present study aims at finding out the consumption-income and savings— income relationships in India at the macrolevel for the period 1960-61 to 1981-82. Such a study has been undertaken in the main to examine the relevance of Keynesian consumption function analysis in case of a developing country like that of India.

The basic Keynesian idea of consumption function can be summarised as follows :—

i) the marginal propensity to consume (MPC), and the marginal propensity to save (MPS) are positive and less than one,

ii) a part of total consumption (hence a part of total savings) is autonomous, i.e., independent of the level of income,

iii) the average propensity to consume (the average propensity to save) is inversely (directly) related to changes in income.

The Keynesian consumption function, in its simplest form, is represented in the form of a straight line, $C=C_a+cY$, where C is total consumption expenditure, C_a is the autonomous part of it, c is the slope of the function (MPC), and Y is the total disposable income. Similarly, the savings function is given in the form of a straight line, $S=S_a+sY$, where S is total savings, S_a is autonomous savings, s is the MPS. C_a is assumed to be positive and hence S_a, by definition, is negative.

METHODOLOGY

The present study has adopted the following methodology. Data on private disposable income (PDI) and private final consumption expenditure (PFCE) for the years 1960-61 to 1981-82, in constant (1970-71) prices, have been taken. Private savings for each of these years have been computed from the aforesaid data simply by deducting the PFCE from the respective PDI. The APC, MPC, APS, and MPS, have also been computed by adopting Keynesian technique. The relationship between consumption and income has been estimated by fitting a linear regression line to the data for all these years. Then the entire period has been divided into four shorter periods of approximately equal length, 1960-61 to 1964-65, 1965-66 to 1969-70, 1970-71 to 1975-76 and 1976-77 to 1981-82. Separate regression lines have also been fitted to the data for each of these shorter periods for better understanding of the relationship. The same technique has also been adopted to examine the savings-income relationship.

ANALYSIS OF THE FINDINGS

Table—I shows how aggregate consumption and aggregate savings have varied with aggregate income during the period under consideration.

Column 5 in the table gives the computed values of MPC. In eight of the total twenty one cases, MPC is more than one and in two cases it is negative. In rest of the eleven cases it is less than one and positive. A considerable variation in the values of the MPC from year to year is also marked. Hence, the MPC, as found in the present study, does not portray the features of the Keynesian MPC.

Column 6 in the table gives the computed values of APC. In seven out of twenty two cases the APC rises with rise in income and in two of the cases it falls with a fall in income and hence goes against the Keynesian proposition. But it is quite interesting to note that in none of these nine cases the deviation (either rise or fall) is significant. Moreover, four out of these nine exceptions are found during the last six-year period, i.e., from 1976-77 to 1981-82.

Computed values of MPS and APS have been given in column 7 and 8 of the table respectively. Since MPS and APS have been calculated from MPC and APC respectively, they show quite similar features as shown by their counterparts. In those eight years in which MPC has been found to be more than one, MPS has been negative and in those two years in which MPC has been found to be negative MPS has been positive. The values of MPS have also varied remarkably from year to year. Thus MPS, like its counterpart, has been found to be not in line with the basic Keynesian idea. APS has fallen with increase in income in seven cases (where APC has risen) and has also risen with fall in income in two cases (where APC has fallen) and hence, has gone against the basic Keynesian proposition. But in none of these nine cases the deviation is of any great significance.

But such type of study does not reveal much. For example, though it is found out that the MPC has not remained constant throughout it has not been able to explain the cause of its variation. An humble attempt is made in this present study to isolate all the factors other than income which affect consumption in order to find out the portion of the actual changes in consumption that were due to changes in income. Simple linear regression analysis has been used for this purpose.

The regression equations found in case of consumption are :

(1) 1960-61 to 1981-82 : $C = 4758.076 + \underset{(0.01435)}{0.7517}\, Y, \; r^2 = 0.9927$

(2) 1960-61 to 1964-65 : $C = 3350.556 + \underset{(0.0367)}{0.7904}\, Y, \; r^2 = 0.994$

(3) 1965-66 to 1969-70 : $C = 725.15 + \underset{(0.0862)}{0.9166}\, Y, \; r^2 = 0.974$

(4) 1970-71 to 1975-76 : $C = 7128 + \underset{(0.1036)}{0.69}\, Y, \; r^2 = 0.918$

(5) 1976-77 to 1981-82 : $C = -716.9 + \underset{(0.0419)}{0.87}\, Y, \; r^2 = 0.991$

(Figures in the parentheses are errors of estimate)

The equation (1) shows the relationship between consumption and income for entire twenty two years, whereas the equations (2) to (5) reveal the relationship between these two variables in the four shorter periods. The correlation and slope co-efficient in all these five equations are significant at 0.05 level.

In equation (1) the autonomous part of the consumption, given by the intercept term, is Rs. 4758.076 crores. The MPC is 0.75, which means that for every Rs. 100 crores change in disposable income, final consumption would change by Rs. 75 crores. In equations (2) to (4), C_a is positive and consequently, in the corresponding three short periods APC has run mostly in conformity with the Keynesian ideas, barring a few exceptions. But in the equation (5), C_a is negative and for this, during the short period ranging from 1976-77 to 1981-82 the APC has shown features mostly contrary to the usual Keynesian conception.

By using the same procedure to analyse the savings income relationship the following regression equations are found :

(6) 1960-61 to 1981-82 : $S = -4758\ 076 + 0.2483\ Y,\ r^2 = 0.937$
(0.0144)

(7) 1960-61 to 1964-65 : $S = -3350.556 + 0.2096\ Y,\ r^2 = 0.9213$
(0.0354)

(8) 1965-66 to 1969-70 : $S = -725.15 + 0\ 0834\ Y,\ r^2 = 0.2377$
(0.08624)

(9) 1970-71 to 1975-76 : $S = -7128 + 0.31\ Y,\ r^2 = 0.6916$
(0.10333)

(10) 1976-77 to 1981-82 : $S = 716.9 + 0.13\ Y,\ r^2 = 0.7084$
(0.04168)

(Figures in the parentheses are errors of estimate)

The equation (6) shows the relationship between savings and income for the entire twenty two years, whereas the equations (7) to (10) show the relationship between these variables in the short periods. The 'S_a' s in these five equations are simply the negative 'C_a' s in equations (1) to (5) respectively. In a similar manner the 's' s are nothing but '(1—c)' s in equations (1) to (5) respectively, the correlation and the slope coefficients in equations (6), (7), (9) and (10) are significant at 0.05 level. But the correlation and slope coefficient in equation (8) are not significant. This means that during the period 1965-66 to 1969-70, the association between savings and income is very poor. Moreover, in the equation (10) the intercept term is positive (in its corresponding consumption equation (5) the intercept term is negative), which has resulted in making APS mostly deviate from Keynesian line.

SUMMARY OF THE FINDINGS

To sum up, the findings of the present study do not conform entirely with the Keynesian ideas. MPC has not been found to be positive

Table—I

Year	PDI at 70-71 prices	PFCE at 70-71 prices	PS at 70-71 prices	MPC	APC	MPS	APS
1960-61	22534	21202	1332	—	0.941	—	0.059
61-62	23106	21506	1510	0.698	0.935	0.311	0.065
62 63	23538	22037	1501	1.021	0.936	−0.021	0.065
63 64	24575	22605	1970	0.548	0,920	0.452	0 080
64-65	26766	24571	2195	0.897	0.918	0.103	0.082
65-66	25479	23836	1643	0.571	0.936	0.429	0.064
66-67	25868	24382	1486	1.404	0.943	—0.404	0.057
67-68	27368	26272	1096	1.260	0.960	—0.260	0.040
68-69	28657	27056	1601	0.608	0.944	0.392	0.056
69-70	30095	28082	2013	0.713	0.933	0.287	0.067
70-71	33032	29838	3194	0.598	0 903	0 402	0.097
71-72	33704	30704	3000	1.289	0.911	—0.289	0.089
72-73	33509	30070	3439	3.251	0.897	—2.251	0.103
73-74	35282	30880	4402	0.457	0.875	0.543	0 125
74-75	34197	31143	3054	—0.242	0.911	1.242	0.089
75-76	37938	33467	4471	0.621	0.882	0.379	0.118
76 77	39247	33194	6053	—0.209	0.846	1.209	0.154
77-78	42788	36589	6199	0.958	0.855	0.041	0.145
78-79	44255	38175	6080	1.081	0.863	—0.081	0.137
79-80	42946	36769	6177	1.074	0.856	—0.074	0.144
80-81	46911	39757	7154	0.754	0.847	0.246	0.153
81-82	47958	41008	6950	1.195	0.855	—0.195	0.145

Source : Data given in col. (2) & (3) have been collected from National Account Statistics Feb issue, published by CSO.

and less than one always. APC has not also shown an inverse relationship with changes in disposable income in all the years. Similarly, MPS has been found to be negative and more than one in certain years and APS has not revealed a direct relationship with changes in income in all the years.

By fitting linear regression lines to the actual data for isolating the influence of all factors other than changes in income on changes in consumption and savings, it has been found out that the basic

Keynesian proposition regarding consumption-income and savings-income relationship holds good in case of India in most of the years. The only exception found has been for the period 1976-77 to 1981-82 in which the autonomous part of the consumption has been negative and hence the autonomous part of the savings has been positive. This phenomenon may be treated as something peculiar and further study may be undertaken to find out why such a peculiarity really existed.

NOTES

1. A linear line has been fitted to the data because the relationship between PDI and PFCE has been found to be approximately linear. In technical terms $\Sigma (u)^2$ has been found to be least when a linear line is fitted.

APPRAISAL OF KEYNESIAN ECONOMICS.

Sri Uttam Charan Nayak

INTRODUCTION:

In recent years a curious situation has arisen in the state to Keynesian economics and the evaluation of Keynesian Revolution. On the one hand, there is increasing disenchantment with Keynesian economics from the practical point of view. The criticism of Keynes is so widespread now that even a cursory reading of the popular literature provides incontrovertible evidence of this phenomenon. There are many who have not struggled with the intricacies of the Treatise and the General Theory, but are now prepared to make glib pronouncements that Keynesianism has been discredited. Some have even gone so far as to say that the "Keynesian era" has ended or that Keynes is dead. On the other hand, theoretical interest in Keynesian model is greater than it has been before. The theoretical literature proves beyond doubt that Keynes made fundamental contributions to economic theory.

KEYNES AND THE KEYNESIAN ECONOMICS:

In the classical set up the value theory and the monetary theory were not integrated. The integration between these theories was highly needed, both in the interest of theory and policy making. It was appreciated by Keynes as early as 1930 when he published his two volumes of A Treatise on Money (1930). Subsequently in his General Theory, he came out with an alternative paradigm which could explain more scientifically both the persistence of unemployment and the failure of the quantity theory based policy prescriptions. This he did by identifying some special features of a monetary economy that would prevent the automatic attainment of full employment even when wages and prices were completely flexible. He placed special emphasis on the role of uncertainty and expectation in such an economy and the consequent information problems to which they give rise. In this way Keynes attempted to build a theory of output and employment that would be capable of analysing the economic behaviour of the present under the influence of changing ideas about the future.

Money has crucial role in such a theory because it is a subtle device for linking the present to the future. In this theory Keynes focussed his attention on the disequilibrium situation. To him, in a monetary economy in disequilibrium it is possible that 'pessimistic transactors' response in the market may be such that they apprehend that they are unable to buy the entire output potential of the economy. In such a context no amount of price and wage flexibility can alter this behaviour, and wage cuts, even if implemented, they would not achieve full employment. Thus he predicted that in a depression situation like that of the 1930's only an exogenous stimulus to demand could make the self-defeating expectations of the transactors nugatory. And this only could cure the mass unemployment. His prescription for policy therefore was to increase public expenditure in order to raise the level of effective demand to a level consistent with full employment. Thus in Keynes' writings, monetary theory was transformed from a theory of the price level to an expectational theory of output and employment as a whole.

KEYNESIAN ECONOMICS X-RAYED:

In the General Theory, Keynes provided a systematic analysis of the determinants of output. In the Treatise, Keynes started with a given level of output. But he did not explain how this level of output is determined. The revolutionary contribution of the General Theory consisted in its demonstration that equilibrium level of output is determined by the intersection of the aggregate demand and supply functions. Keynes defines these functions in terms of the proceeds expected by entrepreneurs. Hence his analysis is explicitly monetary and price movements play an integral part in his theory of output determinations. The theory of prices in the General Theory is in fact based on the price theory of the Treatise.

Keynes in his General Theory points out that the behaviours of the price level as a function of change in the supply of money is compounded of the behaviour of three variables, viz; (i) the behaviour of aggregate effective demand (ii) the behaviour of the total output and employment and (iii) the behaviour of the cost structure. He aims at integrating the theory of money with the theory of value with the help of two important assumptions that all unemployed resources are homogenous and interchangeable and secondly all factors of production entering into marginal cost are content with the same money wage so long as there is surplus of the factors unemployed entering into marginal cost. The second assumption implies that wage unit is perfectly rigid and there is perfect elasticity of the supply of resources. In the light of these assumptions, Keynes interpreted the quantity theory of money. Keynesian theory says that a rise in the quantity of money leads to increase in output and employment and not prices as long as there is unemployment but is cause equal and proportionate rise in the prices, once the full employment level has been reached and the productive resources have been fully employed and absorbed.

This transmission process as viewed by Keynesians can be summarised as follows:

Money Supply— Interest Rates— Aggregate Demand-GNP. A change in the money supply causes a change in interest rates which in turn changes aggregate demand. When aggregate demand changes, aggregate spending (GNP) changes.

An increase in the money supply, the money demand remaining constant, causes a decline in interest rates. A fall in interest rates increases aggregate demand, viz (i) interest rate effect and (ii) wealth effect.

(I) INTEREST RATE EFFECT:

A fall in interest rates increases consumption, investment and government expenditure. It increases consumption expenditure bacause, it reduces the cost of buying on credit. It increases investment expenditure because it makes marginal investments profitable. A decline in the interest rate also stimulates government expenditure. In the United States construction projects of state and local governments depend heavily on borrowed funds and are, therefore, affected by the cost of borrowing.

(ii) WEALTH EFFECT:

Change in interest rates also influences, aggregate demand via wealth effect. When interest rates fall, prices of stocks and bonds rise. Prices of stocks rise because falling interest rates and considered to have a stimulative effect on the economy. Prices of bonds rise because they are inversely related with interest rates. When prices of stocks and bonds rise the value of household wealth rises. A rise in the value of household wealth tends to enhance consumption spending. An increase in aggregate demand results in an increase in aggregate spending.

The modern quantity theory of money is a step in the direction of full-fledged monetary theory. It is the result of investigations and researches of Milton Friedman who is supposed to be the leader of the Monetarist Revolution. He has the privilege to place the quantity theory of money at the centre of modern macro economics. He has replaced the Keynesianism very successfully in the field of macro-analysis of economic policy. His quantity theory as a demand for money treats money as a significant factor for the determination of the country's real national income. Other things remaining the same, an increase in the quantity of money will lead to an increase in nominal and in real national income of a country. But the nominal income is governed by the income velocity of money.

The area of disagreement between the monetarists and the Keynesianism lies around the supply of money, the former considering it as exogenously determined by the monetary authorities and the latter considering it as being largely endogenously determined in response to the needs of the economy. The monetarists think that the leading course of economic instability in the economy is the money supply. But to Keynes, the cause of instability is located some where other than the money supply. The demand for money in an equilibrium model of Friedman which operates at full employment is affected by changes in (i) interest rates (ii) yields between financial and non-financial assets, (iii) income or wealth and (iv) expectations. Abstracting from possible inter relations between these four forces, at least in the short run, a decline in nominal interest rates would induce people to substitute cash for bonds in their portfolios because of capital gains that bond-holders are able to realise. The capital gains realized represent an increase in the public's wealth and people being wealthier switch from money to assets. Thus the sequence of adjustments described by M. Friedman fall into place. The introduction of capital gains is a perfect substitute for "money rained down from heaven", and necessary to refute the Keynesian criticism that the switch from bonds to money represents nothing but a change in the composition of an unchanged total wealth that does not justify another switch from money to goods.

CONCLUSION:

(1) Keynesians believe that interest rates are crucial links between the money supply and aggregate demand. Monetarists, on the other hand, assert that there are a number of rates of return including interest rates which link the money supply with the aggregate demand.

(2) Keynesians believe that the money supply has only an indirect effect on aggregate spending. Monetarists, on the other hand, assert that it has both direct and indirect effects on aggregate spending.

(3) To Keynes, in the long run, changes in the money supply affect both prices and output as long as the economy is operating below full employment. But when the economy is at full employment level, such changes will affect only prices. It is not clear whether monetarists associate the idea of the long run period with a full employment level, but they repeatedly point out, in the longrun, changes in the money supply influence only prices.

(4) Keynesians say that the relationship between the money supply and GNP is unstable. Monetarists claim that this relationship is stable.

(5) Keynesians argue for mobilisation of physical resources, whereas the monetarists argue for monetary resources.

(6) The feature of monetarism which distinguishes it from the Keynesian approach, is that what matters the quantity of money and not interest rates, money markets conditions, credit conditions and the like.

Both Keynesianism and monetarism are one-sided. They over emphasise only one of the aspects of problems emerging in one of the phases of the trade cyclical fluctuations. Hence they emphasise the use of only one of the instruments of economic policy which is effective in that particular phase of the trade cycle. So Prof. Friedman considers himself a Keynesian when he says— we are all Keynesians to-day.

UNDEREMPLOYMENT EQUILIBRIUM AND TECHNICAL PROGRESS

Sri Bimal K. Mohanty

Keynesian optimistic illusion of 'underemployment equilibrium' and classical pessimistic conclusion of 'stationary stagnation' are drawn from the same premise of unchanging technical knowledge of production. Classicists, with the assumption of a given and unchanging technical knowledge could anticipate an economy moving only by very small steps towards a distant stationary state. Under the pressure of thorough-going-competition and diminishing returns, full-employment is achieved when the net-saving and net-investment have fallen to zero at a positive rate of interest and the economy has reached its ultimate stagnation. Keynes could forecast the fate of an industrialised capitalist economy only to be trapped by the grips of underemployment equilibrium. In his opinion, a capital rich nation could reach a position where capital would cease to be scarce within a reasonably short period of time. This fact is attributed to the perfectly elastic nature of liquidity preference function at a floor rate of interest. Hence, equilibrium between saving and investment is reached considerably below the full-employment level of labour and natural resources. The equality between saving and investment the observable elements in the model is never a test of full employment "Savings be equal to investment,... are simply formulas for the retention of the income status-quo. If underemployment was present yesterday, it would still remain here today. If yesterday's income was at a full-employment level that income level would be retained today." Keynesian illusion of underemployment equilibrium seems, therefore, incompatible with a state of full employment.

This unfortunate happening is due to the merciless exclusion of the exceedingly important role that technical progress would play in course of the prosperity of capitalist development. Keynes has observed that during the nineteeth century, the schedule of the marginal efficiency of capital — the reflector of technological improvement in production, was high owing to 'the growth of population and of innovations, the opening up of new lands, the state of confidence and the frequency of war....Today and presumably for the future, the schedule of the marginal efficiency of capital is, for a variety of reasons, much lower than it was in the nineteenth century'. Variety of reasons which contribute to the falling tendency of marginal efficiency of capital are : 'the depressing effect of a large and growing stock of capital, the inhibiting influence of a positive rate of interest,... uncertainty surrounding private investment decisions with respect to fixed-capital that links the economic future to the present'. In the absence of technical change, the profit rates (marginal efficiency of capital) would be pushed to minimal levels. Keynes feared that such minimal rates of interest and of profits on risky ventures might create a stationary state of stagnation with chronic unemployment and underemployment. "People might still want to save at full-employment, but no matching real investment would be forthcoming when the promised profit rate is too low to coax out risk taking." If technical change is included into Keynesian scheme of things, the position might become much more cheerful. "Technical progress may widen the range of profitable investment opportunities in the future as it has in the past".

Keynes' analysis of the capitalist progress is not incompatible with capital accumulation. Capital accumulates, is invested, helps multiplying income and employment through multiplier to let savers and investors to realise their intentions but having failed to provide tanquility to labour market It is because technical inventions and progress have been kept far away from appearing. Technical change is a shorthand expression for any kind of shift in the production function Thus slowdown speedups, improvement in the education of the labour force and all sorts of things" may be included in it. Technical progress function contributes exclusively towards the alteration of capital-labour ratio being infused into the economic system through the creation of new equipment. So long as the capital-labour ratio is constant, additional capital accumulation and investment is unprofitable. The burst of technical progress takes a discrete time interval and each burst shifts the horizon of development. The gap between bursts of 'creative innovation' would be long enough such that before the attainment of stagnation, another burst takes place. Quicker the bursts are, speedier is the alteration between the capital-labour ratio to break the vicinity of stagnation. It is a state of moving equilibrium which will proceed indefinitely. The irregular bursts in technical progress describes a regular, continuous and steady economic development. The most important feature of the development is its 'technical dynamism'— the continuous improvement in methods of production. "By far the larger part of the observed increase in output per head is a consequence of 'technical progress' rather than of increased capital per head". Thus, unlike Keynes, the level of employment and output becomcs a function of technical knowledge of production.

With technological progress two things might happen : (i) The lower is the average age of a community's capital assets, the higher will be its output per man. (ii) Even with a given stock of capital, the capital productivity rises in view of the technical inventions. Because, new and more productive machines have replaced the old and less productive ones. "Explicit account of obsolescence must be taken into, it is caused by the fact that the profitability of plant and equipment of any particular 'vintage' must continually diminish in time owing to the competition of equipment of superior efficiency installed at subsequent dates". When enterpeneures are more willing to scrap old machines, by replacing them by new and more productive ones, both aggregate demand and aggregate supply are sustained. ' Technical progress is the main engine of economic growth– determines not only the rate of growth of productivity but also the rate of growth of obsolescence, the average life time of equipment, the share of investment in income, the share of profits, the relationship between investment and potential output (i.e. capital-output ratio on new capital)". Actually, the technical inventions are neither very much irregular nor are taking place at frequent and regular intervals. In reality, the situation will lie somewhere in between the two extremes. The technical progress does take place at continuous intervals where in some periods it is extremely rapid.

A dynamic industrialised economy exhibits the growth of both labour force and capital stock. A singular feature is, capital growing more rapidly than labour. If full employment of capital is maintained, labour per unit of capital (labour-capital ratio) must be falling, the growth process in a sense to be labour-saving and capital-using. In this case capital 'deepens' resulting in increase in capital-labour ratio, fall in the rate of interest or the profit rate, increase in the wage rate and increase in the capital-output ratio under the framework of a constant technological relation of production and with no shift in the aggregate production function. Capital investment and technological change do go hand in hand often they are inseparable. Samuelson's parable of 'interplay of technology and capital' is a testimony to it. Technological progress reduces labour employment by making capital more productive. That does not mean that we shall abolish technological progress thus escaping from unemployment. This is a defeatist solution.

Technological change usually saves labour and capital in different proportions. Rather than being 'neutral' (by leaving the marginal rate of substitution between capital and labour unchanged but raising the output attainable from given input), it is biased toward one factor of production in one time and toward other in other time. In industrialised economy, the labour saving inventions are coming with nonstop frequency. But these inventions are hardly a matter of new worry. When technical change leads to labour displacement, no change in wages may be large enough to offset that unemployment.

With a step towards a dynamic economy, there arises an outward conflict between the provision for justice to growing capital stock and growing labour force. But this conflict is resolved by proving the complementarity between labour and capital through the working of technical improvements (increase in labour productivity). If the economy is having a growing labour force, under ordinary circumstances one would prescribe for labour-intensive activities, those with low capital-labour ratio which amounts to low capital-output ratio. But the practical experience shows that in industrially advanced economies, production techniques are oriented towards large scale production which is capital-intensive under the weight of continuous scrapping of old capital instruments. Hence, a paradox : an industrial society having faced the growth of both capital and labour should have both capital-intensive (with high capital labour ratio) and labour-intensive (with low capital-labour ratio) techniques of production at a time.

It seems paradoxical but experience from the growth pattern of Japan and South Korea proves these are simultaneous. Growth of output via the technical innovations and in growth employment can coexist without any difficulty. When more than a single production period is considered, the analysis approaches a state where advantages to both capital and labour can be guaranteed without damaging the interest of its counterpart in production. Capital-intensive techniques now produced equipments which will be labour-intensive in use in the future. Though both labour-intensive and capital-intensive techniques cannot be adopted simultaneously, they can be adopted with at least one period lag within the same production process. Spinning wheels produced now with capital-intensive techniques will be labour-intensive in its use tomorrow. Hence, a clear case of eliminating underutilisation of capital and underemployment of labour in the immediate long-run. All this is attributed to the growing significance of technological improvements in production.

Technical progress as such does not guarantee a rise in income by itself. it might place a 'power' and the 'ability' of achieving a growing income. Technological progress may become a curse or a blessing depending upon the nature of economic policy that we adopt. To be conducive to growth, investment of today must exceed saving of yesterday with the pushing up of the horizon of technical progress. A mere absence of hoarding will not do. An injection of new money (or dishoarding) must take place everyday. Moreover, this injection must proceed in absolute terms at an accelerated rate. The economy must continuously expand. It is believed, therefore, that with suitable controls, a programme for continuing full employment, a steady development of productive forces and the gradual reduction in economic inequality at the same time, without any sudden and revolutionary change in social and political institutions, which could be viewed as a liquidation of capitalism can be brought about. Thus the technical progress function playing its role with vigour avd vitality, yields the Keynesian system of things compatible with a state of full employment of labour and of capital only in the immediate long-run through a suitable state policy.

KEYNES : THE SOCIALIST

Dr. R. Padhi Sarma

The title may raise eyebrows and create doubt in the minds of many, but on close observation it would show that even though Keynes had no dogmatic philosophy of his own in the future course of the development of the society, like Marx, his sophisticated and fragmented mind reveals the ideas of socialism in many a place concealed in his writings.

Keynes was almost ignorant of the works of Marx. Das Capital eventhough taken birth in the British soil, Marxism was bypassed in England by the British left movement. Like most of the British intelligentsia Keynes was not very much influenced by Marxian thought, as he himself stated categorically, but he shared similar economic arguments in analysing economic activities of capitalism; his ideas were akin to socialism with which he "buried Marxism for a generation of the mainstream British left".

Keynes had no interest to understand Marxian philosophy, perhaps either due to the happenings of communist regime in the Soviet Russia, or the latters general basis on the classical economics, for which he regarded Marx as one among them. is evident from a letter of Keynes to George Bernard Shaw in 1935: "I will take your words to heart. There must be in something what you say, because there generally is. But I have made another shot at old K. M. (Karl Marx) last week, reading the Marx-Engels correspondance just published.... I can discover nothing but out of date controversialising. To understand my state of mind however you have to know that I believe myself to be writing a book on economic theory which will largely revolutionise .. the way the world thinks about economic problems.... There will be a great change in particular the Ricardian foundations of Marxism will be knocked away".

In heart Keynes had a soft corner for socialism, specially what Halm called Liberal Socialism. Towards the middle of the thirties there was a tendency towards communism among the young at Cambridge. Keynes' biographer R. F. Harrod who studied the mind of Keynes says that "thirty years before he (Keynes) would have wished to consider for membership of the (communist) society".

ROLE OF THE STATE:

The main core of socialism is economic in nature. Economic ideas formulated in the minds of Keynes on the working of capitalist system in 1923-24, long before the Great Depression and crisis in the western world, shows that he was not satisfied with the functions of the State in the society. It is the role of the State that differentiates the capitalist economy from a socialist one. Keynes was for a powerful State but not to the degree wanted by Marx by the workers.

Keynes first attack to demolish traditional capitalist structure shot in November 1923, with the publication of "A Tract on Monetary Reforms" with regard to management of monetary affairs by the State. His bold suggestion to delink gold from the management of currency system was acceptable neither by the academician nor to the statesmen then, but ultimately world abondoned gold standard in 1931, as a consequence of great world depression. The gold standard perhaps the most respected and "sacrosanct of all the mechanisms of the 19th century capitalism." Even the socialist then have not rejected the monetary system attached to gold. The Labour party at the beginning opposed the move for abolition of gold standard. Abolition of gold standard taken away privilege of the individual, to influence the money supply in the economy, that was there with him from the time immemorial. The abolition of gold standard can be treated as the transfer of power from the individual to the State, which empowered the latter, absolute power of managing the currency system for the welfare of the economy as a whole.

Alfred Marshall, the last of the great economist of classical heritage, died in the year 1924, and in the same year Keynes selected a topic to address at the Oxford University on "The End of Laissez faire". It was an annual lecture of the Sedney Ball Foundation at Oxford.

There he proposed to nationalise the big concerns of national importance, such as, the Bank of England, to be governed solely on the considerations of efficiency and public interest. This he called 'self-socialisation' and believed that it would reorganise the economic life of the Great Britain.

With regard to the functions of the State he wanted to separate the services which are technically social from those technically individual. He advocated that the State should not do those activities which the private individuals are already fulfiling but those decisions which are made by no one if the State does not make them.

Keynes confessed his discontent with money making and money loving instinct of the individuals as the main motive force in capitalism, and he was in search of a " social organisation which shall be as efficient as possible without offending our notions of a satisfactory way of life.

But Keynes believed, unlike Marx and followers of Marx, that the change in the social system must come not by political agitation or premature experimentation but from thought. " We need' said Keynes " a new set of convictions which spring naturally from a candid examination of our own inner feelings in relation to the outside facts." His mind is more akin to the Fabian socialism, with some concrete proposals of reforms in the economic activities of Laissez Faire capitalism.

THE CONCEPT OF LABOUR:

Socialism is mainly based on the concept of labour as the sole producer of value and sole factor of production of the goods and the commodities. Accordingly all the socialist thinkers advocated for the emancipation of the workers from the exploitation of the capitalist. This also is the view of Keynes when he says:

"It is preferable to regard labour, including of course the personal services of the entrepreneur and his assistant, as the sole factors of production cperating in a given environment of technique, natural resources, capital equipment and effective demand. "Alike Marx, the concept of capital as past labour in order to value every production on the basis of labour embodied in the commodity produced is also found in Keynes. He sympathised "therefore with the preclassical doctrine that everything is produced by labour aided by what used to be called art and is now called technique by natural resources which are free or cost a rent according to their scarcity or abundance".

SOCIALISM OF KEYNES

Keynes was not in favour of communism or command economy, he was a democratic socialist. He married Lydia, a Russian ballet dancer, in August 1925 and went on a honymoon tour to Russia during the days of power strife after the death of Lenin in 1924. He wrote three good articles on Russia for the 'Nation'. Later those articles were published in a booklet form as "A Short View of Russia." Keynes was impressed by the religious quality of the communist experiment, but not influenced by it. He wrote : "I could not subscribe to the new official faith any more than to the old. I should detest the action of the new tyrants not less than those of the old". He visited Russia twice later in different capacities but could not accept the new regime which he called State Socialism.

Keynes' mind in favour of democratic socialism can also be traced in "Dilemma of Modern Socialism" an article published in 1932. He was actually in dilemma since on the one hand he neither appreciated the existing working of the Laissez Faire capitalism nor the command regime of communist Russia.

In 'General Theory", published at the height of the Great World Depression, Keynes appreciated the contribution of Silvo Gesel (1862-1930) a German economist whose main work was The Natural Economic Order'. 'It seems Gesel influenced the Keynesian thought. Keynes accepted the Geselian version of socialism because it just matched his thought process. Keynes observed that the main purpose of Gesel's book was "Establishment of an anti-Marxian socialism, a reaction against Laissez faire, built on theoretical foundations". This shows that Keynes was a socialist in mind but not the type of socialism conceived of by Marx.

Important characteristics of socialism of Keynes can be specified here which are implicit in his writings :

First, unemployment is the most important aspect of capitalism; and for its cause both Marx and Keynes were on the same plane : While Marx tried to prove that crisis and creation of Industrial Reserve Army of unemployed persons in the society are mainly due to the underconsumption by the workers as a result of accumulation of wealth by the capitalist who divert most of it on the further expansion of the fixed capital; Keynes tried to analyse it from the point of view of lack of effective demand, and imbalance between savings and investment that creates unemployment and crisis in an economy. Both wanted that the State must intervene in the economic affairs of the society, but the Marxians advocate for the obsolute power for the State, what Keynes called State Socialism, while Keynes advocated for the socialisation of investment' and wanted control by the

State for such aspects of the individuals' activities which are responsible for unemployment and general economic crisis. Keynes was not for "a system of state socialism which would embrace most of the economic life of the community".

In Marxian philosophy even the State has no role to play ultimately; in an ideal condition of communism there will be no necessity of state—the state will witherway. Keynes was more practical in providing only such role to the State to control the economy, removing most of the disadvantages of capitalist system and also of a command economy.

With regard to the strategy the State should adopt Marx and Keynes differed. Keynesian New Economics is demand side management through macro approach, while Marxian economics, his solution for an alternative system, mainly macro approach through supply side. To overcome the crisis permanently Marx advocated for ownership of all factors of production as well as production of all consumer goods by the State. To avoid exploitation of the workers he wanted entire control of the capital as well as consumer goods from the supply side so that there would not be any crisis of under-consumption or unemployment of human resources. Keynes wanted to regulate the economy through demand side; by nationalising such institutions in the economy so that there would not be any crisis due to deficiency in effective demand. Both Marx and Keynes were of the same opinion that it is the accumulation that creates crisis and advocated state intervention.

Economic planning is a part of socialism. Keynes was in favour of planning. In a letter to Mr. F. A. Von Hayak expressing opinion of Hayak's book, "The Road to Serfdom" Keynes wrote :

"I should say that what we want is not no planning or even less planning, indeed I should say that we almost certainly want more." With regard to the nature of planning he clearly views that ' the planning should take place in a community in which as many people as possible, both leaders and followers wholly share... Moderate planning will be safe if those carrying it out are rightly oriented in their own minds and hearts to the moral issues."

Keynes was for improving the lot of the poor quickly. He felt that far more progress was possible than was being made, but he viewed all this not for the sake of equality but to make their lives happier. He explained that 'good life' could not be provided for all in the present system but he firmly believed that day would come quickly in future. Keynes' practical mind was not dogmatic to maintain perfect equality in the economy. He was against the idea of "destroying any thing good in itself in the interest of equality" Elimination of wider inequalities in enjoyment of income and wealth is not simply a characteristic of socialist philosophy, for Keynes it is an economic necessity for a developed economy so that there would not be any deficiency in effective demand which is responsible for unemployment, poverty and crisis in the economy.

The above analysis of Keynesian writings clearly indicates the socialist bent of his mind. Without a bloody revolution to establish state socialism, in his peaceful revolution he transformed the 19th century Laissez Faire capitalism into democratic socialism. He conquered capitalism at the height of depression unaware, and to conceal their unawareness in the process of conversion the western world branded Keynes as a saviour of capitalism instead of honouring him as the originator of democratic socialism.

KEYNESIAN THEORY OF INTEREST-
A REALISTIC APPROACH

Sri Madhusudan Mohanty

An effective discussion of Keynesian theory of interest necessitates a comparative evaluation of all such theories, particularly, classical and neoclassical with that of Keynesian, in the light of their applicability to real world situations. A comprehensive perusal of the subject can be made from following angles.

WHY INTEREST RATE ARISES.

Classical thinkers believe that interest is a reward for abstinence (or sacrifice). Marshall opines that it is a price for waiting. Bohm Bawerk is of the view that it is a discount paid to induce people to postpone present consumption to a future date. Fisher holds that it is a discount against time preference of income holders. However all of them are unanimous in their opinion that interest is a reward for sacrifice.

The neo-classical economists like Wicksell, Ohlin, Robertson and Viner in their loanable funds theory lay emphasis on the monetary factors, such as, hoarding and dis-hoarding of money, money created by bank etc. But the classical real forces still assume a place of importance as the primary causative factor for interest in their theory.

Under full employment assumption to which the classical and neoclassical theories are wedded, the above arguments appear to be quite sound. But when the real world scenerio with unemployment reigning everywhere, is projected, the basis for interest in classical and neoclassical theory vanishes. In a full employment economy with given income, increase in saving for lending invariably reduces consumption and thus a sacrifice is involved, and consequently interest payment becomes imperative in order to induce people to make the sacrifice. But in an economy with unemployment which Keynes emphasized so vehemently investment can be carried on by utilising unemployed resources, whereby nobody's consumption is reduced nor any sacrifice is involved, and consequently, the question of interest payment would not arise, if classical theory were to be accepted. Empirically, such a situation is hardly conceivable, because borrowing involves interest payment, irrespective of the fact whether there is sacrifice or not.

Keynes theory of interest provides a realistic solution to this problem. The theory holds that interest is not a reward for waiting but a price paid for parting with liquidity. Everybody wants to maintain liquidity in order to satisfy his transaction, precautionary and speculative motive, and as such, he won't be inclined to lend his ready cash-reserve unless a monetary reward in the form of rate of intereat accrues to him. Thus this Keynesian proposition solve' the question as to why interest payment arises even in the presence of unemployed resources.

HOW INTEREST RATE IS DETERMINED:

Classical theory regards that the rate of interest is determined at the point where the supply of savings and demand for savings to invest coincide. It assumes savings and investments to be interest-elastic, i.e., $I = I(r)$, and $S = S(r)$. The equilibrium in the commodity market can be achieved when $I(r) = S(r)$ which implies $I(r) = Y - C(r)$. Since Y in a full employment economy is more or less fixed, equilibrium in classical frame work can be established by reducing consumption in face of an increased demand for investment. But empirically such a proposition is unsound because of the following reasons.

(i) A reduction in consumption expenditure by depressing aggregate demand will make profit-prospect bleak on the part of the investors, who in turn, will cut-down investment, because in real world investment depends not only upon r, but also on expected profitability, which is sustained by high level of aggregate demand.

(ii) Saving does not depend upon rate of interest. Unless ones income exceeds his consumption expenditure, he cannot save whatever may be the rate of interest. Therefore, in real world situation, $S \neq S(r)$, but $S = S(Y)$.

(iii) Since increased investment results in increased income and savings depend upon income, the impact of an increase in investment on rate of interest cannot be explained in isolation to the complete negligence of its impact on the saving schedule.

(iv) Since savers and investors very often constitute different groups of persons, it is very much likely that the saving schedule and investment schedule may not intersect in the positive quadrant, in which case the rate of interest becomes indeterminate.

(v) It involves circular reasoning in the sense that income cannot be determined unless the rate of interest, which influences investment and hence income, is known. On the other hand, r cannot be determined unless income, which affects saving and hence rate of interest, is known.

In order to solve these empirical flaws of classical theory, the neo-classical economists introduced other variables on both demand and supply sides of loanable funds. Apart from savings, dishoarding, bank money and disinvestment appear on the supply side and part from investment, dis-saving (consumption) and demand for hoarding figure on the demand side of loanable funds. Though by including a number of other variables especially the monetary factors, loanable funds theory marks an improvement over the classicals. It suffers from the same empirical limitations as that of their predecessors, because of their inherent similarity with them.

Keynes breaks the tradition of holding rate of interest as a real phenomenon. To him, it is purely a monetary phenomenon and depends upon the strength of the preference for liquidity in relation to total quantity of money available to satisfy the desire for liquidity. Like any price in a free market, it is established at a level where demand for money is equilibrated with supply available to meet the demand. At any time, an increase in the desire of public to hold cash will push up the price (interest rate) unless is accompanied by a simultaneous rise in money supply.

Since money is not produced by public, Keynes assigns a minor role to money supply in influencing rate of interest because as an instrument in the hands of the monetary authority it is more or less inflexible. It is the liquidity preference, that is quided by transaction, precautionary and speculative demands for money, which plays the dominant role in influencing r. Keynes makes his theory more realistic by emphasising the role of expectations through speculative demand for money, which, according to him, is the most important factor in affecting the rate of interest. Because of the change in expectations, the liquidity preference schedule may shift upwards or downwards, causing interest rate to increase for decline, even if the monetary authority makes adequate provisions to stabilise it through its influence on the supply of money.

By accepting rate of interest strictly as a monetary phenomenon Keynes theory is able to overcome all the empirical flaws of classical theory. Poindextar observes that the equilibrium in money market in Keynes theory corresponds to the equilibrium in the bonds market, because demand for money equals supply of bonds and supply of money equals demand for bonds. Thus r in Keynes theory established equilibrium in both money and bond markets. However, it is not free from the circular reasoning, that necessitates simultaneous determination of r and Y.

In post-Keynesian days Hicks and Hansen have devised a general model which establishes equilibrium in both commodity and money markets simultaneously. This goes by the name IS-IM analysis and overcome the circular reasoning by simultaneously determining rate of interest and income. This marks an improvement over Keynes theory by bringing some real factors in harmony with the monetary factors. However, it is undeniable that without liquidity preference theory, the general IS-IM model could not have been so realistic.

POLICY PROPOSALS

The empirical validity of Keynesian theory of interest is more pronounced in its policy proposals than in other theoretical developments.

First, in classical theory, any disequilibrium in commodity market is corrected by means of rate of interest. It is through the manipulation of rate of interest that the monetary authority can secure saving investment equality, and thus equilibrium in commodity market is established. For example, when investment exceeds savings, the interest rate will be pushed up imparting a favourable impact on saving and an adverse one on investment, and ultimately S–I equality is achieved But practically such simple adjustment is inconceivable because savings are not very much sensitive by rate of interest, rather they depend, to a great extent, on income. When investments exceed savings immediately income rises via multiplier and finally savings go up leading to the establishment of saving-investment equality. Thus adjustment via income appears to be more realistic a policy than adjustment through rate of interest.

Second, classical theory makes exclusive reliance on monetary policy in healing economic maladies of trade cycles. Following quantity theory approach, it suggests to increase the supply of money by easy money policy to cure depression, and the strategy during inflation should be a dear-money approach. But such proposals were invalidated during the Great Depression of 1930's, when no recovery could be obtained by injecting considerable amount of money to the economy. Classical theory keeps silent before such a situation. Keynes theory possesses a prolific answer to this question. In liquidity preference theory, rate of interest diminishes as money supply is boosted up, provided the liquidity preference schedule is unchanged. But in the face of a depression, when prices are constantly falling, preference of the public to hold cash increases and consequently the liquidity preference schedule shifts upward. As a result, rate of interest will have a tendency to increase inspite of the Govt's effort to lower it down through increased money supply. Higher interest-rate being detrimental to investment, the economy will have no recovery. Keynes goes further by claiming that even though the rate of interest is brought down to a very low level by deliberate Government policy, no desired improvement can be realised because rate of interest not only depends upon r, but on the relationship between r and marginal efficiency of capital (prospective yield of capital). The profit-prospect during depression being low due to the deficiency of aggregate demand, a low interest rate may not induce investors to come forward, and consequently, monetary policy, the only weapon in the hands of the classical thinkers, becomes abortive.

It is due to the failure of monetary policy, Keynes suggested fiscal policy to tackle the depressionary situation. Nobody, today disapproves the effectiveness of fiscal policy as a weapon against depression. This shows how Keynes was realistic in his policy proposals.

Third, many people believe that Keynes is anti-monetarist. Such an objection is highly ill-conceived. Had it been true, he would not have taken rate of interest as a determinant of investment in his General theory. Failure of r (monetary policy) to confront a specific economic situation (depression) and consequent application of another alternative policy (fiscal policy), does not necessarily imply ones complete disapproval of the former (monetary policy), which may be useful in some other situation In fact, in post-Keynesian days Hicks and Hansen, in their IS-IM analysis have shown two specific ranges for policy programmes. In the Keynesian range where income and interest are very low, particularly in a depressionary state, fiscal policy is highly effective to obtain recovery. In the classical range, where income and rate of interest are quite high, especially during inflation, monetary policy becomes more effective than the fiscal policy. In the intermediate range a monetary-fiscal policy-mix is imperative. Keynesians never disapprove monetary measures, rather they believe in the complementarity of both the policies in the intermediate range. But they understood the promptness of the effects of fiscal policy in relation to monetary policy on the economy. It is accepted that the monetary policy is persuasive whereas fiscal policy is coercive. It is, therefore, very much natural on the part of Keynes, who staunchly believes in the solution of short-run problems, to be inclined to fiscal policy. But use of a particular policy during a period when it is warranted should not spoil the realistic image of Keynesian theory.

CONCLUSION

Keynesian theory was designed to investigate the determinants of the overall level of employment in modern industrial economy. To that extent, its applicability, in the context of undeveloped countries, is limited. In the post-oil-crisis era, the Keynesian prescriptions do not seem to be fully applicable even to the industrialised economies. Hence, "the age of Keynes was for a time but not for all time". He was a practical thinker, and his prescriptions were effectively directed against the then problems, as he believed "in the longrun, all are dead." Due to the emergence of monetarists under the leadership of Milton Friedman, and changes in the economic situations, Keynesian theory may have lost its weight. But viewing a situation of 1930's, nobody can deny the fact it is the Keynes theory and Keynes theory alone, which can provide an effective solution, even today, if 1930 repeats,itself again.

JOHN MAYNARD KEYNES IN RETROSPECT

Sri Subodh Chandra Giri

Thirty years back modern economics was labelled 'Keynesian economics'. We have travelled a long way since then. The aim of this paper is to examine the legacy of John Maynard Keynes in the centenary year to commemorate this outstanding scholar of Economics and evaluate his contributions in a retrospective glance.

The classicals advocated the self-equilibrating character of the capitalistic economic order which was directly derived from Say's law of markets. This law stated that supply creates its own demand. Keynes challenged this doctrine on two grounds. Firstly he repudiated the assumption that unemployment would disappear if workers accept sufficiently low rate of wage and secondly he did not agree that the relationship between the saving was a function of rate of interest alone. Keynes was of the opinion that it is the level of income which determines the volume of saving. He also argued that general wage cut would reduce income, demand and employment. The classical thesis of automatic correction of upswing and downswing of the business activity through a flexible movement of interest rate was not vindicated during the prolonged depression of 1930's. At this crucial period, Keynes' analysis of depression and unemployment in terms of lack of effective demand and the remedial measure signalling public investment broke new grounds. He was responsible for redirecting the main thrust of economic thinking from micro level cost and price phenomena to a macro level where attention is focussed on the level of national income and employment.

Keynes' discovery of effective demand is composed of (a) consumption demand (b) investment demand. Since the consumption demand is more or less a stable function, investment demand has to be stepped up. But private investment is governed by marginal efficiency of capital and the rate of interest. However one may reduce the rate of interest, private investment cannot pick up during depression where marginal efficiency of capital is low. In a flash of moment Keynes visualised that the public investment under the aegis of the Government was the only way out. He prescribed public investment in the form of public welfare programme. The industrially developed capitalist countries of the western Europe and a short time after, the United States heeded this advice and started recovery in a miraculous way. Thus Keynesian revolution was waged and Keynesian economics arrived.

Milton Friedman set up permanent income hypothesis of consumption function. To him actual income may be subject to temporary windfall gains and losses. Therefore, it should be broken up into 'permanent' and 'transitory' components. Thus permanent consumption should be related to permanent income.

According to Friedman, when consumption is a function of permanent income, a rise in actual income would be expected to affect the consumption only, if such a rise is of permanent nature, so that consumer's permanent income rises. However, the direct effect of a change in current income on permanent income usually being very small, there remains a low marginal propensity to consume. If, however, an increase in income is expected to lead to a greater rise in the permanent income than it was originally thought, then the marginal propensity to consume would tend to be very high. In practice, however, it is difficult to measure the effect of a change in actual current income on permanent income; hence it is also difficult to visualise its effect on consumption. This means, the marginal propensity to consume in a community is very unstable and unpredictable.

Keynes, showed the impact of investment upon national income and employment through multiplier but neglected acceleration. It was post-Keynesians like Hansen who combined both multiplier and accelerator and derived important principle of income generation and income fluctuation.

A simple prescription for the Government to lower tax rates and increasing spending actually did make good sense in the early 1930s when grass grew in Main Street and one bank failure led to another. But in due course of time as Samuelson says "this simple Keynesianism is dead". He writes, "What remains alive, however, is the apparatus of thought born with Keynes which recognises that the supply of jobs and the supply of workers who want jobs are not automatically brought into balance in the short-run by economic forces and that Government should not be a silent spectator of the sadistic view."

Towards the beginning of 1939, Keynes turned his attention towards inflation. He explained it through inflationary gap. The inflationary gap for the economy as a whole may be defined as "an excess of anticipated total expenditure over the money value of available output at base prices". The modern analysis of inflation runs in terms of an amalgam of demand pull, cost push, monetary and institutional factors. Shapiro has demonstrated the interaction between demand pull and cost push fectors.

Post-Keynesians have gone far deyond 1936 Keynesianism in other directions too. Franco Modigliani of M. I. T, has showed that people's spending depends not only on their current incomes, as Keynes had said, but also on their accumulated holdings of liquid wealth money, bank accounts and other very liquid assets— plus other assets such as equities, long-term bonds and homes. Then again, James Tobin of Yale University has improved on Keynes' theory of demand for money in the 1960s' and showed how interest rate affects money velocity— the rate at which money changes hands in the economy.

Moreover, the shadow of Keynes hovers over the most aconometric models of today. The Wharton model at the University of Pensylvania and the DRI model in Harvard are a far cry from 1936 "Model T" version of Keynes. But the basic methodology is much closer to the Keynes' general theory. It is like the relationship of the modern jet-liner to the Write brothers' original model.

Monetary policy was completely amasculated by Keynes. He argued that as a result of the liquidity trap and the wage price rigidities, an expansionary monetary policy will fail to prove to be an effective remedy for unemployment. But monetarism emphasises the critical importance of money supply in determining the level of total output of goods and services in a nation's economy. This sharply contradicts the great depression version of Keynes, which establishes the importance of fiscal policy and undermines the monetary policy. Monetarists like Friedman of Chicago and his disciple Karl Brunner of University of Rochester doubt that freezing the money supply for all time to come is the best way to run an economy.

Keynes has criticised the classical theory of interest as indeterminate. Hazlitt argues that the same criticism is valid for Keynes' Liquidity Preference theory. Modern economists like Hicks and Hansen constructed IS-LM functions which are a determinate theory of interest.

Keynes was born in a reputed English family. He was a brilliant product of Cambridge University. As a youngster he virtually ran the

British Treasury during world War-I. In 1925, Keynes warned Winston Churchil against the folly of England's return to gold standard. But his suggestions were trampled. Britain had to suffer a lot due to mass unemployment and she lost her position as a leading economic power. He has made important contribution in the field of Indian monetary management.

Keynes' name is indelibly linked with Brettonwoods conference which advocated a system of fixed exchange rates. This system lasted until 1971 and may emerge again. Keynes' formulation of a plan to tackle the transfer problem arising out of international trade and reparation payment to war-torn countries is regarded as an important contribution to-day.

Karl Marx sounded the death knell of capitalism. But it is Keynes whose touch rejuvenated the capitalist system. In the long run however, Paul Samuelson says "his prescription of public investment in its most simple form has defeated itself as the obligation to run a full-employment humanitarian state caused modern economics to succumb to the new disease of stagflation— high inflation along with joblessness and excess capacity"

Keynes is dead. But the General Theory of Employment, Interest and Money continues to sell in large numbers.

J. M. KEYNES AND CONTEMPORARY WORLD ECONOMY

Sri G. B. Nath

The year Nineteen eighty three is quite significant to us for a number of reasons. First, this year marks the Death Centenary of Karl Marx, the revolutionary economist who fathered the scientific socialism. Second, this is the year for the Birth Centenary of John Maynard Keynes (1883-1946), the great monetary economist. Third, on 5th August' 1983 we lost Joan Robinson the great Keynesian Economist.

The appearance of Keynes theory was the most important event in bourgeoise political economy. Not only Keynes but his well known followers like R. F. Harrod, Evsey D. Domar, Alvin H. Hansen and Joan Robinson have made a tremendous influence on the policy making of the world economy, is a divided house today. Fierce competition is going on between the capitalist system and socialist system, between the advance countries and under developed and also within the capitalist system itself.

Then what is the relevance of Keynes today ? J. A. Schumpeter writes in his book "Ten Great Economists" Practical Keynesianism is a seeding which cannot be transplanted into foreign soil, it dies there and becomes poisonous before it dies.... Left in English Soil, this seedling is a healthy thing and promises both fruit and shade... all this applies to every bit of advice that Keynes offered". But it can be demonstrated taking into consideration the level of economic development of the top five developed capitalist countries of the world like U.S.A., Britain, France, West Germany and Japan that these countries are facing acute economic crisis due to inter imperialist competition to appropriate the profit by capturing the world market.

Has the Keynesian political economy given any answer to avert such crisis in capitalist economy ? More over the under developed countries in general and India in particular have seen development for the few and under development for majority. Money wage is increasing but real wage is falling. Unemployment, under employment, disguised unemployment is the order of the day. But by following Keynesian advice the state is spending large amount of resources to maintain the status-quo which is very dear to Keynes. I sincerly feel that the application of Keynesian prescription has only delayed the breaking down of the capitalist economic system due to its own failure. But it can never combat final break down.

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