CHAPTER 5

SUMMARY OF

RECOMMENDATIONS
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1. Introduction

In the previous chapter, a summary of findings of this study was furnished. In this chapter, the Researcher's recommendations in the context of the findings arrived at are furnished.

2. Summary of Recommendations

The following is the summary of findings:

1. Revenue receipts of the government are an aggregation of tax revenues and other revenues, capital receipts being items like market loans raised by the government, borrowings from the RBI through sale of treasury bills, loans from foreign bodies and recovery of past loans represent liabilities. Ideally, liabilities should come down and revenues should go up. The correlation coefficient in the circumstances should be low unlike a high 0.84 that we now witness. The government should restrict borrowings and improve collection of taxes. This does not mean taxes should be hiked because it is high already - what it means is that tax defaulters should be ferreted out and punished exemplarily. This is possible only when the
unholy nexus which does obtain to a certain extent between the tax administration and the tax-paying public is broken. The earlier the government acts in the matter, the better.

2. Receipts on public account have been volatile. In respect of these receipts, the government acts more as a banker - for example, transactions relating to provident funds, small savings collections, other deposits and so on. In other words, these are liabilities which need not be acquired unless government is in dire need of funds or the government can raise resources cheaply. Not long ago, government tapped small savings to raise cheap borrowings. This practice has since been given up as market borrowings come cheaper. Even the Food Corporation of India has minimised bank borrowings for similar reasons. Hence volatility concerning public account receipts need not concern the government.

3. Of the three items, viz., revenue receipts, capital account receipts and public account receipts, the first two are tractable. When the volatility is occasioned by either revenue receipts or capital account receipts or both, the government has to set right the volatility by performing consistently in collection of revenues and in raising borrowings. The collection machinery has to be fine-tuned for better performance and borrowings should be gradually brought down through prudent financial and fiscal management as is being done presently through the MTFP. This will go a long way in
subduing the degree of volatility attaching to total receipts. As regards the volatility attaching to the other component, viz., public account receipts, the government cannot do much. After all, in respect of this component, the government is only the custodian of public money. The standard deviation can be considerably narrowed by following the measures recommended.

4. Barring a couple of occasions, revenue expenditure and capital a/c disbursements of the government have tended to move together. The statistical tool which is 0.89 or close to unity also confirms this trend. Theoretically, revenue expenditure should move in tandem with capital account disbursements. But this does not mean that the two should move so closely as to result in a correlation coefficient of 0.89. Although revenue expenditure tends to increase with increase in capital expenditure, this increase can be tempered by factors like economy of scale, cost-cutting, downsizing of personnel, etc. These measures can considerably bring down this high degree of correlation between the two items. Computerisation, for example can bring down expenditure significantly; so can accountability which can prevent the occurrence of cost overrun and time overrun. Government's withdrawal from businesses which have witnessed complete erosion of capital should also be seriously considered since it is not the government's business to be in business. It has to provide the enabling environment in the form of appropriate social
infrastructure, appropriate industrial infrastructure, etc. It should leave the rest to the market, viz., investors and entrepreneurs.

5. For the year ending 2001-02 and 2002-03, revenue expenditure has remained almost the same but during 2003-04, it has increased significantly. The latter is inexplicable considering that no revenue-draining activity like pay hike for government staff has been taken up during the year. The volatility in growth rate in revenue expenditure only indicates that financial discipline was lacking on the part of the government. Cost-cutting measures need to be contextually identified and promptly enforced as explained in the previous paragraphs.

6. Only thrice (1993-94, 1995-96 and 2004-05) during the period under review have the revenue receipts exceeded the revenue expenditure; the surplus was not significant either. All the same, it is an achievement of sorts given the propensity of governments to spend more than what they earn. It only shows that given the willpower, government can cut down on expenses and register improvement in collection of revenues. The implication is that the willpower was conspicuous by its absence in the other years. No magic wand is needed to achieve this goal except sincere efforts on the part of the government. However, mere carrots cannot do the job. Government should follow the carrot and stick policy towards its workforce to optimise revenue generation. Performing staff should be
rewarded in the form of promotion etc while the laggards should be punished through measures like denial of promotion, demotion in rank, etc. On its part, the government should give a free hand to the workforce.

7. Revenue surplus has been achieved only during three years out of the ten years reviewed, viz., the years are 1993-94, 1995-96 and 2004-05. This is surprising considering that the post-1996 phase has seen Karnataka's economy growing from strength to strength, thanks to its IT sector growing exponentially and other sectors looking up in general. If even during this phase the government could not achieve a revenue surplus, even if modest, then something has gone seriously wrong somewhere. There can be no excuse for this poor show. A lax revenue collection machinery and poor financial management alone are responsible for this state of affairs. The remedy lies, as reiterated in the earlier paragraphs, in improving collection and cutting down on costs.

8. Revenue expenditure on account of general services has tended to accelerate from the year 1996-97. This trend unfortunately manifests itself in almost all State budgets. Expenditure on account of general services represents expenditure related to organs of State, fiscal services, interest payments and servicing of debt, administrative services and pension. Interest payments and servicing of debt cannot be wished away. They will have to be paid in hard cash. Expenditure incurred for rendering fiscal
services can be made more useful if revenue collection is improved. There is not much leeway available in respect of expenditure incurred on pension payments and administrative services. The ratio of expenditure on fiscal services to revenue collection should come down. So should the ratio of expenditure on administrative services to revenue collection. Revenue expenditure on account of economic services covers agriculture and allied activities, rural development, special area programme, irrigation and flood control, energy, industries and minerals, transport, science, technology and environment and general economic services. It is not advisable to skimp on any of these items owing to their relevance to the State’s economy although it is essential to ensure the end-use of the scarce but precious resources spent on these items. Social services cover education, sports, art, culture, health and family welfare, water supply, sanitation and housing, information and broadcasting, welfare of SC/ST/OBCs, labour and labour welfare, social welfare and nutrition and others. Here too, the State cannot afford to skimp although the end-use of the resources spent should be ensured. Spending on social services is nothing but investment in social infrastructure which is as vital industrial infrastructure for the growth of the State’s economy. Cutting corners will not help here owing the relevance of social infrastructure to economic growth. But the question is whether the expenditure percolates to the targeted masses. The percolation level has not been up to the mark if past experience is anything to go by. The State will ignore economic
expenditure and social expenditure at its own peril. Spending on social and economic services in a focused manner will, apart from leading to swift recovery of the investment, result in long-term benefits for the State's economy.

9. An increase in expenditure on economic services has led to more or less a proportionate increase in expenditure on social services – more or less similar because the correlation coefficient between the two, viz, 0.99 is almost perfectly positive. Expenditure on economic services is as important as expenditure on social services. It is not possible to say which is more important of the two. If one takes a look at advanced economies like USA, one will realise that it is because of their large expenditure on economic services and social services, they are what they are; conversely it is because of our insignificant expenditure on these services, we are what we are. It is not possible to cap the expenditure to be incurred in these two services since the benefits are proportionate to the expenditure committed. In the case of a growing economy like India, we can only state that our commitment to the two services should be as large as possible.

10. Expenditure on economic services and general services too has moved together though to a slightly lesser degree, as evidenced by a slightly lower correlation coefficient of 0.93. This is unfortunate since expenditure on economic services should be way ahead of expenditure on general
services in view of the higher degree of relevance of the former to the economy. It is not possible to cut back on expenditure on general services although it is possible to rein in such expenditure. However in the case of economic services the opposite action is required, viz., increasing expenditure. Focused spending on economic services will return the investment swiftly and what is more, the government can hope to receive a stream of benefits in the future from such spending.

11. Expenditure on social services and general services has moved in tandem; the correlation coefficient between the two is 0.94. This is unfortunate since expenditure on social services is a proxy for investment in social infrastructure, as said earlier. On the other hand, general services had better be reined in since its ratio to the former should be as low as possible. Expenditure on general services are more or less sunk costs and do not generate a stream of benefits for the government in the future.

12. Employee strength hit a trough of 4,96,921 in the year 1991-92. It peaked in 1999-00 with 6,39,331 employees after which there has been a fall, albeit gradual in employee strength. As of 2004-05, the number was only 6,18,826. Governments the world over are trying to become lean and mean which means with minimal input they would like to reap maximum output. Well, government being government, this is easier said than done.
However, on this pretext the government cannot afford to bite off more than what it can chew since the government alone will be blamed if at a later stage, it is unable to pay salaries to its employees or it is unable to pay pension to retired employees. Digitisation of hard files or computerisation should be taken up in all spheres of government activity to tone up its functioning. It will lead to a surplus in staff. Being government, it cannot afford to terminate the services of employees who are in surplus. All the same these surplus employees can be used to fill in vacancies, immediately or in the future. At least that way, future recruitment can be controlled, employee productivity can be increased and investment in information technology can be optimised.

13. Salary expenditure on the other hand, does not reflect volatility of a similar degree although it has been increasing too. Digitising more and more of government files will certainly bring down the need to recruit personnel further. As a matter of fact, the government will be left with a surplus. This will help in controlling if not capping salary expenditure.

14. The correlation coefficient, which is a high 0.91 indicates that employee strength and salary expenditure have moved almost hand-in-hand which does not augur well for the financial health of the government. But there is no way out of this stalemate since being the government, it cannot sack
serving employees. It can at best control future recruitment. But the government should learn from past mistakes.

5. A comparison between salary expenditure and pension expenditure presents a disconcerting picture indeed. The co-movement between the two items of expenditure is almost perfectly positive, as indicated by the high level of correlation coefficient of 0.98 (after rounding off), just 0.02 less than 1. This is true of every government and can be attributed to the reluctance on the part of governments, State / Central, to introduce pension reforms. A defined-contribution pension scheme should be introduced in lieu of the defined-benefit pension scheme that is in force now. Of course the new pension scheme is an improvement over the earlier scheme but it is still inadequate. More importantly, the management of the corpus of the pension fund should be entrusted to professionals instead of entrusting it to traditional agencies. Regulatory relaxation facilitating investment of a part of the corpus in capital market securities should be permitted immediately. The burden of pension will not weigh heavily on the government once this is done.

16. Even more disconcerting is the fact that pension which accounted for just 19.71% of salary expenditure in 1995-96, increased to 38.50% of salary expenditure in 2004-05. At this rate, before long, pension expenditure will surpass salary expenditure. This is already true in the case of the
country’s armed forces. Other employees cannot hope to be pampered a
la our armed forces for obvious reasons. As said earlier, pension reforms
are overdue and once they are introduced, government’s pension liabilities
will come down significantly.

17. By the year 2014-15, revenue expenditure will mount to Rs 42,532.98
crores and capital account disbursement will mount to Rs 11,797.81
crores.

18. The gradually increasing divergence between the two trendlines is a
telltale sign of things to come – the gulf between revenue expenditure and
revenue receipts does not bode well for prudent management of public
expenditure.

19. With each passing year, the growth in salary expenditure has been
alarming. For the year ending 2015, it is projected at Rs 9,425.42 crores
compared to a mere Rs 2,480.74 for the year ending 1995-96. This
represents a compounded annual growth rate (CAGR) of 7.28%.

20. Pension expenditure will touch Rs 4,100.39 crores by 2014-15 from a
mere Rs 558.55 crores in 1995-96. This implies that pension liability will
grow at a CAGR of 11.06%. This compares unfavourably with the CAGR
of 7.28% associated with salary expenditure.
Tax revenue has declined from 66% to 63% in 2006-07. Non-tax revenue and devolution from the Centre have remained more or less constant. Grants from the Centre have increased to 13% from 9%.

The gulf between revenue expenditure and capital account disbursement can be narrowed down only after the measures recommended in the earlier paragraphs are implemented in all seriousness. Pension and salaries will become unmanageable if pension reforms are not promptly enforced and computerisation is not taken up wholeheartedly.

The government has made a good beginning by going in for MTFP for the period 2006-10. But it remains to be seen if the government will stick it out or will treat this as a one-off experiment.

Medium Term Fiscal Plan (MTFP), 2006-10

22. A decline in tax revenue is unacceptable given the fact that even the GoI has been doing well on the tax collection front, be it direct taxes or indirect taxes. Either tax evasion is not being taken notice of by the government for whatever reason or there is to some extent an unholy alliance between the tax administration and the taxpayer.

23. Given willpower, it is possible to hold interest cost, salaries and pension. It is also possible to reduce subsidy of the general kind or power subsidy,
as the government has found out to its surprise. Government should approach the issues positively even if it is politically inconvenient. This is true of other revenue expenditure too. If devolution to urban local bodies has remained constant, then decentralisation as envisaged has not been achieved.

Performance of the State's economy in 2004-05 and 2005-06 consecutively in terms of growth in Gross State Domestic Product (GSDP) has been far better than that of the previous two years, due to a strong agricultural recovery supplemented by improved power supply position. A quick estimate of 2004-05 has revealed a remarkable growth of 10.2%, much higher than the all-India average of 7.5% during 2004-05. However for 2005-06 the estimated growth rate of the State is 8.7%. The reduction in the growth of GSDP in 2005-06 is mainly attributed to the slow growth of the primary sector. The floods of July and September 2006 devastated agricultural crops in Karnataka at least in parts. Despite these problems the projected total growth rate of GSDP in 2005-06 is higher than the projected national average of 8.1% for 05-06. The advance estimate of GSDP growth in primary sector consisting of agriculture, forestry and logging, fishing, mining and quarrying is 6.4% during 2005-06. The secondary and tertiary sectors are expected to maintain their overall growth trends. GSDP is not significantly influenced by the primary sector these days. Primary sector's down-slide is more than compensated by the
healthy growth one witnesses in the secondary and tertiary sectors. To improve agricultural performance, the government should come up with path-breaking reforms like the amendment of the APMC Act. It will help farmers realise better prices for their produce. More private investments will flow into the agricultural sector. Contract farming will pick up. Organised retail will procure directly from the agriculturists. Private markets will come into being. Agriculture will no longer be the proverbial albatross round the government’s neck. According to an Asian Development Bank (ADB) study, an estimated sum of Rs. 50,000 crores is lost annually in the marketing chain owing to poor marketing infrastructure and controls in India. If private investments can minimise this loss, why should the government come in the way?

25. If collection of MVT has decelerated in 2005-06 it is an anomaly. The performance on the motor vehicle tax front is anomalous considering that with each passing day; more number of vehicles are sold. The trend should have reflected a consistent secular rise in respect of MVT. It is to be ascertained whether the lackadaisical performance on the MVT front is on account of an ambitious budget estimate or on account of genuine failure on the part of the governmental machinery.