V. BUDGETARY TRENDS AND FISCAL POLICY

153. The events of 1971-72 were of far reaching significance for the Indian economy and affected profoundly the budgetary developments, both in 1971-72 and 1972-73. The big spurt in public expenditure in 1971-72, resulting largely from the expenditure on refugee relief and war with Pakistan disturbed the balance between aggregate demand and aggregate supply in the economy, consequences of which though not very much apparent in that year itself, have become pronounced in the course of the current fiscal year. As a backdrop to current year’s fiscal developments, a brief resume of the state of Government finances in 1971-72 therefore appears necessary.

Budgetary Developments in 1971-72

154. The combined revised estimates of the budgetary transactions of the Central and State Governments for 1971-72 reveal that the gap between total outlay and current revenues turned out to be of the order of Rs. 2839 crores as compared to the original budget expectation of Rs. 2192 crores. Additional resource effort (including changes in railway freight rates and fares) undertaken by the Central Government through the May 1971 budget and the two supplementary proposals introduced in October and December, 1971 was expected to yield Rs. 295 crores in 1971-72 (about Rs. 500 crores in a full year) and that undertaken by the State Governments another Rs. 50 crores (including Rs. 9 crores earmarked for refugee relief). However, the improvement in revenue receipts as a result of additional tax measures, was more than offset by a sharp increase in Government outlays. Compared to the budget estimates for 1971-72, the revised estimates revealed a step-up of Rs. 129 crores in developmental expenditures and of Rs. 791 crores in non-developmental expenditures, the latter being accounted for mainly by increases in expenditure on refugees (Rs. 265 crores), defence outlay (Rs. 169 crores), assistance to Bangladesh (Rs. 62 crores), famine relief (Rs. 128 crores) and revision of pay, interim relief and dearness allowance etc. by both the Central and State Governments (Rs. 133 crores).
### Table VI

**Budgetary Transactions of the Central and State Governments**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Total Outlay</td>
<td>8207</td>
<td>8955</td>
<td>9875</td>
<td>10273</td>
</tr>
<tr>
<td>(a) Developmental;</td>
<td>4716</td>
<td>5405</td>
<td>5534*</td>
<td>5984</td>
</tr>
<tr>
<td>(b) Non-developmental;</td>
<td>3491**</td>
<td>3550</td>
<td>4341@@</td>
<td>4292</td>
</tr>
<tr>
<td>II. Current Revenues</td>
<td>6064</td>
<td>6763</td>
<td>7036</td>
<td>8001</td>
</tr>
<tr>
<td>III. Gap (I-II)</td>
<td>2143</td>
<td>2192</td>
<td>2839</td>
<td>2272</td>
</tr>
</tbody>
</table>

**Financed by:**

(i) Draft on voluntary domestic private savings | 1337 | 1300 | 1577 | 1589 |
(ii) Draft on foreign savings | 382 | 461 | 502 | 380 |
(iii) Foreign assistance earmarked for refugee relief | .. | .. | 120 | 10 |
(iv) Budgetary deficit | 424 | 431 | 640 | 293 |

*Excludes national entry of Rs. 212 crores on account of conversion of loan capital into equity capital in respect of Public Undertakings.

@Excludes Contingency Fund transactions of the Central and State Governments—Rs. 32 crores in 1970-71, Rs. 88 crores in 1971-72 (RE) and Rs. (—) 58 crores in 1972-73.

**Excludes subscriptions to IMF, IBRD in negotiable securities amounting to Rs. 115 crores.

@@Includes Rs. 325 crores on account of expenditure on refugee relief.

†As per accounts. Does not include R.B.I.’s transactions in long-dated securities. Adjusted for that, deficit financing works out to Rs. 710 crores for 1971-72.

155. The gap between total outlays and current revenues was partly met by an increased resort to the Government’s draft on private domestic savings; the net market borrowing by the Central Government in 1971-72 showed an increase of Rs. 126 crores over the budget provision. In the revised estimates, the utilisation of foreign aid was also higher, despite the disruption of aid. Besides, external sources provided an earmarked assistance of Rs. 120 crores for meeting expenditure on refugees from Bangladesh. Nonetheless, the budgetary operations of the Central and
State Governments resulted in an overall deficit of Rs. 738* crores which was the largest ever in any single year and far exceeded the earlier heaviest deficit of Rs. 502 crores recorded in 1957-58. Such a huge deficit could not but have its repercussions on the monetary situation and its lagged effects have become evident in the course of the current fiscal year.

**Budgetary Developments in 1972-73**

156. Presented against the background of a difficult economic situation, the most urgent tasks to which the Central Budget for 1972-73 had to address itself were to contain the inflationary pressures and to accelerate the tempo of developmental activity while ensuring greater social justice and self-reliance. Therefore, while providing for substantial step-up in the Plan expenditure, the growth of non-developmental expenditure was sought to be restricted and further taxation was undertaken in order to contain deficit financing within reasonable limits. The Central Budget for 1972-73 made a total Plan provision of Rs. 2569 crores which was 14.7 per cent higher than the budgetary allocation in the preceding year. Out of this total, a provision of Rs. 1787 crores was made for the central Plan and centrally sponsored schemes (22.8 per cent more than in the preceding year) and Rs. 720 crores were earmarked for Plan assistance to States and Rs. 62 crores for assistance to Union Territories. Inclusive of resources to be raised by State Governments, non-departmental undertakings and financial institutions etc., the total provision for Plan outlay in the public sector was estimated at Rs. 3973 crores, which represented an increase of about 26 per cent over the 1971-72 budgeted level of Rs. 3158 crores. At the same time, the total non-developmental expenditure of the Central and State Governments was expected to show a decline of 1.1 per cent in 1972-73 as compared to the revised estimates for 1971-72. While expenditure on refugee relief accounted for only Rs. 10 crores, provision had to be made for assistance to Bangladesh, continued increase in the debt servicing charges and larger outlay on food subsidy consequent on the substitution of indigenously procured foodgrains for the concessional foodgrains imported from abroad.

157. As a result of the additional resource effort undertaken in 1971-72 and the measures adopted both by the Central and State Governments in 1972-73, total tax revenues of the Central and State-Governments budgeted at Rs. 6316 crores for 1972-73 were expected to show an increase of 13.8

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

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

72 M of Fin.—4
per cent over the preceding year's level. Due to the marked buoyancy in
tax receipts of both Central and State Governments, the proportion of tax
revenue to national income (at market prices) was expected to show some
further rise over the ratio of about 14 per cent attained in 1971-72.

158. The fresh taxes imposed by the Central Government in 1972-73
were estimated to yield Rs. 171.7 crores of which Rs. 16.5 crores were to
come from direct taxes and the remainder from customs and excise duties.
Increases in railway freights and fares were expected to bring another
Rs. 17 crores. The States' share in the Centre's additional tax effort was
reckoned at Rs. 48 crores.

159. The budget left unaffected rates of personal income tax, the only
major change being that certain casual and non-recurring receipts (e.g.
income from crossword puzzles, races, cardgames etc.) which were earlier
exempt from personal income tax were made liable to tax as capital gains.
However, in the case of corporation tax, the 2.5 per cent surcharge levied
in December, 1971, was raised to 5 per cent and the special deduction for
priority industries which had been reduced from 8 per cent to 5 per cent
in 1971-72 was completely withdrawn.

160. In respect of indirect taxes, whereas the preceding year's budget
had widened the tax base of excise duties by bringing in 24 new items,
1972-73 measures were confined to revising upwards the duties on existing
items. Some of these upward adjustments were a result of the implementa-
tion of the National Development Council's decision to increase the rates
of additional excise duty which accrues to States in lieu of sales tax, and
some were on account of the merger of basic and special duties in accor-
dance with the Fifth Finance Commission's Award. The excise duty on
items like steel was raised to bridge the gap between domestic and interna-
tional prices and on kerosene was raised to reduce the pressure on the
balance of payments. The increase in excise duty on fertilisers from 10 per
cent to 15 per cent and the imposition of 10 per cent duty on power driven
pumps (in 1971-72, a duty on agricultural tractors had been imposed) was
intended to tax high income groups in the rural sector, within the constraints
of the Constitution. In respect of certain categories of imports, the
Government also raised the rates of regulatory duty on imports imposed
in December 1971.

161. Taking together expenditures and receipts, both on revenue and
capital accounts, the overall budgetary deficit of Central and State Govern-
ments for 1972-73 was estimated at Rs. 293 crores (Rs. 252 crores at the
Centre and Rs. 41 crores in States) as compared to an overall deficit of
Rs. 738 crores for 1971-72. However, if adjustments are made for the
States' share in the additional taxation by the Centre which has not been
taken credit for in the State budgets and also for certain proposals of the
States to raise additional resources, the budget estimates of State Govern-
ments for 1972-73 would reveal a small surplus instead of a deficit.

162. In order to assess the budget's economic impact, attention needs
to be focussed on a reclassification of Government expenditures and receipts
in terms of economic categories. Such a reclassification is available in
respect of the Central Budget. This reveals that while the growth of the
Central Government's consumption expenditure budgeted for 1972-73
worked out to 2.5 per cent as against an increase of 14.9 per cent recorded in 1971-72, the aggregate provision for gross capital formation by the Central Government was expected to rise by 12.2 per cent in 1972-73. The financing pattern shows that gross savings of the Central Government and its departmental undertakings which declined from Rs. 403 crores in 1970-71 to Rs. 306 crores in 1971-72 (R.E.) were estimated to rise to Rs. 741 crores in 1972-73 (B.E.). The draft by way of domestic capital receipts was also estimated to be larger as compared to the preceding year; on the other hand, the draft on foreign savings in 1972-73 was expected to be smaller both in absolute terms and in terms of percentage to the total capital formation.

**Table VII**

*Capital formation by the Central Government and its financing (Rs. crores)*

<table>
<thead>
<tr>
<th></th>
<th>1970-71 (Accounts)</th>
<th>1971-72 (Revised)</th>
<th>1972-73 (Budget)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Gross capital formation out of the budgetary resources of the Central Government</td>
<td>1804*</td>
<td>2176</td>
<td>2441</td>
</tr>
<tr>
<td>(i) Gross capital formation by the Central Government</td>
<td>519</td>
<td>611</td>
<td>724</td>
</tr>
<tr>
<td>(ii) Financial assistance for capital formation to the rest of the economy</td>
<td>1285*</td>
<td>1565</td>
<td>1717</td>
</tr>
<tr>
<td>II. Gross Savings by the Central Govt.</td>
<td>403</td>
<td>306</td>
<td>741</td>
</tr>
<tr>
<td>III. Deficit (I-II)</td>
<td>1401</td>
<td>1870</td>
<td>1700</td>
</tr>
<tr>
<td>Financed by:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV. Draft on other sectors of the domestic economy</td>
<td>1019</td>
<td>1368</td>
<td>1320</td>
</tr>
<tr>
<td>(i) Domestic capital receipts</td>
<td>693</td>
<td>983</td>
<td>1068</td>
</tr>
<tr>
<td>(ii) Budgetary deficit</td>
<td>326</td>
<td>385(460)†</td>
<td>252</td>
</tr>
<tr>
<td>V. Draft on foreign saving</td>
<td>382</td>
<td>502</td>
<td>380</td>
</tr>
</tbody>
</table>

*Excludes compensation paid to Nationalised Banks amounting to Rs. 84 crores.
†As per accounts. Does not include RBI’s transactions in long-dated securities.

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

163. Besides capital formation, the Central Government’s outlays on development include current expenditure on social and economic services. The economic and functional classification of the Central Government budget for 1972-73 reveals that the total expenditure on social and economic services, which corresponds broadly to total developmental outlay on both Plan and non-Plan accounts, was envisaged to be of the order of Rs. 3543 crores and formed 52 per cent of the entire expenditure for that year. Compared to the preceding year’s provision, the budgetary allocation for social and economic services for 1972-73 went up by 13 per cent.
164. What also needs to be stressed in this context is that since 1970-71, the Central Government has been taking bold initiatives in implementing schemes which combine the elements of both social welfare and growth and are specifically designed to help the needy and under-privileged sections of the community. The 1970-71 budget thus made specific provisions for schemes for small farmers, marginal farmers and agricultural labour, special nutrition programmes for children, housing and urban development, rural drinking water supply and social security benefits for industrial workers and Government employees. In the 1971-72 budget, these initiatives were carried further when a specific provision of Rs. 50 crores was made for the crash programme of rural employment and another Rs. 25 crores provided for the educated unemployed. In the Central budget for 1972-73, the provision for such social welfare schemes was substantially raised to Rs. 240 crores; this included a lump sum provision of Rs. 125 crores to cover the requirements of rural water supply, rural home sites, slum clearance, primary education and schemes for educated unemployed and of Rs. 72 crores for the continuance of the crash programme for rural employment, rural works programme in drought prone areas and programmes for dry farming development. Also the budgetary provision for small farmers development agencies and for marginal farmers and agricultural labour programme was doubled and the outlay on special nutrition programmes for children stepped up from Rs. 11 crores in 1971-72 to Rs. 21.5 crores in 1972-73.

165. The trends in the Central Government's receipts and expenditure in the current year so far indicate that tax revenues are likely to be larger than visualised at the time of the budget. Likewise, both small savings collections and market borrowings are expected to register substantial improvement over the budget estimates. The market borrowing undertaken by the Central Government is expected to yield Rs. 478 crores, in the net, which is Rs. 263 crores more than the budget provision and Rs. 184 crores higher than the total net realisation in 1971-72. On the side of expenditures, outlays on defence, assistance to States for natural calamities and the provision for food subsidy are expected to be larger than what was originally visualised. Also, the Central Government has already provided through the Supplementary Demands for a sum of Rs. 32 crores for compensation payments in respect of General Insurance and Rs. 250 crores for additional loans to States for stepping up food production and relief expenditure. Even after allowing for some shortfalls in Plan outlay in the Central sector it appears that the revised estimates may reveal an overall deficit larger than the original anticipation of Rs. 252 crores.

Performance of Public Undertakings

166. The performance of non-departmental commercial undertakings of the Central Government reveals that the accumulation of surpluses for financing further development has been scarcely adequate in relation to a total investment of over Rs. 5000 crores made in these enterprises. In 1971-72, 84 non-departmental commercial undertakings (including Hindustan Steel) incurred a total net loss of Rs. 18.8 crores as against an aggregate net loss of Rs. 2.5 crores in 1970-71. However, some improvement in the working of public enterprises other than Hindustan Steel was noticeable during 1971-72. During that year, 83 of these non-departmental commercial undertakings other than Hindustan Steel made a net profit of Rs.
26.8 crores as against a net profit of Rs. 2.2 crores in 1970-71. In 1971-72, concerns making profits numbered 53 and their profits amounted to Rs. 98.4 crores whereas there were 30 concerns which incurred an aggregate net loss of Rs. 71.6 crores. The rate of return by way of gross profits (after providing for working expenses and depreciation but before deducting interest) to capital employed, in respect of the 83 undertakings other than Hindustan Steel worked out to 5.9 per cent in 1971-72 as against 4.3 per cent during the preceding year. There was however, a marked deterioration in the financial performance of the Hindustan Steel whose net loss increased from Rs. 4.72 crores in 1970-71 to Rs. 45.63 crores in 1971-72; this was due mainly to the collapse of the roof in the melting shop at Rourkela in July 1971. There were also other aggravating factors such as high cost of raw materials, increases in wages and fringe benefits etc.

167. Among departmental undertakings of the Central Government, the financial position of the Railways has been under strain for quite a number of years, the Railways having been in the red for five successive years between 1966-67 and 1970-71. In 1971-72, it was only as a result of the relief of Rs. 21.53 crores granted by the Railway Convention Committee that the revised estimates of Railway finances could reveal a net profit of Rs. 9 crores as against the budgeted loss of Rs. 6.9 crores. The financial picture for 1972-73 is also not promising; as a sequel to the sanction of the interim dearness allowance, implementation of wage awards, and increases in other working expenses, the budgeted surplus of Rs. 32.5 crores (which the Railways had arrived at after taking into account the relief of Rs. 22.2 crores accruing from the recommendations of the Railway Convention Committee and the effect of enhancement in the Railway fares and freights amounting to Rs. 17 crores) may not materialise. The financial position of Posts and Telegraphs, on the other hand, has been showing considerable improvement since 1969-70, and reflecting mainly the buoyancy in revenues, particularly receipts from telephone service, their net profit in 1972-73 is expected to be larger than the budgeted figure of Rs. 29 crores.

168. The overall financial performance of the undertakings of State Governments remains unsatisfactory. Most of the State Electricity Boards and more than half of the State Road Transport Undertakings are showing losses and the aggregate loss by the State Irrigation Works (Commercial) may well be close to Rs. 100 crores in 1972-73. The fact that revenues of these undertakings of the State Governments fail to cover even their working expenses and interest payments reveals the leeway to be made up and indicates the vast potential which is available for tapping additional resources through improvement in operational efficiency and adoption of appropriate pricing policies.

Some Major Fiscal Issues

169. Given the background of the recent trends in the Central and State Governments' budgetary operations it is instructive to seek to identify the crucial problem areas in the country's fiscal structure and focus attention on some of the major fiscal issues which need to be tackled in the immediate future. These include: measures to correct shortfalls in plan outlays, the imperative need of toning up the managerial and operational efficiency of the public sector undertakings, Centre-State financial relations, and the need for continued emphasis on refashioning the fiscal policy as a more potent instrument of short-term economic management as well as of promoting long-term objectives of growth and social justice.
170. In the last year's Economic Survey, particular attention was drawn to the adverse effects of the persistence of shortfalls in Plan outlays; the shortfall in the Centre's Plan was Rs. 236 crores in 1969-70, Rs. 160 crores in 1970-71 and about the same in 1971-72 and these shortfalls had occurred in such critical sectors as Bokaro Steel, Fertilisers, Petro-chemicals and Railways. As a result, the level of investment activity in the public sector has been behind the schedule which has affected the overall level of investment in the economy in the recent years and is also accountable to some extent for the existence of unutilised capacity in some of the capital goods industries and for the shortages of some of the critical items prevailing in the economy to-day.

171. In order to reduce shortfalls in Plan outlays, the Government has for sometime past been examining the question of overhauling financial and administrative procedures connected with the sanctioning and implementation of Plan projects. The Public Investment Board has been recently constituted with a view to securing a more expeditious screening and processing of investment proposals emanating from public sector undertakings.

172. No less crucial in this context is the task of extracting savings out of the public sector undertakings in which huge investments have been made in the past. A high level Action Committee constituted by the Planning Commission is currently engaged in identifying the operational and managerial deficiencies of public enterprises and its recommendation should help these enterprises in taking suitable measures with a view to achieving higher level of performance and generating surpluses so vital to economic growth. Similarly, in the public undertakings in the States sector, greater operational efficiency and adoption of pricing policies for achieving financial viability have to be given high priority, particularly in the context of the huge financial losses that continue to be incurred by such enterprises as State Irrigation Works.

173. Of late, the problem of Centre—State financial relationship has also assumed growing importance. An aspect of State finances which has been causing serious concern to the Central Government in the recent past was the disquieting trend in the size of overdrafts which some of the States were having with the Reserve Bank of India. Despite the Central Government's efforts to bridge the non-Plan gaps of certain States through special assistance, the overdrafts of the State Governments with the Reserve Bank of India continued to increase and reached a record level of Rs. 642 crores at the end of April, 1972. The Central Government helped to clear them by giving the States ways and means advances to the tune of Rs. 416 crores and by advance release of Plan assistance and share in the divisible tax pool due to them. Under the new procedure introduced with effect from 1st May, 1972, no overdrafts are allowed by the Reserve Bank except for a purely temporary period of seven days. In case a State Government's overdraft continues to exceed seven days, suspension of payment on behalf of the concerned State Government becomes automatic. Concurrently, in order to enable the States to tide over their temporary budgetary difficulties, the permissible limits of normal ways and means advances from the Reserve Bank of India have been enhanced.
174. It is yet to be seen if this can be a lasting solution in the face of a chronic fiscal imbalance from which several of the States are suffering and whether given the sorts of pressures to which a federal polity is subject, this will not simply result in the transference of deficits from State budgets to the Central budget. In the past, in spite of a significant rise in the transfer to the States of resources under the successive Finance Commission Awards, and increased assistance for Plan schemes as well as grants and loans given for non-Plan purposes, there has been no let up in the intense fiscal pressures developing in most of the States resulting in huge overdrafts from the R.B.I. What is frequently overlooked in this context is that tax revenues of State Governments have been showing a buoyancy which has been no less marked than that of taxes raised by the Centre; the reason for unrelenting pressure for more funds to balance their budgets has been due to the fact that State Governments’ commitments on both revenue and capital accounts—Plan as well as non-Plan—have been increasing at a rate much faster than the rate at which their own tax and non-tax receipts as well as resources transferred from the Centre have been growing. To provide some idea of the relative growth of the tax revenues of the Central and State Governments, it may be mentioned that between 1960-61 and 1970-71, the proportion of States’ own tax revenue to national income at market prices had gone up from 3.2 per cent to 4.1 per cent and that of taxes collected by the Centre from 6.3 per cent to 8.6 per cent. If the effect of tax transfers from the Centre to States is taken into account, the step-up in the ratio of the tax receipts of State Governments to national income (from 4.4 per cent to 6.1 per cent) shows a sharper rise than the step up in the ratio of taxes retained at the Centre to national income (from 5.1 per cent to 6.6 per cent). The factors which have particularly strained the States’ budgetary position include expenditures on account of revision of pay scales and sanction of increases in dearness allowances as also the burden arising from payment of interest and principal in respect of loans contracted from the Centre for both Plan and non-Plan purposes.

175 The wider terms of reference under which the Sixth Finance Commission has been appointed have special significance for States. Unlike in the past, the Commission has been asked to make an assessment of the non-Plan gap of the States not only on their revenue accounts but also on their capital accounts. The Commission is also required to make a general review of the States’ debt position with particular reference to the Central loans advanced and outstanding at the end of 1973-74 and suggest changes in the existing terms of repayment having regard inter-alia to the overall non-Plan gap of the States, their relative position and the purposes for which the loans have been utilised, and the requirements of the Centre. Yet another new assignment to the Commission is to examine the feasibility of establishing a national fund to meet relief expenditure connected with natural calamities to which both the Centre and States can contribute specified percentage of their revenues. The Commission has also been asked particularly to bear in mind the requirements of maintenance expenditure of capital assets and Plan schemes completed by the end of 1973-74 and requirements of backward States in standards of general administration with a view to bringing them at par with more advanced States over a period of ten years. The Commission is required to report by the end of October, 1973.
176. The States have long complained about the inelasticity of the sources of revenue at their disposal. A Committee appointed under the chairmanship of Dr. K. N. Raj to examine the feasibility of raising more revenue by taxing agricultural income submitted its report sometime ago. The Committee's major recommendations include the imposition of a graduated levy on operational holdings with a rateable annual value of Rs. 5,000 and above, partial integration of agricultural and non-agricultural incomes for the purposes of calculating income tax liability on non-agricultural incomes and the treatment of family as the basis of assessment not only for the purpose of the recommended levy on agricultural holdings but also for taxation of non-agricultural incomes. The Central Government has remitted to States the Raj Committee's recommendations since their implementation falls within their purview. Suitable action on the recommendations of the Committee would help to bring about a greater measure of equity and elasticity in the tax structure.

177. The combined expenditure of the Central and State Governments accounts for about 25 per cent of the total national expenditure. In addition, nearly 60 per cent of the total investment in the economy takes place in the public sector. Thus the fiscal operations of the Government exert a powerful influence on the course of aggregate demand in the economy. Besides, in the Indian conditions the budgetary operations can have a major impact on the growth of money supply. As such, the role of fiscal policy as an instrument of demand management assumes added significance.

178. It is of course a truism that in order to bring down the growth rate of money supply, resort to deficit financing has to be kept within reasonable limits. The dilemma, however, is that any curtailment of developmental activity is self-defeating; this could only slacken growth which in turn would erode the base of resource mobilisation and thus pile up for the future a fiscal problem of far more serious proportions. Even in respect of non-developmental expenditures, defence preparedness cannot be made to suffer; nor do outlays on contractual obligations (e.g. interest payments etc.) contain any cushion for securing economies. A scrutiny of the Central budget reveals that if expenditures on Plan, defence and contractual obligations are kept out, the category of civil expenditure susceptible to economy measures would hardly work out to a little more than 10 per cent of the Central Government's total expenditure on both revenue and capital accounts. This, however, is not to minimise the need of enforcing utmost economy in the non-essential expenditures of the Government or for that matter even in Plan expenditures. Economies in the latter can be secured through proper screening at the stage of project formulation and more efficient implementation of Plan schemes.

179. A strategy for non-inflationary financing of public sector investment involves a judicious combination of the following three elements: restraint on the growth of expenditure on public consumption, mobilisation of additional resources by way of taxation and accumulation of profits by public undertakings, and diversion to the public sector of private savings in excess of the requirements of socially productive investment in the private sector. The savings potential implicit in the massive tax effort by
the Central Government in recent years has not been realised on account of exceptionally large but unavoidable increases in non-developmental expenditures. The percentage of net public saving to the net disposable income of the public sector declined from 21.6 per cent in 1965-66 to 9.5 per cent in 1970-71 and as a result the percentage of public saving to the Net Domestic Product at market prices came down from 2.8 per cent to 1.1 per cent over the same period. Taking the Central Government alone, the ratio of its saving to its disposable income declined from 24.1 per cent in 1965-66 to 11.8 per cent in 1970-71 and further to 4.7 per cent in 1971-72. In terms of the budget for 1972-73, this ratio was expected to be raised to 19.8 per cent. However, the actual outturn may reveal a less reassuring picture. In the interest of orderly implementation of the Fifth Plan, this trend has to be reversed. Tax policy has to play a major role in mobilising resources for development. To that end, there has to be a widening of the base and effectiveness of direct taxation. At the same time full use has to be made of the potentialities offered by the commodity taxation for curbing ostentatious consumption, mopping up excess profits in the case of commodities in short supply and for restraining domestic consumption for balance of payments reasons.

180. In the last few years, several steps have been taken to simplify and rationalise the tax structure. In order to increase the elasticity of the tax system, the basis for the levy of excise duties has been shifted from specific to ad valorem for a number of commodities. Measures have also been adopted to increase the degree of progression in the rates of taxes on personal income and wealth. However, it is well known that the existence of widespread evasion and avoidance of direct taxes, often facilitated by loopholes in tax laws and administrative laxities, reduces considerably the effective degree of progression of the tax structure. In the current financial year, a number of measures have been taken to check tax evasion through under-valuation of properties in sale deeds and through hawala transactions. The Direct Taxes Enquiry Committee has made several other recommendations to plug loopholes in tax laws and to discourage evasion and avoidance of taxes. It is proposed to bring forth a separate legislation to give effect to those recommendations of the Committee which are acceptable to Government. The totality of these measures, it is hoped, will increase the yield from direct taxes and also help to impart greater elasticity and progression to the tax structure.