CHAPTER IV

FINANCIAL VIABILITY

170. Financial and economic considerations have always been regarded as relevant to any scheme of redistribution of territories. The important questions to consider are whether financial viability can be defined, and if so, how far it should be a factor having a bearing on the changes which we might propose.

171. In some of the memoranda which have been received by us, attempts have been made to link financial viability with concepts like *per capita* national income and *per capita* State income. These concepts involve statistical and other assumptions which may themselves be questioned. In particular, potential *per capita* income will be difficult to estimate and we may not always be justified in our forecasts of how soon and in what stages this potential growth in regional national income can be realised. It is safer, therefore, to confine ourselves to a consideration of the revenue and expenditure of the various units.

172. The term "viable" is generally understood to mean "capable of living, or existing, or developing". The two cardinal concepts of viability would, therefore, appear to be:

(a) maintenance, and

(b) growth.

Translated into financial terms, these concepts would imply that a State should have adequate financial resources to maintain itself and to develop its economy. In other words, financial viability has two aspects: the short-term aspect is the ability of the State to balance its budget over a period of time, not necessarily within each single financial year; the long-term aspect is the capacity of the State to increase its economic resources in such a way that it is possible for it to balance its budget at a higher level of development, unless it chooses, on grounds of economic policy, to have a deficit budget.

173. It has been said that in a federation it is not necessary for every unit to be self-sufficient, and that a State may be able to incur the expenditure which is necessary in order to maintain a desirable minimum standard of welfare, even without financial self-

sufficiency, tne resources for this purpose being made available to it by transfers, if needed, from the wealthier units. Another view is that to lay down minimum national standards is impracticable, and that such a transfer of resources to units which are responsible for spending, rather than for the provision of the resources required, is bound to lead only to waste of public money.

174. We do not feel called upon to examine this question in any detail. Our view, subject to the findings of the Finance Commission which will presumably examine this question in greater detail, is, however, that as far as possible, units should be self-supporting. They should be so constituted that they have an incentive to raise and are able to raise, on their own initiative, at least a part of the resources needed for their development. A transfer of financial resources from the Centre to the States may be unavoidable, but such transfers should normally be utilised for development purposes and not for meeting the ordinary obligations of a State on revenue account.

175. The question of financial viability, that is to say, the ability to balance the budget over a period of time, is, as has already been stated, linked up also with the question of norms of expenditure. The Expert Committee of the Constituent Assembly on the financial provisions of the Constitution, it may be recalled, was of the opinion that it was impracticable to lay down for India a national minimum standard of expenditure. Nothing has happened since then which makes it any the easier to prescribe a pattern of expenditure in the States which can be regarded as the "norm". But several small units spend disproportionately large amounts from their revenues on general administration and administrative overheads. Obviously, it will be preferable to have units where the percentage of expenditure on general administration and overheads is not excessive.

176. We have tried to translate these general ideas into a few working principles. It seems to us that a unit to be regarded as financially self-supporting should be able to meet the following broad tests:

(i) on the average, and over a reasonably short period, a State's revenue and expenditure should be in balance—unless a deficit is deliberately being planned as a part of wider economic policy for the country as a whole; this balanced budget standard is to be attained after providing in full for servicing the State's public debt, including all the loans obtained from the Centre:

(ii) consistently with (i), the State should be able to afford such increases as are necessary in the expenditure on productive and nation-building services which are legitimately within the State sphere, *e.g.*, the extension of community projects. No all-India standards can, of course, be prescribed, but it should be possible for each State to set apart progressively more and more funds for development purposes; and

(iii) no State should be dependent on the Centre to such an extent as to cause any embarrassment either to itself or to the Centre.

177. The tests set out in the preceding paragraph may appear to state the obvious. But this is really not so, for the financial position of a number of States at the present time cannot be considered altogether satisfactory; and any change that is being made should. if possible, be an improvement on the existing state of affairs.

178 The most important test of financial viability, it will be seen, is ability, on the average, over a fairly short-term period to have a balanced budget standard. This is not, perhaps, as widely accepted as might be expected. In the memoranda which have been submitted to the Commission, there has been an attempt to argue, especially on behalf of the Part C States, that if a State is able to cover its normal non-development or rather non-plan expenditure, its financial position must be regarded as satisfactory—development being the responsibility of the Centre; an alternative approach to this question has been that the Centre must, as part of the arrangements necessary in order to improve the financial position of the States, write off a proportion of the debt due from the States to the Centre.

179. Subject to the findings of the Finance Commission, or other expert bodies which will presumably examine the claims of the different States in due course, our views are that the States of the Indian Union, which are now committed to a policy of development, should normally be in a position to meet their expenditure by raising the necessary resources to the extent agreed upon between them and the Centre from time to time. To the extent that a State fails in raising sufficient revenue to meet the expenditure which is legitimately to be borne by it, a further burden is necessarily thrown on the Centre, and this is bound to prevent the utilisation of central resources for other purposes, including grants or loans to other States.

180. It is not necessary, and it is not in any case the function of this Commission to prescribe in detail rules regulating allocations to capital or revenue account, servicing and amortisation of the public debt, arrangements for the collection or utilisation of the proceeds of the betterment levy etc. But whatever these arrangements as to detail may be, and even though some of them may vary from State to State, depending on the amount of discretion exercised by State Governments, the essential principle, namely, that over a fairly short period, the revenue budget should be balanced, every commitment being honoured as it falls due, must not be obscured.

181. It is no doubt true that all the States of the Indian Union are now dependent in varying degrees on central aid for development expenditure. However, we must not lose sight of the fact that excessive dependence on the Centre detracts from the federal principle, since a real division of political power is not possible without an adequate separation of financial powers and resources. The balance of a federal union is bound to be disturbed, if there are amongst its constituent units poor relations or mendicants, particularly if they are inclined to be extra-vagant. "If a federal system, with any real independence in the States is to continue", says Sir John Latham, formerly Chief Justice of the Australian High Court, "the States must have financial resources under their own control reasonably adequate to their responsibilities".

182. We are conscious of the fact that, with the growing need for administrative co-operation between the Central and the State Governments, the partial dependence of the State Governments upon payments from the Centre, and the fact that the Central Government, by the use of the system of conditional grants, frequently promotes development in matters which are constitutionally assigned to the States, the concept of federalism is now everywhere undergoing a change. How much importance is to be attached to inter-state co-operation rather than to the strictly constitutional aspects of federalism will depend on the needs and circumstances of the time and the context in which this problem is being discussed.

183. At the present time, however, we have thought it best to take the view that, as far as possible, the units which are created should not be saddled with an excessive burden on account of the overheads of administration and should be fully informed by a sense of financial responsibility, and, being so informed, should co-operate with the Central Government in financial matters, by raising resources within the provincial field and avoiding as far as possible non-development expenditure.

184. Financial viability as we have attempted to define it, should, in our opinion, be regarded as an important criterion bearing on the reorganisation of States. Financial considerations, however, have to be weighed with other important factors, and decisions have to be taken on a balance of arguments and advantages and in accordance with the larger national interests.