M. Govinda Rao’s Lecture
on
Finances of State Governments and Developmental Efforts

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A RAPPORTEUR'S REPORT

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Rapporteur's Report

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On the invitation of Centre for Development Economics and Innovation Studies (CDEIS), Punjabi University, Patiala, Dr. M. Govinda Rao, Director, Institute of Public Finance and policy, New Delhi and Member, Economic Advisory Committee Council to Prime Minister of India delivered a special lecture on the theme 'Finances of State Governments and Development Efforts' on August 03, 2012 in the University Syndicate Room. The lecture was presided over by Professor S.S. Khehra, Dean, Academic Affairs and acting Vice-Chancellor, Punjabi University. Dr. Inderjeet Singh while welcoming the Chief Guest and other participants argued that there is urgency to attend deteriorating fiscal health of the Punjab economy. The fiscal imbalance has also damaged the environmental health of the economy of the state of Punjab. Professor Lakhwinder Singh, Coordinator of the CDEIS introduced the speaker.

In a thought provoking presentation, Dr. M. Givinda Rao elaborated the role of the state/government to promote various economic activities in desired direction for ensuring equality in the distribution of income. Another major argument that he builds in favour of state intervention in economic activities was basically revolving around assisting the markets so that these can function effectively and efficiently. He stated that, in Indian federal set-up, the central government has been playing a predominant role in the stabilization and redistribution policies. Though the sub-national (state) governments in India play very strategic role in the implementation of various policies, but their roles are limited in the absence of abundance of finances at their command. He discussed the role of various Finance Commissions in the stabilization of state finances from time to time. However, these allocations are not enough compared to the mounting needs of states, and there is need to rebalance these allocations both at the central and state levels to give more focus and boost to the development agenda.

Regarding India's economic growth performance, he stated that Indian economy has achieved a major breakthrough by enhancing the growth rate from the Hindu growth rate to Dancing Elephant growth rate. More specifically, Indian economy grew at the rate of 3.5 per cent per annum during 1950-80 (Hindu growth rate), 5.8 per cent per annum during 1981-2000 and 7.7 per cent per annum during 2001-10 (Dancing Elephant growth rate). However, the growth rates across the major Indian states remained uneven. And, such uneven growth rates have led to rising disparities in the income of people across the states as proved by the rising coefficient of variation in the per capita GSDP over the time period. During this high growth period, Punjab economy witnessed slow growth rates during the last three decades, i.e., 2.56 per cent per annum during 1980-81 to 1993-94, 2.49 per cent per annum during 1994-95 to 2002-03 and 6.17 per cent per annum during 2003.04 to 2009-10. These growth rates are much below the national averages, what to speak of making comparison with the fast growing Indian states like Haryana, Gujarat, Maharashtra, etc. Elaborating the causes of slow growth rates in Punjab economy, he stated that growth of any region is largely dependent on the level of investment, quality of institutions and technological progress. However, Punjab lacks all these parameters, instead of these; the state has become victim of competitive populism. Moreover, Punjab entered the deficit syndrome where the mounting interest payments, rising salary bill of state employees due to frequent pay revisions and tax free budgets are ruling the roust. Since today’s borrowings are tomorrow’s taxes, the state is facing a peculiar problem regarding the credibility of state government. Distorted subsidies also contributed the fiscal crisis of state government.

He opined that during 2001-02 and in few subsequent years, both the central and state governments faced a serious fiscal imbalances in the revenue generation compared to their expenditures. After the four-five time lags, the fiscal situation in most of the states remained satisfactory except the states like Kerala, Punjab and West Bengal. And, the Thirteenth Finance Commission of India recommended a special adjustment path to solve these states’ precarious fiscal position. Taking the case of Punjab, he argued that Punjab’s finances are not in a good shape. Punjab state can regain its past glory in development process only when it puts its fiscal health in order. He highlighted that the growth trends in development expenditures across all other states found to be doubled during the 2000s when compared the 1990s, but Punjab has become a laggard state on the count of lower development expenditure both in the 1990s and 2000s. Further, all those states who incurred most of their development expenditure on the education services, health services and required infrastructure are found to be better performing states in India. Clearly, the correlation coefficient between the per capita GSDP and development expenditure found to be very high and positive across all fast growing states. It indicates that all states must spend more and more money efficiently on these services to achieve high growth path.

He suggested that states like Punjab must take corrective steps to raise investment levels in the economy, raise the efficiency of institutional service delivery system and increase the tax efforts to finance rising need of development expenditure. He recommends that user charges must be levied in Punjab on most of the services provided by the state government. Moreover, the competitive populism must be discarded at the earliest. He stated that, in future, transfer of resources from the central government will come with accountability or matching grants or both. There is a strong need to phase out the implicit and explicit subsidies to put the Punjab economy on the high growth path. He also lauded the tax efforts made by the other states compared to Punjab since the 2000-01.

He suggested that there is need to reorient fiscal policy towards development agenda in the states like Punjab. And, to accelerate the growth in a sustained manner, Punjab requires substantial increase in development expenditures and ensuring its efficient spending towards achieving outcomes – peoples' welfare. He also cautioned that heavy dependence on the private sector to provide public services to may not work everywhere. He stated that in Punjab, there is need to create fiscal space for spending more on developmental heads compared to non-development heads. To finance the rising development expenditures in Punjab, he suggested that (i) new/old taxes must be levied/enhanced; (ii) user charges must be levied who use these services, (iii) competitive populism must be shunned, and (iv) steps must be taken to reduce unproductive expenditures. Moreover, the transfer of funds from the central government also calls for reforms. Seeing it a difficult path he states whether the states including Punjab are prepared to take these bold steps.

Professor Lakhwinder Singh, Professor Kesar Singh, Professor S.S. Khehra and Mr. Surinder Singh Riar participated in the discussion. In the end, Professor R.K. Bansal, Head Department of Economics proposed the vote of thanks.