Speech of

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Chief Minister, Uttaranchal

On the Occasion of the

Visit of the

Twelfth Finance Commission

To

Dehradun

Government of Uttaranchal

October 6, 2003

Esteemed Dr. Rangarajan, Chairman Twelfth Finance, Commission, Shri Som Pal, Shri T.R. Prasad, Prof D.K. Srivastava, Members, Shri G.C. Srivastava, Member Secretary, and other officers from the Commission, I warmly welcome you all on the visit of the Twelfth Finance Commission to the newly created state of Uttaranchal, historically acclaimed as the "Dev Bhumi" of India.

2. Uttaranchal was carved out of Uttar Pradesh as a recognition of the aspirations of the people of this mostly backward region. Given the specificities of its mountains, Himalayan and sub-Himalayan terrain, economic structure, scarce resource endowments and weak fiscal capabilities, it was accorded a 'special category' status in 2001.

3. While its Constitutional separation from Uttar Pradesh should have permitted it to start on a clean slate, this unfortunately has not been the case. Uttaranchal has been disadvantaged right from its inception. Not only was it thrust with an unfair share in UP's debt, it received, virtually speaking, no revenue deficit grants during the award period

of the Eleventh Finance Commission. This also happened due to the fact that the report of 11th Finance Commission was laid on the table of Parliament in July, 2000, while the Uttaranchal State came into existence four months later, on 9th November, 2000. Thus, there was no question of examining Uttaranchal's case by the 11th Finance Commission. Further, the state was not provided with any additional assistance for creation of minimum necessary infrastructure to establish even the mandatory organs of the state. Consequently the state had to resort to borrowing, to meet even its basic consumption requirements. All this has been due to factors outside our control. It needs no emphasis that a continuation of this situation will jeopardise the future prosperity of Uttaranchal. We have, therefore, pinned our hopes on the Finance Commission to rectify these anomalies and the ensuing adverse financial implications.

4. As Uttaranchal has been recently created, a brief introduction to the profile of Uttaranchal would be in place. This will help in contextualising the current and the emerging

fiscal scenario in Uttaranchal, as the revenue raising capability of a state as well as its expenditure needs are critically linked to its economic and demographic features.

5. Covering an area of 53483 sq kms, Uttaranchal has a very diverse topography ranging from plains in the South to snow covered peaks in the North. Over 62 per cent of its area is under forest cover. The geography of the state has direct expenditure implications. The state is largely characterised by a large number of relatively small and dispersed habitations, as the terrain generally does not support large clusters of households. These features do not permit the State to exploit scale economies in public service delivery and therefore significantly increases the cost of delivering a minimal level of these services.

6. The neglect of the region is obvious from its growth performance. Between 1993-94 and 1999-2000, when the Indian Economy registered a growth of 6.6 per cent per annum, Uttaranchal's real GDP grew at an anaemic rate of 2.9 per cent.

7. The most worrying aspect of the evolving economic structure of Uttaranchal is the shrinking share of industry in its overall GSDP. Lagging industrialisation has induced significant out-migration amongst adult males, leading to a high incidence of both child and old age dependence. In addition, although the state has a high overall level of literacy, the gender gap at all levels of educational attainment is relatively high. Health indicators of women and children are also relatively weak. The credit deposit ratio is around 25 %, which is less than half of the national average, which stands at 54%. All these factors call for a concerted increase in the level and quality of public services.

8. Partly due to terrain, but also because of relatively low levels of investment, the state has come into existence with a weak infrastructure base. Substantial investments are needed to enhance the growth potential of the state and these needs to be maintained and operated to derive full value.

9. Let me now dwell upon the fiscal situation of Uttaranchal. While Uttar Pradesh received only Rs.1000

crores as non-plan revenue deficit grant from the 11th Finance Commission, of which the share of Uttaranchal was a meagre Rs.17 crores, for the year 2000 only, we did not benefit from the recommendations of the 11th Finance Commission regarding special category states in Para 3.77 of the report.

Uttaranchal, thus was deprived of its legitimate share of revenues despite the Finance Commission award period coinciding with its birth because Finance Commission transfers had been frozen before the state came into existence. Our request for an interim relief for the remaining period of 11th Finance Commission award has not been entertained by the Government of India. We would strongly urge the 12th Finance Commission to take a sympathetic view in this regard. The restructuring of finances of special category states which the 11th Finance Commission has recommended in Para 3.77 of its report still holds valid today and the Government of India in yet to take decision on the recommendation of that important para. May I quote here this Para 3.77 in full to highlight its importance for help to the non-plan period of

2001-2005 by the Government of India, which you may kindly consider recommending as an interim relief to us to cover the period form November 2000 upto March 2005.

Para 3.77 of report of Eleventh Finance Commission reads as follows "Out of 25 States currently forming the Indian Union, 10 are grouped under a "special category" for various purposes, particularly plan financing. Unlike the general category States, States of the special category get Central plan assistance for their plans in the form of 90 percent grants and only 10 percent as loan. Such special consideration is given to this category of States presumably in view of their weak economic bases. Their own revenue sources meet on an average a small percentage of their revenue expenditure. The bulk of their revenues come from the Centre. Because of their weak revenue base, all the special category States have large deficits on their non-Plan revenue account before devolution. With 90 percent of Central assistance for the State Plans in the form of grant, the revenue budgets of the States are left with sizeable surpluses. Even so, all the special category States have large fiscal deficits. Even with massive infusion of Central funds, the finances of these States remain under acute stress with fiscal deficits running at over 10 percent of their GSDP in some cases. Evidently, the system of financing of the expenditure of these States needs a fundamental restructuring. In our view, such restructuring should proceed on the following lines:-

(i) The non-plan revenue gap of these States assessed on the basis of norms relevant in their case after taking into account their share in Central taxes should be met out of Finance Commission grants. There should be no need for any Plan grant to meet these gaps.

(ii) Responsibility for development of infrastructure of vital importance to the region requiring large investment should be that of the Centre.

(iii) The system of plan assistance for special category States may be reviewed. The review of Gadgil formula as suggested by us earlier should also cover the review of plan assistance to the special category States".

Uttaranchal having been carved out of a non special category state, received a higher share of liabilities which is reflected in its high debt burden but was deprived of benefits accrued to other similarly placed special category states.

The mechanism of transfer of liabilities without recognition of the fact that it was a Special Category State led to a higher share of debt being passed on to it and lack of revenue deficit grant to meet its essential and unavoidable non-plan expenditure has led to further debt even to meet its consumption expenditure.

10. Thus, the rising debt burden of Uttaranchal has been on account of factors outside its control. We therefore request the Finance Commission to sympathetically examine the circumstances leading to Uttaranchal's indebtedness and award suitable debt relief. The Ninth Finance Commission has recommended that "The Central loans obtained on Plan account by each of the three newly constituted States of

Arunachal Pradesh, Goa and Mizoram, upto 1986-87 as Union Territories (as outstanding on 31st March 1990), in excess of what it would have received during that period by way of loan on the basis of the 90:10 or 30:70 formula applicable to States, should be written off (para 9.21)".

11. Despite the fiscal disadvantages implicit in its profile, Uttaranchal has made commendable revenue raising efforts ever since it came into existence. Its per capita sales tax collection, at Rs 640.3, is the highest among the special category states. Our weak economic base not withstanding, our endeavour is to improve the revenue raising and collection effort of the state.

12. Forestry and Mining were important sources of non-tax revenue. The required environmental and ecological conservation of forests and the consequent restrictions have reduced the revenue potential from forestry.

13. Power and tourism have the potential to emerge as an important source of revenue for the state and the state has initiated a number of efforts in this direction. But, given the

long gestation period of hydro projects (due to environmental considerations), the revenue flow will take place only after a lag of few years. These flows will also remain controlled due to the regulatory mechanism of the Central and State Commissions.

14. The expenditure needs of a hilly and backward state like Uttaranchal are much higher in comparison to plains because of higher costs of creation and maintenance of assets, higher transport costs and higher cost of delivery of essential services. All these are critically linked to the harsh and, eco fragile nature of the terrain which do not permit the state to take advantage of agglomeration economies that characterise the provision of many essential services. For example, multi-stage pumping schemes have to be constructed through costly lift-schemes for providing drinking water in many areas. The cost of supply of water in some of these schemes ranges from Rs 21.74 to Rs 37.0 per kl, whereas the recovery through user charges is only Rs.1.25 to Rs. 2.0 per kl. The cost disabilities are apparent from the fact that average cost of

construction of roads in hills is, Rs.30 lakhs per Km. compared to Rs.14 Lakhs in plains region. Similarly cost of construction of a building in hill is almost 25% higher in the plains. The cost of L.T power line in hills is about Rs.2.60 lakh per Km. compared to Rs.1.20 lakh in the plains. Small irrigation channels in hills cost around Rs.12 lakh per Km. which is unit cost of medium sized canal elsewhere. The same is true of provision of health and education services. In addition to normal salary and allowances, remote area allowance has to be paid to attract/motivate officials to work in far-flung and relatively backward areas of Uttaranchal. Due to difficult terrain and climatic conditions, rain, snow, landslides etc., the maintenance requirement works out to be much higher and more frequent. Frequent cloud-bursts in different areas as has currently been witnessed, in unprecedented landslides in the Uttarkashi town, and Naitwar-Mori area, Burha-Kedar area of Tehri District and Kailash-Mansarovar route-area in Pithoragarh area in the recent past are a few examples. Rehabilitation and re-location of thousands of people because of such calamities seems inevitable.

15. The very high proportion of committed liabilities is also a major concern for the State. This is in spite of the fact that in many critical areas like taxation departments, civil services, education, health, police etc. there are a large number of vacant positions, which at present is being reflected in sub normal expenditure levels. The necessity of implementing centrally announced pay revision, allowances all around is also to be kept in mind.

16. Our expenditure forecasts have been made keeping in mind the requirements of the state to spend on social and economic infrastructure as well as servicing the committed liabilities of the state. The increased attention to social security schemes and new schemes announced by the Central Government will also push up the non-plan expenditure in social sector.

17. The total pre-devolution non-plan revenue deficit has been projected at Rs 15,780.9 cores for the period 2005-06 to

2009-10. The expenditure requirements of this fiscally disadvantaged state are higher both on account of higher cost of delivery of services (due to terrain) and for bridging the gap with respect to the more prosperous states. The non-tax revenue raising efforts will pay off in the medium/long run. The support of the Finance Commission in meeting the projected revenue gap of Uttaranchal will go a long way in ensuring the future prosperity as well as financial viability of Uttaranchal.

18. Almost 62 per cent of Uttranchal's area is under forests. I would like to emphasise that Uttaranchal's forest resources should be treated as a special feature with important implications for centre-state financial transfers. It is now well established that forests are a resource that generates benefits to a multiple groups of stakeholders far beyond the confines of the state where they are located. The potential beneficiaries exist at various levels – local, state, national and global.

19. Sir, I would take this opportunity to illustrate the indirect benefits of forestry through the example of what is

happening to glaciers in the Himalayan region. The glaciers and the snowy mountains and all the forest cover are significant sustainable sources of fresh water as large quantities of water flows from them in summer while fresh snow is added every winter.

20. A major ecological concern relates to the rapid melting and the consequent shrinking of glaciers. The International Commission for Snow and Ice (ICSI) has pointed out that Himalayan Glaciers are receding faster than those in any part of the world.

21. A continuation of this trend can spell ecological disaster not only for the Himalayan region but also for the northern plains.

22. However, maintaining the forest cover is an important way to check the enhanced melt rate of glaciers. While the responsibility of maintaining the forest cover/ afforestation falls squarely on states like Uttaranchal (which have significant forest cover), the benefits flow to the entire country as well as to the rest of the world.

23. Regulatory imperatives that induce the state to preserve its forests are not backed up by any economic incentives. As a result, the state faces a dilemma, involving a significant economic cost, between exploitation and preservation of its forests.

24. I therefore make an earnest request to the Finance Commission to give due weight to the role of Uttaranchal's forests as a national and even global resource and the best way to address it is to build it into the devolution formula with an appropriate weight, and it should be treated as special problem and given due consideration in arriving at the total quantum of transfers to the state.

25. Now I would like to draw your kind attention to another unique feature of Uttaranchal-the Yatra tourism. Uttaranchal is host to Haridwar, Rishikesh, the Char Dhams (Badrinath, Kedarnath, Gangotri, Yamnotri,) and Kailash-Mansarovar Yatra and the sacred Ganga & Yamuna. Beside these there are many other pilgrimage sites, and sites of historical and religious importance. These pilgrimage sites are a national

heritage and play an important role in promoting national unity and integrity.

26. As a result of tourism on the Yatra Routes, civic infrastructure, sanitation, drinking water, health and medical facilities and law and order come under tremendous stress. The need to provide these facilities assumes greater significance in view of the fact that average spending ability of 'Yatris', unlike leisure tourists, is quite low. Further, since a significant portion of the Char Dham Yatra and Kailash-Mansarovar Yatra is undertaken on foot, safety of the tourist comes out to be a major concern.

We have taken initiative to set up wayside amenities, Sadhana Kutirs, Yoga Dhyana Kendra, Public conveniences under various schemes of self-employment etc. on the Yatra Routes, wherein, however, adequate support would be needed.

27. Besides the Char Dham and the Prayags, there are a number of other pilgrimage sites and sites of historical and religious importance which attract a lot of visitors. A number

of local fairs over a period of time have started attracting a large number of pilgrims and tourists creating a pressure on infrastructure and civic services. Thus, there is dire need of funds to provide and improve the infrastructural facilities, including the road connectivity and maintenance thereof since the rail network is very very limited and air services are almost non-existent.

28. As pointed out earlier, another characteristic of Uttaranchal is its constant exposure to hazards like earthquakes, landslides, cloud burst, avalanches and forest fires. These calamities not only disrupt normal life by cutting off communication and choking essential supplies but also result in loss of life and property. Of the various calamities that Uttaranchal faces, earthquake is the most devastating disaster and also the most unpredictable one. We are still grappling with the landslide problem in Uttarkashi where almost the entire township of Uttarkashi is threatened.

29. In this context certain changes will help the state like Uttaranchal to mitigate certain pressing difficulties faced during calamity control.

- For a disaster prone area like Uttaranchal, which is also fiscally disadvantaged, the central assistance should come in the form of 100 per cent grant for Calamity Relief Fund.
- Under the CRF, activities such as flood control and irrigation works undertaken due to cloudburst or flash flood, though critical for a vulnerable state like Uttaranchal, are not entitled for any financial assistance. This needs to be brought under the ambit of Calamity Relief Fund.

30. The Eleventh Finance Commission grants of Rs. 4.75 crores per year to Urban Local Bodies has been inadequate in generating substantial infrastructure. The Municipalities have to bear the burden of Yatra Tourism, which hardly generates any revenue to them but put tremendous pressure on civic services. The size of Nagar Panchayat's in Uttaranchal is

small and small municipalities had to be set up to cater to the needs of Yatris. The Eleventh Finance Commission gave a weight of 40% to population of Municipalities which fails to address the problem of smaller Municipalities. We therefore recommend a minimum population floor for each body.

31. The Eleventh Finance Commission grant of Rs. 30 crores per year to Panchayati Raj Institutions needs substantial enhancement as the village Panchayats with even small population have large areas in which to develop civic amenities, substantial funds are required. We recommend to review the devolution formula for Panchayats also in the light of the problem of Panchayats with small population and large areas. Our Municipal Bodies and Panchayati Raj Institutions in hill areas suffer from resource constraint, cost disabilities and there is a need to provide funds to cover critical gaps both in the organisational structure as well as in physical infrastructure.

32. Although the terms of reference of the Twelfth Finance Commission do not explicitly require it to take into account

the requirements of the states for up-gradation of the standards of administration and special problem grants, this in no way binds the Commission not to consider these under Article 275(1) of the Constitution. The system of transfers under 'special purpose and up-gradation grants' has evolved over time and the various Commissions have adopted flexibility in this regard.

33. The requirements of Uttaranchal under special problems and upgradation of standards can be broadly classified into three categories:

- Arising out of reorganization of the state
- Special problems
- Requirements for up-gradation of standards

34. In view of the special circumstances/problems arising out of reorganization of the state and the dire need for up-gradation of standards in Uttaranchal, we request the Commission to take a pragmatic approach in this regard and recommend these grants, request for which is detailed in a separate volume (Volume IV).

- With the creation of a new state, the necessary infrastructure to meet the needs of a new state needs to be created including that for a state capital.
- There has been a persistently felt need for upgradation of educational institutions at primarily and secondary levels. i.e from primary to middle levels and middle to intermediate levels.
- The problem of providing reasonable livelihood to ex-soldiers who retire early and the growing number of war-widows and for auxiliary force personnel, who may not get the same type of after-service support as regular servicemen is also a matter of concern for the State. There is an ever growing demand for the State pension for the widows, disabled, elder citizens etc.
- Similarly health care facilities in the remote areas need to be taken care of, more so keeping in view the high child and old age dependency. There is hardly any institutions for tertiary health care in whole of the

state. The need for upgradation of district and base hospitals is very pressing.

- Because of lack of any railway infrastructure in the hilly areas, construction of motor roads, including villages road, bridle road, foot-track etc. seems inevitable. All this requires higher maintenance expenditure compared to many other States.
- Private investment in health and education sector in rural areas is not forthcoming and the capacity of people to pay is also limited. Therefore Government will have to continue to shoulder the responsibility and will have to support whatever private institutions are functioning.

- Another major area of concern especially from the security angle is the slow migration of population from the remote border villages due to lack of connectivity and infrastructure leaving the area quite vulnerable. There is need for an effective policing alongwith infrastructure building in these remote areas more from a security point of view.

- I would like to draw your attention to the problems of dislocation because of Tehri Dam which has thrust a large liability on the State on the rehabilitation account in its wider connotations, for example, road connectivity, access to schools, colleges, hospitals etc. have to worked out afresh. The costs of maintaining massive rehabilitation infrastructure scheme for thousands of village & town people like the Tehri Dam and such other Hydel projects being constructed now and planned for the future has also to be considered.

35. Last, but not the least, I would like to suggest some improvements in the devolution formula. The shareable pool of Gross Union Tax Revenue should also include surcharge on income tax and the States should be insulated against shortfalls in central tax revenues by a mechanism wherein a minimum amount of tax devolution be prescribed.

For working out the horizontal devolution of Union Tax revenues a divisible pool be separately earmarked for Special Category States.

36. The existing devolution formula needs some modification, as in its current form it is unlikely to do justice to the newly formed States like Uttaranchal. While it is important to incentivise the revenue transfers to states to promote efficiency, it is equally important to ensure that the criteria used is objective and reliable. While per capita income is a good criteria for determining the revenue raising capacity of a state, structure of the economy also plays a critical role and should be given due weight in the devolution formula.

37. The use of infrastructure index as a criteria for the devolution of taxes is essential as it recognizes the disabilities of the states with poor infrastructure particularly in attracting investments. This assumes greater significance in the context of the present regime of liberalization and delicensing where infrastructure related factors are influential in shaping the investment decisions of private investors. Further, the ability

of the states to use fiscal incentives for attracting investments is fast diminishing. However, the infrastructure index in its present form does not fully capture the status of infrastructure as it fails to capture its quality.

38. Fiscal discipline is an important criteria in the context of heightened fiscal stress at the state level. However, the way in which fiscal discipline is measured can disadvantage the newly created state of Uttaranchal. Uttaranchal suffers from higher cost disabilities and right now is at a fiscal disadvantage, as the transfers received by it have been used for investment in "human capital" rather than in material capital, the investment in former generating higher expenditure and less revenue yielding assets. Added to this is the relatively higher financial burden in providing a given level of public services in special category states than in its counterparts.

39. For the reasons outlined above the ratio of own revenues to revenue expenditure is likely to fall at least for the next many years, before the expenditures reach their normal level

and the expenditure on creation of assets (power, infrastructure for tourism) yields dividends. Thus, the computation of fiscal discipline on the basis of the ratio of own revenues to revenue expenditure will discriminate against the genuine requirements of states like Uttaranchal and needs to be suitably modified. The Special Category norm of uniform grants and loans for our Special Category State on 90:10 basis are not being applied in many cases. The Reserve Bank and the Banking system has yet to develop special norms for the Himalayan region of the country. The regime of Ways & Means advances, and permissible Overdraft limits should have more flexibility for the Himalayan region.

40. I must re-emphasise that the state is committed to improving its fiscal situation in the coming years. This requires that it should start on a clean slate. Our memorandum demonstrates the adverse fiscal implications of its split from a normal state in terms of negligible grants-in-aid from Finance Commission as well as disproportionate

share in liabilities of Uttar Pradesh. The revenues from power projects and tourism will materialise with a lag. Therefore, the support of the Finance Commission in the transition period will be critical for the financial viability and future prosperity of the state.

As I conclude on my behalf and on behalf of our Council of Ministers, I feel it my bounden duty to once again thank you for visiting us here giving us a patient hearing with all our warmth.

I am sure that your report will chart out a new financial course and would set out constructive and innovative policies not only for this first decade of the 21st century, but for the next decades also.

Jai Hind