A Free Enterprise Society in Maharashtra

Economic Policy and Public Finance Blueprint

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Abbreviations

APMC	Agriculture Produce Marketing Committees
GDP	Gross Domestic Product
GSDP	Gross State Domestic Product
GST	Goods and Service Tax
MERC	Maharashtra Electricity Regulatory Commission
MSP	Minimum Support Price
NPA	Non Performing Assets
NET	National Eligibility Test
PSUs	Public Sector Undertakings
PDS	Public Distribution System
SEBI	Security Exchange Board of India
UK	United Kingdom
US	United States
VAT	Value Added Tax

Introduction

> "In a free enterprise, the community is not just another stakeholder in business, but is in fact, the very purpose of its existence"[1] - J Tata.

Future society in Maharashtra

Imagine a society, where an individual is free to choose an occupation, an enterprise based on his likes and skills. Where every other person is free to set a target of standard of life for him, and there is every possibility for it to become true. Where the set of rules and regulation prove to be guidelines instead of becoming obstructions in one's own path to progress. Where quality education, research, innovations, inventions become a part of average person's lifestyle.

The developed countries throughout the world have experienced economic as well as political freedom, until end of 2nd world war. Society was free and mostly unregulated where people set up businesses, made use of available natural and human resources, earned profits, created jobs, and so the wealth. The government systems were not as big as they are today. Competitive private business arrangements and capitalism in most of the sectors of the economy in those countries triggered the entrepreneurial skills. Trade within country and offshore trades helped people come together and benefit from mutual and voluntary exchange of not only goods and services, but of cultures and social norms. A healthy social lifestyle of work and businesses and creation of abundant wealth took place in this period.

Free India, along with some other developing countries however, adopted Russian model of development. Centralized planning of economy was the policy that was adopted by government of India that paved way for series of five year plans. Detailed five yearly planning has given the central directions and allocation of funds for carrying out businesses all over the country. State level and local governing bodies have no authority whatsoever to participate in the planning process and decision making.

In case of India in 1980s, Milton Friedman – an ardent advocate of free markets rightly noted about Mahalnobis–an able mathematician, the father of 5-year plans in India -

"Able mathematicians like Mahalanobis are usually recognized for their ability at a relatively early age. Realizing their own ability as they do and working in a field of absolutes, tends, in my opinion, to make them dangerous when they apply themselves to economic planning. They produce specific and detailed plans in which they have confidence, without perhaps realizing that economic planning is not the absolute science

[1] http://www.tata.com/aboutus/articles/inside.aspx?artid=1U2QamAhqtA

THAT MATHEMATICS IS. THE SCHEME OF THE FIVE YEAR PLAN ATTRIBUTED TO MAHALANOBIS FACES TWO PROBLEMS; ONE, THAT INDIA NEEDS HEAVY INDUSTRY FOR ECONOMIC DEVELOPMENT; AND TWO, THAT DEVELOPMENT OF HEAVY INDUSTRY USES UP LARGE AMOUNTS OF CAPITAL WHILE PROVIDING ONLY SMALL EMPLOYMENT. BASED ON THESE FACTS, MAHALANOBIS PROPOSED TO CONCENTRATE ON HEAVY INDUSTRY DEVELOPMENT ON THE ONE HAND AND TO SUBSIDIZE THE HAND PRODUCTION COTTAGE INDUSTRIES ON THE OTHER. THE LATTER COURSE WOULD DISCRIMINATE AGAINST THE SMALLER MANUFACTURERS. IN MY OPINION, THE PLAN WASTES BOTH CAPITAL AND LABOR AND THE INDIANS GET ONLY THE WORST OF BOTH EFFORTS."

Coercive Socialism Vs Voluntary Capitalism

Competition has two very different meanings. In ordinary discourse, competition means personal rivalry, with one individual seeking to outdo his known competitor. In the economic world, competition means almost the opposite. ***There is no personal rivalry in the competitive market place.*** There is no personal fighting. The wheat farmer in a free market does not feel himself in personal rivalry with, or threatened by, his neighbor, who is, in fact, his competitor. The essence of a competitive market is its ***impersonal character***. *No one participant can determine the terms on which other participants shall have access to goods or jobs*. All take prices as given by the market and no individual can by himself have more than a negligible influence on price though all participants together determine price by the combined effect of their separate actions.

Adam Smith said in his advocacy of free markets that, competition does not protect the consumer because businessmen are more soft-hearted than the bureaucrats or because they are more altruistic or generous, or even because they are more competent, but only *because it is in the self-interest of the businessman to serve the consumer*[2]. If one storekeeper offers you goods of lower quality or of higher price than another, you're not going to continue to patronize his store. If he buys goods to sell that don't serve your needs, you're not going to buy them. The merchants therefore search out all over the world the products that might meet your needs and might appeal to you. And they stand behind them because if they don't, they're going to go out of business. When you enter a store, no one forces you to buy. You are free to do so or go elsewhere. That is the basic difference between the market and a political agency. You are free to choose. There is no policeman to take the money out of your pocket to pay for something you do not want or to make you do something you do not want to do.

[2] Wealth of nations, Adam Smith

Economic Freedom as necessary condition for Political Freedom

> "Economic freedom is an essential requisite for political freedom. By enabling people to cooperate with one another without coercion or central direction, it reduces the area over which political power is exercised. In addition, by dispersing power, the free market provides an offset to whatever concentration of political power may arise. The combination of economic and political power in the same hands is a sure recipe for tyranny[3]".

In the 19th century, a combination of economic and political freedom produced a golden age in both United Kingdom and the United States. As a result, United States prospered even more than Britain. It started with a clean slate: fewer labels of class and status; fewer government restraints; a more fertile field for energy, drive, and innovation; and an empty continent to conquer.

In United States, abundance of freedom was demonstrated most dramatically and clearly in agriculture. When the Declaration of Independence was enacted, almost 3 million persons of European and African origin occupied a narrow fringe along the eastern coast. Agriculture was the main economic activity. It took 19 out of 20 workers to feed the country's inhabitants and provide a surplus for export in exchange for foreign goods. Today it takes less than 1 out of 20 workers to feed the 220 million inhabitants and provide a surplus that makes the United States the largest single exporter of food in the world[4].

Economic freedom

An essential part of economic freedom is freedom to choose our work, our profession, how to use our income: how much to spend on ourselves and on what items; how much to save and in what form; how much to give away and to whom.

In India and effectively in Maharashtra, more than 40 % of our income (GDP and GSDP) is disposed of on our behalf by government at central, state, and local levels combined.

Of course, we have something to say about how much of our income is spent on our behalf by government. We participate in the political process that has resulted in government's spending an amount equal to more than 40% of our income (GDP). Indian democracy, meaning *Majority rule*, is supposed to be necessary and desirable. It is, however, very different from the kind of freedom you have when you shop at a supermarket.

[3] Milton Friedman: "Free to Choose- A personal statement", 1990, A Harvest Book, Harcourt Inc
[4] Milton Friedman: "Free to Choose- A personal statement", 1990, A Harvest Book, Harcourt Inc

How many times do we vote daily? Every time you are choosing certain products over others with your hard earned money in a supermarket, you are voting for products and services of your choice.

When you enter the voting booth once a year, you almost always vote for a *package* rather than for specific items. If you are in the majority, you will at best get both the items you favored and the ones you opposed but regarded as on balance less important. Generally, you end up with <u>something different from what you thought you voted for</u>. If you are in the minority, you *must conform to the majority vote* and wait for your turn to come. Whereas, when you vote daily in the supermarket, you get precisely what you voted for, and so does everyone else.

"The ballot box produces conformity without unanimity; the marketplace, unanimity without conformity[5]"

That is why it is desirable to use the ballot box, so far as possible, only for those decisions where conformity is essential.

Another essential part of economic freedom is freedom to use the resources we possess in accordance with our own values— freedom to enter any occupation, engage in any business enterprise, buy from and sell to anyone else, so long as we do so on a strictly voluntary basis and do not resort to force in order to coerce others.

Today you are not free to offer your services as a lawyer, a physician, a dentist, a teacher or engage in a host of other occupations, without first getting a permit or license from a government official. You are not free to work overtime at terms mutually agreeable to you and your employer, unless the terms conform to rules and regulations laid down by the government.

You are not free to set up a bank, go into the taxicab business, or the business of selling electricity or telephone service, or running a railroad, bus line, or airline, without first receiving permission from the government.

You are not free to raise funds on the capital markets (stock markets) unless you fill out the numerous pages of forms required by the government regulated Security Exchange Board of India (SEBI). The SEBI regulation has made capital markets unattractive to investors at large and accessible to very few. And getting SEBI approval may cost upwards of Rs 1,00,00,000[6] which certainly *discourages small firms our government professes to help*. Ironically, SEBI is a government regulatory setup to 'protect investors'; it discourages new small entrepreneurs to take up new businesses and investors the opportunities to make money out of these businesses.

[5] Milton Friedman: "Free to Choose- A personal statement", 1990, A Harvest Book, Harcourt Inc

[6] Security Exchange Board of India: "http://www.sebi.gov.in/vc/vcregistration.html

Occupation license

For government, licensure is a tool to restrict market entry in certain occupations and businesses. Government has the authority to assign and reject licenses, and its' decision is based on whether it believes that by doing so, it is protecting the consumer from risks. However, we have seen many undesirable businesses such as shops selling alcohol and tobacco, or lottery shops get licenses from the government quite easily. The government does not seem to protect consumer interests while issuing these licenses. This is not to say, that there absolutely is no need to have licenses for these businesses. An individual has the right and the responsibility of consuming products and services of his choice. If government assumes a responsibility of "protecting consumers", then they should issue licenses to sky divers and sea sailors. These too are risky activities. The rational of `consumer protection' behind license is baseless.

For example, National Eligibility Test (NET) is an entry test, a kind of occupation license for teachers to enter teaching profession. Instead of students and teachers deciding which person has more teaching abilities, it's a central government decision. This lack of freedom for students and their parents to choose teachers has cost the society many talented experimenting teachers of caliber, who do not wish to fit into the `NET' category. The qualification of the teacher itself should be sufficient to be a market entry for these occupations.

Additionally licensing creates a society, where individuals do not trust and commit to each other and instead, rely on and give power to a third party which is in no position to judge any of them on fair grounds.

Freedom to own property is another essential part of economic freedom and stability. However, there are many difficulties in exercising this freedom. Various taxes applied by the government such as registration fees, wealth tax, property tax prove to be major hurdles for masses in owning houses. Less than half of countrymen own the houses they live in. Regarding ownership of machines, factories and similar *means of production*, the situation is even more difficult. Income tax, property tax, capital gains tax and inflation prove to be the biggest obstacles in people creating, owning and expanding properties of their own. Individuals can only succeed in creating and expanding their private properties by resorting to mending laws and buying local administrators.

One might argue that allowing individuals to practice any profession or run any business freely may result in anarchy that it may result in consumer exploitation and disorder in the society. Free markets arrangements do not guarantee flawless societies. Persons – a dentist, a banker or a teacher without central authority certification may create blunders in short term, but to continue providing his / her services he /she will have to satisfy his / her consumer class. Consumers and clients decide who stays in what business on basis of efficiency and skills. The consumer is always in the best position to judge the quality and usability of the products and services that are manufactured and sold under free market arrangements. The consumers, meaning the general public, decide what products and services are being produced and provided by spending their money on them.

Human Freedom

Restrictions on economic freedom inevitably affect freedom in general, even such areas as freedom of speech and press. Paid news and news channels owned and run by political leaders does not serve the very purpose of media of flow of transparent and true information for the social good.

Political Freedom and Economic Freedom

The planning commission and the Finance Minister of India are in agreement with the need to curb the size of government. Lifting government controls and encouraging private businesses to take up opportunities in publicly owned sectors is an indication of the same.

Limited Governments and Free Market Society

Role of government in a free society is limited to four core and fundamental functions, which are: -

1. Defense: Protection of citizens from outside forces;
2. Law and order: Protection of citizens among themselves;
3. Rules of conduct of business: Framework of law for private businesses and individuals as a society;
4. Issuance of currency: as a medium for trade and communication and carrying out other activities[7].

Limited Government in practice

In today's world where big governments seem pervasive, we may well ask whether there exist any contemporary examples of societies that rely primarily on voluntary exchange through the market to organize their economic activity and in which government is limited to the above four duties.

Perhaps the best example is Hong Kong—a small piece of land next to mainland China with an area less than 1,104 square km and a population of roughly 7.1 million people. The entire population is urban. Hong Kong enjoys one of the highest standards of living in all of Asia, second only to Japan and perhaps Singapore.

Hong Kong has no tariffs or other restraints on international trade, except for a few 'voluntary' restraints imposed by the United States and some other major countries. It has no government direction of economic activity, no minimum wage laws, no fixing of prices. The residents are free to buy from whom they want, to sell to whom they want, to invest however they want, to hire whom they want, to work for whom they want.

[7] Adam Smith: *"An Inquiry into the Nature and Causes of the Wealth of Nations"* First published in 1776

Government plays an important role that is limited primarily to the four duties mentioned above, interpreted rather limitedly in this chapter. It enforces law and order, provides a means for formulating the rules of conduct, adjudicates disputes, *facilitates transportation and communication*, and supervises the issuance of currency. It has provided public housing for refugees arriving from China. Though government spending has grown as the economy has grown, it remains *among the lowest in the world, being a fraction of per capita income*. As a result, *low taxes act as incentives*. Businessmen can reap the benefits of their success but must also bear the costs of their mistakes.

Example of policy adoption in India and Japan

Closer home, an especially illuminating example, worth examining in greater detail, is the contrast between the experiences of **India** and **Japan**.

Economists and social scientists in general can seldom conduct controlled experiments of the kind that are so important in testing hypotheses in the physical sciences. However, the Hong Kong experience can be termed as an eight-decade long controlled experiment in economic organization. In all other respects the two countries were in very similar circumstances at the outset of the periods that are compared.

1. Experiences of India during the first 30 years after it achieved independence in 1947
2. Experiences of Japan during the first 30 years after the Meiji Restoration in 1867

Both were countries with ancient civilizations and a sophisticated culture. Each had a highly structured population. Japan had a feudal structure with daimyos (feudal lords) and serfs. India had a rigid caste system with Brahmans at the top and the untouchables, designated by the British the 'scheduled castes', at the bottom.

Both countries experienced a major political change that permitted a drastic alteration in political, economic, and social arrangements. In both countries a group of able, dedicated leaders came to power. They were full of with national pride and determined to convert economic stagnation into rapid growth, to transform their countries into great powers.

Almost all differences favored India rather than Japan. The prior rules of Japan had enforced almost complete isolation from the rest of the world. International trade and contact was limited to one visit from one Dutch ship a year. The few Westerners permitted to stay in the country were confined to a small enclave on an island in the harbor of Osaka. Three or more centuries of enforced isolation had left Japan ignorant of the outside world, far behind the West in science and technology, and with almost no one who could speak or read any foreign language other than Chinese.

India was much more fortunate. It had enjoyed substantial economic growth before World War I. That growth was converted into stagnation between the two world wars by the struggle for Independence from Britain, but was not reversed. Improvements in transportation had ended the localized famines that had earlier been a recurrent curse. Many of its leaders had been educated in advanced countries of the West, particularly in

Great Britain. British rule left it with a highly skilled and trained civil service, modern factories, and an excellent railroad system. None of these existed in Japan in 1867. India was technologically backward compared to the West, but the differential was less than that between Japan in 1867 and the advanced countries of that day.

India's physical resources, too, were far superior to Japan's. About the only physical advantage Japan had was the sea, which offered easy transportation and a plentiful supply of fish. For the rest, India is nearly nine times as large as Japan, and a much larger percentage of its area consists of relatively level and accessible land. Japan is mostly mountainous. It has only a narrow fringe of habitable and arable land along the seacoasts. Finally, Japan was on its own. No foreign capital was invested in Japan; no foreign governments or foreign foundations in capitalist countries formed consortiums to make grants or offer low interest loans to Japan. It had to depend on itself for capital to finance its economic development.

It did have one lucky break. In the early years after the Meiji Restoration, the European silk crops experienced disastrous failure that enabled Japan to earn more foreign exchange by silk exports than she otherwise could have. Aside from that, there were no important fortuitous or organized sources of capital.

India fared far better. Since it achieved Independence in 1947, it has received an enormous volume of resources from the rest of the world, mostly as gifts. The flow continues today. Despite the similar circumstances of Japan in 1867 and India in 1947, the outcome was vastly different. Japan dismantled its feudal structure and extended social and economic opportunity to all its citizens. The lot of the ordinary man improved rapidly, even though population exploded. Japan became a power to be reckoned with on the international political scene. It did not achieve full individual human and political freedom, but it made great progress in that direction.

India paid lip service to the elimination of caste barriers yet made little progress in practice. Differences in income and wealth between the few and the many grew wider, not narrower. Population exploded, as it did in Japan eight decades earlier, but economic output per capita did not. It remained nearly stationary. Indeed, the standard of life of the poorest third of the population has probably declined.

What explains the difference in results of these 2 countries? Many observers point to different *social institutions and human characteristics*. Religious taboos, the caste system, a fatalistic philosophy—all these are said to imprison the inhabitants of India in a straitjacket of tradition. Indians are said to be unenterprising and sluggish.

By contrast, the Japanese are lauded as hardworking, energetic, eager to respond to influences from abroad, and incredibly ingenious at adapting what they learn from outside to their own needs.

This description of the Japanese may be accurate today. It was not in 1867. An early foreign resident in Japan wrote: "Wealthy we do not think it [Japan] will ever become.

The advantages conferred by Nature, with exception of the climate, and the love of indolence and pleasure of the people themselves forbid it. The Japanese are a happy race, and being content with little are not likely to achieve much." Wrote another: "In this part of the world, principles, established and recognized in the West, appear to lose whatever virtue and vitality they originally possessed and to tend fatally toward weediness and corruption."

Similarly, the description of the Indians may be accurate today for some Indians in India, even perhaps for most, but it certainly is not accurate for Indians who have migrated elsewhere. In many African countries, in Malaya, Hong Kong, the Fiji Islands, Panama, and, most recently, Great Britain, Indians are successful entrepreneurs, sometimes constituting the mainstay of the entrepreneurial class. *They have often been the dynamo initiating and promoting economic progress*. Within India itself, enclaves of enterprise, drive, and initiative exist wherever it has been possible to escape the *deadening hand of government control*.

In any event, economic and social progress *does not depend on the attributes or behavior of the masses*. In every country a tiny minority sets the pace, determines the course of events. In the countries that have developed most rapidly and successfully, *a minority of enterprising and risk-taking individuals have forged ahead, created opportunities for imitators to follow, have enabled the majority to increase their productivity*.

The characteristics of the Indians that so many outside observers deplore reflect rather than cause the lack of progress. Sloth and lack of enterprise flourish when hard work and the taking of risks *are not rewarded*. A fatalistic philosophy is an accommodation to stagnation. India and Maharashtra has no shortage of people with the qualities that could spark and fuel the same kind of economic development that Japan experienced after 1867, or even that Germany and Japan did after World War II. Indeed, the real tragedy of India is that it remains a subcontinent teeming with desperately poor people when it could, we believe, be a flourishing, vigorous, increasingly prosperous and free society.

Free Markets and Human Character

There is a fascinating example of how an economic system can affect the qualities of people. Chinese refugees who streamed into Hong Kong after the communists gained power sparked its remarkable economic development and gained a deserved reputation for initiative, enterprise, thrift, and hard work. The liberalization of emigration from Red China had produced a new stream of immigrants—from the same racial stock, with the same fundamental cultural traditions, but raised and formed by thirty years of communist rule. It was heard from several firms that hired some of these refugees that they were very different from the earlier Chinese entrants into Hong Kong. The new immigrants show little *initiative and want to be told precisely what to do. They are lethargic and uncooperative.* No doubt a few years in Hong Kong's free market would change all that.

What then accounts for the different experiences of Japan from 1867 to 1897 and of India from 1947 to date? We believe that the explanation is the same as for the difference between West and East Germany, Israel and Egypt, Taiwan and communist China.

Japan relied primarily on voluntary cooperation and free markets— on the model of the Britain of its time. India relied on central economic planning—on the model of the Britain of its time.

The Meiji government did intervene in many ways and played a key role in the process of development. It sent many Japanese abroad for technical training. It imported foreign experts. It established pilot plants in many industries and gave numerous subsidies to others. But at no time did it try to control the total amount or direction of investment or the structure of output. The state maintained a large interest only in shipbuilding and iron and steel industries that it thought necessary for military power. It retained these industries because they were not attractive to private enterprise and required heavy government subsidies. These subsidies were a drain on Japanese resources. They impeded rather than stimulated Japanese economic progress. Finally, an international treaty prohibited Japan during the first three decades after the Meiji Restoration from imposing tariffs higher than 5 percent. This restriction proved an unmitigated boon to Japan, though it was resented at the time, and tariffs were raised after the treaty prohibitions expired.

India and inevitably Maharashtra is following a very different policy. Its leaders regard *capitalism as synonymous with imperialism*, to be avoided at all costs. Some areas of production are strictly reserved to government; in others private firms are permitted to operate, but *only in conformity with the five yearly Plans*. *Tariffs and quotas control imports, subsidies control exports*. *Self sufficiency* is the ideal offshore trade is highly regulated. Needless to say, these measures produce shortages of foreign exchange. These are met by detailed and extensive foreign exchange control—a major source both of inefficiency and of special privilege. Wages and prices are controlled throughout the nation.

A government permit is required to build a factory or to make any other investment. Taxes are omnipresent, highly graduated on paper, evaded in practice. Smuggling, black markets, illegal transactions of all kinds are every bit as omnipresent as taxes, undermining all respect for law. In fact, India is a place with highest number of laws with least respect for them.

Reliance on the market in Japan released *hidden and unsuspected resources of energy and ingenuity*. *It prevented vested interests from blocking change*. It forced development to conform to the harsh test of efficiency. Reliance on government controls in India *frustrated initiative or diverts it into wasteful channels*. It protects vested interests from the forces of change. ***It substitutes bureaucratic approval for market efficiency as the criterion of survival***.

Case study: Textile Industry in two countries[8]

The experience in the two countries with homemade and factory- made textiles serves to illustrate the difference in policy. Both Japan in 1867 and India in 1947 had extensive production of textiles in the home. In Japan foreign competition did not have much effect on the home production of silk, perhaps because of Japan's advantage in raw silk reinforced by the failure of the European crop, but it all but wiped out the home spinning of cotton and later the hand-loom weaving of cotton cloth. A Japanese factory textile industry developed. At first, it manufactured only the coarsest and lowest-grade fabrics, but then moved to higher and higher grades and ultimately became a major export industry.

In India hand-loom weaving was *subsidized and guaranteed a market*, *allegedly to ease the transition to factory production*. Factory production has been growing gradually but has been deliberately held back to protect the hand-loom industry. *Protection has meant expansion.* The number of hand looms roughly doubled from 1948 to 1978. Today, in thousands of villages throughout India, the sound of hand looms can be heard from early morning to late at night. There is nothing wrong with a hand-loom industry, provided it can compete on even terms with other industries.

In Japan a prosperous, though extremely small, hand-loom industry still exists. It weaves luxury silk and other fabrics. In India the hand-loom industry prospers because it is subsidized by the government. Taxes are, in effect, imposed on people who are no better off than the ones who operate the looms in order to pay them a higher income than they could earn in a free market.

Early in the 19th century Great Britain faced precisely the same problem that Japan did a few decades later and India did more than a century later. The power loom threatened to destroy a prosperous hand-loom weaving industry. A royal commission was appointed to investigate the industry. It considered explicitly the policy followed by India: subsidizing hand-loom weaving and guaranteeing the industry a market. It rejected that policy out of hand on the ground that it would only make the basic problem, an excess of hand-loom weavers, worse—precisely what happened in India. Britain adopted the same solution as Japan—the temporarily harsh but ultimately beneficent policy of letting market forces work.

The contrasting experiences of India and Japan are interesting because they bring out so clearly ***not only the different results of the two methods of organization but also the lack of relation between objectives pursued and policies adopted***. The objectives of the new Meiji rulers—who were dedicated to strengthening the power and glory of their country and who attached little value to individual freedom—were more in tune with the Indian policies than with those they themselves adopted. The objectives of the new

[8] Milton Friedman: "Free to Choose- A personal statement", 1990, A Harvest Book, Harcourt Inc

Indian leaders—who were ardently devoted to individual freedom—were more in tune with the Japanese policies than with those they themselves adopted.

> "The record of history is absolutely crystal clear: that there is no alternative way so far discovered of improving the lot of the ordinary people that can hold a candle to the productive activities that are unleashed by a free enterprise system."
>
> Milton Friedman

Vision for Maharashtra

Free enterprises for Maharashtra

After 60 years of socialistic approach towards development, we are here to rethink our goals, objectives, and policy choices to check the existing ones and opting for new fresh perspectives towards true long term development.

The vision we hold today assumes the individual as an end in himself, and not a tool for development for other individuals. The vision does not make false promises of social aids, welfare schemes, programs or guarantees but ensures sufficient freedom of choice in practice.

The vision takes into account what the average people in Maharashtra require for their own progress.

In the following chapters, we see what too much government intervention has done to the economic growth and quality of life of people in the state.

We simultaneously provide solutions to be adopted to bring the state on the path of prosperity and development.

Present state of Maharashtra Economy

The current Maharashtra economy is a picture of contrast between how individuals react under a government-controlled environment and how they respond to a market-based environment. All over the world, evidence suggests that those economic reforms which encouraged *individual enterprise* have led to higher *inclusive* economic growth in the region.

Maharashtra can generate additional economic growth by fostering entrepreneurial activity within its borders. Among other things, Maharashtra is poised to generate new business startups in the high technology area that can help it become a major competitor in the world economy. For example, it has a strong education base suited to entrepreneurial activities, increased inflows of foreign capital aimed at its growing information technology services sector, and a host of successful new business startups. To pursue further the entrepreneurial approach to economic growth, Maharashtra must now provide an environment where the government's role of intervention overall should be minimized so that the influence of the free market and individual self-interest can be fully realized.

Present state of Maharashtra's economy cannot be explained better without explaining the state of India's economy. In fact, the present state of Maharashtra's economy is an inevitable result of the economic policies that have been adopted at central level since Independence.

Socialistic approach[9] of development

It was with the advent of the Industrial Revolution in the world economy that the role of the governments in economic development of their countries began to change dramatically. In the West, the resulting industrialization and economic development were based on the establishment of individual property rights that encouraged the growth of private capital. Competition and individual enterprise thrive in this environment because *individuals pursue their self-interest of survival and wealth accumulation*. *The instinct to survive under competitive pressures fosters innovation, and a rise in productivity*, which eventually leads to both increased profits for business and lower prices for consumers, thereby ensuring the welfare of the society at large.

Socialists all over the world argued that capitalism, or private ownership of capital can lead to greater inequalities of income and wealth, while developmental economists

9 By socialist approach, we mean here the promise to raise the standard of living through directed and controlled economic development.

argued that private decisions may not always lead to socially desirable outcomes, particularly in the case of market imperfections. Indeed, many policymakers at the time saw market failures as quite common and therefore assumed that only appropriate government interventions could guide an economy to a path of sustained economic development.

In the early 20th century, the former Soviet Union attempted a bold experiment of improving the country's well-being as measured by greater equality of income and wealth, through the idea of total ownership of capital by the government. Initially, the Soviet Government was able to raise productivity through directed industrialization and, within a span of 25 years, towards the end of World War II, had emerged as a superpower. It was around this time that a substantial number of colonized nations were gaining their independence, India being one of them. Unfortunately, as colonies of the western nations, these countries had been deprived of industrialization that many of the western nations were undergoing. Based on the successful experience of the former Soviet Union, many economists and policymakers concluded that *planning* was essential for the efficient allocation of an economy's resources, particularly in a poor country [10].

India's economic development strategy after Independence

India's economic development strategy immediately after Independence was based primarily on the Mahalanobis model of 5 year plans, which gave preference to the investment in goods industries sector, with secondary importance accorded to the services and household goods sector. For example, the Mahalanobis model placed strong emphasis on mining and manufacturing (for the production of capital goods) and infrastructural development (including electricity generation and transportation). The model downplayed the role of the factory goods sector because it was more capital intensive and therefore would not address the problem of high unemployment in India. Any increase in planned investments in India required a *higher level of savings* than existed in the country – the government could invest only if its citizens maintained sufficient savings. *Because of the low average incomes in India, the needed higher levels of savings had to be generated mainly by restrictions on the growth of consumption expenditures. Therefore, the Indian government implemented a progressive tax system not only to generate a higher level of savings but also to restrict increases in income and wealth inequalities*. Among other things, this strategy involved channelization of resources into their most productive uses. Investments were carried out both by the government and the private sector, with the government investing in strategic sectors such as national defense and also those sectors in which private capital would not be forthcoming because of lags or the size of investment required, such as infrastructure. The private sector was required to contribute to India's economic growth in *ways envisaged by the government planners*. Not only did the government determine where

[10] Economic Development in India: the role of individual enterprise (and entrepreneurial spirit) *Anil K. Lal** and *Ronald W. Clement***, Asia-Pacific Development Journal Vol. 12, No. 2, December 2005

businesses could invest in terms of location, but it also identified *what businesses could produce, what they could sell, and what prices they could charge*.

Centralized planning: its effect on the economy

Thus the strategy of economic development in India meant

1. Direct participation of the government in economic activities such as production and selling; and
2. Regulation of private sector economic activities through a complex system of controls.

In addition, the Indian economy was sheltered from foreign competition through use of both the 'infant industry argument' and a binding foreign exchange constraint. Imports were limited to goods considered essential either to the development of the economy (such as raw materials and machines) or to the maintenance of minimal living standards (such as crude oil and food items). It was further decided that exports should play a limited role in economic development, thereby minimizing the need to compete in the global market place. As a result, India became a relatively *closed economy*, permitting only limited economic transactions with other countries. Domestic producers were sheltered from foreign competition not only from abroad but also from within India itself[11].

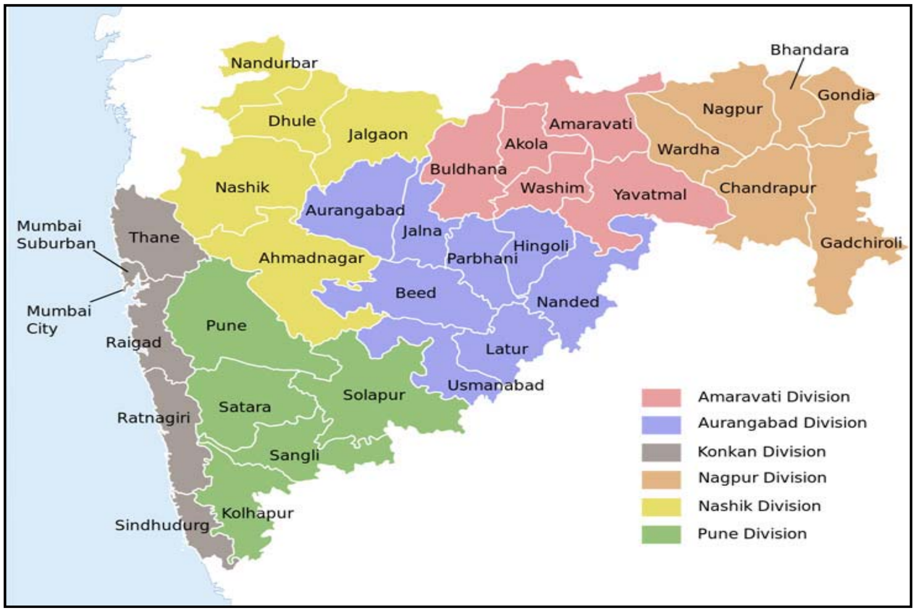
The consequences of India's regulated economic development

India's environment of regulated economic development led to the formulation of policies that were concerned with both macroeconomic and microeconomic aspects. Whereas the macroeconomic issues are already well known, we focus primarily on the microeconomic aspects of Indian economic policies.

In particular, we examine how individuals guided by their self-interests of survival and wealth accumulation will act in a regulated environment that discourages the pursuit of those self-interests.

[11] Economic Development in India: the role of individual enterprise (and entrepreneurial spirit) *Anil K. Lal** and *Ronald W. Clement***, Asia-Pacific Development Journal Vol. 12, No. 2, December 2005

Maharashtra state



Economic survey of Maharashtra 2011-12

Maharashtra occupies the western and central part of the country and has a long coastline stretching nearly 720 kilometers along the Arabian Sea.

The state of Maharashtra, established on May 1, 1960, is the second largest state in India both in terms of population and geographical area (3.08 lakh sq. km.). The state has a population of around 11 crore (Census 2011) which is 9.3 per cent of the total population of India. The state is highly urbanized with 45 per cent people residing in urban areas[12].

Administration in state

The state has 35 districts which are divided into six revenue divisions viz. Konkan, Pune, Nashik, Aurangabad, Amravati and Nagpur for administrative purposes.

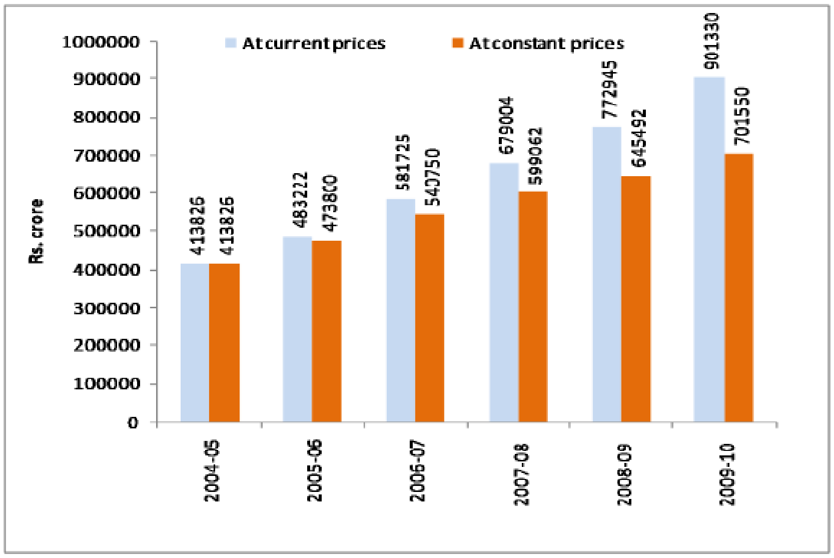
The state has a long tradition of having statutory bodies for planning at the district level. For local self-governance in rural areas, there are 33 Zilla Parishads, 351 Panchayat Samitis and 27,906 Gram Panchayats. The urban areas are governed through 23 Municipal Corporations, 221 Municipal Councils, 5 Nagar Panchayats and 7 Cantonment Boards[13].

Mumbai, the capital of Maharashtra and the financial capital of India, houses the headquarters of most of the major corporates and financial institutions. India's main

[12] Economic survey of Maharashtra 2011-12: "Government of Maharashtra" https://www.maharashtra.gov.in
[13] Economic survey of Maharashtra 2011-12: "Government of Maharashtra" https://www.maharashtra.gov.in

stock exchanges as well as capital market and commodity exchanges are located in Mumbai.

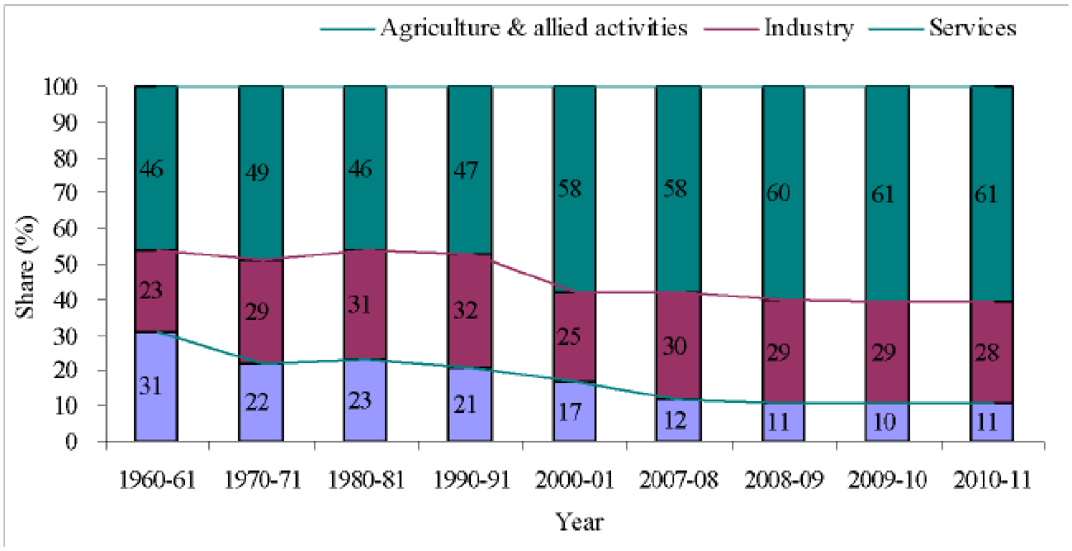
Gross State Domestic Product of Maharashtra[14]



The gross state domestic product (GSDP) at current prices for 2010-11 is estimated at Rs. 1068327 crore and contributes about 14.9 per cent to the national GDP. The GSDP has been growing at a rapid pace over the last few years. Presently industrial and services sector both together contribute about 87 per cent of the state's domestic product. The agriculture and allied activities sector contribute 13 per cent to the state's income.

[14] Presentation by Government of Maharashtra before Planning commission, New Delhi, 19 May, 2011 http://planningcommission.nic.in/plans/stateplan/present/MAHARASHTRA.pdf

Sectoral composition of Maharashtra State Income[15]



State and National Income and Comparison with Other States

Table 3.3 State Comparison – 2010-11

State	Growth rate (%) (at constant prices)	Share in GDP (%) (at current prices)	Per capita Income (₹) (at current prices)
Andhra Pradesh	10.0	8.23	62,912
Bihar	14.8	3.04	20,708
Gujarat	10.5	7.17	75,115
Karnataka	8.9	5.66	60,946
Kerala	9.1	3.87	71,434
Madhya Pradesh	8.2	3.63	32,222
Maharashtra	11.3	14.93	87,686
Punjab	7.0	3.20	69,737
Rajasthan	11.0	4.52	42,434
Tamil Nadu	11.7	7.65	72,993
Uttar Pradesh	7.9	8.31	26,355
West Bengal	7.1	6.62	48,536

Source : CSO, GoI for other states and DES, Maharashtra for Maharashtra State

The growth rates, share of GSDP in GDP and per capita income of major states are given in table above. The percentage share of Maharashtra in GDP is 14.9 per cent, highest among these states[16].

[15] Economic survey of Maharashtra 2011-12: "Government of Maharashtra" https://www.maharashtra.gov.in
[16] Economic survey of Maharashtra 2011-12: "Government of Maharashtra" https://www.maharashtra.gov.in

District Income[17]

Estimates of domestic product at district level in the state of Maharashtra are compiled by the 'Income Originating Approach', the method used for calculating the State Domestic Product. District domestic product estimates, therefore, have all the inherent limitations of the State Domestic Product estimates. As such, wherever the basic data is available, the methodology used at the State level has been followed for preparation of estimates at district level. The district level data in respect of agriculture and allied activities sector is mostly available, but the data for other sectors is very inadequate. Proxy indicators are used to allocate state level estimates to districts, as and when the actual data is not available. Because of the paucity of data, use of proxy indicators and various limitations in estimation procedure, the district domestic products may be used with a margin of error and can be used only to have a broad judgment of income at district level.

Developed districts	Mumbai, Raigad, Pune, Nagpur
Developing districts	Ratnagiri, Sindhudurg, Satara, Sangli, Kolhapur, Solapur, Latur, Ahmednagar, Nashik, Aurangabad, Dhule, Jalgaon, Akola, Amravati, Yavatmal, Wardha, Chandrapur, Bhandara
Underdeveloped districts	Buldhana, Washim, Jalna, Hingoli, Beed, Osmanabad, Parabhani, Nanded, Nandurbar, Gondia, Gadchiroli

Inter-regional Disparity

Inter-regional income inequality within Maharashtra has been a matter of concern for long. As early as 1984, a fact-finding committee under the chairmanship of V.M. Dandekar had attempted to quantify the regional imbalance in Maharashtra. Table 4 gives district-wise income in the state. It should be noted that the calculation of district income has started in recent years and such estimates should be considered tentative. Per Capita Net District Domestic Product (PCNDDP) for 2002-03 in 1993-94 prices indicates that the districts of Kolhapur, Mumbai (including Mumbai suburban), Nagpur, Pune, Raigad and Thane have an income greater than the state's average of Rs.16,479. In all these districts, except Raigad, 60 per cent of the population is urban. Nashik, Ratnagiri, Sangli and Sindhudurg districts have a PCNDDP that is above average, if calculated by excluding Mumbai.

Districts of Nashik, Ratnagiri, Sangli and Sindhudurg have PCNDDP that is above an average calculated after excluding Mumbai. *None of the districts in the Amravati and Aurangabad divisions have PCNDDP that is greater than the state's average even after excluding Mumbai*.

[17] Economic survey of Maharashtra 2011-12: "Government of Maharashtra" https://www.maharashtra.gov.in

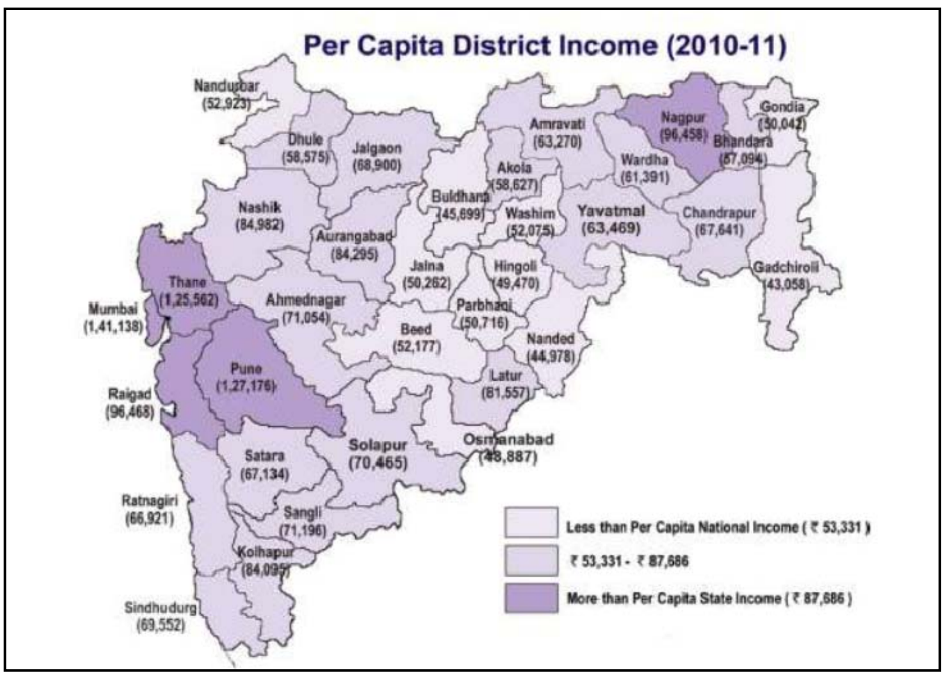
In Amravati and Aurangabad divisions, the average annual growth of PCNDDP between 2000-01 to 2003-04 is lower than the state's average in 8 of the 13 districts, viz., Amravati, Aurangabad, Beed, Jalna, Latur, Osmanabad, Parbhani and Yavatmal and it was negative in Aurangabad, Beed and Osmanabad.

Income Inequality – Our Analysis

To study the issue of widespread income inequality / disparity in the state, we have compared the data available with Economic Survey of Maharashtra from year 2003. Prior to 2003 there was no norm of calculating district wise per capita income as part of database of economic survey.

The data and analysis below shows state wide NOMINAL[18] income inequality (expressed in Rs.) whereas, we believe, there is more ACTUAL[19] income inequality in the state, considering the constantly reducing purchasing power of money.

Economic survey of Maharashtra 2011-12



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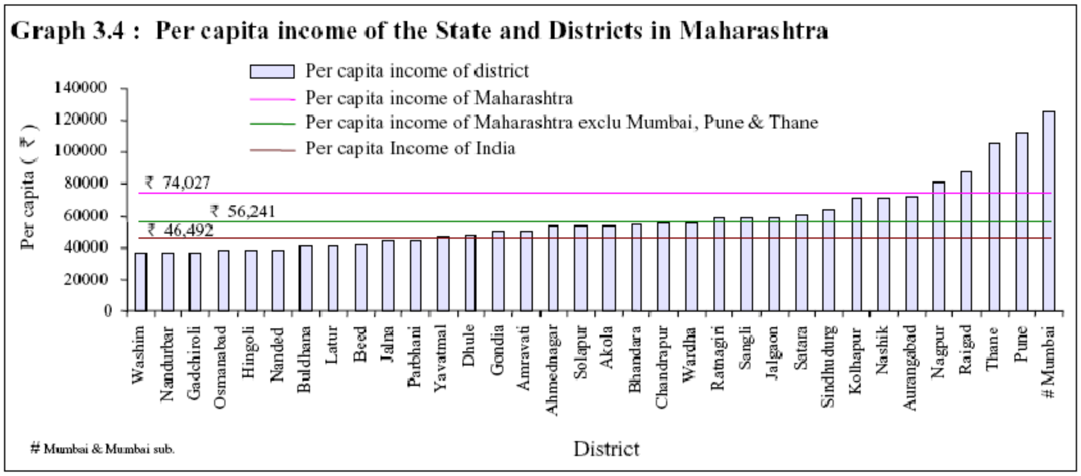
18 Nominal value in economics refers to a value expressed in monetary terms for a specific year or years, without adjusting for inflation http://www.investopedia.com/terms/n/nominalvalue.asp#ixzz2EGHbVEno

19 Actual value of income is what is inflation adjusted. Devaluation of currency at domestic and international standards

Key observations-

1. 4 out of 35 districts are above the average per head income at Maharashtra level (best)
2. 11 out of 35 districts are even below the average per head income at National level (worst)

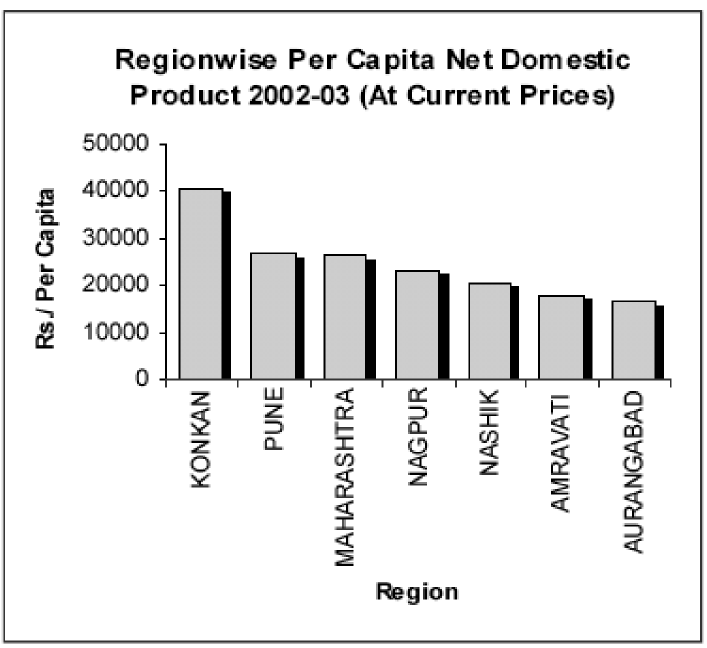
Economic survey of Maharashtra 2010-11



Key observations

1. Almost 50% of Maharashtra earns less than average per head income level of India.
2. More than 75% of Maharashtra -almost all the districts except Mumbai, Pune and Thane earn LESS THAN average per head income at Maharashtra level.

Economic survey of Maharashtra 2003-04



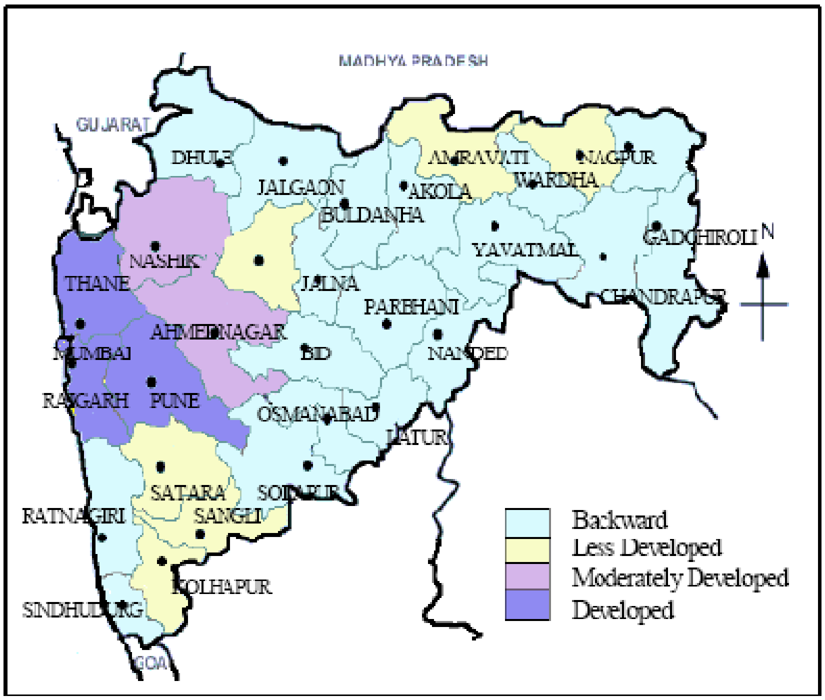
This is the oldest economic survey available with us and on the website of Maharashtra State Government. It does not show income inequality - district-wise - as can be seen from above. It is shown division-wise, where the poorest divisions of Aurangabad and Amravati, are well below average income of Rs 20,000 per head in the year 2002-03.

[According to one of the recent Environmental Status Report of ESR Maharashtra, It should be noted that the calculation of district income has started in recent years and such estimates should be considered tentative.]

Spread of Industrialization

The geographical spread of industrialization is assessed on the basis of the nature and extent of facilities and incentives provided by the State Government. Figure 1.8 shows the level of industrialization, which is categorized into four types viz, Backward, Less Developed, Moderately developed and Developed. It is noticed that industrialization has happened only in and around Mumbai.

The districts of Pune, Thane and Raigad are the developed districts with a few less developed pockets. Nashik and Ahmednagar are moderately developed while Satara, Sangli, Kolhapur, Aurangabad, Amravati and Nagpur are less developed. The rest of Maharashtra is categorized as backward.



Maharashtra State Development Report 2005

<u>THE QUESTION ARISES, WHY, IS THAT ONLY SUCH SMALL REGION IS DEVELOPED WITH NO SIGN OF GROWTH, LET ALONE DEVELOPMENT IN REST OF THE STATE OF MAHARASHTRA?</u>

The answer to which will follow as rest of the chapters unfold …

We now see how the economic development took and taking place…the oligarchic capitalism and nexus of business and politics

'Oligarchic Capitalism'[20]

After 1990's much celebrated LPG economic reforms, the country produced business icons like Ratan Tata, Narayan Murthy, Azim Premji, K V Kamath, Deepak Parekh, Sunil Mittal and Anand Mahindra. Murthy and his company Infosys set new benchmarks in governance norms. Their world-class campus and ESOPs-for-drivers showed India the new way the rich behaved. Their modest background and grand vision fired up a billion dreams in a country, which was still very unsure of its place in the world.

KV Kamath to Deepak Parekh, Sunil Mittal to Murthy most of them were first-generation entrepreneurs who led companies and espoused values that were steeped in middle-class ethos and high ethical standards. Even those who were not first generation like Wipro's Premji too reflected the values that the first-generation entrepreneurs were embracing. And not surprisingly, almost all of them got their inspiration in sunrise sectors like telecom and IT which did not have the old entrenched players to stifle them and which were somewhat *free from government controls*.

The newly appointed economic advisor to Prime Minister's office Raghuram Rajan admits that since the past decade, India has seen a sharp rise in what economists call "**oligarchic capitalism**". He notes that India has the largest number of billionaires in the world per trillion dollars of GDP. The predominant source of this wealth creation has been land, natural resources and government contracts. This ***government-business nexus*** has made things difficult for new players to emerge. In the global media, India is still closely associated with its technology-based entrepreneurs, but lately these dynamic moguls are getting replaced in the billionaire list by a new group: ***provincial tycoons who have cut deals with state governments to corner the market in location-based industries like mining and real estate***.

Despite economic reforms of 1991, the Liberalization, Privatization, and Globalization – LPG model of development ended the license raj on paper. In reality, businesses continue to patronize politicians and vice-versa. License raj has meant ***access to government patronage as a key factor in doing business and shaping fortunes***. However, those who did succeed in forming corporate-political nexus and using them for business aspirations, have failed in earning the respect that many of their peers from 1990s today command among countrymen.

[20] http://economictimes.indiatimes.com/news/news-by-company/corporate-trends/five-reasons-why-india-has-failed-to-produce-next-gen-business-icons/articleshow/16153410.cms

Economic Liberalism

The present centralized development in the pockets of the state and the country is a result of private entrepreneurs, trade opportunists and those entrepreneurs who knew their own way around the Parliament and bureaucracy.

In order to bring about 'inclusive' and a bottom to top approach of development, there is no alternative to keep government limited to its core functions and responsibilities of maintaining law and order and to create a competitive and transparent environment where individuals are free to setup businesses without too many restrictions.

The number of subjects under central and state government list and concurrent list mentioned below gives an idea to an individual the scope and extent of government regulation in the social and economic spheres and activities involved.

Center list[21]

Following are some of the subjects defined and enlisted under the List - I of the Seventh Schedule of the Constitution of India, which form the exclusive domain of the Central Government of the Union of India excluding all the states and the union territories.

- ✓ Diplomatic, consular and trade representation.
- ✓ Railways.
- ✓ Public debt of the Union.
- ✓ Currency, coinage and legal tender; foreign exchange.
- ✓ Foreign loans.
- ✓ Reserve Bank of India. Inter-State trade and commerce.
- ✓ Incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations but not including Co-operative Societies.
- ✓ Banking.
- ✓ Insurance.
- ✓ Establishment of standards of quality for goods to be exported out of India or transported from one state to another.
- ✓ Industries, the control of which by the Union is declared by Parliament by law to be expedient in the public interest.
- ✓ Regulation and development of oilfields and mineral oil resources; petroleum and petroleum products; other liquids and substances declared by Parliament by law to be dangerously inflammable.
- ✓ Taxes on income other than agricultural income.
- ✓ Duties of customs including export duties.
- ✓ Duties of excise on tobacco and other goods manufactured or produced in India except -

[21] The Constitution of India: http://www.constitution.org/cons/india/const.html

- alcoholic liquors for human consumption;
- opium, Indian hemp and other narcotic drugs and narcotics;
- but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

- ✓ Corporation tax.
- ✓ Taxes on the capital value of the assets, exclusive of agricultural land of individuals and companies; taxes on the capital of companies.
- ✓ Estate duty in respect of property other than agricultural land.
- ✓ Duties in respect of succession to property other than agricultural land.
- ✓ Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights.
- ✓ Taxes other than stamp duties on transactions in stock exchanges and futures markets.
- ✓ Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.
- ✓ Taxes on the sale or purchase of newspapers and on advertisements published therein.
- ✓ Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.
- ✓ Offences against laws with respect to any of the matters in this List.

The list above demonstrates the scope of Central government regulation, and the huge expenditure it makes on these sectors. Majority of these subjects are purely business, which can be run more efficiently in private arrangements, but the government control has restricted these businesses.

State list[22]

Following are the subjects defined and enlisted under the List - II of the Seventh Schedule of the Constitution of India, which form the exclusive domain of each one of the State Governments within India, and thus effectively ousting the domain of the Central (Union) Government in framing laws under these subjects:

- ✓ alcoholic liquors for human consumption
- ✓ opium, Indian hemp and other narcotic drugs and narcotics but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.
- ✓ Taxes on the entry of goods into a local area for consumption, use or sale therein.
- ✓ Taxes on the consumption or sale of electricity.
- ✓ Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92-A of List I.
- ✓ Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.

[22] The Constitution of India: http://www.constitution.org/cons/india/const.html

- ✓ Taxes on goods and passengers carried by road or on inland waterways.
- ✓ Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tram-cars subject to the provisions of Entry 35 of List III.
- ✓ Taxes on animals and boats.
- ✓ Tolls.
- ✓ Taxes on professions, trades, callings and employments.
- ✓ Capitation taxes.
- ✓ Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

The list shows the extent of state government control over economic and business activities among people. The list needs to be revised in order to reduce the government restrictions and ensure more freedom to people instead. Though this is a constitution of Independent Republic of India, it looks like people of country are still a colony being governed by foreign nation, where each and every activity is taxed to squeeze out money.

Concurrent list[23]

The following are the subjects defined and enlisted under the List - III of the Seventh Schedule of the Constitution of India, which form the joint domain of both the state Governments and the Union territories of India as well as the Central Government of India under these subjects.

- ✓ Bankruptcy and insolvency.
- ✓ Economic and social planning.
- ✓ Trade unions; industrial and labor disputes.
- ✓ Social security and social insurance; employment and unemployment.
- ✓ Trade and commerce in, and the production, supply and distribution of -
    - o products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products;
    - o foodstuffs including edible oilseeds and oils;
    - o cattle fodder, including oilcakes and other concentrates;
    - o raw cotton, whether ginned or unginned, and cotton seed; and raw jute
- ✓ Price control.
- ✓ Mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied.
- ✓ Factories.
- ✓ Boilers.
- ✓ Electricity.

The list shows the subjects with double government regulations. These sectors are most hampered due to center-state funds allocations and conflicts arising due to the division of decision making authorities.

[23] The Constitution of India: http://www.constitution.org/cons/india/const.html

Public Finance

> There are four ways in which you can spend money. You can spend your own money on yourself. When you do that, you really watch out what you're doing, and you try to get the most for your money. Or you can spend your own money on somebody else. For example, I buy a birthday present for someone. On this occasion I'm not so careful about the content of the present, but I'm very careful about the cost. Or, I can spend somebody else's money on myself. And in this case, I'm sure going to have a good lunch! While I will make sure to make the most of it, I will be least concerned about being frugal. **Finally, I can spend somebody else's money on somebody else. And if I spend somebody else's money on somebody else, I'm not concerned about how much it is, and I'm not concerned about what I get. And that's Government[24].**

When we live together as a society; the society as a whole needs some services. These services are needed for the smooth running of every component of society. These services are such that roughly every individual needs them as much as the others and exactly in the same proportion as others. These are the services that are and can be provided collectively and made use of collectively. No single individual or set of individuals has ownership on these services. Access to these services as well as their quality becomes the foundation for a prosperous and harmonized society.

As components of a single society, all individuals need protection from outside forces and from fellow individuals (if necessary). They also require a guarantee of fair justice and the means of communication (single currency), so that they can carry out their separate activities while pursuing their separate interests.

It follows that these services, since they are used and consumed by the society at large, should also be financed publicly.

Public finance

We know public finances by 'taxes', the contributions we make out of our earnings to the governing body so that it can provide us those public services. Not all people earn the same income, and so the quantity of contribution in the form of taxes varies.

[24] Milton Friedman: "Free to Choose- A personal statement", 1990, A Harvest Book, Harcourt Inc

In the existing scenario of the country and state economy, education and health are considered to be public services. Everybody agrees that education and healthcare facilities are needed for everybody. And yet, the kind of education, its duration and the kind of healthcare facilities required tends to differ from person to person. Not everyone wants to learn the same subjects to pursue the same career, not everyone falls ill every year with similar diseases.

All over the world, when the role of government was very limited, people had incentives to work, earn, save for healthcare, invest in educations and skill enhancing techniques and take care of their current and future needs. After World War II, governments became bigger and started intervening in services such as education and healthcare. These are fundamental and permanent services that everybody makes use of at one or the other time.

In India, with centralized planning, huge amount of taxes are collected by central government and ever higher funds are allocated for provision of these services in annual budgets and Five year investment plans. The government wants to ensure the welfare of its citizens by providing equal amount of facilities such as education and health care. However, the quality of these services suffers, and public money is grossly mismanaged. The government thus fails in its objective.

The reason for this failure of government can be given very simply in one sentence:
"When everybody owns something, nobody owns it, and *nobody has a direct interest in maintaining or improving its condition"*.

Those who are better off, pay to get better quality private services. The poor, who are dependent on socialized services, have no choice but to make do with the poor quality of these publicly financed services.

Planning Commission and State Annual Plan

The Planning Commission was set up by a Resolution of the Government of India in March 1950 in pursuance of declared objectives of the Government to promote a rapid rise in the standard of living of the people by efficient exploitation of the resources of the country, increasing production and offering opportunities to all for employment in the service of the community. The Planning Commission was charged with the responsibility of assessing the resources of the country, augmenting deficient resources, formulating plans for the most effective and balanced utilization of resources and determining priorities. Jawaharlal Nehru was the first Chairman of the Planning Commission[25].

All the states in the country present an 'Annual Financial Plan', also called Budget. The size of budget plan for the year consists of state's own income (tax and non-tax revenue),

[25] Planning Commission: Government of India, http://planningcommission.nic.in/

along with central government's grants and fund allocations under various schemes and programs.

Planning commission plays an eminent role in deciding central government schemes, programs and fund allocation and their disbursement in state government's annual budgets. There are many other important functions and roles that the planning commission performs at the central as well as state level. In this chapter, we study the Maharashtra State Budget, – a key instrument by which one learns how public funds are spent in the Maharashtra state.

Private Vs Government expenditure

Companies and businesses in private enterprise arrangements maintain their accounts and present their balance sheets to the investors and shareholders – it serves as useful basic information for people to trust and invest their hard earned money in these companies. Private businesses raise funds from interested shareholders in stock market, carry out business activities, provide quality goods and services and the profits generated by them are distributed among the participant shareholders and investors.

However, the situation in government is in total contrast. Take for example, an urban local body such as the Pune Municipal Corporation, or even the state government. These institutions raise revenue from people in the form of taxes. People contribute their hard earned money in return for poor quality services. Nor do these institutions maintain accounts by using state-of-the-art accounting methods. And instead of generating profits, they make financial blunders, which again are bailed out by extra taxes levied on people.

In private arrangements, people voluntarily invest in companies that serve them with goods and services. Under government financed system, people are forced to pay taxes in exchange of such services that prove to be hazardous rather than beneficial.

Budgets –Financial statements of Government

Revenue – It is an income from or expenditure on those services which are recurrent in nature. For example, salaries and wages, maintenance, repairs etc.
Capital- It is an income from or expenditure on fixed physical assets that are one time. For example, constructed building, dams, roads etc.

To understand where the money comes from and where it goes, one needs to be familiar with the following terms:

Revenue Income / Revenue Receipts	Income earned/ receipts received from taxes charged on service provided by the state, urban local bodies
Revenue Expenditure	Expenditure on social, economic services provided by the state or local governing bodies
Capital Income / Capital Receipts	Income / profits generated on physical assets owned by governing bodies
Capital Expenditure	Expenses made on creation of physical assets by governing bodies.

The administrative expenditure, consisting of salaries of government employees and wages of contractual workers, that is the cost of running the government system, roughly comes to 60% of annual budgets. The detailed analysis of government expenditure, its rational, practical output and the need to curb it drastically is discussed mainly the subsequent chapters.

Table 1.1

GOVERNMENT OF MAHARASHTRA : BUDGET AT A GLANCE

(₹ crore)

	Item	2005-06 (Actual)	2006-07 (Actual)	2007-08 (Actual)	2008-09 (Actual)	2009-10 (Actual)	2010-11 (R.E.)	2011-12 (B.E.)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1.	**Revenue Receipts (a + b)**	**48,438**	**62,195**	**79,583**	**81,271**	**86,910**	**1,07,159**	**1,21,504**
	a) Tax Revenue	38,522	46,122	55,126	60,049	67,354	84,915	97,404
	b) Non-Tax Revenue	9,916	16,073	24,457	21,222	19,556	22,244	24,100
2.	**Revenue Expenditure**	**52,280**	**61,385**	**64,780**	**75,694**	**94,916**	**1,12,847**	**1,21,446**
	of which							
	a) Interest Payments	10,523	11,983	12,932	13,027	14,838	16,102	18,049
	b) Administrative Services	4,207	4,824	5,504	6,560	8,173	10,793	12,561
	c) Pensions & Misc. gen. Services	4,104	4,364	4,215	5,199	6,229	9,177	10,007
3.	**Revenue Deficit (2 - 1)**	**3,842**	**(-) 810**	**(-) 14,803**	**(-) 5,577**	**8,006**	**5,688**	**(-) 58**
4.	**Capital Receipts**	**24,176**	**16,298**	**1,718**	**19,065**	**30,383**	**31,560**	**32,676**
	of which							
	a) Recovery of loans	551	51	733	560	515	578	475
	b) Other capital receipts	0	0	0	18	25	0	0
	c) Borrowings & Other Liabilities	17,883	11,540	(-) 3,717	14,363	26,018	25,208	22,860
5.	**Capital Expenditure**	**20,082**	**17,121**	**17,414**	**24,278**	**22,865**	**25,706**	**32,679**
6.	**Total Receipts (1 + 4)**	**72,614**	**78,493**	**81,301**	**1,00,336**	**1,17,293**	**1,38,719**	**1,54,180**
7.	**Total Expenditure (2 + 5)**	**72,362**	**78,506**	**82,194**	**99,972**	**1,17,781**	**1,38,553**	**1,54,125**
8.	**Appropriation to Contingency Fund**	**0**	**0**	**0**	**0**	**350**	**0**	**0**
9.	**Budgetary Deficit (7 – 6 – 8)**	**(-) 252**	**13**	**893**	**(-) 364**	**138**	**(-) 166**	**(-) 55**
10.	**Fiscal Deficit (9 + 4 C)**	**17,631**	**11,553**	**(-) 2,824**	**13,999**	**26,156**	**25,042**	**22,805**
				As per cent of G.S.D.P.				
1.	**Revenue Receipts (a + b)**	**10.0**	**10.6**	**11.6**	**10.8**	**10.0**	**10.0**	**9.7**
	a) Tax Revenue	7.9	7.9	8.0	8.0	7.8	7.9	7.8
	b) Non - Tax Revenue	2.0	**2.7**	3.6	2.8	2.3	2.1	1.9
2.	**Revenue Expenditure**	**10.7**	**10.5**	**9.5**	**10.0**	**10.9**	**10.6**	**9.7**
	of which							
	a) Interest Payments	2.2	2.1	1.9	1.7	1.7	1.5	**1.4**
	b) Administrative Services	0.9	0.8	0.8	0.9	0.9	1.0	**1.0**
	c) Pensions & Misc. gen. Services	0.8	0.7	0.6	0.7	0.7	0.9	0.8
3.	**Revenue Deficit (2 - 1)**	**0.8**	**(-) 0.1**	**(-) 2.2**	**(-) 0.7**	**0.9**	**0.5**	**0.0**
4.	**Net Capital Receipts**	**5.0**	**2.8**	**0.3**	**2.5**	**3.5**	**3.0**	**2.6**
	of which							
	a) Recovery of loans	0.1	0.0	0.1	0.1	0.1	0.1	0.0
	b) Other capital receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	c) Borrowings & Other Liabilities	3.7	2.0	(-) 0.5	1.9	3.0	2.4	1.8
5.	**Capital Expenditure**	**4.1**	**2.9**	**2.5**	**3.2**	**2.6**	**2.4**	**2.6**
6.	**Total Receipts (1 + 4)**	**14.9**	**13.4**	**11.9**	**13.3**	**13.5**	**13.0**	**12.3**
7.	**Total Expenditure (2+5)**	**14.9**	**13.4**	**12.0**	**13.3**	**13.6**	**13.0**	**12.3**
8.	**Appropriation to the contingency fund**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
9.	**Budgetary Deficit (7 – 6 – 8)**	**(-) 0.1**	**0.0**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
10.	**Fiscal Deficit (9 + 4 C)**	**3.6**	**2.0**	**(-) 0.4**	**1.9**	**3.0**	**2.3**	**1.8**

Source - Finance Department, GoM.

B.E.-Budget Estimates   R.E.- Revised Estimates

Economic Survey of Maharashtra 2011-12

Table 1.2

GOVERNMENT OF MAHARASHTRA BUDGET : TRENDS IN RECEIPTS ON REVENUE AND CAPITAL ACCOUNTS

(₹ crore)

	Item	2005-06 (Actual)	2006-07 (Actual)	2007-08 (Actual)	2008-09 (Actual)	2009-10 (Actual)	2010-11 (R.E.)	2011-12 (B.E.)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(A)	**Total Revenue Receipts (1+2+3+4)**	**48,438**	**62,195**	**79,583**	**81,271**	**86,910**	**1,07,159**	**1,21,504**
(1)	**State's own Tax Revenue (1 to 9)**	**33,539**	**40,098**	**47,528**	**52,031**	**59,106**	**73,496**	**83,686**
	(1) Sales Tax	19,677	24,131	26,753	30,680	32,676	40,815	46,000
	(2) Stamps and Registration Fees	5,266	6,416	8,550	8,288	10,774	14,140	15,677
	(3) State Excise Duties	2,824	3,301	3,963	4,434	5,057	5,800	8,500
	(4) Taxes and Duties on Electricity	1,561	1,577	2,688	2,395	3,289	4,686	4,400
	(5) Other Taxes on Income & Expenditure	1,157	1,246	1,488	1,561	1,612	1,608	1,700
	(6) Taxes on Vehicles	1,309	1,841	2,143	2,220	2,682	3,471	4,000
	(7) Other Taxes & Duties on Commodities & Services	712	878	1,043	1,015	1,325	1,041	1,099
	(8) Tax on Goods and Passengers	504	224	388	892	977	739	813
	(9) Land Revenue	429	484	512	546	714	1,196	1,497
(2)	**Non-Tax Revenue (1−2)**	**5,935**	**7,518**	**16,948**	**9,790**	**8,353**	**8,993**	**9,731**
	(1) Interest Receipts	1,737	2,504	1,170	1,017	1,342	1,621	1,156
	(2) Other non-tax revenue	4,198	5,014	15,778	8,773	7,011	7,372	8,575
(3)	**Share in Central Taxes (1 to 6)**	**4,983**	**6,024**	**7,598**	**8,018**	**8,248**	**11,419**	**13,718**
	(1) Taxes on Income other than Corporation Tax	960	1,141	1,618	1,651	1,891	2,359	2,726
	(2) Corporation Tax	1,378	1,881	2,411	2,629	3,394	4,463	5,542
	(3) Taxes on Wealth	3	2	3	2	8	9	11
	(4) Customs	971	1,175	1,436	1,533	1,154	1,997	2,323
	(5) Union Excise Duties	1,309	1,247	1,371	1,337	930	1,452	1,771
	(6) Service Tax	362	578	759	866	871	1,139	1,345
(4)	**Grants in Aid from Central Government**	**3,981**	**8,555**	**7,509**	**11,432**	**11,203**	**13,251**	**14,369**
(B)	**Total Capital Receipts (1+2+3+4)**	**24,176**	**16,298**	**1,718**	**19,065**	**30,383**	**31,560**	**32,676**
(1)	*Receipts from Public Debts (a+b)*	***23,659***	***14,557***	***13,761***	**21,612**	**21,564**	**25,507**	**25,872**
	(a) Internal Debt of the State Govt.*	23,169	14,059	13,432	21,227	20,812	24,698	24,000
	(b) Loans & Advances from Central Govt.	490	498	329	385	752	809	1,872
(2)	***Loans & Advances by the State Government (Recoveries).***	***551***	***51***	***733***	***560***	***515***	***578***	***474***
(3)	***Other Capital Receipts. (net) ‡***	***(-)134***	***183***	***0***	***75***	***24***	***0***	***0***
(4)	***Public Account (net)* (a+b+c+d)**	***100***	***1,508***	***(-) 12,776***	***(-) 3,182***	***8,280***	***5,475***	***6,330***
	(a) Small Savings, Provident Funds, etc. (net)	587	640	685	804	1,790	2,341	2,372
	(b) Reserve Funds (net) (1+2)	1,019	1,646	(-) 11,717	190	(-) 351	405	311
	(1) Interest Bearing	3	7	24	44	51	(-) 57	(-) 9
	(2) Non-interest Bearing	1,016	1,639	(-) 11,741	146	(-) 402	462	320
	(c) Civil Deposits (net) (1+2)	1,425	1,714	1,876	1,240	3,502	2,632	4,148
	(1) Interest Bearing	554	570	468	768	1,899	2,616	3,500
	(2) Non-interest Bearing	871	1,144	1,408	472	1,603	16	648
	(d) Others	(-) 2,931	(-) 2,492	(-) 3,620	(-) 5,416	3,339	97	(-) 501
	Total Receipts (A + B)	**72,614**	**78,493**	**81,301**	**1,00,336**	**1,17,293**	**1,38,719**	**1,54,180**

Source - Finance Department, GoM.

‡ It comprises 'inter-state settlement' (net), appropriations to the 'contingency fund' (net) and 'contingency fund' (net).

* Inclusive of ways & means advances. R.E. – Revised Estimates B.E. – Budget Estimates

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Table 1.3

GOVERNMENT OF MAHARASHTRA BUDGET : TRENDS IN EXPENDITURE ON REVENUE AND CAPITAL ACCOUNTS

(₹ crore)

	Item	2005-06 (Actuel)	2006-07 (Actual)	2007-08 (Actual)	2008-09 (Actual)	2009-10 (Actual)	2010-11 (R.E.)	2011-12 (B.E.)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(A)	**Revenue Expenditure (1+2)**	**52,280**	**61,385**	**64,780**	**75,694**	**94,916**	**1,12,847**	**1,21,446**
(1)	**Development Expenditure (a+b+c)**	**30,583**	**36,279**	**40,934**	**49,109**	**62,845**	**73,707**	**77,488**
	(a) Social Services (1 to 8)	**19,917**	**23,559**	**26,773**	**31,052**	**41,005**	**52,281**	**56,552**
	(1) Education, Sport, Art & Culture	10,762	12,316	13,642	16,447	22,208	27,994	30,940
	(2) Health & Family Welfare	2,124	2,254	2,695	3,105	3,696	4,705	4,864
	(3) Water Supply Sani. Housing and Urban Development	2,302	3,565	5,044	4,460	6,939	7,837	9,224
	(4) Information & Broadcasting	22	24	27	31	40	49	49
	(5) Welfare of SC. ST. & OBC	1,653	1,904	2,392	3,200	4,145	5,016	5,547
	(6) Labour and Labour Welfare	273	319	402	528	599	693	718
	(7) Social Welfare and Nutrition	2,749	3,132	2,527	3,237	3,325	5,912	5,131
	(8) Others	32	45	44	44	53	75	79
	(b) Economic Services (1 to 9)	**9,315**	**11,703**	**13,237**	**16,813**	**20,372**	**20,495**	**20,083**
	(1) Agriculture and Allied activities	2,732	3,363	3,468	6,403	6,460	6,072	5,853
	(2) Rural Development	2,019	2,589	1,060	1,980	2,493	2,482	2,799
	(3) Special Area Programme	21	33	33	31	28	62	40
	(4) Irrigation and Flood control	1,318	1,514	1,648	1,939	2,340	2,402	2,562
	(5) Energy	1,993	2,601	3,411	2,808	4,138	3,714	3,407
	(6) Industry and Minerals.	458	566	1,043	682	998	974	684
	(7) Transport and Communication	554	697	2,254	2,691	3,227	3,673	3,364
	(8) Science, Technology & Environment	13	25	26	42	72	67	74
	(9) General Economic Services	207	315	294	237	616	1,049	1,300
	(c) Grants-in-Aid & contributions to Local Bodies & P.R. Institutions	**1,351**	**1,017**	**924**	**1,244**	**1,468**	**931**	**853**
(2)	**Non-Development Expenditure (a+b)**	**21,697**	**25,106**	**23,846**	**26,585**	**32,071**	**39,140**	**43,958**
	(a) General Services (1 to 5)	**11,941**	**12,925**	**11,081**	**13,686**	**17,129**	**22,674**	**25,410**
	(1) Organs of State	434	466	541	641	1,149	1,279	1,268
	(2) Collection Charges	761	405	743	1,194	1,486	1,333	1,482
	(3) Administrative Services	4,208	4,824	5,503	6,560	8,173	10,793	12,561
	(4) Pensions and Miscellaneous General Services	4,104	4,364	4,215	5,199	6,229	9,177	10,007
	(5) Transfers to Reserve Funds	2,434	2,866	79	92	92	92	92
	(b) Interest Payments & Debt Services	**9,756**	**12,181**	**12,765**	**12,899**	**14,942**	**16,466**	**18,548**
(B)	**Capital Expenditure (1+2)**	**20,082**	**17,121**	**17,414**	**24,278**	**22,865**	**25,706**	**32,679**
	(1) Development Expenditure (a+b)	**14,340**	**12,414**	**12,715**	**20,154**	**18,690**	**19,932**	**23,338**
	(a) Capital Expenditure outside the Revenue Account	10,078	10,092	11,490	18,873	17,429	18,823	22,439
	(b) Loans and Advances given by the State Government	4,262	2,322	1,225	1,281	1,261	1,109	899
	(2) Non-Development Expenditure (a+b) (Repayment of Public debt)	**5,742**	**4,707**	**4,699**	**4,124**	**4,175**	**5,774**	**9,341**
	(a) Internal Debt of the State Government	5,216	4,304	4,286	3,704	3,398	5,292	8,827
	(b) Loans & Advances from Central Govt.	526	403	413	420	427	482	514
	(c) Appropriation to the Contingency Fund	0	0	0	0	350	0	0
	Total Expenditure (A + B)	**72,362**	**78,506**	**82,194**	**99,972**	**1,17,781**	**1,38,553**	**1,54,125**

Source – Finance Department, GoM.

R.E. - Revised Estimates. B.E. - Budget Estimates.

Economic Survey of Maharashtra 2011-12

The figures from last 5 to 6 years (2005-06 till 2011-12) show us the pattern of revenue generation and expenditure of state government.

- As percentage of Gross State Domestic Product (GSDP), the revenue expenditure tends to be 3 to 5 times the capital expenditure incurred by the state government. Most of the revenue generated by taxes goes into salaries and wages and expenses of such kind.
- The capital expenditure, being as low as 3 to 4 % of GSDP, consists of both development and non-development (repayment of public debt) expenditure.
- The physical infrastructure development in the state is therefore, less than 2% of GSDP every year.

State budget along with all other urban municipal corporations still maintain their accounts in 'cash based single entry accounting system'. On the other hand, companies and businesses in private arrangements maintain their accounts in state-of-the-art double entry accounting system. The example given below points out the difference between the two different systems.

Cash-based single entry accounting: only one entry is made for a transaction (either receipt or expense) in the book of accounts.

Amount : in Rs

Date	Description	Receipt	Expense
Jan 4	Water charges received	275	

Accrual-based double entry accounting: two entries are made for each transaction in the books of account.

Date	Accounts		Debit	Credit
Jan 4	Cash a/c	Dr	275	
	To water charges a/c			275

Cash basis of accounting	**Accrual basis of accounting**
Receipts and expense represent the amounts actually received and payments actually made only	Income includes revenue actually received and receivable and expenditure includes both payments made or payable
Statement commences with the opening balance- cash on hand and cash at bank.	Account is confined to the year of accounting only. Does not include income or expense of past or future years

All the municipal corporations in the state, along with state government, have been strongly advised to adopt this state of the art accounting system to bring transparency and accountability in government financials.

Codification

Other major concern individuals come across while reading / studying budgets is its codification patterns.

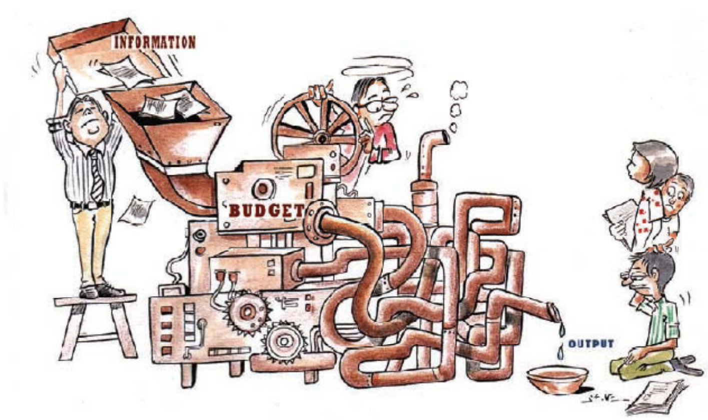
The codification logic is given in the National Municipal Accounting Manual, a document that provides detailed guidelines about preparing and writing a budget. This document has been published by Ministry of Urban Development and is the guiding tool for local governing bodies across the country.

However, many a times, the codes once used for certain work are repeated for another work in next year's budget, thereby confusing the reader.

Output and outcome indicators

The development works that are taken up in the budget need to be presented along with their outputs and outcomes. Indicators need to be identified in order to give citizens an idea of the effects of the projects on the city's or state's development. These indicators can be qualitative and quantitative. They demonstrate quantitative output of a certain development project and qualitative outcome effects.

The budget documents that are produced today do not have **Performance indicators** or **Budget variance Reports** that are expected to form a part of budget document at any level of governing body.



International Budget Partnership, Open Budgets Report 2008

Transparency

Crucial information of taxpayers' money that is available in the budget document is presented in such a bleak way that it is almost inaccessible and incomprehensible to the taxpayers. Due to the age old accounting methods, language and codification, it fails to serve the purpose of correct information transmission to its end users.

Conclusion

Public finance documents of the State of Maharashtra rate poorly on user friendliness in the criteria of language, descriptions, codification and accounting methods. Ambiguity in financial information has been mainstay in public funds management of the state. It is suggested that these documents be made user friendly, so that the information reaches the common person.

Public Finance in Gram Panchayat in Maharashtra

The average annual Plan Outlay of the Gram Panchayat in Maharashtra has been around average Rs 40 Lakh. The budget is typically designed by the members of Gram Panchayat, duly signed and submitted to Panchayat Samiti before the month of November of the previous year. The Panchayat Samiti does make changes if needed in the size and the design of the budget and the sanctioned budget is received by the Gram Panchayat before March 31. The budget of that year gets implemented with the commencement of the financial year on April 1.

Like any other governing body in the country, the income sources for the Gram Panchayat are **housing tax and water tax,** the income of which is estimated to generate revenue of around Rs 8 to 9 lakhs every year. The main expenditure heads of the Gram Panchayat are the supply of drinking water, construction /repairs of internal roads, drainage, electrification and health.

Since the capacity of the Gram Panchayat to raise their own income has been very limited, it has always been dependent on funds from the state and the center. The public works which are not covered by the center funds are left to the mercy of funds of local public representatives known as Corporator Fund.

Tax and non-tax revenues of rural local governing bodies are almost insignificant as compared to urban governing bodies.

No capital or infrastructure development related work takes place, due to non delivery of funds from a welfare state, which is the far-off, distant and detached central government.

Conclusion

This leaves the rural governing bodies at the total mercy of the state and central resources, making them spineless and incapable of planning and leading their own development.

No central or state aid or grant and neither the seasonal defective employment schemes are going to bring about the real development in the rural areas of the state. The need of the time is bridging the gap between urban and rural areas by voluntary business activities. When the urban businesses and markets expand their activities by investing in the potential land, labor, infrastructure available with rural areas, the real sustainable growth and development is going to take place.

Taxation Reforms

> A nation's tax system is often a reflection of its communal values or/and the values of those in power. To create a system of taxation, a nation must make choices regarding the distribution of the tax burden, about who will pay taxes and how much, and how the taxes collected will be spent. In democratic nations where the public elects those in charge of establishing the tax system, these choices reflect the type of community that the public wishes to create. In countries where the public does not have a significant amount of influence over the system of taxation, that system may be more a reflection on the values of those in power.

Current Taxation in India – Problem Analysis

Faced with an almost insatiable demand for an increase in its developmental activities and expenditure, the Government of India is hard-pressed and in constant search of more and more revenue. Among the many problems arising from the implementation of the Second Five-Year Plan, the role of taxation has received increasing emphasis.

In so far as personal and business taxes are concerned, there are three dominant features which determine the tax policy: to levy heavy taxes on the higher income groups not only to raise revenue but also as part of the program to reduce inequalities; to give relief to lower income groups by way of family allowances, etc.; and to treat the business incomes more favorably and to encourage their reinvestment. This category of taxes includes wealth, expenditure, capital gains, annual capital and gift taxes.

Thus we have reached a peculiarly tragic position in the field of personal taxation. **If an individual earns an income, (s)he has to pay income tax and a surcharge. If the individual saves, (s)he attracts wealth Tax; if (s)he spends, then there is expenditure tax; if (s)he gains any capital appreciation, then there is capital gains tax; and finally when (s)he dies, there is the death duty** - taxes imposed on the transfer of property on account of a person's death. This is the ultimate limit of squeezing.

Company taxation inflicts still heavier strain on the firms. There are about nine singular as well as complementary taxes on profits and assets. Companies pay income-tax on the whole of their assessable profits at the rate of 30%. Next they pay a surcharge of 1.5% of their total profits. Then they are subject to a super-tax called the corporation tax at the rate of 20% of their profits. Further the profits of companies are subject to three special 'penalty' taxes. The first being excess dividends tax charged at the rate of 10% on dividends declared by the Company amounting to between 6% and 10% of its paid-up Capital; at 20% between 10% and 18% and at 30% beyond 18%. Secondly, under the provisions of Section 23A of the Income-Tax Act, companies in which the public are not so substantially interested are required to distribute between 45% and 100% by way of dividends. Failure to distribute such dividends attracts a penalty super-tax at the rate of 37.5% and 50% on the undistributed profits in excess of the minimum levels laid down under Section 23A. To any discerning reader, the peculiar conflict in the principle underlying these two 'penalty 'cases will be clear. Thirdly, the bonus tax - companies have to pay a super-tax at the rate of 30% on the value of bonus shares issued to shareholders out of reserves on accumulated profits[26].

With regard to indirect taxation, the main levy of importance is the Excise Duty. The aim with which **it was imposed was one thing and the result was another**. It has only helped inflationary pressures inasmuch as it rules out the possibility of a decline on the price of cloth, sugar and vegetable products, since the mills seem to be content with a smaller margin of profits. By the same effect, it offends the principle of automatic increase in revenue, in step with the increase in national income. The increase in prices has only belied the government's claim to have given the fight against inflation the highest priority.

The aforesaid taxation measures adversely affect the **rate of domestic capital formation**. There has been a decline also in **corporate savings**. India's taxation on the investments made by foreign companies is in general **the highest in the world.** It is very much higher than that of other countries, both developed and underdeveloped, which are actively seeking to attract foreign investment. Even after four months of allowing Foreign Direct Investment in the fastest growing retail sector in India in January 2012, no foreign investment has found its way in the Indian cities so far.

The burden of direct taxation in India is one of the heaviest in the world. Typically in India, there is a tendency to introduce a number of different taxes in order to conceal the existing total burden of taxation and to secure the acceptance of a new tax by stressing its responsibilities or its moderateness so as to mislead the public and to prevent them from realizing that the new tax was being introduced on top of an already heavy structure of taxation. The kind of confiscatory direct taxation of personal wealth and income has been defended on the ground that it affects a very small minority of the total population. But the indirect effects of a majority of taxes on the economic development and livelihood of the millions have been conveniently forgotten. It is rather unfortunate that scant attention is paid to serious adverse economic conditions that will set in the long run. There are also vast and undesirable discretionary powers to the tax officials who are in charge of reducing evasion incidences. The cost of concentration of these powers in the hands of few officials has to be borne by the society.

26 R.S. Sivaramakrishnan: " New pattern of taxation in India" Christian College, December 1959, Madras

Income tax rates in India

	IT slab (2010)	Average	% increase in tax rate
	0 to 2,00,000		No tax
Bracket A	2,00,001 to 5,00,000	35,000	10%
Bracket B	5,00,001 to 10,00,000	1,60,000	20%
Bracket C	Above 10,00,000	3,00,000	30%

Though as stated by Government of India, on paper this structure looks like regressive tax. In reality, considering the purchasing power of money, and the value associated with the money as the income range increases, it is very much a progressive taxation structure. For example, the increase in income from bracket A to bracket B is 60% but the tax rate rises by 10%. Similarly, the increase in income from bracket B to bracket C is 88%, yet the tax rises only by 10%.

Taxes in India are highest in the world

This kind of nation-wide tax structure is defended on the ground that tax should be broad-based and that in countries with higher standards of living, tax rates are still higher. Prima facie, the progressive tax structure in India hits the lower middle class people severely who have already suffered by inflation, rising costs of education and medical facilities etc. and who also have to bear the burden of most of the indirect taxes. Besides, the comparison with other countries is misleading. The countries with which the comparison has been made enjoy many free or cheap facilities and also social security benefits, while these advantages are absent in India. Some relief in this respect is granted by children's allowances and reduction in the excise duties on tea, etc. However this does not seem to be sufficient.

Hence the remedies will be: Tax rates must be fairly fixed, leaving the individual and the companies with an **incentive to save and invest**; the structure should be nationalized; simplification is also essential; abolition of prohibition and reform of land revenue taxation must be taken into consideration; finally, a comprehensive structure based on sound economic principles needs to be adopted.

Inflation - the worst hidden tax

Indians are aware of income tax but are totally unaware of the many hidden taxes we pay. Corporate and excise taxes are paid for in the prices of the goods people buy, without separate accounting. Only sales taxes, property taxes and income taxes are directly and painfully visible, and most of the opposition is to these taxes.

Inflation is a tax that nobody votes for, but has to bear. Citizens want the government to spend on them; rarely do they like to be taxed for the same. This presses the government to resort to 'money creation' at the central bank level. The monetary policy adopted by the reserve bank of India has been successfully reducing the value of rupee in people's hands.

> "In a fully free society, taxation—or, to be exact, payment for governmental services—would be voluntary. Since the proper services of a government—the police, the armed forces, the law courts—are demonstrably needed by individual citizens and affect their interests directly, the citizens would (and should) be willing to pay for such services, as they pay for insurance."
>
> Ayn Rand[27]

Voluntary government financing

In place of current scenario, where taxes are omnipresent and harsh to the extent that they are fearlessly avoided, the economic policy suggests a paradigm shift where the financing of local and limited government will be made voluntary.

The principle of voluntary government financing rests on the following premises: that the government is not the owner of the citizens' income and, therefore, cannot hold a blank check on that income—that the nature of the proper governmental services must be constitutionally defined and delimited, leaving the government no power to enlarge the scope of its services at its own arbitrary discretion.

Consequently, the principle of voluntary government financing regards the government as the servant, not the ruler, of the citizens. It is an agent who must be paid for his services, not a benefactor whose services are unjustified.

Negative Income Tax

In a negative income tax system, people earning a certain income level would owe no taxes; those earning more than that would pay a proportion of their income above that level; and those below that level would receive a payment of a proportion of their shortfall, which is the amount their income falls below that level.

A negative income tax is intended to create a single system that would not only pay for government, but would also fulfill the social goal of making sure that there was a minimum level of income for all. It is theorized that, with negative income tax, the need for minimum wage, food stamps, welfare, social security programs and other government assistance programs could be eliminated, thus **reducing the administrative effort** and cost to a fraction of what it is under the current system. It would also eliminate the undesirable incentives created by these overlapping aid programs, e.g. when a minimum wage worker who earns a little more, makes do with less income when he

[27] Ayn Rand:"Government Financing in a Free Society", Essay ,1963

becomes ineligible for aid because of his slightly higher income. The worker is stuck in a welfare trap and has no incentive to enhance work skills and seek higher wages.

Negative income tax would reduce administrative overheads, since the large bureaucracies responsible for administering taxation and welfare systems, along with the multitude of rules, thresholds and different applications required, could be eliminated. The resources saved by eliminating these bureaucracies could then be spent on more productive government activities, or returned to the people via tax cuts.

The tax revolution in Sweden is not a rich man's revolution. It is taking place at all income levels. . . .The Swedish welfare state is in a dilemma. Its ideology pushes for more and more government spending. . . . But its citizens reach a saturation point after which further tax increases are resisted . . . the only ways Swedes can resist the higher taxes is by acting in ways detrimental to the economy. **Rising public expenditures thereby undercut the economic base upon which the welfare economy depends**.

- Free to choose, Milton Friedman

Tax Evasion and Administrative obstacle

It needs to be adequately recognized that the deciding factor in the promotion of honest tax-paying is the conviction of the public that the **tax is justified** and this conviction can only be secured if there is a **reasonable lowering of rates**. This is not to suggest that a man who deliberately falsifies his return would suddenly become honest if the rates were less. His incentive to evade would, however, be by that much reduced and curbed by fear of detection and penalty. This leads us to another important point. No tax measure will be effective unless it is backed by severe checks and punishments. This presupposes an improvement both in the pay and training of the officers of the Income-tax Department. This need is all the more accentuated by the immense administrative difficulties brought about recently, where tax officials themselves indulge in corruption by joining tax evaders in their tax evasion practices.

Need for a Simple Tax Structure

The system of company / corporate taxation in India has become highly complicated, thus hindering our industrial and businesses development. There is a very urgent need of simplifying it. “The power to tax involves the power to destroy,” said Chief Justice Marshall of the United States. Regrettably, this power is being wielded in a manner calculated literally to destroy economic activity. To quote Dr. C. D. Deshmukh: “Government has to find out forms of taxation which were **less repugnant and more voluntary**”.

Indian tradition has always recognized **personal initiative and individuality as the greatest incentives to efficiency**. Such a society in which freedom and initiative can flourish demands not only political democracy but also a large measure of economic democracy. Today, perhaps more than at any time, there is the need of evolving an economic policy, which, while doing the greatest good to the greatest number, leads to an all-round increase in income, savings, investment, production and wealth. A scientific and rational tax structure forms an integral part of such a policy wedded to a mixed economy.

Conclusion

In a free enterprises society, a simple, flat rate tax (negative income tax) will be charged by a decentralized, small and limited governing body on the people in the particular region under its jurisdiction.

Reduce Government spending

Government spending or expenditures are those expenses which are paid for salaries to government employees, pensions to retired government employees, building of railways, roadways, electricity, bridge, hospitals, schools, education, health care, defense, welfare of poor etc.

In India, government expenditure occurs at central, state and urban and rural local body's levels.

The expenditure of the central government is highest in the country, higher than any other state government, followed by the urban and rural local bodies.

In most countries government spending has grown quite rapidly in recent decades. Government spending (or government expenditure) includes all government consumption and investment.

Government Expenditures in India

In India, government expenditure is determined under five year plans and the union government budget. Indian government expenditure is divided into three parts:

Part one, which has expenditures of ministries;
Part two, which has non-plan expenditures;
Part three, which has plan expenditure.

In the first year plan (1951 - 1956), only Rs. 1960 crore were fixed for government expenditure but in 2010 union budget and 11th five year plan (2007 -2012), total government expenditure is fixed at Rs. 11,08,749 crore.

GoI's revenue income, expenditure and the fiscal deficit from 1992-93 to 2012-13 is given below in the table.

Central Government : Revenue, Expenditure and Fiscal Deficit (% of GDP at current market prices)

	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 (BE)	2010-11 (P)	2011-12 (BE)	2011-12 (RE)	2012-13 (BE)
Total Revenue Receipts	11.02	9.50	10.12	9.85	9.81	9.40	9.53	9.90	9.80	9.70	10.90	12.60	9.44	9.40	10.12	10.87	9.68	8.87	9.84	10.27	8.80	8.61	9.21
Total Expenditure	16.38	16.51	15.87	15.01	14.69	15.24	16.04	15.30	15.50	15.90	16.80	17.10	15.37	13.70	13.59	14.29	15.83	15.87	15.99	15.60	14.00	14.80	14.67
Fiscal Deficit	5.37	7.01	5.75	5.16	4.88	5.84	6.51	5.40	5.70	6.20	5.90	4.50	3.88	3.97	3.32	2.55	6.04	6.48	5.50	4.87	4.60	5.86	5.06

Source : Budget documents. The 2011-12 figures are RE and the 2012-13 figures are BE; BE - Budget Estimates; P - Provisional data (unaudited).

Rational behind Government expenditure

The currency (or the printed money in the economy) is backed by equal amount of goods and services being produced in the country.

If suppose, for example, the printed stock of money (currency) in India is Rs 10 billion, then there has to be a volume of goods and services being produced of the *equal amount*.

When the amount of goods and services being produced is equal or is increasing proportionate to the volume of money in a country, the money prices of goods and services tend to be unchanged or it is stable for a long time.

Since government does not have any money of its own (since government does not gets engaged in manufacturing of goods or services), it can spend *only after* taking it from its citizens, in the form of taxes. Another way the government collects money is by borrowing from institutions, individual business investors, RBI (which is the government's own bank) or Open Market Operations (OMO). There is *no other way* the government can raise money for its own expenses.

For Government of India, as any other governments in the developing world, levying higher taxes is politically an unattractive option. Governments from these countries therefore often resort to the second option, that of creating money. The following paragraphs explain how the government can cover its expenditure without raising it from its citizens in the form of taxes.

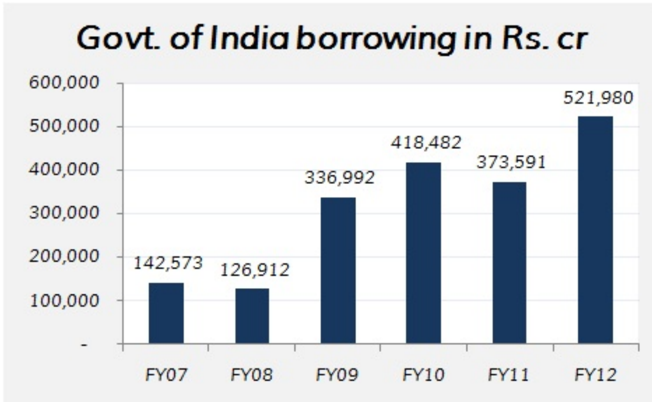
From the table above, one can see that the `total expenditure' of the government always exceeds `revenue receipts' of the government. The different in the two creates fiscal deficit'. This fiscal deficit needs to be financed by `government borrowing' (the money) from RBI, its own bank. RBI, in turn, prints more currency. However, the law of supply from economics does not fail to apply to the volume of money. As supply of money increases, the price (value) of money (currency) decreases. In common parlance, the event is known as 'inflation'[28].

Government borrowing and fiscal deficit are two terms of the same coin. RBI Deputy Governor H.R. Khan, who oversees the government's borrowing program at the central bank, says that the government badly missed both its fiscal deficit target of 4.6 per cent as well as its targeted borrowing program of Rs 4.17 lakh crore this fiscal year (2011-12), as it ended up borrowing as much as Rs 92,000 crore extra, thereby pushing up the fiscal deficit number to 5.9 per cent of the GDP[29].

The graph below shows how the needs of GoI have continued to increase in recent years, thereby forcing it to increase its borrowing.

[28] Inflation: http://www.caporbit.com/inflation-in-india-plain-english/

[29] http://www.thehindu.com/business/Economy/article3009127.ece



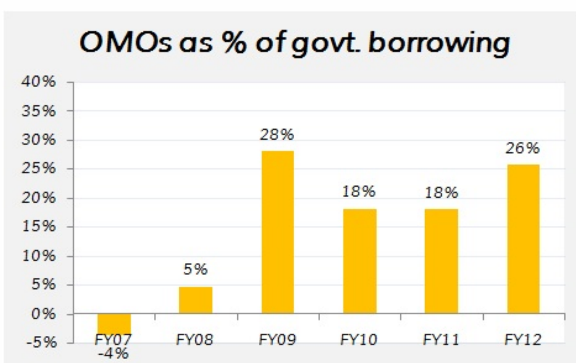
Source: Planning Commission

No attempt has been made to identify an ideal level of government expenditures. The ideal level will vary from country to country, depending on factors ranging from culture to geography to level of development. However, volumes of research have shown that excessive government spending that causes chronic budget deficits is one of the most serious drags on economic dynamism.

RBI – The Government's Financier

Quantitative Easing (QE) is a word that has become famous since the financial crisis of 2008. One of the key ways of QE is for a central bank to buy government debt.

The chart below shows the amount of borrowing by the Government of India that the RBI supported by buying government bonds over the last 6 years.



Source: Planning Commission

RBI's infusion of money stock in the economy has a direct impact on the devaluation of the Rupee.

Higher government spending and inflation

Higher government spending will not lead to more rapid monetary growth and inflation *if* additional spending is financed either by taxes or by borrowing from the public. In that case, government has more to spend, the public has less. Higher government spending is matched by lower private spending for consumption and investment. However, taxing and borrowing from the public are politically unattractive ways to finance additional government spending. Many of us welcome additional government spending but few welcome additional taxes. Government borrowing from the public diverts funds from private uses by raising interest rates, making it both more expensive and more difficult for individuals to get mortgages on new homes and for businesses to borrow money. The only other way to finance higher government spending is by increasing the quantity of money.

Financing government spending by increasing the quantity of money is often extremely attractive to both the Prime Minister and members of the political party that is in power. It enables them to increase government spending, providing goodies for their constituents, without having to vote for taxes to pay for them, and without having to borrow from the public.

Remnants of the Raj swallow public funds at central level

Directorates, inspectorates, controllers, research stations and several other government entities, which are relics of the British and license-permit Raj, continue to be in operation despite having outlived their utility. MAIL TODAY[30], in the first part of its investigation series, blows the lid off these government offices *feeding on the tax-payers' money*.

This investigation carried out by MAIL TODAY of several central government ministries dealing with sectors such as agriculture, health, environment, water resources, and commerce and food supplies shows that tax payers' money continues to be spent on government offices *which have no meaningful role to play anymore.*

The list of redundant offices includes directorates for various crops and commodities (sugar, cotton, jute, cement, rice, tobacco, oilseeds, pulses, vanaspati etc.), National Test House, National Oilseeds and Vegetable Oils Development Board, Indian Plywood Industry Research and Training Institute, National Institute of Water Sports and Hindustan Vegetable Oil Corporation, among others.

Most of these offices handle minor regulatory roles or are just standard-setting bodies or testing centers — functions which are already being carried out by full-fledged regulatory

[30] http://epaper.mailtoday.in/epapermain.aspx?queryed=9&querypage=1&boxid=379500&parentid=53637&eddate=09/24/12

authorities. Some others produce training manuals, conduct training programs or simply generate inconsequential reports. Most of these offices, however, occupy prime real estate and have hundreds of employees on their rolls. “Such bodies have no business to exist after they have outlived their role, purpose and utility. In the past, many committees of the government have made clear recommendations on what needs to be done with such organizations which consume crore of rupees each fiscal”, reports MAIL TODAY.

Countrywide experiences like these show that once government undertakes an activity, it is seldom terminated. The activity may not live up to expectation but that is more likely to lead to its expansion, to its being granted a larger budget, than to its curtailment or abolition.

The lesson to be drawn from the misuse of people’s money is that we should develop the practice of examining both the benefits and the costs of proposed government interventions and require a very clear balance of benefits over costs before adopting them.

Maharashtra State Government – Fiscal deficit

Table 5.1 Budget at a glance

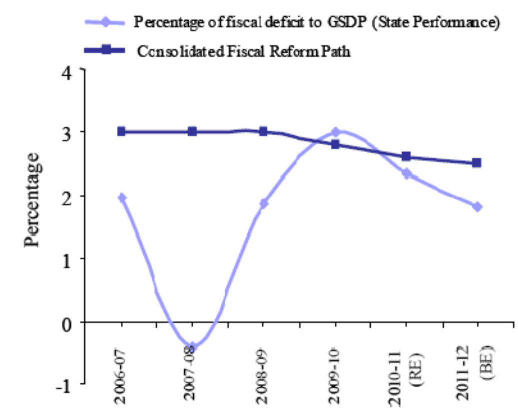
(₹ crore)

Items	2009-10	2010-11 (R.E.)	2011-12 (B.E.)
1. Revenue Receipts	86,910	1,07,159	1,21,504
2. Revenue Expenditure	94,916	1,12,847	1,21,446
3. Revenue Deficit (2-1)	8,006	5,688	(-)58
3.1 As % of GSDP	0.9	0.5	0.0
4. Capital Receipts #	26,558	25,786	23,335
5. Capital Expenditure #	18,690	19,932	23,338
6. Total Receipts (1+4) #	1,13,468	1,32,945	1,44,839
7. Total Expenditure (2+5) #	1,13,606	1,32,779	1,44,784
8. Budgetary Deficit (7-6)	138	(-)166	(-)55
9. Fiscal Deficit	26,156	25,042	22,805
9.1 As % of GSDP	3.0	2.3	1.8

Source : Finance Department, GoM # net of loan repayment

R.E. – Revised Estimates B.E. – Budget Estimates

Graph 5.5 : Consolidated Fiscal Reform Path- vis –a- vis –State Performance



Note - Consolidated Fiscal Reform path for 2006-07 to 2008-09 as per FRBM and for 2009-10 to 2011-12 as per 13th FC

The fiscal deficit, which was 4.4 per cent of GSDP in 2004-05, has gradually declined to 0.4 per cent of GSDP in 2007-08. In 2011-12, the percentage of fiscal deficit to GSDP is again expected to increase to 1.8 per cent.

Table 5.15 Debt Stock and interest payments

(₹ crore)

Year	Debt Stock	Interest payments	Average cost of borrowing (per cent per annum)
2006-07	1,33,723	11,983	9.6
2007-08	1,42,383	12,932	9.7
2008-09	1,60,672	13,027	9.1
2009-10	1,81,447	14,838	9.2
2010-11 (R.E.)	2,05,689	16,102	8.9
2011-12(BE)	2,26,926	18,049	8.8

Source: Finance Department, GoM

Note: Average Cost of borrowings is the percentage of interest payment to the outstanding liabilities in preceding year.

The accumulation of unpaid loan and other liabilities on the government forms the debt stock. The debt stock of the state is increasing over the year due to increase in internal debt required to finance the development activities and increasing obligatory loan repayment. The debt stock which was Rs. 1,09,167 crore in 2004-05 is increased to Rs. 2,05,689 crore by the end of 2010-11, out of which open market borrowings (OMO) were Rs 73,825 crore (35.9 % of total state government borrowings).

Over the years, the Twelfth Finance Commission has continued to recommend transfer of funds from the centre to the states; however, since central government continues to be steeped in debt, the flow of funds has shrunk in real terms.

This has effect on borrowings of the Maharashtra State Governments from 2005-06 onwards, resulting in a sharp decline in the inflows of loans from the Centre in the subsequent years.

Comparison with other states

Following the global economic crisis that set in during 2008-09, the fiscal health of the Indian states deteriorated to a great extent in the ensuing period. This was caused by a number of factors, including a slowdown in the growth of tax revenues following the economic slowdown that set in during 2008-09; an increase in employee costs in a number of states (with the Sixth Central Pay Commission as well as State Pay Commissions recommending increases in pay and pension); and a rise in food and power subsidies. A widening of the financing gap of the states enlarged their borrowing requirements. Accordingly, the debt stock of the Indian states expanded considerably in recent years (refer Chart 1). The debt liabilities expanded at a faster pace in the period between 2008-11 as compared to 2005-08 for all the states in the ICRA sample (in terms of the compounded annual growth rate or CAGR).

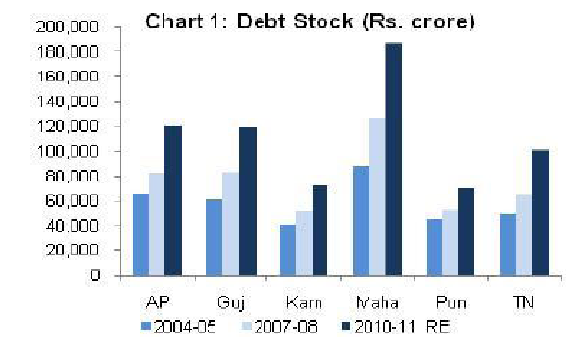
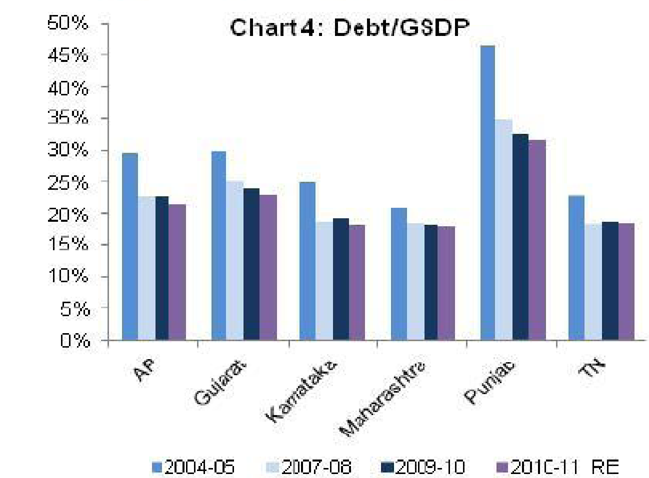


Table 1: Debt Stock- Three-year CAGR

	March 2008	March 2011*
AP	8%	14%
Gujarat	11%	13%
Karnataka	7%	12%
Maharashtra	13%	14%
Punjab	6%	10%
TN	9%	16%

Source: Budget Documents, various publications of the Reserve Bank of India (RBI), ICRA Research

As we can see, among the developing states in India, Maharashtra ranks highest on the debt stock.



Source: Budget Documents, RBI, ICRA Research

As can be seen from above, Maharashtra State Government's debt is close to 20% of state's Gross State Domestic Product. In 2010-11, Maharashtra's GSDP is Rs 10,29,621[31] crore. So, the debt stock is Rs 2,05,924.2 crore.

In real life, taxes only pay for a government bureaucracy that collects the tax and provides little or nothing for the poor. And since most government bureaucracy is not profit-motivated, it has no incentive to increase its efficiency.

It has a disincentive: the government cannot cut welfare without public outcry, so the behemoth just continues, blind and inefficient, year after year.

I believe that 'government', as we know it today, should pull out of most things except for law enforcement and justice, national defense and foreign policy, and let the private sector, a 'Grameenized private sector', a social-consciousness-driven private sector, take over their other functions."

[31] Central Statistics Office: Directorate of Economics & Statistics of respective State Governments and for All-India

-***Muhammad Yunus*** *(Banker to the poor: Micro-Lending and the Battle Against World Poverty)*

Government of Maharashtra's spending

Shown in subsequent graphs, GoM spends on the following - consumption expenditure[32], capital expenditure, subsidies and guarantees.

Out of total expenditure of GoM, almost 60% is spent on administrative purposes.

GOVERNMENT FINAL CONSUMPTION EXPENDITURE AND EXPENDITURE ON CAPITAL FORMATION

(₹ Crore)

	Item	2005-06 (Actual)	2006-07 (Actual)	2007-08 (Actual)	2008-09 (Actual)	2009-10 (Actual)	2010-11 (R.E.)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
A.	**Consumption Expenditure**						
1.	Compensation of Employee (1.1+1.2)	9,406	11,005	13,208	14,771	18,322	24,308
1.1	Wages & Salaries	6,635	7,933	9,533	10,244	12,915	16,190
1.2	Pension	2,771	3,072	3,675	4,527	5,407	8,118
2.	Net Purchases of Commodities & Services	2,587	4,571	7,077	7,607	9,992	11,880
	2.1 Purchases	2,626	5,121	6,215	6,117	8,614	10,099
	2.2 Maintenances	1,171	1,682	2,207	2,545	2,938	3,725
	2.3 Less Sales	1,210	2,232	1,345	1,055	1,560	1,944
	Total Consumption Expenditure	**11,993**	**15,576**	**20,285**	**22,378**	**28,314**	**36,188**
B.	**Expenditure of Capital Formation**						
1.	Buildings	673	1,217	1,103	1,269	1,139	1,675
2.	Roads & Bridges	539	978	979	1,723	2,974	2,368
3.	Other Capital Outlay	1,331	2,012	1,992	2,270	2,448	2,287
4.	Transport Equipment	33	45	58	82	63	151
5.	Machinery & Equipment	237	340	428	650	704	648
6.	Cultivated Assets	0	53	82	44	86	41
7.	Animal Stock	36	1	2	0	0	0
8.	**Expenditure on New Capital Formation (1 to 7)**	**2,849**	**4,646**	**4,644**	**6,038**	**7,414**	**7,170**
9.	Change in Stock	(-) 7	35	0	1	(-) 7	1
10.	**Gross Capital Formation (8 + 9)**	**2,842**	**4,681**	**4,644**	**6,039**	**7,407**	**7,171**

[32] Economic survey of Maharashtra 2011-12, Government Of Maharashtra,

Subsidies[33]

Like in other states, In Maharashtra, certain goods and services are subsidized to make it affordable to the civil society and / or for economic development.

The provision for such subsidies in 2010-11 (Revised Estimates) was Rs 7,949 crore, same is estimated at Rs 7,100 crore during 2011-12.

The major budgeted subsidies are:

- Rs 3000 crore for compensation to Maharashtra State Electricity Distribution Company Ltd. MSEDCL for subsidized tariffs to agricultural / power loom users` 400 crore to industrial units including mega industrial projects.
- Rs 505 crore to Maharashtra State Road Transport Corporation MSRTC for reimbursement of losses of the Corporation for providing concessional fares to certain categories of passengers such as senior citizens, students, freedom fighters etc.
- Rs 281 crore for food grain transactions and related schemes such as Antyodaya Anna Yojana.

State Government Guarantees

The outstanding guarantees given by the State Government at the end of 2009-10 amounted to Rs 17,320 crore. The major guarantees given by the government were to the Public Works Department (Rs 3,628 crore), Co-operation, Marketing & Textile Department (Rs 3,328 crore), Industry, Energy and Labor Department (Rs 3,165 crore), Water Resources Department (Rs 2,608 crore) and Water supply and Sanitation Department (Rs 2,403 crore). The details[34] are given in the table below.

[33] Economic survey of Maharashtra 2011-12

[34] Economic Survey of Maharashtra 2011-12, Government of Maharashtra,

Table 5.16 Guarantees given by the Government during 2009-10

(₹ Crore)

Sr. No.	Name of the Department	Outstanding at the beginning of the year 2009-10	Addition during the year 2009-10		Deletion (other than invoked) in the year 2009-10$	Outstanding at the end of the year 2009-10
1	2	3	4a	4b #	5	6
1	Agriculture & ADF	451	150	10	443	168
2	Industry, Energy & Labour (Industry)	330	0	0	123	207
3	Social Justice & Special Assistance	279	0	14	60	233
4	Tourism & Cultural Affairs	4	0	0	2	2
5	Urban Development	229	0	2	22	209
6	Industry, Energy & Labour (Energy)	4,177	0	250	1,262	3,165
7	Water Resources	3,123	0	0	515	2,608
8	Home	15	0	0	15	0
9	Public works	3,535	1,085	0	992	3,628
10	Revenue & Forest	2	0	0	0	2
11	Tribal Development	50	25	8	10	73
12	Co-operation, Marketing & Textile	4,918	853	0	2,443	3,328
13	Rural Development & Water Conservation	86	0	0	11	75
14	Water Supply & Sanitation	2,812	0	0	409	2,403
15	Minority Development	23	0	5	6	22
16	Planning	1,267	0	0	70	1,197
Total		**21,301**	**2,113**	**289**	**6,383**	**17,320**

Source: Finance Department, GoM

Note : i) # - Loans received on the revolving guarantee & amount changed due to revised interest rate, are given.

ii) $- Invoked Amounts during 2009-10 are nil.

Reserve Bank of India, which overlooks the state finances and its fiscal positions, has warned the states about their spiraling outstanding guarantees.

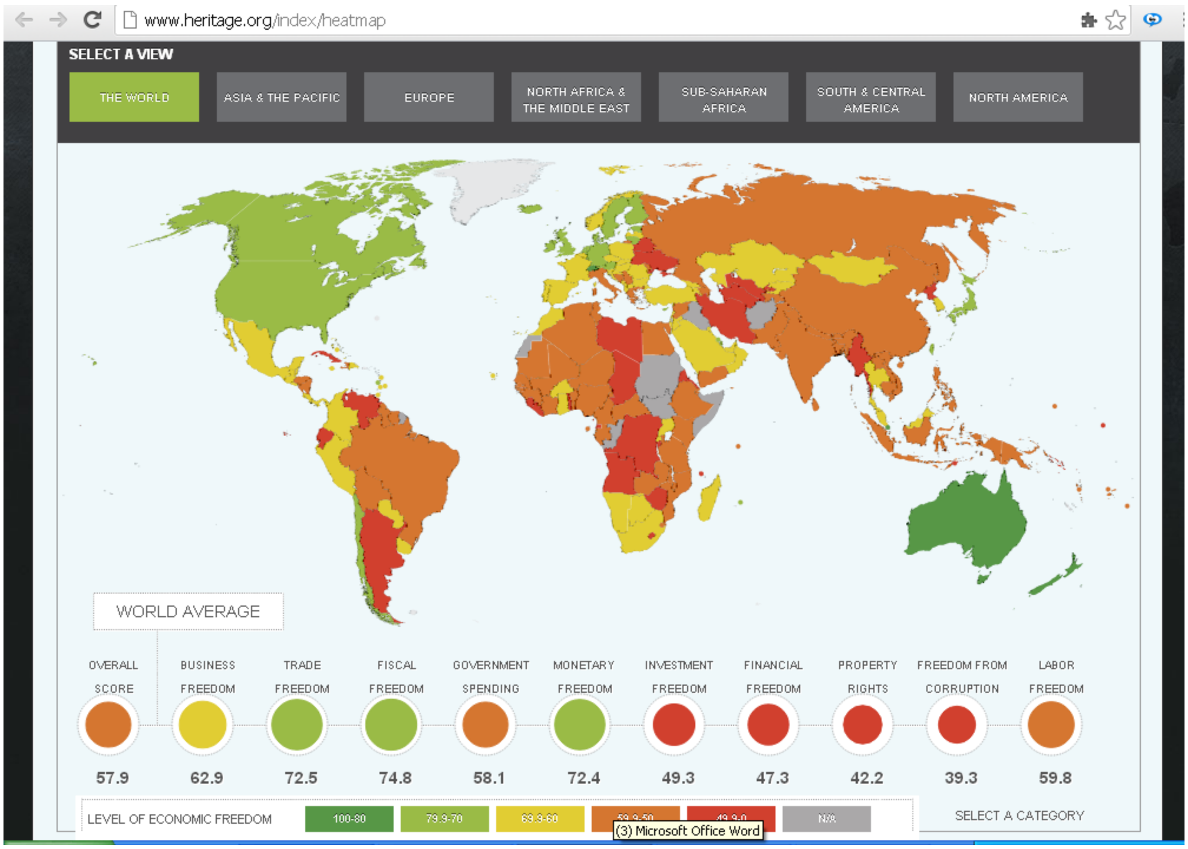
Outstanding state government guarantees went up from 4.4% in 1996 to 8.1% of GDP in 2011-12.

According to RBI, a few states have taken initiatives to place ceilings on guarantees, but the Maharashtra government interestingly, does not figure in the list of states to impose ceilings on guarantees[35]. This is despite a number of bond issues guaranteed by the state *facing downgrades and severe servicing problems* (we have ample data which proves that the public sector enterprises which receive state guarantees are directly or indirectly linked to political parties. Nanded district co-operative bank is a recent example).

[35] http://articles.economictimes.indiatimes.com/2002-08-31/news/27358963_1_guarantees-sales-tax-revenue-productivity

Economic Freedom

India's economic freedom[36] score is 54.6, making its economy the 123rd freest in the 2012 *Index*. Its score is unchanged from last year, with an improvement in labor freedom offset by declining scores in five other areas including business freedom, freedom from corruption, government spending and monetary freedom. India is ranked 25th out of 41 countries in the Asia–Pacific region, and its overall score is below the world average.



Swaminathan Anklesariya Aiyar on his agenda for reforms says, "the 2012 Doing Business Report of the World Bank ranks India at just 132nd out of 183 countries in ease of doing business. The Economic Freedom index 2012 of the Heritage Institute ranks India at 123rd position. On a range from free to unfree, India is ranked '***mostly unfree'***. If that's the situation after 21 years of reform, one wonders what the reforms did.

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36 http://www.heritage.org/index/pdf/2012/countries/india.pdf

Limited Government in Free Market Reforms

Government is a form of voluntary cooperation, a way in which people choose to achieve some of their objectives through governmental entities because they believe that is the most effective means of achieving them[37].

In *The Wealth of Nations,* the masterpiece that established the Scotsman Adam Smith as the *father of modern economics*, Smith has analyzed the way in which a free market system could combine the freedom of individuals to pursue their own objectives with the extensive cooperation and collaboration needed in the economic field to produce our food, our clothing and our housing. Adam Smith's key insight was that both parties to an exchange can benefit and that, *as long as cooperation is strictly voluntary,* no exchange will take place unless both parties do benefit. No external force, no coercion, no violation of freedom is necessary to produce cooperation among individuals all of whom can benefit. That is why, as Adam Smith put it, an individual who "intends only his own gain" is "led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good".

Free market reforms assume four basic functions of Government:

1. Protection of boundaries from foreign enemies (defense, foreign policy);
2. Protection of individual citizens from other fellow citizens (Law and order);
3. 'Rules of Game' Social law framework (obligation of contracts for private businesses);
4. Facilitation of mediums of communication (coining currency).

What needs to be done

Most of the present welfare programs should never have been enacted. If they had not been, many of the people now dependent on them would have become self-reliant individuals instead of wards of the state. In the short run that might have appeared cruel for some, leaving them no option to low-paying, unattractive work. But in the long run it would have been far more humane. However, given that the welfare programs exist, they cannot simply be abolished overnight. We need some way to ease the transition from where we are to where we would like to be, of providing assistance to people now dependent on welfare while at the same time encouraging an orderly transfer of people from welfare rolls to payrolls.

Such a transitional program has been proposed that could enhance individual responsibility, end the present division of the nation into two classes, reduce both government spending and the present massive bureaucracy, and at the same time assure

[37] Milton Freidman: "Free to Choose –A personal statement", 1990, A Harvest Book, Harcourt Inc,

a safety net for every person in the country, so that no one need suffer dire distress. Unfortunately, the enactment of such a program seems a utopian dream at present. Too many vested interests— ideological, political, and financial—stand in the way.

The program has two essential components: first, reform the present welfare system by replacing the ragbag of specific programs with a single comprehensive program of income supplements in cash—a negative income tax linked to the positive income tax.

Such a comprehensive reform would do more efficiently and humanely what our present welfare system does so inefficiently and inhumanely. It would provide an assured minimum to all persons in need regardless of the reasons for their need while doing as little harm as possible to their character, their independence, or their incentive to better their own condition.

Deregulation

GOVERNMENT REGULATIONS ANYWHERE AND EVERYWHERE HAVE ALWAYS PROTECTED SOME BUSINESSES AT THE COST OF OTHER BUSINESSES IN THE FORM OF RULES, BANS, QUOTAS, SUBSIDIES, TARIFFS OR FIXED PRICES.

In the state of Maharashtra today, we see, a lot of direct and indirect government regulation in a majority of economic and social spheres. Besides taxation and other rules and regulations for industries, services and professions, many a times we do not realize that this stream of regulation defines the standard of life and choices of occupations for communities at large.

Restrictions on economic freedom inevitably affect freedom in general, even such areas as freedom of speech and press. The very purpose of government regulation has always been found to impose entry restrictions for new businesses in markets. The policies are framed in such a way as to protect the existing businesses.

No Political Freedom without Economic Freedom

Fundamentally, essential part of economic freedom is freedom to use the resources we possess in accordance with our own values— freedom to enter any occupation, engage in any business, enterprise, buy from and sell to anyone else, so long as we do so on a strictly voluntary basis and do not resort to force in order to coerce others.

The experience of recent years—slowing growth and declining productivity—raises a doubt about whether private ingenuity can continue to overcome the deadening effects of government control if we continue to grant ever more power to government, to authorize a 'new class' of civil servants to spend ever larger fractions of our income supposedly on our behalf. Sooner or later, and perhaps sooner than many of us expect, an ever bigger government would destroy both the prosperity that we owe to the free market.

Command Economy and Regulation

It is natural to assume that in economy society, someone must give orders to make sure that the right products are produced in the right amounts and available at the right places. That is one method of coordinating the activities of a large number of people—the method of the army. Not even the head of a family can control every act of other family members entirely by order. No sizable army can really be run entirely by command. Commands must be supplemented by voluntary cooperation—a less obvious and more subtle, but far more fundamental, technique of coordinating the activities of large numbers of people.

Russia is the standard example of a large economy that is supposed to be organized by command—**a centrally planned economy**. But that is more fiction than fact. At every level of the economy, voluntary cooperation enters to supplement central planning or to offset its rigidities—sometimes legally, sometimes illegally.

We do need a governing body, but a small one

Completely private transactions are impossible between citizens of a largely market economy. One side is necessarily represented by government officials. Political considerations are unavoidable, but conflicts would be minimized if the governments of market economies permitted their citizens the maximum possible freedom to make their own deals with the governments. Trying to use trade as a political weapon or political measures as a means to increase trade with democratic countries only makes the inevitable political frictions even worse. A small and local governing body is desirable which only oversees the trade activities and does not aim at it as a revenue generating source.

Deregulation always benefits consumers

To understand this, one needs to know what 'regulation' is.

A common belief is that to protect consumers from competition of businesses, government regulates the concerned businesses. A consumer ***always*** benefits from competition among businesses. To win consumers and expand their existing consumer base, the businesses always adopt the most economical strategy of minimum cost with maximum returns. Also for long run, a business has to maintain the quality of products and services it gives to its consumers and update them on regular basis.

So in free market arrangements, as there is more competition among businesses, consumer benefits are highest. Also a consumer class benefits from economies of scale: as the production of a product increases, its price falls. The society benefits by using its resources optimally and in the most efficient manners. Take any example of food restaurants, automobile industry, mobile phones industry, internet services, time and cost saving online shopping websites.

Regulation is a protection for businesses, not consumers

Government regulation however serves and has always been used as a protection for those businesses, who wish to stop other competitive businesses from entering in the market. The serving government officials pass numerous rules and regulation to prevent other competitors from sharing profits in particular industry. The consumer loses twice, by tax contributions that put government in such a position to pass such laws thereby killing competitiveness in market, and by reducing their benefits from a variety of other better products and services that competition will allow.

To regulate over businesses, either by restricting entry to other competitors or by fixing prices – which makes doing business impossible for new entrants in the market, the government has to set up a regulatory body. Besides the administrative costs of running such regulatory agencies, the losses to consumers and society are incalculable.

The highly regulated predominantly socialized energy sector in India has regulatory commissions in almost all the states, when historically this was a public sector. In the energy sector, one sees measures like unbundling - decentralizing business of generating, distributing and transmitting electricity.

MERC and Uniform Tariffs in Mumbai

Maharashtra Electricity Regulatory Commission was recently approached by Reliance Infra for implementation of uniform tariffs in Mumbai. Reliance Infra is in the business of selling electricity along with other companies, one of them being Tata Power. Tata Power has been selling cheaper electricity for years and its consumer base is rapidly increasing. Reliance Infra, which has a small consumer base, many defaulters and high electricity tariffs, wishes the government to pass a law that will increase the electricity tariffs of Tata Power, to match with that of Reliance Infra. This, they claim, will eliminate any variation in price of electricity, thereby ending the competitiveness in the electricity market. The consumers face higher tariffs. And as if this was not sufficient, the government will have to give a subsidy of Rs. 1000[38] crore in order to implement this measure of 'uniform tariff'. Needless to say, the subsidy will be raised from taxes.

The demand for uniform tariff is being made ever since Tata Power made an entry in the city's domestic market in 2009. It provides electricity at rates 30% to 40% less than its competitors, who are feeling the pinch because in the last one year, more than one lakh consumers have switched to Tata Power. The rate of migration is higher in the suburbs, where Reliance Infra supplies power at the highest rates.

Uniform tariff policy has been adopted in Delhi, where electricity is highly subsidized, and the policy allows the *sole supplier of electricity* in the region Reliance Infra a <u>protected environment</u> where there is <u>no competition in the market</u>.

Conclusion

The Preamble of Industrial Policy of Maharashtra 2001 stresses deregulation and opening up of capital markets to attract more domestic as well as foreign investment for development. The policy aims at simplification of procedures and rationalization of rules. These principles need to be implemented in practice by having more trust between people and a small, local but influential governing body.

[38] http://www.hindustantimes.com/India-news/Mumbai/Tata-Power-questions-uniform-tariff-move/Article1-690116.aspx

Decontrol of Markets

> The key insight of Adam Smith's *Wealth of Nations is* simple: if an exchange between two parties is voluntary, it will not take place unless both believe they will benefit from it. Most economic fallacies derive from the neglect of this simple insight, from the tendency to assume that there is a fixed pie, which one party can gain only at the expense of another. This key insight is obvious for a simple exchange between two individuals. It is far more difficult to understand how it can enable people living all over the world to cooperate to promote their separate interests.

This quote helps understand the wonderful price system that works so well and so efficiently, that we remain unaware of it most of the time. We never realize how well it functions until it is prevented from functioning.

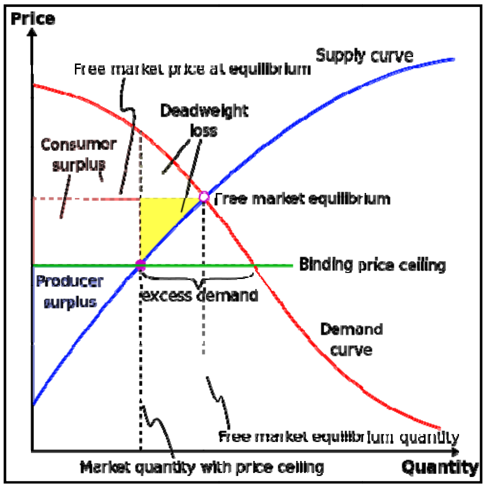
Price control is Government control of Markets

Price controls are governmental restrictions on the prices that can be charged for goods and services in a market. The intention behind implementing such controls stems from the desire to maintain affordability of staple foods and goods, to prevent prices rising during shortages or prices dropping during surpluses.

There are two primary forms of price control, a price ceiling (or a price cap), the maximum price that can be charged, and a price floor, the minimum price that can be charged. Commonly they are known as ‘subsidies’ and ‘price supports’.

In India and Maharashtra, we see price ceilings especially in markets of energy, petroleum products, staple food (ration shops) and public transportation. The Maharashtra Electricity Regulatory Authority (MERC) sets a maximum price that can be charged by the companies selling electricity in Maharashtra.

Price ceiling



A price ceiling is a government-imposed limit on the price charged for a product. The Indian government or the Government of Maharashtra declares price ceilings with the intention of protecting consumers from conditions that could make necessary commodities such as electricity unattainable.

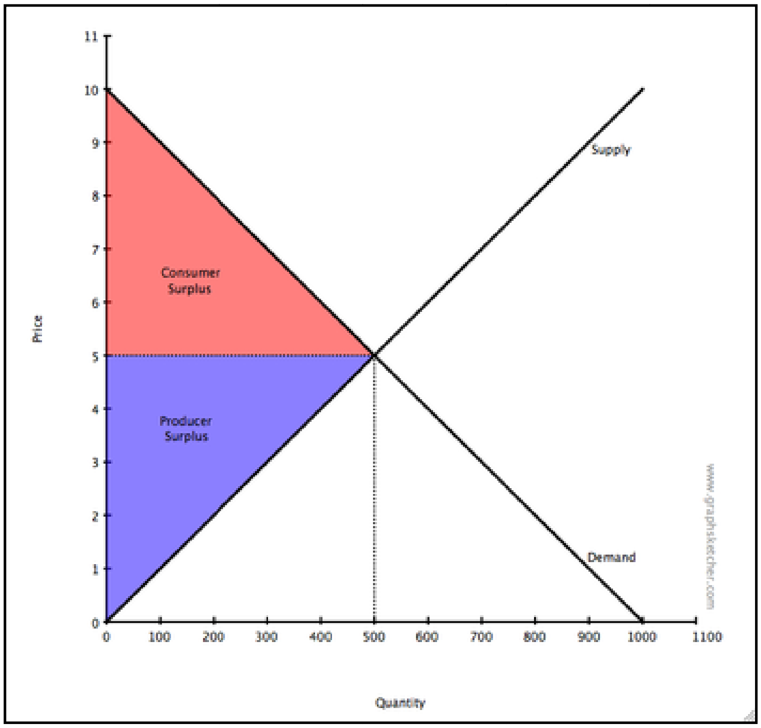
As shown in the graph[39] above, governments often set the price ceiling **below** the free-market price. This has several effects. Suppliers find they cannot charge what they would have otherwise charged in free markets. As a result, some suppliers drop out of the market. This reduces supply. Meanwhile, consumers find they can now buy the product for a smaller cost, and so the demand increases. These two actions cause the demand to exceed supply, thereby causing a shortage.

Price Floor

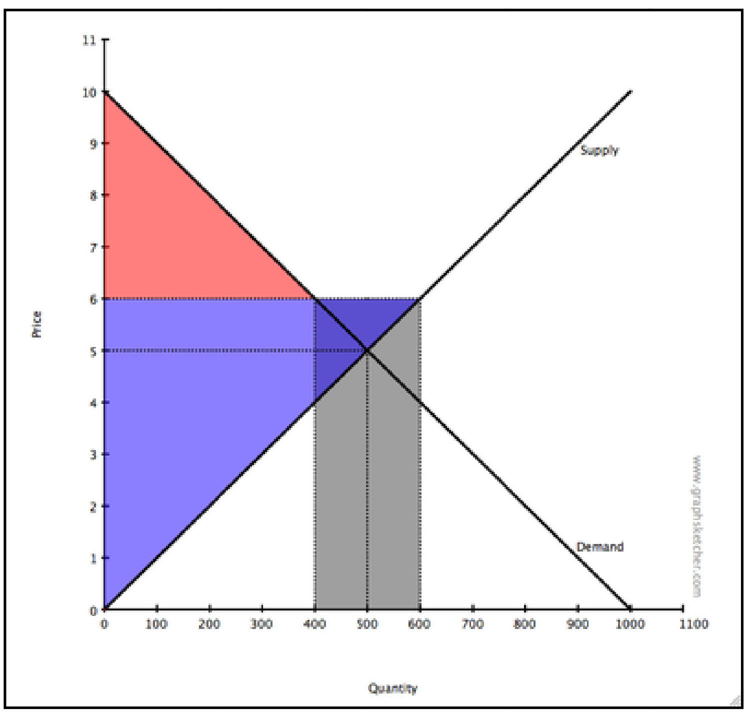
In India and Maharashtra, Minimum Support Price (MSP) is a type of price control. In free markets, it will be termed as a government intervention.

As all other welfare programs of the central and state governments, MSP is a well intended welfare measure to ‘protect’ farmers from fluctuating market prices. Farming is a business like any other business, subject to price fluctuations and changing incomes. However this price control policy, directly adopted from United States and various other developed countries, works as explained in the following diagrams, giving an illusion of ’stable prices’.

[39] Price ceiling, http://en.wikipedia.org/wiki/File:Binding-price-ceiling.svg



Graph 1 is indicative of the free market equilibrium where the price is set at the point where the demand meets supply. There is no MSP..



Graph 2 indicates how MSP distorts the market. Due to promise of higher price, production is increased.

Government assurance of a higher price creates surplus food grains in the economy. Citing higher price, farmers increase their production, but the stock does not get sold in the market. Maharashtra government operated Agriculture Produce Marketing

Committees (APMCs) promises to purchase the surplus. The government has to use taxpayer's money to be able to purchase, store, and then sell the surplus stock.

Support prices, farm purchase and politics

Farm price supports are justified on grounds other than the political fact that rural areas are over-represented in the political spheres, with the belief that farmers on the average have low incomes. Even if this be accepted as a fact, farm price supports do not accomplish the intended purpose of helping the farmers who need help.

In the first place, benefits, if anything, are inverse to the need, since they are in proportion to the amount sold in the market (higher profits for higher quantities sold). The poor and marginal farmers sell less in the market as compared to what the wealthier farmer sells. In the second place, the benefits, if any, to the farmers from the price-support program are much smaller than the total amount spent in the program. This is clearly true of the amount spent for storage and similar costs which do not go to the farmer at all. Indeed, the suppliers of storage capacity and facilities may well be the major beneficiaries. It is equally true of the amount spent to purchase agricultural products. The farmer is thereby induced to spend additional sums on fertilizer, seed, machinery, etc. At most, only the excess adds to his income. And finally, even this residual of a residual overstates the gain since the effect of the program has been to keep more people on the farm than would otherwise have stayed there. Only the excess, if any, of what they can earn on the farm with the price-support program over what they can earn off the farm, is a net benefit to them. The main effect of the purchase program has simply been to make farm output larger, not to raise the income per farmer.

The costs of the government farm purchase program

The consumer pays twice, once in taxes for farm benefit payments, and again by paying a higher price for food. The farmer has been saddled with taxing restrictions and detailed centralized control while the nation has been saddled with a spreading bureaucracy. There is, however, one set of costs which is less well known. The farm program has been a major hindrance in the pursuit of foreign policy. In order to maintain a higher domestic price, it has been necessary to impose quotas on imports for many items.

The farmers with surplus onions have no freedom to export their produce at the right time. Onion export affects the domestic onion prices. There have been incidences where political parties have suffered because of price fluctuations in food grains. Ruling political parties are forced to tampered with food prices as a result of public opinion that is based on half knowledge.

Sharad Joshi of Shetkari Sanghatana believes that only free and open markets without government intervention for farmers is the solution for the despair of farmers in Maharashtra[40]. Recently, Maharashtra's Rs 26,000-crore sugar industry, which

[40] Sharad Joshi: http://en.wikipedia.org/wiki/Sharad_Anantrao_Joshi

contributes nearly 30 % to India's total sugar output, has now formally made a case for decontrolling the sector. As a first step, the industry wants the government to do away with the levy obligation and procure sugar to be distributed through the Public Distribution System (PDS) from the open market[41].

India's newly appointed Chief Economic Advisor Raghuram Rajan has advocated decontrolling diesel prices rather than increasing the tax on diesel vehicles. Rajan said, "The best policy is (to) move towards true cost of the fuel. The problem with diesel versus petrol is not the vehicle but the fuel cost. If we can bring both (petrol and diesel) to international prices or market prices, then people would make a choice[42]."

The Price system

The price system is the mechanism that performs the task of organizing economic activities, without central direction, without requiring people to speak to one another or to like one another. When you buy your pencil or your daily bread, you don't know whether the pencil was made or the wheat was grown by a white man or a black man, by a Chinese or an Indian. As a result, the price system enables people to cooperate peacefully in one phase of their life while each one goes about his own business in respect of everything else.

The price system works so well, so efficiently, that we are not aware of it most of the time. We never realize how well it functions until it is prevented from functioning, an even then we seldom recognize the source of the trouble.

Prices perform three important functions in organizing economic activity:

- Prices transmit information;
- Prices provide an incentive to adopt those methods of production that are least costly and thereby use available resources for the most highly valued purposes;
- Prices determine who gets how much of the product— the distribution of income.

These three functions are closely interrelated. Smooth functioning of this system without confusing signals by government control is essential and crucial for economic activities.

Non-Functioning of Price System in Socialist countries

The intimate connection among the three functions of the price system mentioned above has given different results in different countries, such as (Soviet Russia, China, and India). For physical resources—land, buildings, mineral resources and the like—these countries have been able to go farthest by making them the property of the government (read-

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http://www.loksatta.com/index.php?option=com_content&view=article&id=218926:2012-03-31-15-58-29&catid=55:2009-07-20-04-00-45&Itemid=13

41 http://www.business-standard.com/india/news/maharashtra-sugar-industry-bats-for-decontrol/477250/

42 http://www.thehindubusinessline.com/industry-and-economy/economy/article3935847.ece

Nationalization of coal mines, banks and natural resources). But the effect is a lack of incentive to maintain and improve the physical capital. Nationalization of these factors of production have made doing business on equal terms impossible. Public Sector Undertakings (PSUs) are debt ridden and have made business environment stagnant in Maharashtra.

India is following a policy where leaders regard capitalism as synonymous with imperialism, to be avoided at all costs. India embarked on a series of Russian-type five-year plans that outlined detailed programs of investment. Some areas of production (heavy industries) are reserved to government; in others private firms are permitted to operate, but *only in conformity with The Plan*. Tariffs and quotas control imports, subsidies control exports. Self sufficiency is the ideal. Needless to say, these measures produce shortages of foreign exchange. These are met by detailed and extensive foreign exchange control—a major source both of inefficiency and of special privilege. Wages and prices are controlled. A government permit is required to build a factory or to make any other investment[43].

Let Market forces work

A major argument for letting market forces work is the very difficulty of imagining what the outcome would be. The one thing that is certain is that no service would survive that users did not value highly enough to pay for. Neither the users nor the producers would be able to put their hands in anybody else's pocket to maintain a service that did not satisfy this condition.

> Economists may not know much. But we know one thing very well: how to produce surpluses and shortages. Do you want a surplus? Have the government legislate a minimum price that is above the price that would otherwise prevail. That is what we have done at one time or another to produce surpluses of wheat, of sugar, of butter, of many other commodities. Do you want a shortage? Have the government legislate a maximum price that is below the price that would otherwise prevail.
>
> Milton Friedman

Reason behind price controls

One of the basic reasons for price control is the public outcry when the prices increase. By attempting to stabilize prices through control, government becomes a welfare agent of the masses. The government's mechanism of 'price control' somehow, seems to be the solution to keep prices within a fixed range. Now, removing price controls would reveal

[43] Free to choose, Milton Friedman

that the government is naked—it would show how useless, indeed harmful, are the activities of the thousands of employees of numerous Ministries.

Why oppose price and wage controls

Price and wage controls are counterproductive. They distort the price structure, which reduces the efficiency with which the system works. The resulting lower output adds to the adverse side effects of a cure for inflation rather than reducing them. Price and wage controls waste labor, both because of the distortions in the price structure and because of the immense amount of labor that goes into system of the bureaucracy that constructs, enforces, and then evades the price and wage controls.

<u>In the light of the experience of six centuries, only the short time perspective of politicians and voters can explain the continued enforcement of price and wage controls.</u>

What should be done in Maharashtra

Understanding, the dynamics of functioning of price system

- Enabling the consumer, for whom the price is the cost he is required to pay, to make choices about his consumption.
- Enabling the producer, for whom the price is the incentive he looks at, to make decisions about his production plans and strategies.

In order to let the market forces work in the free market economy of Maharashtra, and thereby ensure true long term economic growth and development, we recommend the following-

1. **Lift all the controls on prices of all commodities**

This needs to be done by gradually reducing the taxes and excise and import duties which contribute towards higher prices of consumer goods and services. The reduction is taxes and duties will have favorable effect in the market in the form of increased consumption.

2. **Start the process of eliminating subsidies on all commodities**

Subsidy programs on commodities needs to be phased out. This will reform market prices and align production and consumption of concerned commodities.

FDI for development in Maharashtra

Foreign direct investment (FDI) is a direct investment into production or business in a country by a company in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

General Opposition to FDI

1. Foreign investors, businesses will kill local businesses / traders
2. Foreign companies will take the profits out of India/ Maharashtra – loss of wealth for host region

History of world is full of examples of mutual trade and business or manufacturing investments among many societies or countries. India has been a closed economy with a principle of 'self sufficiency' for last five decades. This has affected the business and investment environment and moreover, people's mindset a great deal.

Mutual trade of not only goods and services, trade of investment, business ideas, and market skills is the need of the hour all over the world.

The liberalization of Indian Economy in 1991 has opened up opportunities to attract more foreign direct and institutional investment; but the existing countrywide tax and investment sentiment makes it impractical for fast developments on this front.

Attract foreign investment in Maharashtra

What needs to be done

1. Simplify existing tax structure and reduce tax rates

Reduction in local body taxes like octroi at Municipal Corporation levels. This will give the boost to small domestic businesses and help attract foreign investment in urban areas of Maharashtra

2. Deregulation of Businesses

Cut down on number of required licenses and simplify the process of opening and expanding of businesses. Age old rules of regulation need to be terminated

Measures like above will help set up an environment where more competitive private business arrangements are ensured with freedom.

Free Trade

> "None of the thousands of persons involved in producing the pencil performed his task because he wanted a pencil. These people live in many lands, speak different languages, practice different religions, may even hate one another--yet none of these differences prevented them from cooperating to produce a pencil[44]."

Free trade is a policy by which a government does not discriminate against imports or interfere with exports by applying tariffs (to imports) or subsidies (to exports) or quotas. According to the law of comparative advantage, the policy permits trading partners to mutually gain from trade of goods and services.

Rules of Trade

The clearest example of free trade practices is in international trade. The loss to other producers and especially to consumers in general is always more than the gains to some favored producers from tariffs and quotas. Free trade would not only promote our material welfare, it would also foster peace and harmony among nations and spur domestic competition. Tariffs and quotas, duties and subsidies are always biased towards entrepreneurs who can manage the ruling party to get the acts and legislations passed in their favor. Once the legislation is passed, citizens are made to believe that such trade policy is for society welfare. In reality, nothing serves the consumers more than a free trade without such legislative restrictions. Such restrictions are often seen to be the causes of conflicts in foreign policies, which the government officials need to handle at the cost of consumer's (read taxpayer's) money! Controls on foreign trade extend to domestic trade as well. They become intertwined with every aspect of economic activity.

A comparison of the experience of Japan after the Meiji Restoration in 1867 and of India after independence in 1947 tests this view. It suggests, as do other examples, that free trade at home and abroad is the best way that a poor country can promote the well-being of its citizens.

The Political Case for Free Trade

Interdependence is a all-encompassing characteristic of the modern world: in the economic sphere, between one set of prices and another, between one industry and another, between one country and another; in the broader society, between economic activity and cultural, social, and charitable activities; in the organization of society, between economic arrangements and political arrangements and between economic freedom and political freedom.

[44] Free to choose, Milton Friedman

In the international sphere as well, economic arrangements are intertwined with political arrangements. International free trade fosters harmonious relations among nations that differ in culture and institutions just as free trade at home fosters harmonious relations among individuals who differ in beliefs, attitudes and interests.

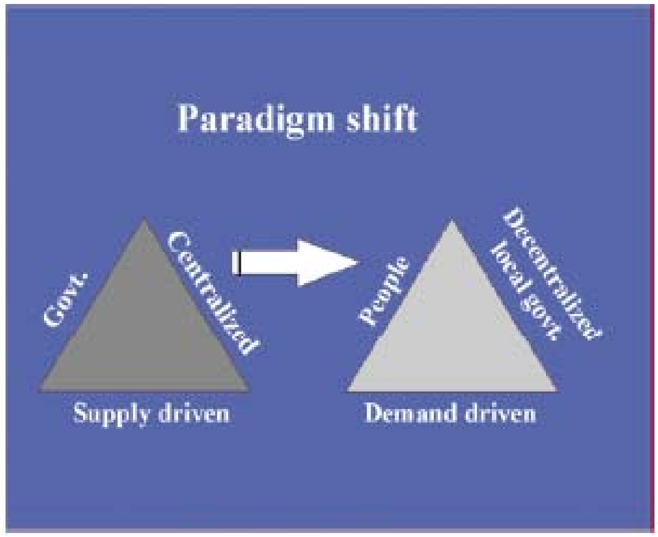
In a free trade world, as in a free economy in any one country, transactions take place among private entities—individuals, business enterprises and charitable organizations. The terms at which any transaction takes place are agreed on by all the parties involved in that transaction. The transaction will not take place unless all parties believe they will benefit from it. As a result, the interests of the various parties are harmonized. ***Cooperation, not conflict, is the rule.***

When governments intervene, the situation is very different. Within a country, enterprises seek subsidies from their government, either directly or in the form of tariffs or other restrictions on trade. They will seek to evade economic pressures from competitors that threaten their profitability or their very existence by resorting to political pressure to impose costs on others. Intervention by one government on behalf of local enterprises leads enterprises in other countries to seek the aid of their own government to counteract the measures taken by the foreign government. Private disputes become the occasion for disputes between governments. Every trade negotiation becomes a political matter. High government officials jet around the world to trade conferences. Frictions develop. Many citizens of every country are disappointed at the outcome and end up feeling they got the short end of the stick. ***Conflict, not cooperation, is the rule.***

Free Trade policy for state of Maharashtra

- ✓ It is suggested that Government of Maharashtra reduces excise and octroi duties on goods traded within the state.
- ✓ Government of Maharashtra is suggested to push for a legislation that favors reduction in custom duties on imported goods.
- ✓ In the existing scenario, Nhava Sheva, officially Jawaharlal Nehru Port comes under Central Government rule. It is suggested that Government of Maharashtra pushes for legislation that gives the state government authority to privatize the container. Competitive business practices will reduce the prices of imported items and cut down the administrative costs.
- ✓ To support expansion of existing businesses and boost new businesses, it is suggested that Government of Maharashtra pushes for a legislation that ends regulation in banking sector. The inefficient banks in Public sector need to be sold to private businesses. This will save misuse of huge public funds.

Roadmap –Economic policy



The paradigm shift that is being suggested in the economic policy for Maharashtra is a bottom top approach in its true sense. The policy and its recommendations empower the people with more authoritative participation not only in law and decision making but more importantly in economic activities. Economic activities are the foundation of a developed and prosperous society. The type and volume of economic activities determine the growth and development of societies. The policy or vision gives the necessary absolute freedom to people to make use of available local resources, human as well as natural, while maintaining the state or government's right to execute the 'Rules of the Game', the unanimously decided rules and regulation in all sections of the society .

The foundation on which this 'Free Enterprise policy stands true is this: human beings, when set free, pursue their own self-interest, and the society as a whole benefits from voluntary co-operative trade incentives among them. The state or government is not an end in itself; it is a system through which people choose to carry out mutually agreeable activities such as law and protection.

The blueprint chapters

- ✓ Tax reforms
- ✓ Deregulation – end license system to ensure freedom to businesses
- ✓ Reduce Government expenditure, phase out subsidies and price regulation
- ✓ Disinvestment – encourage competitive privatization in enterprises currently in public sector ambit
- ✓ Free trade – phasing out of trade barriers

-are themselves the steps towards the goal of "inclusive economic growth and development". These chapters discuss the details of why the measures need to be taken and what effect can be expected out of these initiatives.

The fiscal corrective measures – the steps suggested in the vision document, have already been recommended and advised for long by the central planning commission and economic advisory council at central government level.

The recent advances of the union government to enforce cash transfers, open retail sector for foreign direct investment, to sell off government shares in many publicly held enterprises, to replace Value Added Tax (VAT) with Goods and Service Tax (GST) are all part of economic reforms such as reduction in subsidies, allowing market prices to work, opening trade for foreign investment / reduction in trade barriers, disinvestment and making way for competition among private enterprises and tax reforms / simplifying tax structure.

At Maharashtra State level

Basically, the above measures need to be taken simultaneously to get the desired result of sustainable economic development, because the suggested measures represent the causes which are interdependent and interlinked in the economy.

However, to start with, tax reforms and disinvestment are highest on the priority list.

FISCAL FITNESS PLAN

STEP 1

TAX REFORMATION

Move to Goods and Service Tax (GST), cut down on excise and service tax rates. Make tax collection more decentralized. Local governing bodies need to be given more powers as compared to state government and central government to charge and collect taxes. The process of Tax devolution needs to be made effective. Revamp tax administration (for lesser taxes, of course).

STEP 2

REDUCE SUBSIDIES

Cut down all subsidies currently disbursed by Government of Maharashtra. These subsidies have been distorting prices and giving wrong and confusing signals to the state economy. Shift all government assistance to "direct cash transfers" and curb state sponsored welfare programs.

STEP 3

DISINVESTMENT

Government of Maharashtra sells off its stake in state run enterprises and gives way to competitive private enterprises to run businesses. The procedures are already taking place in state PSUs like MSRTC. The speed needs to be increased.

STEP 4

DECENTRALIZED LOCAL GOVERNANCE

Contrary to existing centralized over powerful government, local governing bodies should be made capable of governing local issues. The size and role of government will be important but smaller and restricted to its core responsibilities. It will be a servant to the people and not master over their life choices.

Conclusion

The challenges Government of Maharashtra faces today are slower economic growth, ever increasing public debt and largely financial mismanagement.

There is no other alternative way to fight massive public debt burden, dispiriting tax system or an inflexible business regulation than to push for limited decentralized governments and free enterprise system as the pillars of a thriving society in Maharashtra.

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