II Issues and Perspectives

Even as state governments stay on course for fiscal consolidation they face several challenges during 2013-14. A positive development is the central government's decision to restructure centrally sponsored schemes (CSS), which is expected to provide flexibility to the states in designing and implementing these schemes. At the same time, a revision in the mechanism of transfer of funds to the states, i.e., routing all transfers through state government budgets will increase the accountability of states. The public distribution system under the recently enacted National Food Security Act 2013 may have favourable implications for the states in terms of state-level subsidies, even as it requires preparedness by way of creating storage facilities and identifying beneficiaries within the specified time frame and putting in place an institutional set up for implementation and monitoring of PDS under the Act. While the overall debt position of the states is sustainable, narrowing of the growth-interest rate differential could exert pressure on the debt of certain states in the medium-term. Further, states' contingent, off-budget and unfunded liabilities could pose a risk to their fiscal and debt sustainability. In this context, the implementation of the financial restructuring plan (FRP) for state-owned power distribution companies (discoms) will have implications on the finances of participating states in terms of higher expenditure and additional debt and contingent liabilities in the short to medium-term. However, in case the restructuring plan, as envisaged, brings about a turnaround in the viability of the discoms its overall impact on state finances in the long-term will be positive. Cooperation between the central and state governments through mutual confidence building measures is crucial for facilitating the process of introducing the goods and services tax (GST), a long pending tax reform which could increase revenue mobilization in the medium-term by increasing the tax base, reducing tax evasions and bringing in transparency and efficiency in the tax collection mechanism.

1. Introduction

2.1 State budgets for 2013-14 indicate a further move towards fiscal consolidation, which is in line with the fiscal roadmap laid down by the Thirteenth Finance Commission (FC-XIII). The central government's recently announced policy initiatives, like restructuring of the centrally sponsored schemes (CSS), financial restructuring plan of the state-owned power distribution companies and the National Food Security Act 2013 are important from the point of view of their impact on state finances. In addition, the introduction of the goods and services tax (GST), which is still being debated, will have a significant bearing on the resource raising potential of the state governments, besides being an important tax reform measure for improving tax efficiency and reducing the cost-cascading prevalent in the present indirect tax regime, thereby contributing to higher growth. The financing of gross fiscal deficit (GFD) at the state level has exhibited a compositional shift, with the contribution from the National Small Savings Fund (NSSF) losing its significance as a source of finance in the recent period. On the issue of debt sustainability, although the states have fared reasonably well, this process was aided by a favourable macroeconomic environment, enactment of fiscal responsibility legislations by the states and implementation of debt and interest relief measures by the centre. However, going forward, narrowing of the growth-interest rate differential and increases in contingent, off-budget and unfunded liabilities could pose risks to debt sustainability of some states. This chapter examines and provides an assessment of the above issues.

2. Central Assistance to State Plans: *Compositional shift towards plan programme linked assistance in alignment with central government objectives*

2.2 States are primarily responsible for major sectors such as health, education and employment which often involve large public expenditures. Recognising the higher resource requirements of the states relative to their resource-raising capacity, the Constitution mandates statutory transfers of tax and grants from the central government to the state governments in accordance with the Finance Commission awards. In addition, states also have access to central assistance to state plans and central plan funds through CSS. Central assistance to state plans has three components, *viz.,* normal central assistance (NCA), additional central assistance for externally aided projects (ACA for EAP) and assistance for programmes based on specific criteria and guidelines. Assistance to the states under state plans is released as per the scheme of financing approved by the Planning Commission. Normal central assistance is the only 'untied' part of plan assistance, while ACA for EAP and programme linked assistance are both tied.

2.3 The NCA's share in total central assistance for all states increased during 2002-03 to 2006-07 before declining gradually thereafter to 20.6 per cent in 2012-13 (41.4 per cent in 2006-07). So, nearly four-fifths (80 per cent) of all the central assistance to states was in the form of 'tied' assistance in 2012-13 as against around 65 per cent during 2002-03. Among all three components of plan assistance to the states, the share of special plan assistance was the highest at around 75 per cent in 2012-13 while that of ACA for EAPs was only around 5 per cent (Table II.1). From 2007-08 onwards, the centre has not been extending loans to the states under the state plans but the grants portion of the assistance has been significantly enhanced in pursuance of the recommendations of the Twelfth Finance Commission (FC-XII). Each state raises market borrowings for the loan

Table II.1: Central Plan Assistance to Non-special and Special Category States

(Share in Per cent)

Year	Normal Central Assistance			ACA for EAPs			Special and Other Programmes		
	NSC States	SC States	Total	NSC States	SC States	Total	NSC States	SC States	Total
1	2	3	4	5	6	7	8	9	10
2002-03	29.1	60.0	35.0	43.3	5.9	36.1	27.6	34.1	28.8
2003-04	30.5	54.9	35.6	40.5	4.9	33.0	29.1	40.3	31.4
2004-05	31.9	53.5	36.5	32.4	6.2	26.8	35.7	40.4	36.7
2005-06	35.5	56.1	40.1	29.9	7.4	24.9	34.6	36.5	35.0
2006-07	37.2	56.5	41.4	23.0	8.5	19.8	39.8	35.1	38.8
2007-08	20.5	51.3	31.1	11.1	13.0	11.7	68.5	35.7	57.2
2008-09	16.6	46.7	26.1	7.0	11.6	8.5	76.4	41.7	65.4
2009-10	16.0	38.6	23.9	5.6	9.2	6.8	78.5	52.3	69.2
2010-11	15.8	39.2	23.8	3.8	9.5	5.7	80.5	51.3	70.4
2011-12	15.3	36.1	22.6	2.1	9.2	4.6	82.7	54.7	72.8
2012-13	14.4	31.1	20.6	1.8	9.1	4.5	83.8	59.8	74.8
2013-14	16.1	32.0	22.4	2.1	10.2	5.3	81.8	57.8	72.4

NSC: Non-special category. SC: Special category. ACA: Additional Central Assistance. EAP: Externally Aided Project.

Note: 1. Data compiled from statement 'detailed break-up of central assistance under State Plans to the states for years 2002-03 to 2013-14' appearing under financial resources section of State Plans.

2. Data from 2007-08 onwards includes assistance in form of grants only to States.

Source: Planning Commission, Government of India.

portion of the state plan schemes subject to its borrowing caps for the year. Based on FC-XII's recommendation, transfer of external assistance to non-special category states (as state governments cannot access external sources of finance directly) is being made on a 'back-to-back' basis from April 1, 2005[1]. Special category states continue to get external assistance from the centre at the earlier loan-grant ratio of 10:90.

3. Centrally Sponsored Schemes: *Restructuring would provide greater flexibility to the states but would also entail greater responsibility*

2.4 Over the years, the central government has introduced several CSS in areas of national priority such as health, education, agriculture, skill development, employment, urban development and rural infrastructure. While the primary responsibility for developing several of these sectors vests with the state governments, the central government extends support to state governments through CSS which cover education and health, among others. The CSS are operationalised by the central ministries based on scheme-specific guidelines and are largely funded by the central government[2], with state governments having to make a defined contribution. These schemes are implemented by state governments or their designated agencies. Notwithstanding a decline in the number of such schemes in recent years, the share of CSS in the gross budgetary support (GBS) has gone up progressively in the last few plans, particularly in the Eleventh Plan (Table II.2) while the significance of normal central plan assistance in GBS has declined in relative terms.

Table II.2: Plan Assistance to States/ UTs through CSS

Plan	Gross Budgetary Support (GBS) (₹ billion)	No. of Schemes	CSS (₹ billion)	Share of CSS in GBS (Per cent)
Ninth Plan* (1997-2002)	3,163	360	990	31.3
Tenth Plan* (2002-07)	5,946	155	2,298	38.6
Eleventh Plan* (2007-12)	11,313	147	4,274	37.8

* At Constant Prices.

Source: Report of the Committee on Restructuring of Centrally Sponsored Schemes and Planning Commission, Government of India

2.5 Some of the issues raised by the states in the past relating to the operation of CSS include: (i) inability of some states to provide counterpart funds to access the funds under CSS; (ii) lack of flexibility in implementing CSS, and the resultant need to provide for flexibility in norms (both in physical and financial terms) taking into account state specific requirements and to ensure effective convergence between schemes run by the states and CSS in the same sector; (iii) thin spread of resources due to proliferation in the number of schemes; (iv) lack of transparency in guidelines relating to transfer/release of funds under the schemes; and (v) difficulty in effective monitoring of final use of funds under CSS, particularly in the case of funds released directly to various societies.

2.6 The Committee on Restructuring of Centrally Sponsored Schemes (Chairman: Shri B.K. Chaturvedi), which was set up by the Planning Commission in April 2011, looked into the working of CSS with a view to enhancing their

[1] However, under externally aided projects, existing arrangements regarding release of external assistance to states for on-going state sector projects signed on or before March 31, 2005 continue, *i.e.,* it is provided in the form of Additional Central Assistance (ACA) in the loan:grant ratio of 70:30 for non-special category states.

[2] The pattern of assistance for states under CSS varies between 90 per cent for north-east states and 65-100 per cent for other states.

flexibility, scale and efficiency. In its Report submitted in September 2011, the Committee recommended that the total number of CSS be reduced to 59 so as to increase the efficiency of these schemes towards serving the desired objectives. It categorised the proposed restructured schemes into nine flagship programmes, 38 sub-sectoral schemes and 13 umbrella schemes.[3] The National Development Council (NDC), while approving the Twelfth plan in its meeting in December 2012, had also recommended building flexibility in the schemes to suit the requirements of the state governments.

2.7 In line with the recommendations of the Chaturvedi Committee and the NDC, the Union Cabinet decided in June 2013 to restructure the existing CSS/Additional Central Assistance (ACA) schemes in the Twelfth Five Year Plan into 66 schemes (Table II.3). This includes 17 flagship programmes with significant outlays for major interventions required in health, education, irrigation, urban development, infrastructure (including rural infrastructure) and skill development. To meet the states' requirements, the Cabinet also approved that a scheme may have state specific guidelines which may be recommended by an Inter-Ministerial Committee constituted for this purpose.

2.8 Under the existing arrangements, transfer of funds under the CSS to state governments takes place through (i) the state budgets and (ii) direct transfer to district rural development agencies (DRDA) and independent societies under the control of state governments. A substantial proportion of the assistance (over 70 per cent) is

Table II.3: Number of Centrally Sponsored Schemes

S. No.	Ministry / Department	Existing CSSs in 2013-14	Proposed by the Chaturvedi Committee	Union Cabinet's Decision
1	2	3	4	5
1	Agriculture & Cooperation	13	6	6
2	Animal Husbandry, Dairying and Fisheries	17	3	3
3	Commerce	1	1	1
4	Aids Control	1	1	1
5	Drinking and Water Supply	2	2	2
6	Environment and Forests	5	4	5
7	Food Processing Industries	1	-	1
8	Health and Family Welfare	13	5	2
9	Industrial Policy and Promotion	2	1	-
10	AYUSH	3	1	1
11	Home Affairs	6	1	2
12	School Education and Literacy	16	6	6
13	Higher Education	2	1	1
14	Information Technology/ Finance	-	-	1
15	Labour and Employment	2	2	2
16	Law and Justice	1	1	1
17	Minority Affairs	4	1	1
18	Panchayati Raj	1	1	2
19	Planning Commission / Finance	-	-	1
20	Land Resources	2	2	2
21	Road Transport and Highways	1	1	-
22	Rural Development	6	4	5
23	Sports	1	1	1
24	Statistics and Programme Implementation	2	1	1
25	Disability Affairs	3	-	1
26	Social Justice and Empowerment	10	5	4
27	Textiles	3	2	2
28	Tourism	1	-	1
29	Tribal Affairs	5	1	1
30	Urban Development	-	-	-
31	Urban Development / Finance	2	-	1
32	Women and Child Development	7	3	4
33	Water Resources / Finance	-	-	1
34	Youth Affairs	1	-	1
35	Housing & Urban Poverty Alleviation	2	2	2
36	Culture	1	-	-
	Total	**137**	**59**	**66**

Source: Planning Commission, Government of India.

[3] Flagship schemes will address major national interventions required on education, health, irrigation, urban development infrastructure, rural infrastructure, skill development, employment and other identified sectors. Major sub-sectoral schemes will address developmental problems of sub-sectors of major sectors like agriculture, education and health. Sector umbrella schemes will address sectoral gaps to help improve the effectiveness of plan expenditure.

disbursed to the DRDA and implementing agencies, bypassing the state budgets. While the agency route reduces the time delay in the agencies receiving the funds, it also dilutes the responsibility of the states in ensuring proper utilisation of the funds as these are not transferred through the state budgets. Under the restructured scheme, the entire financial assistance to the states for CSS will be routed through their consolidated funds from the fiscal year 2014-15 and not directly to DRDAs or through other independent agencies, as is done at present.

2.9 The states will, therefore, be in a better position to monitor the funds flow under the CSS. It will also enable the states to effect convergence of schemes run by the state governments and the central government. At the same time, this will require the state governments to put in place an effective fund transfer mechanism to ensure that funds to the lowest utilising organisational level, *i.e.,* the panchayats, reach with minimum delay.

2.10 Further, to bring in the desired flexibility, the Cabinet has approved that 10 per cent of the total outlay of the schemes be kept as flexi-funds[4]. The guidelines for flexi-funds were issued by the central government on January 6, 2014. For each new CSS/ACA/flagship scheme, at least 25 per cent of funds would have to be contributed by the non-special category states and 10 per cent of funds, by the special category states. As the budgetary provision for 2013-14 has already been made, these arrangements will come into force from 2014-15 for the remaining years of the Twelfth Five-Year Plan and will help in optimum utilisation of resources for desired results. The restructured CSS would help to address the need for state specific flexibility in designing the schemes/programmes. The states would have to take advantage of the same and ensure that the schemes meet the objectives they set out to achieve.

4. Surplus Cash Balances of the state governments: *Need for better cash management*

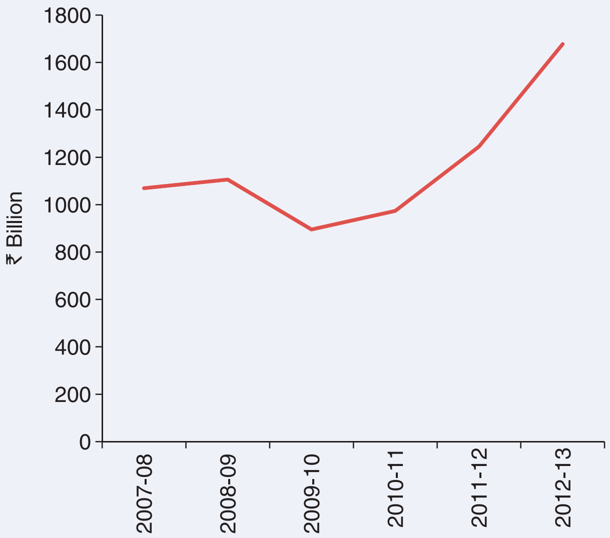
2.11 State governments have been accumulating large cash balances since 2004-05. The accumulation is on account of: (i) surpluses in the revenue account of some states; (ii) borrowing in excess of their requirements; (iii) funds earmarked for meeting certain expenditures, which will be utilised as and when the identified expenditures get crystallised; (iv) funds transferred to lower parastatals/agencies/schemes but not yet utilised by them and (v) unanticipated funds transfer from the centre.

2.12 Build-up of large surplus cash balances increases the interest cost for the state governments, particularly if it is built from borrowed resources. While the investment of surplus balances of the states in centre's treasury bills meets its fiscal requirements, it also complicates its cash management due to the uncertainty about the durability of such flows. As maintenance of large cash balances amounts to draining of liquidity from the system, it could, at times, come in conflict with the liquidity management objective of the Reserve Bank.

2.13 The average investment by the states in treasury bills has been on an uptrend except in 2009-10, in the aftermath of the global financial crisis and the pay commission awards. In general, states have been accumulating large surplus cash balances towards the final quarter of the year to meet year-end expenditure requirements (Chart II.1).

[4] The Chaturvedi Committee had recommended that 20 per cent of the assistance be transferred to the flexi fund.

Chat II.1: Surplus Cash Balances of the States
(Annual Average Outstanding)



2.14 As the GFD-GSDP ratio is capped at 3.0 per cent from 2014-15 under the states' FRBM Acts, it is essential that states adopt a need-based approach to their market borrowings. The FC-XIII had highlighted that while states required some cushion for smoothening expenditure at the implementation level, the accumulation of cash beyond a level reflected inefficiency, leading to avoidable interest burden. Since the return on the central government treasury bills in which states invest their surplus cash balances is lower than the coupon rate on their market borrowings through dated securities, states may consider using their surplus cash balances to finance their GFD rather than resorting to fresh borrowings, in line with the suggestion made by FC-XIII. Cash surplus may also be used for pre-paying old high cost debt as some states have done in the past.

2.15 The recent increase in ways and means advances (WMA) limits by 50 per cent of the existing limits by the Reserve Bank would enable states to maintain lower cash balances as it provides a cushion for meeting unforeseen expenditure, without the states having to maintain large cash balances for precautionary purposes. States can reduce the negative carry on interest rates by increasing their investment in auction treasury bills (ATBs) rather than in intermediate treasury bills (ITBs) that carry a lower interest rate. It is noteworthy that the investment in ATBs more than doubled in recent years, although only a few states have exercised this option. However, states should adopt prudent cash management and refrain from short-term borrowings from the Reserve Bank while maintaining their investment in ATBs.

5. National Small Savings Fund: *Negative contribution to financing of states' GFD in recent years*

2.16 Investments made by the NSSF in special state government securities (SSGS) out of the net proceeds collected under various small savings schemes[5], was the predominant source of GFD financing for the state governments during 1999-2000 to 2006-07. However, its contribution to GFD financing has been declining over the years and has turned negative since 2011-12, with the redemption of SSGS issued to NSSF far exceeding fresh investments. The share of NSSF investments in GFD financing declined from a high of 81.9 per cent in 2005-06 to -4.8 per cent and -3.5 per cent, respectively in 2011-12 and 2012-13 (RE). In contrast, the share of market borrowings in GFD financing increased sharply from 17.0 per cent in

[5] Net small savings collections (collections under small savings schemes net of withdrawals from the schemes) credited into NSSF are invested in central and state government special securities based on norms prescribed from time to time. The amount received on redemption of the special securities are reinvested by NSSF in central and state government special securities in the ratio of 50:50 from 2012-13, with the states' share being distributed amongst various states in the ratio of their previous year's gross collections.

2005-06 to 80.4 per cent in 2011-12 before falling to 72.1 per cent in 2012-13 (RE).

2.17 The declining role of NSSF's contribution to GFD financing can be attributed to three factors: (i) volatility in net collections under small savings schemes; (ii) revisions in norms relating to sharing of net collections between the centre and the states; and (iii) redemption of SSGS during the year.

2.18 Collections under small savings, which were substantial till 2005-06, have been declining in recent years due to higher returns on alternate instruments of savings. In fact, during 2007-08 and 2008-09, when market interest rates ruled higher than small savings rates, which had remained unchanged since March 2003, subscriptions to small savings instruments declined and flows from NSSF dried up, necessitating additional market borrowings by state governments. Although NSSF's investment in SSGS increased in 2009-10 and 2010-11 due to buoyant small savings collections, it slumped again in 2011-12. Seven states did not receive any fresh investment from NSSF in 2011-12 as their net collections had turned negative. Since December 2011, interest rates on small savings instruments have been made more market-aligned, based on the recommendation of the Committee on Comprehensive Review of the National Small Savings Fund (Chairman: Smt. Shyamala Gopinath), but as they are revised at annual intervals, they cannot respond to market signals as quickly as other instruments of savings.

2.19 The volatility in NSSF's contribution to GFD financing is also linked to the revisions in norms relating to sharing of net collections between centre and states during 1999-2000 to 2012-13.[6] From 2012-13 onwards, state governments have been given the option of availing either the entire net small savings collections within the state or only 50 per cent of the net collections. In 2012-13 and 2013-14(BE), 16 out of the 28 states opted for a 50 per cent share of net small savings collections. States which opted for a 100 per cent share include those with large small savings collections, such as Uttar Pradesh, Gujarat and Madhya Pradesh; those which are fiscally constrained like West Bengal[7] and Kerala and all the special category states in the north-east, barring Mizoram. Uncertainty surrounding NSSF collections in recent years may have played a role in their decision to avail 100 per cent of the net small savings collections.

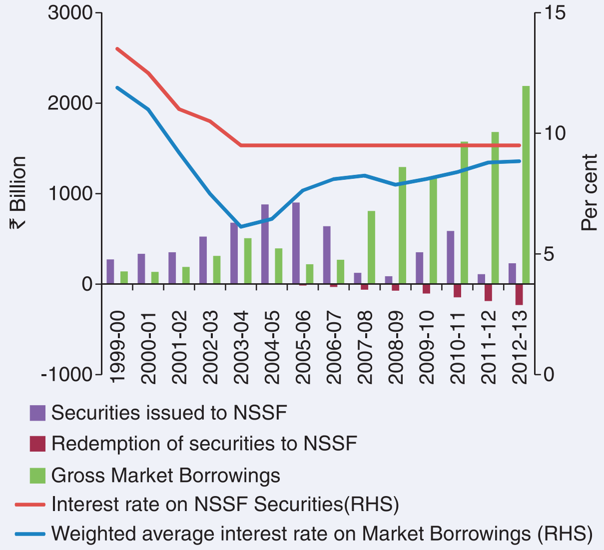
2.20 NSSF's contribution to GFD financing of states also depends on the magnitude and investment pattern of redemption proceeds of SSGS. Up to 2011-12, the redemption proceeds were re-invested primarily in special central government securities[8]. The decline in fresh investment by NSSF in SSGS due to the two factors mentioned earlier coupled with increasing redemption of SSGS over the years led to negative contribution of NSSF to the GFD financing of several states in 2011-12. Apart from Bihar, Chhattisgarh and Uttar Pradesh all the other non-special category states had an outflow under SSGS issued to NSSF in 2011-12. Although the

[6] The sharing between the centre and the states was in the ratio of 20: 80 between 1999-2000 and 2001-2002; 0:100 between 2002-03 and 2006-07; and 20: 80 during 2007-08 to 2011-12, with the option to the states to avail up to 100 per cent of net collections.

[7] West Bengal is also among the states with relatively large small savings collections.

[8] Consequent to an enabling provision made for investment of redemption proceeds in other instruments, a sum of ₹15 billion was invested in India Infrastructure Finance Company Limited (IIFCL) in 2007-08.

Chart II.2: NSSF Investment in Special Securities Versus Market Borrowings



policy decision to reinvest 50 per cent of the redemption proceeds in SSGS in 2012-13 enabled all the states to receive some funds from NSSF during the year, NSSF's contribution in financing the consolidated GFD of the states continued to be negative, as investments in SSGS were lower than redemption requirements.

2.21 With the envisaged reduction in the tenor of SSGS to 10 years from 25 years, the advantage of elongated maturity in comparison to market borrowings would no longer be available. With regard to the interest rates, although interest rate on SSGS was significantly above the weighted average interest rate on market borrowings, the gap between the two has been narrowing in recent years (Chart II.2). The states will, therefore, have to weigh the relative merits of NSSF financing and market borrowings and exercise the option on the proportion of net small savings collections that they would like to avail, taking into account the amounts they would be receiving through reinvestment of redemption proceeds. As intermittent flows from the NSSF could distort the states' cash management, greater clarity in the procedure and periodicity of the transfer/release of funds from the NSSF could remove the uncertainty in the flows and enable the states to undertake active cash management.

6. Public Distribution System: *Reduction in central issue prices under the National Food Security Act 2013 could help in reducing state level food subsidies*

2.22 Under the recently enacted National Food Security (NFS) Act 2013,[9] state governments have the responsibility of implementing and monitoring central as well as state schemes for ensuring food security for the targeted beneficiaries. The impact of the Act on the public distribution system is examined from the perspective of (i) state level food subsidy expenditure (ii) expansion of storage capacity and (iii) identification of beneficiaries.

Table II.4: Central Issue Price

(₹ per kilogram)

Foodgrains	Under Existing TPDS			Under NFS
	AAY	BPL	APL	AAY and priority beneficiaries
Rice	3.00 (25.9)	5.65 (43.3)	7.95 and 8.30 (30.8)	3.00
Wheat	2.00 (20.5)	4.15 (22.9)	6.10 (56.6)	2.00

Note: Figures in parentheses are the percentage shares of the respective categories in the total allocations of rice and wheat for 2013-14.
Source: Foodgrains Bulletin, Ministry of Food and Consumer Affairs.

[9] Details of the provisions of the Act and the role of the states are covered in Chapter III of this report.

Impact of NFS Act on State Level Food Subsidies

2.23 Under the existing targeted public distribution system (TPDS), the central government allocates foodgrains to states at the central issue price (CIP) fixed by it for the three categories of TPDS beneficiaries: below poverty line (BPL), *Antyodaya Anna Yojna*[10] (AAY) and above poverty line (APL) (Table II.4). While the centre provides 35 kg of foodgrains each for BPL and AAY families, APL families are provided foodgrains depending on the availability. The states have the flexibility of fixing the retail issue prices for distributing foodgrains under TPDS, except with respect to AAY, where the end retail price is to be retained at the CIP for that category. In effect, the states have to bear the margins for wholesalers/retailers, transportation charges, levies and local taxes in respect of AAY families but have the flexibility to pass these on to BPL and APL families.

2.24 However, some states have gone beyond the provisions made under the existing TPDS by including other items like edible and cooking oils, sugar, pulses and milk and extending the coverage to other segments of the population. For instance, Tamil Nadu and the union territory of Puducherry have a universal system since June 2011 under which 20 kg of rice is distributed free of cost to all families covered under PDS. The governments of these state/UTs also distribute pulses and pamolein oil at subsidised rates. In Andhra Pradesh and Chhattisgarh, the existing public distribution systems are near universal. Chhattisgarh enacted its own Food Security Act in January 2013 which entails *antyodaya* and priority households to highly subsidised foodgrains, iodised salt, black gram and pulses. BPL category consumers in 13 states/UTs get rice at prices lower than the CIP[11] (including two states/UTs where rice is provided free of cost) and seven states offer wheat at prices lower than CIP for this category. Furthermore, AAY category consumers get rice in 17 states and wheat in one state at prices lower than the respective CIPs fixed for this category[12].

2.25 Under the provisions of the NFS Act 2013, the distinction between BPL, AAY and APL families is no longer relevant from the point of view of fixing the CIP. Instead, 813 million people (about two-thirds of the country's population as per the 2011 census) will be entitled to 5 kg of foodgrains per month at the prices currently applicable to AAY families, *i.e.,* at ₹3, ₹2, ₹1 per kg for rice, wheat and coarse grains for a period of three years from the date of commencement of the Act. Thereafter, the issue price would be fixed by the central government, from time to time, not exceeding (i) the minimum support price for wheat and coarse grains; and (ii) the derived minimum support price for rice, as the case may be. AAY families would continue to get 35 kg of foodgrains. In case the allocation for any state under the NFS Act is lower than their current allocation, it will be protected up to the level of average off-take during last three years, with the CIP for the additional allocation being fixed at levels currently applicable for APL households (*viz.,* ₹6.10 per kg for wheat and ₹8.30 per kg for rice).

2.26 For those states which are offering foodgrains at prices lower than the CIP to beneficiaries under the existing TPDS, the reduction in the CIP under NFS Act would result in narrowing down the difference between the retail

[10] Poor households at the risk of hunger.

[11] Of these, one state offers the concessional price to a limited quantity of foodgrains.

[12] Based on information available in the Foodgrains Bulletin of the Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

price fixed by the states and the CIP, thereby reducing the subsidy that these states would have to incur. This is, however, subject to no further expansion in the coverage of beneficiaries and/or commodities covered under the existing PDS of the states. As the NFS Act requires the central government to share the costs associated with transportation/handling/dealer margin, the states which were hitherto bearing these costs will stand to benefit. However, for the states which have been passing on these costs to BPL consumers in terms of higher retail prices under the existing TPDS, the financial implication will depend on the extent of cost-sharing by the centre.

Expansion of Storage Capacity

2.27 In order to meet storage requirements under the NFS Act, governments, both at the centre as well as in the states, have been allocating funds for constructing high-capacity godowns across the country in the last one year through government schemes as well as through public-private partnerships (PPPs), besides modernising the storage facilities by building state-of-the-art silos for maintaining global standards in storage and distribution. Although the total available storage at 74.6 million tonnes is well above the current requirement of around 61.5 million tonnes under NFS Act, there are wide inter-state differences. States which have made large budgetary allocations for capital expenditure on food and warehousing in 2013-14 include Tamil Nadu, Bihar, Chhattisgarh, Gujarat, Jammu and Kashmir, Tripura, Maharashtra and West Bengal.

Identification of beneficiaries

2.28 Corresponding to the coverage of 75 per cent rural and 50 per cent urban population at all-India level, state/UT-wise coverage has been determined by the central government. The work of identifying eligible households has been left to the states/UTs, which may frame their own criteria or use social, economic and caste census data, if they so desire. The states/UTs have been given a period of 365 days, after the commencement of the Act, to complete the beneficiary identification process. So far, Chhattisgarh, Haryana, Himachal Pradesh, Karnataka, Punjab, Rajasthan and NCT Delhi have been allocated foodgrains under the NFS Act based on the number of beneficiaries reported to have been identified by the respective state governments.

2.29 Implementation of institutional reform measures, such as end-to-end computerisation of public distribution system and leveraging of *aadhaar* for unique identification of entitled beneficiaries, would help to prevent diversion of foodgrains and improve targeting of benefits under the NFS Act in the medium-term.

7. Debt Sustainability: *Overall debt position of the states is sustainable although the narrowing of growth-interest rate differential could exert pressure in the medium term*

2.30 The debt position of state governments in India, which deteriorated sharply during the first half of 2000s, has witnessed significant improvement since 2005-06 (Table II.5). This has been attributed, among others, to the implementation of fiscal rules through the enactment of fiscal responsibility legislations at the state level. The fiscal consolidation initiatives of state governments were complemented by debt and interest relief measures by the centre, and were supported by a favourable macro-economic environment following the high growth phase and a reversal of the interest rate cycle in the mid-2000s. At the end of March 2013, while all the non-special category states were able to adhere to the debt target recommended by FC-XIII, the debt-GSDP ratio for Kerala, Punjab, Uttar Pradesh and West Bengal exceeded 30 per cent.

Table II.5: Debt/ GSDP Ratio of Indian States (Average)

(Per cent)

States	1995-96 to 1999-2000	2000-01 to 2004-05	2005-06 to 2009-10	2010-11 to 2013-14*	End-March 2013
1	2	3	4	5	6
Andhra Pradesh	22.3	30.8	28.3	23.1	22.7
Bihar	57.0	54.8	45.8	26.7	24.8
Chhattisgarh	-	25.6	19.2	13.6	12.5
Goa	33.7	39.4	32.4	27.8	27.6
Gujarat	21.8	35.5	31.0	24.6	23.5
Haryana	21.0	26.1	20.8	18.3	18.6
Jharkhand	-	22.2	27.2	21.4	21.1
Karnataka	18.4	26.2	23.9	21.8	20.6
Kerala	21.1	33.3	33.6	29.8	29.4
Madhya Pradesh	33.8	36.0	34.2	25.7	23.9
Maharashtra	17.9	27.7	25.9	20.4	19.7
Odisha	37.3	52.6	36.2	20.8	18.5
Punjab	34.7	46.1	38.7	32.6	31.7
Rajasthan	28.3	44.2	39.8	25.9	24.3
Tamil Nadu	17.5	25.0	22.1	19.9	20.2
Uttar Pradesh	35.7	48.9	46.4	35.3	33.7
West Bengal	26.0	44.3	46.1	38.6	37.5
NSC States	**24.5**	**35.6**	**32.2**	**25.3**	**24.4**
SC States	**29.2**	**43.0**	**43.3**	**34.4**	**33.2**
All States	**21.8**	**30.1**	**27.6**	**22.2**	**21.7**

NSC = Non-special category states; SC = Special category states
*: 2012-13 relates to revised estimates & 2013-14 relates to budget estimates.
–: Nil/ Not Available
Note: 1. Data for 'All states' are expressed as per cent to GDP
2. Data for Bihar, Madhya Pradesh and Uttar Pradesh for the period 1995-96 to 1999-2000 pertain to the former undivided states

2.31 Traditionally, indicator analysis has been used to assess debt sustainability. The assessment is generally done in terms of credit worthiness indicators (nominal debt stock/own current revenue ratio; present value of debt service/own current revenue ratio) and liquidity indicators (debt service/ current revenue ratio and interest payment/current revenue ratio). These indicators broadly enable an assessment of the ability of a state government to service its interest payments and repay its debts as and when they become due through current and regular sources of revenues. In pioneering work done on debt sustainability, based on post-Second World War US data, Domar (1944) pointed out that the primary deficit path can be sustained as long as real growth of the economy remains higher than the real interest rates.

2.32 An analysis of debt sustainability at the state level, based on various indicators, has been undertaken for the period 1995-96 to 2013-14 (Table II.6). While the rate of growth of debt of state governments at the aggregate and disaggregated levels during 1995-96 to 2004-05 exceeded the nominal GSDP growth rate, there was a significant improvement thereafter, with the difference between the rate of growth of debt and the growth rate of nominal GSDP turning negative during 2005-06 to 2013-14. Similarly, moderation in the effective interest rate coupled with higher growth of nominal GSDP during 2005-06 to 2009-10 and in the subsequent period contributed to an improvement in debt sustainability indicators (Kaur *et. al.,* 2013).

Table II.6: Debt Sustainability Indicators

States	Rate of growth of public debt (k) should be lower than growth rate of nominal GSDP (g) : k-g<0				Rate of growth of GSDP (g) should be higher than effective interest rate (i) : g-i>0			
	1995-96 to 1999-00	2000-01 to 2004-05	2005-06 to 2009-10	2010-11 to 2013-14*	1995-96 to 1999-00	2000-01 to 2004-05	2005-06 to 2009-10	2010-11 to 2013-14*
1	6	7	8	9	10	11	12	13
Non-Special Category								
Andhra Pradesh	5.3	6.2	-5.9	-3.8	2.1	-1.0	7.8	8.0
Bihar	3.6	-2.2	-9.7	-13.4	2.3	-0.5	9.0	14.2
Chhattisgarh	-	3.2	-10.0	-6.3	-	2.1	8.3	10.0
Goa	-2.5	-0.2	-4.3	-0.6	10.6	4.3	10.0	4.1
Gujarat	10.1	4.3	-4.6	-4.8	0.7	1.7	8.1	9.7
Haryana	9.3	-0.1	-7.8	-1.7	1.3	2.1	10.3	7.7
Jharkhand	-	1.2	4.5	-1.0	-	1.0	3.3	6.0
Karnataka	1.5	6.4	-1.1	-4.8	3.5	-0.6	7.1	9.4
Kerala	4.7	8.4	-2.7	0.9	2.6	-3.6	5.9	3.5
Madhya Pradesh	3.4	2.3	-6.3	-6.6	0.4	0.3	7.4	9.4
Maharashtra	8.4	6.8	-5.5	-6.5	3.6	0.3	8.3	10.5
Odisha	6.2	1.4	-11.8	-13.1	2.1	0.6	8.4	9.5
Punjab	4.2	4.6	-7.7	-3.4	0.2	-1.9	7.0	6.1
Rajasthan	8.1	5.9	-6.9	-13.5	2.5	-2.6	7.5	13.8
Tamil Nadu	4.0	5.0	-4.2	-0.9	2.6	-1.5	8.7	6.9
Uttar Pradesh	5.9	4.6	-6.3	-4.5	1.8	-1.9	8.5	7.3
West Bengal	8.6	8.2	-1.3	-7.0	3.9	-2.4	4.6	8.3
NSC states	**6.0**	**5.3**	**-5.4**	**-5.6**	**2.4**	**-0.9**	**7.7**	**8.8**
SC States	**3.4**	**9.3**	**-4.6**	**-6.6**	**1.8**	**-0.7**	**6.8**	**7.8**
All states	**4.8**	**4.7**	**-4.6**	**-5.2**	**3.5**	**0.0**	**6.9**	**8.2**

NSC = Non-special category states; SC = Special category states
*: 2012-13 relates to revised estimates & 2013-14 relates to budget estimates.
-: Nil/ Not Available
Note: 1. Indicators for 'All states' are in terms of GDP
2. Data for Bihar, Madhya Pradesh and Uttar Pradesh for the period 1995-96 to 1999-2000 pertain to the former undivided states

2.33 A steady decline in the debt service burden of Indian states is also evident, as different debt service indicators, *viz.,* interest payments to revenue receipts, interest payments to GSDP and interest payments to revenue expenditure, declined during 2005-06 to 2013-14 (Table II.7). Interest payments, which had crossed one-fifth of revenue receipts (considered as a tolerable ratio of interest burden; Dholakia *et. al.* 2004) during the first half of 2000s, declined to around 12 per cent in the recent period. The improvement in debt servicing conditions in India since the second half of 2000s is, however, to a large extent policy driven, with debt swap scheme (DSS), debt consolidation and relief facility (DCRF) and interest reset on high cost borrowings from the NSSF contributing to the reduction in the interest rates on liabilities of the states owed to the centre.[13]

[13] DSS, which operated during 2002-03 to 2004-05, enabled the states to prepay high cost loans contracted from the central government with low coupon bearing small savings and market borrowings. DCRF, which operated during 2005-06 to 2009-10, was extended to all states which had enacted their FRBM Acts. It provided for consolidation of all central government loans (from the Ministry of Finance) outstanding as on March 31, 2005, into fresh loans at lower interest rates. Repayments due from the states for 2005-06 to 2009-10 for these loans were eligible for write-offs.

Table II.7 : Debt Servicing Indicators

States	Interest Payments to Revenue Receipts				Interest Payments to GSDP				Interest Payments to Revenue Expenditure			
	1995-96 to 1999-00	2000-01 to 2004-05	2005-06 to 2009-10	2010-11 to 2013-14*	1995-96 to 1999-00	2000-01 to 2004-05	2005-06 to 2009-10	2010-11 to 2013-14*	1995-96 to 1999-00	2000-01 to 2004-05	2005-06 to 2009-10	2010-11 to 2013-14*
1	2	3	4	5	6	7	8	9	10	11	12	13
Non-Special Category												
Andhra Pradesh	16.9	23.5	15.4	11.4	2.0	3.0	2.2	1.7	15.0	20.8	15.8	11.6
Bihar	20.2	24.5	14.0	8.3	4.4	4.5	3.2	1.8	17.9	21.6	15.5	9.1
Chhattisgarh	-	16.0	8.2	4.3	-	2.1	1.4	0.9	-	15.8	9.8	4.8
Goa	12.2	16.3	15.7	11.7	2.4	3.0	2.3	1.9	11.7	14.8	16.1	12.1
Gujarat	17.4	27.1	21.8	17.0	1.9	3.0	2.3	1.8	15.4	21.5	21.6	17.2
Haryana	15.7	21.6	13.1	13.5	2.1	2.5	1.5	1.4	13.4	20.2	13.2	12.6
Jharkhand	-	12.4	11.6	8.9	-	1.8	1.9	1.7	-	12.0	11.2	9.6
Karnataka	13.6	17.2	11.1	8.9	1.7	2.4	1.7	1.3	12.6	15.8	12.0	9.2
Kerala	19.5	27.2	21.5	15.7	1.8	2.8	2.5	2.2	16.1	20.6	18.3	14.1
Madhya Pradesh	14.8	19.5	13.8	8.7	2.9	3.2	2.4	1.7	13.0	17.3	15.5	9.8
Maharashtra	15.1	21.6	16.9	14.0	1.4	2.2	1.8	1.4	13.4	17.1	17.4	13.9
Odisha	26.1	33.2	16.3	8.8	3.1	4.9	2.7	1.6	20.1	27.3	18.2	9.6
Punjab	32.6	30.2	23.3	19.9	3.6	3.9	3.0	2.4	25.4	23.0	20.1	17.2
Rajasthan	22.9	30.4	20.9	13.6	2.6	4.0	3.1	1.9	19.0	24.6	20.5	14.0
Tamil Nadu	13.8	18.4	12.5	10.7	1.6	2.2	1.6	1.4	12.0	16.3	13.0	10.6
Uttar Pradesh	27.2	30.2	16.0	11.2	3.1	4.0	2.8	2.2	21.0	23.6	16.7	11.7
West Bengal	28.9	47.3	37.9	25.8	2.4	4.4	3.8	2.8	20.2	30.8	27.8	21.3
NSC states	19.4	25.3	17.1	12.6	2.2	3.1	2.3	1.8	16.4	20.8	17.2	12.7
SC States	12.5	16.6	11.7	8.6	2.7	3.9	3.2	2.2	12.8	15.8	13.4	9.2
All States	18.7	24.3	16.5	12.2	1.9	2.6	2.0	1.5	16.1	20.3	16.8	12.4

NSC = Non-special category states; SC = Special category states
*: 2012-13 relates to revised estimates & 2013-14 relates to budget estimates.
–: Nil/ Not Available
Note: 1. Data for 'All states' in Columns 6 to 9 are expressed as per cent to GDP
2: Data for Bihar, Madhya Pradesh and Uttar Pradesh for the period 1995-96 to 1999-2000 pertain to the former undivided states

2.34 Overall, the debt position of state governments has shown an improvement as is evident from various debt sustainability indicators. However, the recent growth slowdown and volatility in the financial markets may affect the financial health of the state governments, particularly those which have relatively high debt-GSDP ratios. The slowdown in the growth momentum may affect the revenue raising capacity of state governments, which may not only contribute to incremental debt but also have an adverse impact on their debt servicing capacity. Moreover, withdrawal of interest relief[14] for those states which have not adhered to their FRBM targets may increase their debt service burden.

[14] Based on the recommendation of Thirteenth Finance Commission (FC-XIII), states were given provisional interest relief on securities issued to the National Small Savings Fund from 2012-13 onwards provided they amend their FRBM Acts. The central government had stipulated that after availing interest relief, if a state breaches the FRBM targets in actual, the reduced interest on NSSF loans will be withdrawn and the earlier interest rate will become applicable.

8. Going Beyond the Conventional Debt Sustainability Analysis: *Contingent liabilities and unfunded liabilities of the states can increase the risk to their fiscal and debt sustainability*

2.35 The conventional debt sustainability analysis, though useful, may not provide a comprehensive assessment of debt sustainability, as it is based on a narrow coverage of debt and excludes contingent, implicit and off-budget liabilities. Apart from issues of debt coverage, this analysis is generally done in a static framework and, therefore, it does not account for fiscal and economic behaviour in response to shocks (sensitivity analysis) and fiscal vulnerabilities (stress-testing exercise).

2.36 In India, while the enactment and implementation of rule based fiscal policies have resulted in a gradual move towards sustainability of the state governments' fiscal and debt positions, the issuance of guarantees by them has remained an area of concern. Notwithstanding strict monitoring of overall borrowing limits and adherence to various restrictions[15], states have been able to raise additional 'off-budget' borrowings with guarantees through state controlled special purpose vehicles (SPVs) and/or state-owned public sector enterprises (SPSEs). In recognition of the fiscal risk associated with guarantees, both fresh issuances and outstanding, a Group of State Finance Secretaries on the Fiscal Risk on State Government Guarantees (2002) had underlined the importance of according appropriate risk weights with respect to devolvement of guarantees, and making adequate budgetary provisions for honouring these guarantees in case they devolve on the states.

2.37 State-wise data on explicit guarantees from 1990-91 onwards (refer to Statement 30) indicates that there was a declining trend in outstanding guarantees at the aggregate level in the 2000s. This reflected the impact of fixing limits on annual incremental guarantees as ratio of GSDP or total revenue receipts under the FRBM Acts/FRLs enacted by state governments. Notwithstanding this, these explicit contingent liabilities as at end-March 2012 had increased substantially in some states.

2.38 The guarantee commitments of state governments with respect to SPSEs are, in fact, a major source of potential risk to fiscal and debt sustainability at the state level in general[16] and in those states in particular where SPSEs have accumulated huge losses and debt liabilities (Table II.8). In this context, it may be pertinent to draw attention to the financial burden on state governments arising from their participation in financial restructuring plan (FRP) of their power distribution companies[17].

2.39 The fiscal implications of the FRP for participating states are linked to four major aspects: (i) issuance of bonds by the state-owned power distribution companies (discoms) with respect to 50 per cent of short-term liabilities (STL) as on March 31, 2012 and its subsequent replacement through issuance of special securities by the state governments; (ii) issuance of guarantees towards interest and principal repayment of the balance 50 per cent of STL to be restructured by banks/FIs

[15] While states have an automatic entitlement to small savings collections within the jurisdiction of the respective states, depending on the sharing arrangement with the centre, any shortfall/excess under this head under the extant monitoring arrangement with an overall cap on borrowings is adjusted against market borrowings.

[16] The issuance of guarantees/letters of credit to SPSEs poses a fiscal risk especially when cost recovery systems are not fully in place (Reddy 2001).

[17] Financial restructuring plan was introduced by the central government on October 5, 2012 vide Office Memorandum No. 20/11/2012- APDRP, Ministry of Power, Government of India.

Table II.8: Debt and Accumulated Profit/Loss Position of State PSUs

(₹ billion)

States	2009-10		2010-11		2011-12	
	Debt	Accumulated Profits/Losses(-)	Debt	Accumulated Profits/Losses(-)	Debt	Accumulated Profits/Losses(-)
1	2	3	4	5	6	7
Andhra Pradesh	..	..	297.7	-2.8	356.1	-0.2
Arunachal Pradesh	0.1	–	0.1	–	0.1	-0.2
Assam	14.3	-12.8	12.2	-10.9	15.1	-22.5
Bihar	90.4	-46.2	102.4	-72.1	117.4	-98.2
Chhattisgarh	42.5	18.1	52.6	20.5	85.8	20.0
Goa	..	..	..	..	..	..
Gujarat	237.3	-6.0	268.6	1.7	302.5	16.9
Haryana	174.4	-50.9	199.4	-56.8	218.4	-86.2
Himachal Pradesh	26.7	-8.5	30.8	-12.9	36.0	-13.6
Jammu and Kashmir	45.0	-13.4	47.3	-15.3	44.6	-16.5
Jharkhand	47.6	-5.9	50.5	-16.5	60.2	-63.9
Karnataka	247.0	-2.0	253.6	10.1	292.0	13.7
Kerala	..	..	..	..	24.0	30.5
Madhya Pradesh	101.6	-114.9	136.0	-139.2	..	..
Maharashtra	277.0	-85.4	343.5	-96.1	474.2	-115.5
Manipur	0.3	-0.1	0.3	-0.1	0.1	-0.1
Meghalaya	8.7	-5.2	11.3	-6.2	10.8	6.7
Mizoram	0.3	-0.4	0.3	-0.5	0.3	-0.5
Nagaland	0.4	-0.3	0.5	-0.3	0.5	-0.5
Odisha	55.5	21.4	75.9	23.4	74.7	22.5
Punjab	128.1	-106.4	104.6	-121.9	119.9	-124.9
Rajasthan	264.4	-13.4	362.6	-20.7	459.8	-15.9
Sikkim	4.6	-0.7	4.0	-0.7	2.6	-0.8
Tamil Nadu	309.0	-213.0	467.9	-336.2	431.6	-596.4
Tripura	1.1	-3.0	1.3	-3.2	2.0	-3.5
Uttar Pradesh	143.8	-190.2	250.8	-226.0	359.5	-293.8
Uttarakhand	25.9	-4.2	24.7	-8.1	28.8	-19.1
West Bengal	291.1	-50.2	271.2	-50.5	..	..

–: Nil/Negligible. .. : Not available.
Source: State Audit Reports on Public Sector Undertakings, CAG.

and other creditors; (iii) implementation of mandatory conditions under the FRP having financial implications[18]; and (iv) sharing of burden in respect of operational losses and working capital loans (as indicated in the FRP guidelines of the Ministry of Power) by state governments with banks/financial institutions (FIs).

2.40 As the state governments take over the bonds to be issued by the discoms, it will add to their outstanding debt liabilities. The issuance of bonds by discoms is required to be guaranteed by the state governments. In addition, the repayment of principal and interest, with respect to the balance 50 per cent of the STL to be rescheduled by lenders

[18] Include (i) converting all loans given by state governments to discoms into equity or defer the recovery of such loans along with interest till the loans rescheduled by banks/FIs are fully paid; (ii) payment of all outstanding energy bills of state departments/agencies as of March 31, 2012 before November 30, 2012; (iii) payment of subsidy arrears before March 31, 2013 where the STL (outstanding STL net of outstanding subsidy and energy bills due from the state government to the discoms) is positive and in other cases, not later than March 31, 2015; (iv) release of agricultural subsidy based on feeder/distribution transformer meter data; (v) payment of subsidy upfront to the discoms.

and serviced by the discoms, is also to be fully secured by state government guarantees. These guarantees will have a bearing on the states' contingent liabilities.

2.41 In view of the foregoing and considering the strong presence of contingent liabilities in some states, there is a need for a holistic assessment of state government debt. The debt position of state governments should be seen together with their off-budget liabilities and borrowings through SPVs while also taking into account the potential risks to state finances arising from the dismal health of SPSEs, particularly state power utilities.

9. Goods and Services Tax: *Need for building consensus between centre and states for introduction of GST*

2.42 A major indirect tax reform which has been engaging the attention of policy makers, both at the central and state government levels, as well as industry associations in the last few years is the introduction of the goods and services tax (GST). The proposed GST is a comprehensive destination based tax on manufacture, sale and consumption of goods and services, with individual central and state components in the tax structure, *viz.,* CGST and SGST, respectively. GST will replace a number of indirect taxes presently being levied by the central and the state governments and is intended to remove cascading of taxes (Table II.9). The switch to a GST regime will, on the one hand, streamline the entire indirect tax system by reducing inter-state differentials in tax rates, subsuming a large number of taxes into an aggregate levy, which, once paid, can be claimed as credit against subsequent tax payments anywhere in the country. On the other hand, it will incentivise countless producers to enroll themselves into the tax system, because in not doing so their competitive edge will get reduced.

Table II.9: Taxes to be Subsumed in the Proposed GST

Taxes levied by the Central Government which would be subsumed in CGST	Taxes levied by the State Government which would be subsumed in SGST
(i) Central Excise Duty	(i) VAT / Sales tax
(ii) Additional Excise Duty	(ii) Entertainment tax (unless it is levied by the local bodies)
(iii) Excise Duty levied under the Medicinal and Toiletries Preparation Act	(iii) Luxury tax
(iv) Service Tax	(iv) Taxes on lottery, betting and gambling
(v) Additional Customs Duty, commonly known as Countervailing Duty (CVD)	(v) State cesses and surcharges in so far as they relate to supply of goods and services
(vi) Special Additional Duty of Customs	(vi) Entry tax not *in lieu* of octroi
(vii) Surcharges	
(viii) Cesses	

Note: 1. Taxes on alcohol and petroleum products are kept out of GST.
2. Tax on tobacco products will be subject to GST but the central government can levy extra excise duty over and above GST.

2.43 The states' own tax revenue-GDP ratio has grown from an average of 5.8 per cent during the high growth phase, *i.e.,*2004-08 to 6.6 per cent in 2012-13 (RE). While there could be some revenue loss to the states in the short-term due to reduced manoeuvrability in fixing tax rates, improvement in tax compliance, facilitated by the IT infrastructure to be used for GST implementation, is expected to increase tax buoyancy in the medium term.

2.44 The Empowered Committee of State Finance Ministers has been working with the central government for preparing the road map for the introduction of GST. As a preparatory step to implementing GST, the central government had introduced the 115th Constitution Amendment Bill in the Parliament on March 22, 2011. The bill sought to confer simultaneous powers to the Parliament as well as the state legislatures to make laws for levying GST. The bill provided for the setting up of two constitutional bodies - GST Council and GST Dispute Settlement Authority (DSA). The GST Council will make recommendations on all key matters pertaining to GST such as taxation rates under both CGST and SGST and exemptions from GST. The DSA will be responsible for any disputes amidst the Union/states/members with respect to GST. The Constitution Amendment Bill will have to be passed by two-thirds majority in the Parliament, which is then to be ratified by legislatures of at least half the states. The bill was referred to the Standing Committee on Finance on March 29, 2011; the committee tabled its report in the Parliament on August 5, 2013, the main recommendations of which are summarised in Annex 1.

2.45 Two committees were set up by the central government to deliberate on (a) the compensation package for the states *in lieu* of revenue loss on account of reduction of central sales tax from 4 per cent to 2 per cent and (b) the GST design. These two committees submitted their reports in January 2013. As a follow up, three other committees comprising officials from central and state governments were constituted in February 2013: (i) the Committee on Revenue Neutral Rates for State GST and Central GST and Place of Supply Rules in GST regime; (ii) the Committee on Inter-State GST and GST on Import; and (iii) the Committee on the Problem of Dual Control, Threshold and Exemptions in GST. Interim reports have been given by these committees which are being examined and deliberated upon by various stake holders.

2.46 Some of the important issues which need to be resolved include (i) revenue neutral rate for GST; (ii) compensation from the central government for short-term losses, if any, arising from the shift to the proposed GST tax regime; (iii) rules relating to 'place of supply' in order to bring about clarity as to which state will have jurisdiction over transactions in case of services that are complex; (iv) raising the exemption threshold for the benefit of small businesses and; (v) issues relating to the introduction of an integrated GST (I-GST).

2.47 Inter-state trade is currently being subjected to central sales tax (CST) which is levied by the centre but collected and appropriated by the states. As this tax is origin based, it is inconsistent with the proposed GST which is a destination based tax. Keeping in view the proposed introduction of GST from April 1, 2010, it was decided in 2006-07 to phase out CST and accordingly CST rates were reduced in 2007-08 and 2008-09. The states were to be compensated for the reduction in CST rates. The central government has released to the states a sum of ₹308.6 billion as compensation for CST reduction for the years 2008-09 and 2009-10. The centre has made a budgetary provision of ₹93 billion in 2013-14 as the first instalment of the balance amount of CST compensation to states for the year 2010-11.

2.48 Keeping in view the requirement of a strong IT infrastructure for the implementation of GST regime, Goods and Services Tax Network (GSTN), a Section 25 company has been set up. It will primarily be responsible for the implementation and sustenance of the IT infrastructure. The budget for 2013-14 has made a provision of ₹1 billion for providing recurring grant to GSTN.

2.49 Most of the states and UTs have already enabled mission mode projects for computerisation of commercial taxes to align with the roll out of GST. Most of the states/UTs have completed the legal changes required to enable the e-services and have started accepting electronic tax returns.

As at end-December 2013, out of the 33 states/UTs[19], 32 have started e-registration. Thirty two states/UTs have commenced e-payment facility to their dealers. Most of the states/UTs have made PAN compulsory for filing return. Twenty seven states/UTs have collected more than 80 per cent of PAN details from their dealers and remaining states/UTs are collecting it on priority. Seventeen states have started e-issuance of forms required for inter-state trade.

2.50 Based on the recommendations of the Standing Committee on Finance and inputs from various committees set up by the centre, a revised draft Constitution Amendment Bill was prepared by the centre for consideration by the Empowered Committee of State Finance Ministers. The states did not agree on provisions regarding inclusion of petroleum, alcoholic liquor and entry tax in the proposed GST, as this might dent their revenue collections. It may be mentioned that the VAT rate levied by states at present ranges from 0.1 per cent to 33.2 per cent for petrol and from 9.2 per cent to 25 per cent for diesel. Tax revenue from alcoholic liquor is significant for some states as the manufacture of liquor is subject to state excise duty and its sale is subject to VAT; state excise duty on alcohol and intoxicants alone contributed over 15 per cent of states' own tax revenue in 13 out of the 30 states/UTs in 2012-13(RE).

2.51 The Empowered Group on IT Infrastructure on GST (Chairman: Nandan Nilekani) has stated, "*a fully electronic GST can dramatically increase tax collections by reducing leakages. Tools such as matching the input tax credit, data mining and pattern detection will deter tax evasion and thus increase collections*." While the timing of the introduction of GST is still uncertain, a consensus needs to be built through confidence building measures/steps both by the central and state governments, for the successful rollout of GST without any further delay. This would improve compliance and increase overall tax buoyancy.

10. Conclusion

2.52 States, while managing their finances prudently, are also saddled with the additional responsibility of reinvigorating the slowing economy by utilising the fiscal space available with some of them to invest in productive sectors of the economy. The initiative taken by the centre in restructuring CSS will provide states with some fiscal space to manoeuvre the schemes to their advantage by enhancing their impact on the development of states. An early resolution of differences between the centre and the states and among the states themselves will facilitate removing the legislative hurdles for the introduction of GST, with attendant benefits to tax revenue and growth in the medium-term.

[19] including 3 UTs which do not have separate legislatures but collect VAT on sales.