STATE FINANCES
A STUDY OF BUDGETS OF
2002-03

RESERVE BANK OF INDIA

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The State Governments have been experiencing fiscal stress in recent years as evident from large and increasing fiscal and revenue deficits. The rise in the gross fiscal deficit (GFD) was pronounced in the second half of the 1990s, with an increasing high proportion being accounted for by the rising revenue deficit. In recent years, on an average, more than one half of the GFD has been on account of revenue deficit. This implies that a significant proportion of the borrowed funds has been utilised for meeting revenue expenditure. The consequential accumulation of debt and debt service obligations has put constraints on the States' ability to undertake developmental activities, *viz.*, provision of economic and social infrastructure. In order to address this problem, the States have been undertaking a number of policy measures relating to revenue augmentation, containment of expenditure, and public sector reforms. The States' initiatives towards fiscal reforms have also been supplemented by the Central Government. Recognising the fact that significant improvement in States' fiscal health is feasible only in the medium term, a number of States have, in consultation with the Centre, embarked upon medium term strategies towards fiscal consolidation.

The States' fiscal position, after witnessing continuous deterioration during the period 1996-97 to 1999-2000, had shown some improvement in 2000-01 when the GFD of States declined from Rs.91,480 crore (4.7 per cent of GDP) in 1999-2000 to Rs.89,532 crore in 2000-01 (4.3 per cent of GDP). This improvement, however, could not be sustained in 2001-02. According to the revised estimates for 2001-02, the States' gross fiscal deficit rose to Rs.1,06,595 crore (4.6 per cent of the GDP), which was also higher than the budget estimates of Rs.95,087 crore (3.8 per cent of GDP). The deterioration in the revised estimates from the budget estimates of 2001-02 was largely due to shortfall in revenue receipts on account of general slowdown in the economy which affected both States' own tax receipts and their share in Central taxes. In the revised estimates for 2001-02, revenue receipts were lower by Rs.14,766 crore (-5.2 per cent) mainly on account of lower receipts from States' own tax receipts (Rs.10,581 crore or 7.4 per cent) than the budget estimates. States' own non-tax receipts were also lower by Rs.1,382 crore (-4.2 per cent) in the revised estimates. Similarly, States' share in Central taxes was lower by Rs.4,928 crore (-8.2 per cent) than the budget estimates. The States' share in Central taxes accounted for 33.4 per cent of the shortfall in total revenue receipts. This was partly offset by Central grants, which were higher by Rs.2,124 crore (4.4 per cent) than the budget estimates. Over four-fifths of the shortfall in total revenue receipts was, however, due to lower realisation in States' own revenue receipts. The States' aggregate expenditure, however, remained broadly at the budgeted level in 2001-02. The aggregate debt of the States as a percentage of GDP rose from 23.7 per cent in 2000-01 to 25.7 per cent in 2001-02.

The State budgets for 2002-03 generally reflect the increasing need for fiscal reforms. Reckoning for the measures envisaged in the State budgets, the overall resource gap (GFD) of all States taken together is estimated to be lower at 4.0 per cent of GDP in 2002-03 as compared with 4.6 per cent of GDP in the revised estimates for 2001-02.

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[1] A special study prepared by a team in the Division of State and Local Finances of the Department of Economic Analysis and Policy headed by Shri M.R.Nair, Adviser and consisting of Dr. B.N.Anantha Swamy, Director, Shri R.K.Jain, Assistant Adviser, Shri Rajmal and Smt. Anupam Prakash, Research Officers. Statistical assistance was provided by the staff of the Division of State and Local Finances, *viz.*, Smt. M.V.Kulkarni, Kum. G.F.Colabawalla, Shri S.R.Ghanshani and Shri P.P. Joshi, under the supervision of Shri P.R.Jamma, Assistant Manager. The study has been prepared under the overall guidance of Dr. Rakesh Mohan, Deputy Governor.

This study presents an analysis of the finances of the State Governments during 2000-01, 2001-02 (revised estimates) and 2002-03 (budget estimates). The study is based on the States' budget documents and other supplementary information received from the States, the Planning Commission and the Reserve Bank's internal records[2]. A broad overview of the policy initiatives as proposed in the budgets for 2002-03 is presented in Section II. Section III provides a brief analysis of the State finances in 2000-01, while Section IV focuses on the revised estimates for the year 2001-02. An analysis of the receipts and expenditures and other relevant details as per the budget estimates for 2002-03 is provided in Section V. Trends in public debt, market borrowings and outstanding guarantees of the State Governments are presented in Section VI. Concluding observations and emerging issues and concerns are outlined in Section VII.

Section II

Policy Developments

(i) State-Level Policy Initiatives

The States' budgets for 2002-03 have proposed measures for revenue augmentation, expenditure compression, reforms of public sector undertakings (PSUs), promotion of private investment in crucial sectors and institutional reforms. These measures broadly aim at enhancement of the revenue receipts through revision of tax rates, broadening of tax base and improved tax compliance. Other important initiatives relate to the preparatory work for introduction of Value Added Tax (VAT) and rationalisation of user charges mainly relating to power, water, transport, *etc.*

On the expenditure front, a number of States have proposed containment of revenue expenditure through a set of economy measures such as restrictions on fresh recruitment/creation of new posts and curbing the growth in administrative expenditure. Some States have proposed introduction of a new contributory pension scheme for newly recruited staff. A few States have set up Committees/ Commissions relating to fiscal reforms.

The institutional reforms proposed in the State budgets aim at fiscal stability and sustainability. Four States *viz.* Karnataka, Kerala, Maharashtra and Punjab have initiated/proposed measures to provide statutory backing to the fiscal reform process through enabling legislation (Box 1). The State of Karnataka enacted the Fiscal Responsibility Bill in August 2002, while States of Maharashtra and Punjab have introduced fiscal responsibility bills in their Legislatures. The Kerala Government has proposed to introduce a Fiscal Accountability Bill.

In recent years, several States have shown keen interest in undertaking review of the functioning of the State Public Sector Undertakings (PSUs) to facilitate PSU reforms. In continuation of this process, many State Governments in their budgets for 2002-03 have initiated/proposed measures pertaining to State level PSU reforms. The Government of Maharashtra has constituted a Board for restructuring the State PSUs which will also facilitate divestment or closure, wherever necessary. While the Punjab State Disinvestment Commission has tentatively finalised its recommendations, the Government of Tamil Nadu has proposed to constitute a Disinvestment Commission.

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[2] The analysis is based on the budgets of 28 States and the National Capital Territory of Delhi and uses supplementary information on additional resource mobilisation measures received from the States. The budget estimates for 2001-02 include the three new States, viz., Chhattisgarh, Jharkhand and Uttaranchal formed in November 2000. The new States were carved out of the existing States of Madhya Pradesh, Bihar and Uttar Pradesh. The data for the years 2001-02 (both BE and RE) and 2002-03 (BE) are inclusive of the three new States. The accounts for the year 2000-01 include the data of Chhattisgarh and Uttaranchal only. These, however, do not include those of Jharkhand for the period November 2000 to March 2001.

Box 1: Fiscal Responsibility Legislation in States

Fiscal reforms at the State level have assumed critical importance in recent years. To strengthen their finances, States have embarked upon a number of measures. While the State of Karnataka has already enacted the fiscal responsibility legislation, the States of Maharashtra and Punjab have introduced the fiscal responsibility bills in their legislatures. The objective has been to provide legal and institutional framework for fiscal reforms. The Kerala Government has proposed to introduce a Fiscal Accountability Bill. The initiated measures, so far, are summarised below.

(1) Karnataka Fiscal Responsibility Act

As announced in the Karnataka Budget for 2001-02, the Government of Karnataka had prepared a Fiscal Responsibility Bill. Subsequently, this has been notified as the Fiscal Responsibility Act in the Karnataka Gazette dated August 30, 2002.

The key features of the Karnataka Fiscal Responsibility Act are as under:

1. Reduction in the revenue deficit to 'nil' within four financial years beginning April 2002 and ending March 31, 2006.
2. Reduction in the fiscal deficit to not more than three per cent of the estimated gross state domestic product (GSDP) within four financial years beginning April 2002 and ending March 31, 2006.
3. Reduce revenue and fiscal deficits as a percentage of GSDP in each of the financial year.
4. Limiting the guarantees within the prescribed limits under the Guarantees Act.
5. Ensure that by end-March 2015, the total liabilities do not exceed 25 per cent of the estimated GSDP for that year.

In addition to the above-mentioned fiscal targets, the Act provides, *inter alia*, for a Medium-Term Fiscal Plan (MTFP) setting forth a four-year rolling target for prescribed fiscal indicators. This would also include an assessment of the sustainability relating to the balance between revenue receipts and revenue expenditures and the use of capital receipts including borrowings for generating productive assets. The MTFP would also contain an evaluation of the performance of the prescribed fiscal indicators in the previous year *vis-à-vis* the targets set out earlier and the likely performance in the current year as per revised estimates.

The Act enunciates certain fiscal management principles and measures for fiscal transparency. Accordingly, the Government would need to ensure that borrowings are used for productive purposes and for accumulation of capital assets and not for financing current expenditure. The Government would also need to ensure a reasonable degree of stability and predictability in the level of tax burden and maintain the integrity of the tax system by minimizing special incentives, concessions and exemptions. The non-tax revenue policies would be in due regard to cost recovery and equity.

In order to enforce compliance, the Act provides for half yearly review of receipts and expenditure in relation to budget estimates along with remedial measures to achieve the budget targets to be placed before both the Houses of Legislature.

(2) Fiscal Responsibility and Budget Management Bill of Punjab

The Punjab Government has introduced the Fiscal Responsibility and Budget Management Bill in the State Legislature. The Bill provides for the State Government's responsibility to ensure intergenerational equity in fiscal management and long-term financial stability by achieving sufficient revenue surplus, eliminating fiscal deficit, prudential debt management, greater transparency in fiscal operations and conducting fiscal policy in a medium-term framework. The State Government shall -

1. contain the rate of growth of fiscal deficit to two per cent per annum in nominal terms;
2. reduce revenue deficit as per cent of total revenue receipts by at least five percentage points from the previous year, until fiscal balance is achieved;
3. cap the ratio of debt to GSDP at the level achieved in the previous year subject to an absolute ceiling of forty per cent to be achieved by 2004-05; and
4. cap outstanding guarantees on long term debt to 80 per cent of revenue receipts of the previous year.

(3) Fiscal Responsibility and Budgetary Management Bill of Maharashtra

Maharashtra Government has introduced the Fiscal Responsibility and Budgetary Management Bill in the State legislature. The main features of the Bill are as under:

1. Ensuring that for a period of five years from the appointed day, the revenue expenditure shall not exceed revenue receipts.
2. Bringing budget transparency by identifying all liabilities (past and present), constitution of a Doubtful Loans and Equity Fund.
3. Presenting to the legislature every year estimated yearly pension liabilities worked out on actuarial basis for the next ten years.
4. Preparation of the budget in a multi-year framework and presenting three years forward estimates of revenue and expenditure.
5. Restriction on borrowing, regulating salary expenditure, ceiling on expenditure on grant in aid institutions and ceiling on subsidies.
6. Achieving the non-salary development expenditure not less than 60 per cent of the total expenditure.
7. To regulate the guarantees issued during the year so that the amount at risk due to such guarantees shall not exceed 1.5 per cent of the expected revenue receipts and to classify the guarantee obligation according to the risk of devolvement.
8. Constitution of the Fiscal Advisory Board to advise the Government on matters relating to the implementation of the fiscal responsibility legislation.

The important policy initiatives proposed by States in their budgets for 2002-03 are presented in Table A.

Table A: Major Policy Initiatives Proposed in State Budgets for 2002-03

States	Fiscal Measures	Institutional Measures	Sectoral Measures
1. Andhra Pradesh	• Emphasis on fiscal reforms and transparency. • Introduction of a range of budgetary reforms, like rationalisation of budget heads to enhance budget managers' flexibility.	• Introduction of an Integrated Finance Information System to integrate the Finance Department with Accountant General, Reserve Bank, commercial banks and other State Departments through on-line data transfer.	• Setting up an Agricultural Fund to improve agricultural productivity and production. • Establishment of Agri-export Zones. • Intends to improve the share of industry in NSDP by continuing the reform measures, particularly in the

States	Fiscal Measures	Institutional Measures	Sectoral Measures
			power, road, ports and restructuring the PSEs. • Streamlining the 'Single Window' project clearance.
2. Arunachal Pradesh	• Emphasis on economy measures relating to travelling and office expenses, purchase and maintenance of vehicles, *etc*. • Efforts to implement the recommendations of the State Finance Commission set up last year. • Expenditure containment through continuation of efforts pertaining to right sizing the Government and reduction in subsidies.	• Extension of computerisation programme to sub-treasuries and provident funds. • Switch over to zero based budgeting, which was initiated in the previous year.	• Emphasis on creation of infrastructure and investment in the productive sectors such as agriculture, horticulture, handicraft and food processing.
3. Assam	• Measures for broadening the existing tax base, better tax compliance, prevention of leakages and reorientation of administration for augmentation of tax revenue collection. • Mobilisation of additional revenue resources through increase in the rate of taxes on component parts and accessories of motor vehicles, motor cycles, scooters, chemicals, *etc*. • Imposition of entry tax on items such as natural flowers, fish, milk and levy of luxury tax on items *viz*. all types of tobacco, handmade and mill made silk fabrics, *etc*. • Introduction of VAT with effect from April 1, 2003.	• Constitution of a 'Committee on Fiscal Reforms' (COFR) and engaging 'National Institute of Public Finance and Policy' (NIPFP) to undertake a study of the prevailing fiscal scenario to facilitate finalisation of the blue print for fiscal reforms. • Setting up Assam Electricity Regulatory Commission with the primary function of tariff fixation. • In order to manage debt servicing more effectively, State proposes to raise the provision for the Consolidated Sinking Fund to Rs. 70 crore in the budget for 2002-03 from Rs. 60 crore in 2001-02. • Finalisation of the Medium Term Fiscal Reform Programme.	• Emphasis on development of agriculture sector. State Agriculture Policy, which is under preparation, encompasses areas such as multiple cropping, crop diversification, mechanisation, infrastructural development, horticulture, *etc*. • Encourage private sector investment in tourism infrastructure and services.
4. Bihar	• Emphasis on efficient utilisation of internal resources, containment of unproductive expenditure and improvement in tax laws. • Introduction of VAT from April 1, 2003.	• Preparation for finalising the Medium Term Fiscal Reform Programme. • Setting up of State Electricity Regulatory Commission.	• Signed on MoU with Government of India on Power sector reforms. Emphasis on the development of agriculture sector and to cover more area under irrigation.

States	Fiscal Measures	Institutional Measures	Sectoral Measures
5. Chhattisgarh	• Rationalisation of tax structure, simplification of tax procedures and strengthening the tax administration. • Ban on recruitment. • Preparation for the introduction of VAT.	• Setting up of pension fund. • Computerisation of revenue department and other major departments.	• Setting up Food Park and Agro Park and Software Technology Park. • Proposes to increase the irrigated areas with the help of loan from NABARD.
6. Goa	• Increase in the rate of surcharge on sales tax. • Modification in the rates of entry tax on certain items. In case of user charges, emphasis on quality regulatory and monitoring systems to increase the revenue realisation. • Emphasis on controlling wasteful administrative expenditure.	• Emphasis on the extensive computerisation of the Sales Tax and Excise Departments.	• Encouraging private sector investment in tourism and co-opt the private sector as associate in infrastructure development and marketing campaigns. • Legislation to ensure removal of bottlenecks for speedy completion of the projects by Goa State Infrastructure Development Corporation. • Intends to undertake a review of irrigation schemes showing low operational efficiency. • Setting up professional groups, which will facilitate and expedite commercial value addition to agro-based products. • Intends to promote export-oriented activities like floriculture and horticulture.
7. Gujarat	• Rationalisation of sales tax, effective use of computerisation and information technology in sales tax related work. • Inclusion of certain types of professions in the category of profession tax payers. • Reduction in the administrative expenditure. • Review of the existing schemes, discontinuation of unviable schemes and merger of overlapping schemes. • Preparation for introduction of VAT and a bill for the value added tax law.	• Emphasis on implementation of the programme for social infrastructure, industries, agriculture and Gokul Gam Yojana formulated by the Government under Vision 2010.	• Concrete steps for restructuring of the Gujarat Electricity Board. • Establishment of export-oriented Apparel Parks and initiatives for the development of textile industry, particularly the upgradation of technology in powerloom industry. • Incentives in the form of sales tax relief to encourage investment and establishment of new industrial units.

States	Fiscal Measures	Institutional Measures	Sectoral Measures
8. Haryana	• Emphasis on widening the revenue base. • Containment of non-productive expenditure and high establishment cost. • Emphasis on levying user charges by discarding the notion of free public services. • Review the present organisational structure and staffing pattern of departments in order to rationalise them.	• Preparation of long-term perspective plan for development of the State and formulation of concrete strategy to realise the milestones of this plan.	• Introduction of e-governance. • Formulation of Information Technology action plan by various departments.
9. Himachal Pradesh	• Revenue augmentation measures include restarting lotteries from the beginning of the year 2002-03, increasing entry tax on vehicles on main entry points and auction of checkpoints.	• Setting up an inter-disciplinary agency, which will work as an enforcement agency for revenue related matters of different Departments.	• Development of a modern economic base in agriculture, rural infrastructure and various other services sectors with the help of NABARD. • Focus on development of tourism as an industry and according priority to this sector.
10. Jharkhand	• Reforms/rationalisation of taxes, particularly sales tax and entry tax. Preparation for introduction of VAT.		• According priority to education, health, industries and basic infrastructure in order to speed up the development of the State. • Setting up Rural Technology Parks.
11. Karnataka	• Preparation of departmental medium term fiscal plans to enable individual departments to focus on long-term goals based on medium term strategies. • Introduction of Voluntary Retirement Scheme. • Introduction of system of collection of tax through banks after necessary clearance from RBI.	• Proposes to make the Medium Term Fiscal Plan a rolling annual document, which would be helpful in providing an outlook of the fiscal situation in the medium term and would also indicate the actual performance against the stated fiscal targets. • Restructuring the departments on the principles of functional organisation.	• Proposes to start *Krishi Vignana Kendras* in all uncovered districts. • With regard to the power sector reforms, proposed separation of transmission from distribution and formation of four electricity companies.
12. Kerala	• Emphasis on better revenue realisation and expenditure management. • Preparation of Medium Term Fiscal Reforms Programme (MTFRP). • Intention to bring Fiscal Accountability Bill aimed at	• Setting up a Social Safety Fund to take care of minimum needs of the poor and improve the availability of basic services. • Setting up Asset Renewal Fund to ensure adequate investments for the maintenance of institutions,	• Setting up an Agriculture Export Zone for development of horticulture. • Setting up four new Industrial Zones with the active participation of the private sector.

States	Fiscal Measures	Institutional Measures	Sectoral Measures
	creating a legal and administrative framework to rein in reckless borrowings and expenditure.	which predominantly provide services to the poor. • Substantial reforms in power sector and encouraging private sector participation. • To undertake reforms and review measures pertaining to the PSUs.	
13. Madhya Pradesh	• Increase in the sales tax rate on certain items like grain, branded rice, *basen*, sugar, *etc*. purchased from outside the State. • Imposition of surcharge and entry tax on sale of petroleum products. • Reduction in non-essential expenditure.	• Constituted Madhya Pradesh Road Development Authority in order to link rural roads. • Restructuring of public sector undertakings.	• Setting up Software Technology Park. • Setting up a Centre for Industrial Infrastructure Development. • Emphasis on food processing industries and setting up of Food Park.
14. Maharashtra	• Introduction of Fiscal Responsibility Bill to contain the deficit at prudent level and to define the sustainability of expenditure allocations.	• Measures for restructuring the power, irrigation and cooperative sectors. • Setting up an independent Fiscal Advisory Board to advise on matters relating to implementation of the fiscal responsibility legislation.	• Setting up a Special Economic Zone in Navi Mumbai, which is likely to attract foreign investment and promote industrial and service sector.
15. Manipur	• Expenditure containment through measures including freeze on fresh appointment and rightsizing the various departments. • Rationalisation of tax rates and structure of user charges. • Involvement of grass root bodies in developmental activities and utilisation of resources in most cost effective way. • Steps for Medium Term Fiscal Reform Policy to evolve the road map for fiscal restructuring.	• Steps for winding up/ downsizing various government companies.	• Proposes to explore the possibilities of taking up projects with foreign assistance. • Emphasis on completion of the on-going Externally Aided Projects to bring in confidence of the funding agencies.
16. Meghalaya	• Continuation of efforts to generate additional resources. • Continuation of economy measures. • Curtailment of non-plan expenditure.	• Finalisation of proposals for reforms of some State Public Sector Undertakings.	• Launching of Technology Mission on Horticulture. • Development of rural infrastructure including increasing road connectivity to villages with funds from RIDF

States	Fiscal Measures	Institutional Measures	Sectoral Measures
			(Rural Infrastructure Development Fund). • Thrust on strengthening power transmission and distribution and rural electrification.
17. Mizoram	• Implementation and introduction of VAT. • Measures to augment revenue collection by both enhancing existing rates of taxes, fees and tariff as well as by introduction of new measures. • Economy measures such as non-filling up of vacant posts, moratorium on fresh recruitment, *etc*. • Preparation of Medium Term Fiscal Reforms Plan.	• Launching of a self-sufficiency project called 'Mizoram Intodelhna Project' (MIP) aimed at the upliftment and emancipation of the poor, and to help the ongoing aforestation and green Mizoram programmes.	• Priority to the generation of power in the State by setting up new hydel projects. Improvement and extention of transmission lines. • Site preparation for ten community information centres (CIC) is in progress. • Building up of infrastructure with the aid of World Bank.
18. Nagaland	• Implementation of the fiscal reform programme as incorporated in the MoU with the Government of India. • Efforts to increase the level of State's own revenue generation like, introduction of new taxes and streamlining the tax collection machinery, as well as step up user charges. • Efforts to reduce non-plan expenditure so as to wipe out the negative BCR (Balance from Current Revenues).	• Streamlining the State PSUs and reduction in the Government's stake in PSUs. • Efforts to make budget more transparent.	• Highest priority to core productive sectors such as, agriculture and allied sector, and infrastructure, such as, power, transport and communication.
19. Orissa	• Staff strength of the State Government to be reduced by 20 per cent and Voluntary Retirement Scheme to be extended. • Freeze on grants in aid to non-government educational institutes.	• Priority to resource tied up projects like externally aided projects, RIDF, PMGY, AIBP *etc*. • Provision for the one time settlement of SEB dues to Central undertakings. • Establishment of the Guarantee Redemption Fund.	• Thrust on agricultural development, and launching of massive irrigation works with the assistance of NABARD.
20. Punjab	• Compression of non-plan revenue expenditure through restructuring of major departments of the Government with a view to reduce the		

States	Fiscal Measures	Institutional Measures	Sectoral Measures
	redundant staff, shift them to surplus pool and to redeploy them as per requirements. • Introduction of the Fiscal Responsibility and Budget Management Bill. • Introduction of Voluntary Retirement Scheme.		
21. Rajasthan	• Measures to bring down revenue deficit. • Efforts to inculcate a tradition of fiscal discipline through revenue augmentation, by strengthening tax administration, unification of tax rates and better compliance. • Decision taken to start on-line lottery, which was completely banned in 1998.	• New Pension Scheme for new recruits of the State Government. • Emphasis on strengthening of *Panchayati Raj* institutions.	• Energy, road, transportation and irrigation sectors to be given prime importance. • Tourism given special place. • Expansion of education and information technology.
22. Sikkim	• Measures for expenditure containment such as, pruning inefficient sectors, right-sizing the Government machinery, and focusing on merit based subsidies. • Measures to augment revenue, strengthening the tax base. • Preparatory steps towards implementation of VAT.	• Measures to strengthen the process of decentralisation.	• Focus on allocating adequate resources to the core areas (agriculture, infrastructure and social sectors). • Project on 'Agricultural Export Zone' (AEZ) to be concretized.
23. Tamil Nadu	• Reduction in the staff strength in a phased manner. • Rationalisation of staffing pattern in the Government. • Introduction of a new contributory pension scheme for all employees recruited from Dec 1, 2001, similar to the one being formulated by the Union Government. • Under the VAT system, the number of tax rates would be only three, apart from a limited list of exempted goods and also commodities, which would be outside the purview of VAT and the set-off principle. • Zero-based budgeting in all	• Constitution of Disinvestment Commission to frame the guidelines for the disinvestment in the profit making enterprises and privatisation of loss-making State PSUs and co-operative institutions. • Constitution of the Staff and Expenditure Review Commission. • Formulation of Public Sector Reform Programme, which includes an attractive Voluntary Retirement Scheme (VRS) for Government employees and those in the PSUs and co-operative institutions.	• The Government is exploring the possibilities of setting up a special purpose vehicle to develop and promote hubs for investments in IT-enabled services. • Focus on infrastructure development and levy infrastructure surcharge of 5 per cent on sales tax paid under the TNGST Act on all items except rice, wheat, kerosene, LPG and Declared Goods.

States	Fiscal Measures	Institutional Measures	Sectoral Measures
	administrative departments so as to transfer and relocate resources from unproductive schemes to productive ones. • Rationalisation of subsidies, block grants and grants-in-aid to institutions.	• Phased privatisation of select routes, services and operations currently under the control of State Transport Undertakings (STUs).	
24. Tripura	• Efforts towards expenditure containment and revenue augmentation. • Strict monitoring of the non-plan revenue expenditure.	• Signing of a MoU with the Ministry of Power is in its final stage and accordingly formation of the State Electricity Regulatory Commission is under consideration.	
25. West Bengal	• Imposition of surcharge of 10 per cent on sales tax payable under the West Bengal Sales Tax Act, 1994 with effect from April 1, 2002 as an interim measure till the introduction of VAT.	• Thrust on process of decentralisaion in the formulation and implementation of plan schemes, plan budget of each department has been divided into two levels-the State level subjects and the district (and below)-level subjects.	• Proposal to launch focussed skill development programmes in IT enabled services. • Expansion in facilities of education and public health together with improvement in quality.
26. Uttar Pradesh	• Preparation of MTFRP. • Necessary arrangements to implement VAT from April 1, 2003.	• Modernisation of fiscal management through strengthening of audit system. • Financial support to the *Panchayats* as per the recommendations of the State Finance Commission.	• Impetus on Infertile Land Improvement programme. • Setting up of Special Economic Zones for rapid industrial progress. • Special emphasis on social welfare and education.
27. NCT Delhi		• Privatisation and re-structuring exercise in public sector units and power sector.	• Priority to the development of transport sector. • Education and Hospital management on top of the agenda of the Government.

Sectoral measures proposed in the State budgets aim at strengthening the basic infrastructure sectors and setting up sectoral industrial parks, which have relatively high potential for growth. These proposals include setting up of Information Technology Parks/ Institutes of Information Technology and development of agriculture and allied activities including floriculture and horticulture. Some States have sought to encourage flow of private investment into the infrastructure sector. A few States have proposed measures for encouraging private sector investment to promote tourism.

Initiatives for State-level Power Sector Reforms

The power sector reforms have assumed critical importance in recent years. The measures taken by the States in this regard relate to the constitution of State Electricity Regulatory Commissions (SERCs) for determining tariff structure, unbundling of electricity boards into separate entities for power generation, transmission and distribution, increasing power tariffs, measures for reducing transmission and distribution losses, *etc*.

State Electricity Regulatory Commission (SERC) has been constituted or notified in 21 States[3]. Of these, SERCs of 15 States[4] have issued tariff orders. The States of Andhra Pradesh, Delhi, Gujarat, Haryana, Himachal Prdesh, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan and Uttar Pradesh have enacted their State Electricity Reforms Acts which provide, *inter-alia*, for unbundling/ corporatisation of SEBs, setting up of SERCs, *etc*. The SEBs of Andhra Pradesh, Delhi, Haryana, Karnataka, Orissa, Rajasthan and Uttar Pradesh have been unbundled/ corporatised. Twenty-one States have signed Memorandum of Understanding with the Ministry of Power, Government of India to undertake reforms in a time bound manner. Monitoring is being done to ensure that the agreed milestones are achieved.

The details of the initiatives taken by individual States for power sector reforms and restructuring are presented in Table B.

Table B: Initiatives for State-level Power Sector Reforms

States	Status of Reforms and Restructuring
Andhra Pradesh	Andhra Pradesh Electricity Regulatory Commission (APERC) has become operational since April 1999. APSEB has been unbundled into Andhra Pradesh Generation Company Ltd. and Andhra Pradesh Transmission Company Ltd (APTRANSCO). APTRANSCO has been further split into four distribution companies. Distribution privatization strategy is being finalized. The APERC has issued two-tariff orders. The State has signed MoU with Government of India. Reform law has been enacted.
Arunachal Pradesh	The State notified the State Electricity Regulatory Commission (SERC).
Assam	Single member SERC has been constituted. The State has signed MoU with the Government of India.
Bihar	State has signed MoU with the Government of India. The State Electricity Board has revised tariff. SERC has been constituted.
Chhattisgarh	State has adopted the MoU signed with Madhya Pradesh. SERC has been constituted.
Delhi	SERC has been constituted. It has issued tariff order. Reform law has been enacted. Delhi Vidyut Board has been unbundled. The distribution has been privatised.
Goa	The Government is proceeding with restructuring the power sector with assistance from Power Finance Corporation (PFC). The SERC has been constituted. The State Government has appointed consultants to advise and implement privatisation of transmission and distribution system. The State has signed MoU with the Government of India.
Gujarat	The State's restructuring programme has emphasised metering all categories of consumers and imposition of cap on agricultural subsidy. SERC has become functional from March 1999. It has proposed to undertake tariff and reform related studies. SERC has issued first tariff order. Reform Law has been approved by Government of India and has been introduced in the State Assembly. The State has signed MoU with Government of India.

[3] Andhra Pradesh, Arunachal Pradesh, Assam, Bihar, Chhattisgarh, Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttaranchal, Uttar Pradesh and West Bengal.

[4] Andhra Pradesh, Delhi, Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Rajasthan, Uttar Pradesh, and West Bengal.

States	Status of Reforms and Restructuring
Haryana	State Reforms Act came into force in August 1998. The SEB has been unbundled into separate transmission and distribution companies. The SERC has become operational and has issued its two-tariff orders. Reform Law has been enacted. The State has signed MoU with the Government of India.
Himachal Pradesh	The State Government is committed to undertake reforms with technical and financial assistance from PFC. The State has constituted a single-member SERC. The SERC has issued its first tariff order. The State has signed MoU with the Ministry of Power for further reforms in the power sector.
Jammu and Kashmir	Reform bill has been passed by the State Assembly. The State has signed MoU with the Government of India.
Jharkhand	State has signed MoU with the Government of India.
Karnataka	State Electricity Reforms Act came into force from June 1999. The SERC has become functional since November 1999. The SERC has issued one tariff order. The transmission and distribution function is entrusted to Karnataka Power Transmission Corporation Ltd. (KPTCL). Privatisation of distribution is in progress following unbundling into four separate companies, which have started functioning from June 1, 2002.
Kerala	SERC has been constituted. The State aims to reorganise the Electricity Board into three profit centres for generation, transmission and distribution. Distribution company to be further split into three profit centres. State has signed MoU with Government of India.
Madhya Pradesh	SERC has become operational since January 1999. SERC has issued first tariff order. Reform Law has been passed by the State Assembly and notified. SEB has been unbundled. The State has signed MoU with the Government of India.
Maharashtra	The State is committed to reforms with technical and financial assistance from PFC. Action has been initiated for undertaking tariff and reform related studies. SERC has become functional since October 1999. MSEB intends formation of Joint Venture Company for distribution of electricity in Bhiwandi area, Thane. MERC has issued two tariff orders. The State has signed MoU with the Government of India for further reforms in the power sector.
Orissa	First State to initiate power sector reforms. Reform Law has been enacted. Orissa State Electricity Board (OSEB) has been unbundled. Distribution has been privatised. Orissa Electricity Regulatory Commission (OERC) has issued four tariff orders. The State has signed MoU with the Government of India.
Punjab	The State proposes to carry out power sector reforms with the assistance from PFC. The SERC has been constituted. It has issued one tariff order. The State Government has signed MoU with the Government of India for reform and restructuring of the power sector.
Rajasthan	The State's Reforms Law has been enacted. The Rajasthan Electricity Board has been unbundled into one generation, one transmission and three distribution companies. Rajasthan Electricity Regulatory Commission has been constituted. SERC has issued two-tariff orders. The State has signed MoU with the Government of India.
Tamil Nadu	The State has set up the SERC. The State proposes to undertake reforms with the technical and financial assistance from PFC. The State has signed MoU with the Government of India.
Uttar Pradesh	The State has enacted the Reforms Bill. The UPSEB has been unbundled into two generation companies and one transmission and distribution company. Uttar Pradesh Electricity Regulatory Commission (UPERC) has become functional. Three tariff orders have been issued by UPERC. Distribution and privatisation strategy is to be finalised. The State has signed MoU with the Government of India.

States	Status of Reforms and Restructuring
Uttaranchal	The SERC has been constituted. The State has signed MoU with the Government of India.
West Bengal	SERC has become operational and has issued first tariff order. The State has signed MoU with the Government of India.
Others*	These States have shown willingness to constitute Joint Electricity Regulatory Commission (JERC) in order to pursue reforms in power sectors.

* Includes the States of Nagaland, Meghalaya, Mizoram, Manipur, Tripura and Sikkim.

Source: *Annual Report on the Working of State Electricity Boards and Electricity Departments*, Planning Commission, Government of India, May 2002.

(ii) Centre's Initiatives

Supplementing the States' efforts, the Centre has also initiated measures to encourage fiscal reforms at the State level. The Eleventh Finance Commission (EFC) had recommended the establishment of an Incentive Fund for the purpose of encouraging fiscal reforms in the States on the basis of a monitorable fiscal reform programme. In pursuance of this, the Government of India has drawn up a scheme called the 'States' Fiscal Reforms Facility' (2000-01 to 2004-05). Accordingly, an Incentive Fund of Rs.10,607 crore has been earmarked over a period of five years. The objective is to encourage States to implement monitorable fiscal reforms. The releases from the Incentive Fund require a five percentage point reduction in the revenue deficit as a proportion to the State's total revenue receipts in each year till 2004-05. However, in the case of States having revenue surplus, three percentage point improvement in the balance in the current revenue (BCR) is required for release of funds under this facility. Additional amounts by way of open market borrowings are allowed if the State concerned has a structural adjustment burden necessitating voluntary retirement, severance payments for downsizing PSEs and debt swap for bringing down interest payments.

Under this scheme, the States draw up a Medium–Term Fiscal Reforms Programme (MTFRP) which aims at bringing down the fiscal deficit to sustainable levels, elimination of revenue deficit by 2005 and reduction in debt-GDP ratio including contingent liabilities to sustainable levels. The MTFRP covers various aspects such as fiscal consolidation, public sector enterprises reform, power sector reforms and fiscal transparency. Fiscal consolidation measures aim at improving tax and non-tax receipts, reprioritisation of expenditures, phasing out non-merit subsidies, *etc.* PSU reforms aim at restructuring in cases where it is absolutely necessary to remain in public domain, privatisation and winding up of loss making units, wherever necessary. The power sector reforms aim at corportisation and unbundling of SEBs, reducing transmission and distribution losses, 100 per cent metering, implementing the awards for Electricity Regulatory Commissions, *etc*. The objective is to eliminate the gap between average cost of power on an accrual basis and average revenue realisation on a cash basis.

The MTFRP forms the basis for a memorandum of understanding between the Centre and the concerned State. The Planning Commission is also extending support to the MTFRP by ensuring that the Annual Plan framework is consistent with the MTFRP agreed by the State in its MoU with the Ministry of Finance, Government of India.

As per the Mid-Year Review, Ministry of Finance, the medium term fiscal plans have been finalised for 16 States *viz.*, Andhra Pradesh, Arunachal Pradesh, Orissa, Maharashtra, Kerala, Karnataka, Manipur, Sikkim, Tamil Nadu, Himachal Pradesh, West Bengal, Rajasthan, Mizoram, Meghalaya, Tripura and Jammu and Kashmir.

The Union Budget 2002-03 has made provision for reform-linked assistance of Rs. 12,300 crore for States under various schemes such as Accelerated Power Development and Reform Programme (APDRP), Accelerated Irrigation Benefit Programme (AIBP), Urban Reforms Incentive Fund (URIF), and Rural Infrastructure Development Fund (RIDF). In addition, a lump sum amount of Rs.2,500 crore has been proposed for implementing policy reforms in sectors which are constraining growth and development.

As announced in the Union Budget for 2002-03, beginning April 1, 2002, the entire net proceeds of small savings are transferred to the States. Consequently, an additional resource of about Rs.10,000 crore will be available to the States on account of this change. In addition, the interest rate on small savings has been reduced by 0.5 percentage point. As indicated in the Union budget, the State Governments will be able to pre-pay their high cost debt of the past from these additional resources. Furthermore, the Union budget has also announced reduction in interest rate on State Plan loans by 50 basis points.

(iii) Reserve Bank's Initiatives

As a banker and debt manager to the State Governments, the Reserve Bank has undertaken many initiatives. The Reserve Bank provides a forum for State Governments for discussing various relevant issues through its biannual conferences of State Finance Secretaries. The RBI provides ways and means advances and overdrafts facilities to the State Governments to help them tide over the problem of temporary mismatches in their receipts and payments. The limits are revised from time to time. Effective April 1, 2002 the limits on normal WMA have been revised to Rs. 6,035 crore from the earlier limit of Rs. 5,283 crore. The Reserve Bank constituted an Advisory Committee (Chairman: C. Ramachandran) to examine the present scheme of WMA and overdrafts and, to consider rationalisation, if warranted revisions in the limits, keeping in view the needs of State Governments as also the issues relating to fiscal and monetary management. The Committee's recommendations are under consideration.

In the area of market borrowings, the Reserve Bank has, over the years, enhanced the flexibility available to the States. As per the requests received from Maharashtra and Kerala, the Bank has permitted these States to raise up to 50 per cent of the total market borrowings through auction route during 2002-03. Furthermore, keeping in view the likely increase in repayment obligations on account of market borrowings in future years, the Bank has instituted a Consolidated Sinking Fund (CSF) scheme, which is in operation since 1999. Under this scheme, which is optional for State Governments, participating State has to contribute 1 to 3 per cent of its outstanding market borrowings each year.

The State Governments' guarantees is another area where the Bank has taken a number of initiatives. The Technical Committee on State Government Guarantees constituted by the Bank in its report (1999) had recommended: (i) imposition of ceiling on guarantees, (ii) selectivity in calling for and providing of guarantees, (iii) greater transparency in the reporting of guarantees and standardisation of documentation, (iv) guarantee fee and contingency fund for guarantees and (v) monitoring and honouring of guarantees. Following this, many States have initiated measures such as placing ceiling on guarantee, setting up guarantee redemption fund, *etc.* The Bank had constituted a Group to assess the fiscal risks of State Governments guarantees. The Group has submitted its report.

The major recommendations of the Group are as under:

(i) segregation of guarantees which are effectively in the nature of direct liabilities and assess the risk of such guarantees as 100 per cent and treating the same as equivalent to debt, (ii) publication of data regarding guarantees regularly, in a standard format, (iii) classification of projects/ activities as high risk, medium risk, low risk and very low risk and assigning appropriate risk weights; once the guarantees have been categorised, the finance departments of States will have to use their judgment to assign devolvement probability to each risk category, (iv) creation of a Tracking Unit for guarantees (in the Ministry of Finance) at the State level, (v) transferring one per cent of outstanding guarantees to the Guarantee Redemption Fund each year, (vi) the total obligation of interest payments and likely devolvement should not exceed 20 per cent of revenue receipts and (vii) State Governments should take administrative measures to discipline the State level undertakings whose borrowings are guaranteed and set up arrangements like escrow accounts with contributions from project earnings or rationalising user charges.

The Bank has stressed that the State Government guarantee may not be taken as a substitute for proper credit appraisal and such appraisal requirement should not be diluted on the basis of any reported arrangement with the RBI or any other bank for regular standing instructions/ periodic standing instruction for servicing the loan or bond. The banks and financial institutions have been exhorted to undertake due diligence while taking lending decision. The lending should be based on viability and bankability of the project and not purely based on State Government guarantee. The banks should ensure that the revenue from the project is sufficient to meet debt service obligations and that the debt servicing is not out of budgetary resources.

The details of initiatives taken by Reserve Bank are furnished in Table C.

Table C: Reserve Bank's Recent Initiatives on State Finances

Reserve Bank's Initiatives	Status of Initiatives
Setting up a Consolidated Sinking Fund (CSF).	The Consolidated Sinking Fund was set up in 1999-2000 to meet redemption of market loans of States. So far, eleven States, *viz*, Andhra Pradesh, Arunachal Pradesh, Assam, Chhattisgarh, Goa, Maharashtra, Meghalaya, Mizoram, Tripura, Uttaranchal and West Bengal have established the CSF.
Introduction of flexibility in market borrowings of State Governments by encouraging the States to directly access the market for resources ranging from 5 to 35 per cent of gross borrowings, with the States deciding on the method, timing and maturities of the borrowings.	The States that have gone in for the borrowing through auction issue so far, include – Andhra Pradesh, Arunachal Pradesh, Chhattisgarh, Gujarat, Jammu and Kashmir, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Tamil Nadu and West Bengal. The introduction of flexibility in market borrowings helps the better managed States gain through lower borrowing costs as compared to the coupon rates in the combined borrowing programme, and thus put in place incentives for sound fiscal management. In response to the request received from Maharashtra and Kerala, the RBI permitted these two States to raise up to 50 per cent of their allocation through auction in the fiscal year 2002-03.
Constitution of Committee on WMA/Overdraft Scheme.	An Advisory Committee (Chairman: Shri C. Ramchandran) was constituted to examine the existing scheme of WMA and overdrafts to the States and to consider rationalisation, if warranted, revision of limits. The Committee's recommendations are under consideration.
Constitution of Group of Finance Secretaries to examine the Fiscal Risk of Guarantees extended by States.	The Group has been constituted to analyse and classify different type of guarantees including letters of comfort issued by the States and to examine the fiscal risk under each type of guarantee. The Group has submitted its report.

Section III

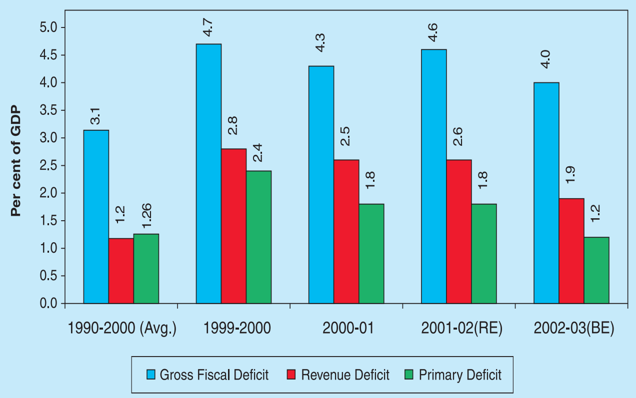
State Finances: 2000-01

The finances of State Governments showed some improvement during 2000-01 over the previous year as evidenced from various deficit indicators. The combined gross fiscal deficit of States declined from Rs. 91,480 crore (4.7 per cent of GDP) in 1999-2000 to Rs.89,532 crore (4.3 per cent of GDP) in 2000-01. The revenue deficit declined marginally from Rs. 53,797 crore (2.7 per cent of GDP) in 1999-2000 to Rs.53,569 crore (2.5 per cent of GDP) in 2000-01. The primary deficit at Rs.37,830 crore (1.8 per cent of GDP) declined by 18.3 per cent from Rs.46,309 crore (2.4 per cent of GDP) in 1999-2000 (Table 1 & Graph 1).

During 2000-01, the revenue receipts at Rs.2,37,953 crore were higher by 14.8 per cent over the previous year (Table 3). The States' own revenue receipts comprising States' own tax and non-tax receipts accounted for 55.2 per cent of the increase in revenue receipts, while the balance was contributed by current transfers from the Centre, comprising States' share in Central taxes and grants. Total tax receipts comprising States' own taxes and States' share in Central taxes recorded an increase of 15.0 per cent, while non-tax receipts comprising States' own non-tax revenue and Central grants registered a rise of 14.4 per cent in 2000-01 over the previous year. Under the non-tax revenues, receipts on account of dividends and profits declined from Rs.250 crore in 1999-2000 to Rs.154 crore in 2000-01.

During 2000-01, the capital receipts at Rs. 1,11,591 crore rose by 7.7 per cent from Rs. 1,03,575 crore in 1999-2000. Of this, the special securities issued to NSSF accounted for 29.2 per cent of total capital receipts, while the share of the loans from the Centre was 17.0 per cent. The increase in capital receipts was mainly on account of special securities issued to the NSSF (23.4 per cent) and recovery of loans and advances (105.2 per cent). However, the loans from the Centre (-12.1 per cent) and public account borrowings of States (-14.1 per cent) were lower in 2000-01 than in the previous year.

Graph 1: Major Deficit Indicators of State Governments



The aggregate expenditure of the States at Rs.3,47,198 crore showed a lower growth of 10.6 per cent in 2000-01 as against 17.8 per cent in the previous year. Component-wise, the revenue expenditure rose by 11.7 per cent in 2000-01 compared with 18.6 per cent in 1999-2000. The growth in capital expenditure was 5.3 per cent and 14.3 per cent in the respective years. Disaggregation of expenditure into developmental and non-developmental components reveals that developmental expenditure (revenue and capital) rose by 12.4 per cent, while non-developmental expenditure showed an increase of 7.9 per cent in 2000-01 (Table 10). With the result, the share of developmental expenditure in aggregate expenditure increased marginally from 59.7 per cent in 1999-2000 to 60.6 per cent in 2000-01.

Section IV

Revised Estimates: 2001-02

As against the improvement noticed in 2000-01, according to the revised estimates for 2001-02, the finances of State Governments witnessed some deterioration. The GFD in 2001-02 at Rs.1,06,595 crore (4.6 per cent of GDP) showed a rise of 19.1 per cent over the previous year. The revenue deficit at Rs. 60,540 crore was higher by 13.0 per cent over the previous year. The primary deficit also showed an increase of 11.3 per cent in 2001-02 over the previous year. However, as ratio to GDP, the revenue deficit showed a marginal rise to 2.6 per cent while primary deficit at 1.8 per cent, remained the same as in the previous year.

During 2001-02, the revenue receipts at Rs. 2,70,901 crore showed a rise of 13.8 per cent over the previous year. While the States' own revenue receipts (tax and non-tax receipts) rose by 10.3 per cent, current transfers from the Centre comprising States' share in Central taxes and grants were higher by 19.8 per cent in 2001-02 over the previous year. The increase in the States' own revenue receipts was mainly on account of rise in States' own taxes (12.8 per cent). The States' own non-tax revenue receipts showed a marginal rise of 0.9 per cent in 2001-02. However, interest receipts of States declined from Rs.11,438 crore in 2000-01 to Rs.9,205 crore in 2001-02. It is important to note that in 2000-01, interest receipts had shown a sharp rise of Rs.2,144 crore (23.1 per cent) over the previous year mainly on account of recovery of past arrears from SEBs in some States. Thus, compared with 1999-2000, the interest receipts in 2001-02 were marginally lower by Rs.89 crore.

In the case of transfers from the Centre, the increase was mainly on account of grants (34.1 per cent), while the States' share in Central taxes rose by 9.2 per cent. Of the increase of Rs.12,897 crore in the grants from the Centre, Rs.4,991 crore (38.7 per cent) was on account of Centrally Sponsored Schemes, while the grants towards State Plan Schemes accounted for Rs.3,701 crore (28.7 per cent). Reflecting the higher growth in Central transfers *vis-à-vis* States' own revenue receipts, the share of current transfers from the Centre in the total revenue receipts rose from 37.2 per cent in 2000-01 to 39.2 per cent in 2001-02.

During the 1990s, the growth rate in States' own revenue receipts averaged 14.4 per cent, while the growth in the transfers from the Centre comprising sharable taxes and grants averaged 13.5 per cent. Subsequently, the growth in States' own revenue receipts decelerated to 12.8 per cent in 2000-01 and further to 10.3 per cent in 2001-02. At the same time, transfers from the Centre (States' share in Central taxes and grants) increased by 18.4 per cent in 2000-01 and by 19.8 per cent in 2001-02, mainly on account of higher growth in grants from the Centre. It is noteworthy that the growth rate in sales tax, which is the most important constituent item under States' own tax receipts, averaged 15.4 per cent during the 1990s which was higher than that of Union excise duty (10.8 per cent). The growth rate in States' sales tax receipts increased to 17.8 per cent in 2000-01, but decelerated to 8.8 per cent in 2001-02. In comparison, the Union excise duties increased by 10.7 per cent in 2000-01 and decelerated to 8.7 per cent in 2001-02.

The States' own tax receipts, in terms of GDP have shown some improvement in recent years, from 5.1 per cent in 1998-99 to 5.6 per cent in 2000-01 and further to 5.8 per cent in 2001-02. However, States' own non-tax receipts, as a percentage of GDP, have been lower in recent years compared to that in the first half of 1990s.

The capital receipts amounted to Rs.1,23,533 crore during 2001-02 and witnessed a rise of 10.7 per cent over the previous year. The increase was mainly on account of loans from the Centre, market borrowings and special securities issued to the NSSF[5]. In the revised estimates for 2001-02, loans from the Centre

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[5] Prior to 1999-2000, States' share in the small savings was included under 'loans from the Centre'. Under the revised accounting procedure, the same are treated as receipts against special securities issued to National Small Savings Fund (NSSF) and are to be included under `Internal Debt'. In their budgets, while some States continue to show it as loans from the Centre, other States show it as part of their internal debt as special securities issued to NSSF. In view of the change in the accounting procedure in 1999-2000, share in small savings has been shown as a separate item as special securities issued to NSSF of the Central Government under the `Internal Debt' and not as 'loans from the Centre'.

increased by 42.1 per cent. Of this increase, loans under State plan schemes alone accounted for Rs. 7,013 crore (88 per cent). The market borrowings of the States also increased by 35.4 per cent in 2001-02 over the previous year. The receipts on account of special securities issued to NSSF rose by 10.3 per cent in 2001-02 over the previous year. However, the receipts from public accounts declined by 26.9 per cent in the revised estimates for 2001-02. The decline was mainly on account of provident funds, deposits and advances, *etc.* (Table 5).

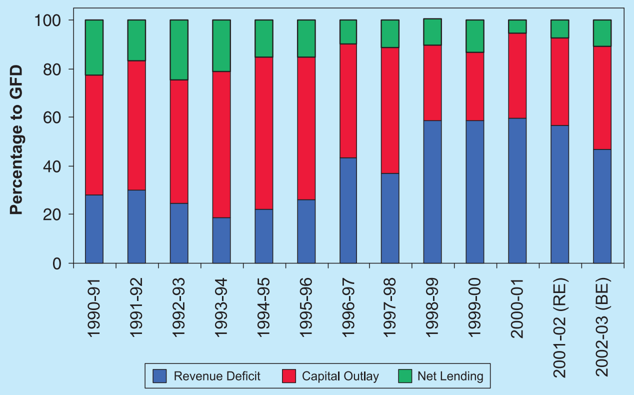
The aggregate expenditure of States at Rs. 4,01,571 crore during 2001-02 showed a rise of 15.7 per cent over the previous year. While capital expenditure increased by 26.0 per cent in 2001-02, the increase in revenue expenditure was 13.7 per cent. The revenue expenditure accounted for 73 per cent of the increase in total expenditure, while the balance was accounted for by the capital expenditure. Under revenue expenditure, interest payments, pension outgo and expenditure towards administrative services accounted for 45 per cent of the total increase in revenue expenditure. Under capital expenditure, capital outlay showed an increase of Rs. 7,204 crore (23.1 per cent) and accounted for 50 per cent of the increase in total capital expenditure. Loans and advances extended by the States were higher by Rs. 3,840 crore (32.7 per cent) in 2001-02 over the previous year.

The pattern of expenditure during 2001-02 showed that the developmental expenditure (revenue and capital) of the States rose by 12.3 per cent (Table 12). Within developmental expenditure, expenditure on social and economic services rose by 14.1 per cent and 10.1 per cent, respectively. Expenditure relating to natural calamity was significantly higher by 45.6 per cent in 2001-02 as compared with the previous year. The non-developmental expenditure increased by 20.8 per cent, which was, among others, due to the increase of 24.8 per cent in interest payments (Table 4). As a result, the share of developmental expenditure in the aggregate expenditure declined from 60.6 per cent in 2000-01 to 58.8 per cent in 2001-02.

A comparison of the trends in States' expenditure *vis-a-vis* that of the Centre shows that the expenditure growth has been relatively high in the case of the States. While the States witnessed an average growth of 15.4 per cent in aggregate expenditure during the 1990s, it was lower at 12.4 per cent in the case of Centre. During 2001-02, the States' aggregate expenditure rose by 15.7 per cent compared with 11.9 per cent in the case of the Centre.

The decomposition of GFD of States reveals that the revenue deficit continued to account for a significantly high proportion of GFD. The share of revenue deficit in the GFD which averaged around 25 per cent during the first half of 1990s, rose to 58.8 per cent in 1999-2000 and further to 59.8 per cent in 2000-01 (Graph 2). This share, however, declined to 56.8 per cent in the revised estimates for 2001-02. The shares of capital outlay and net lending, on the other hand, increased from 34.8 per cent and 5.4 per cent in 2000-01 to 36.0 per cent and 7.2 per cent, respectively in the revised estimates for 2001-02 (Table 7).

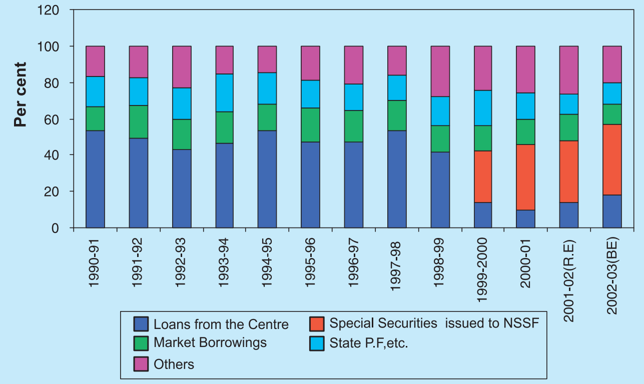
Graph 2: Decomposition of Gross Fiscal Deficit of States



The financing pattern of the GFD indicates that the share of loans from the Centre rose from 9.4 per cent in 2000-01 to 13.9 per cent in 2001-02. The share of market borrowings also increased from 14.0 per cent in 2000-01 to 15.1 per cent in 2001-02. Special securities issued to NSSF financed 33.7 per cent of the GFD in 2001-02 as against 36.4 per cent in the previous year (Table 8 and Graph 3).

The revised estimates have placed the gross transfer of resources from the Centre (comprising States' share in Central taxes, grants and loans from the Centre) at Rs. 133,044 crore during 2001-02, which was higher by 23.8 per cent over that in the previous year. The increase was mainly attributable to grants from Centre, which increased by 34.1 per cent in 2001-02.

Graph 3: Financing Pattern of Gross Fiscal Deficit of State Governments



Revised Estimates *vis-a-vis* Budget Estimates: 2001-02

The revised estimates for 2001-02 show that all the major deficit indicators were higher than their budgeted levels. The gross fiscal deficit in 2001-02 (RE) was higher than the budget estimates by 12.1 per cent, while the revenue deficit was higher by 28.6 per cent. Similarly, the primary deficit was higher by 39.2 per cent than the budget estimates.

According to the revised estimates, States experienced a revenue shortfall of the order of 5.2 per cent *vis-a-vis* the budget estimates for 2001-02 due to the slippage in the States' share in Central taxes by 8.2 per cent and States' own revenue receipts (States' own tax and non-tax revenues) by 6.8 per cent. Component wise, States' own tax receipts were lower than the budget estimates by Rs.10,581 crore (-7.4 per cent), while the States' own non-tax revenue receipts were lower by Rs.1,382 crore (-4.2 per cent). The grants from the Center, however, were higher by Rs. 2,124 crore (4.4 per cent) *vis-à-vis* the budget estimates. Thus, the States' own revenue receipts and current transfers from Centre (shareable taxes and grants) accounted for 81 per cent and 19 per cent of the total shortfall in revenue receipts, respectively, in the revised estimates for 2001-02 over the budget estimates for 2001-02.

On the expenditure front, the States were able to contain their aggregate expenditure at the budgeted levels in 2001-02. While the revenue expenditure was marginally lower, the capital expenditure was higher by 2.2 per cent in the revised estimates than their budgeted level. Some of the States have succeeded in containing their expenditure even below the budget estimates. It is significant that the non-developmental expenditure was lower than the budget estimates by 1.2 per cent. This was mainly due to lower expenditure on administrative services (-6.3 per cent). The expenditure in respect of administrative services in the revised estimates for 2001-02 was lower than the budget estimates by Rs. 1,894 crore (6.3 per cent). This was, however, higher by Rs. 2,900 crore (11.4 per cent) than in the previous year. The lower expenditure *vis-a-vis* the budgetary allocation was mainly on account of 'Secretariat –General Services'. Expenditure incurred on this item was lower than the budget estimates by as much as Rs. 1,180 crore (43.4 per cent) and accounted for about 62 per cent of the expenditure reduction in the case of administrative services in revised estimates *vis-a-vis* the budget estimates. It is important to note that the budget estimates for 2001-02 had projected a rise of Rs. 4,794 crore under this item, which represented an increase of the order of 18.9 per cent. However, the pension payments were higher than the budget estimates by Rs. 1,059 crore (4.0 per cent). The expenditure on developmental activities was marginally higher in revised estimates for 2001-02 than the budget estimates.

Section V
Budget Estimates: 2002-03

Deficit Indicators

The State budgets for 2002-03 have envisaged improvement in the major deficit indicators. Accordingly, the GFD of the States is budgeted to decline by 3.5 per cent from Rs.1,06,595 crore in 2001-02 (RE) to Rs.1,02,848 crore in 2002-03. As percentage of GDP, it is budgeted lower at 4.0 per cent in 2002-03, as compared with 4.6 per cent in the revised estimates for 2001-02. In the budget estimates for 2002-03, the revenue deficit is budgeted to decline by 20.3 per cent from Rs.60,540 crore (2.6 per cent of GDP) in 2001-02 to Rs.48,223 crore (1.9 per cent of GDP). The primary deficit is also budgeted to decline by 27.4 per cent from Rs.42,092 crore (1.8 per cent of GDP) in 2001-02 to Rs.30,562 crore (1.2 per cent of GDP) in 2002-03.

Pattern of Receipts

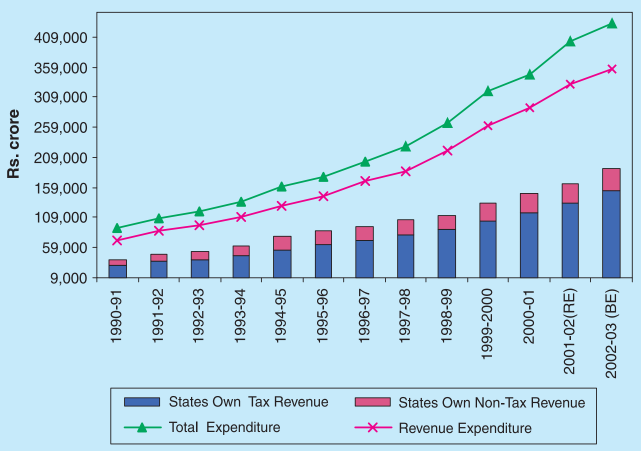
The aggregate receipts (revenue and capital) at Rs.4,25,755 crore are budgeted to be higher by 7.9 per cent over the previous year. While the revenue receipts would increase by 13.3 per cent, the capital receipts are projected to decline by 3.8 per cent. As a result, the share of revenue receipts in the aggregate receipts is budgeted to increase from 69 per cent in 2001-02 to 72 per cent in 2002-03.

Revenue Receipts

During 2002-03, the revenue receipts at Rs. 3,06,943 crore are budgeted to rise by 13.3 per cent over the previous year. A significantly high proportion of this rise (71.0 per cent) would be contributed by States' own revenue receipts, comprising tax and non-tax receipts. Total tax receipts comprising States' own taxes and States' share in Central taxes at Rs. 2,15,049 crore are estimated to show a higher growth of 14.1 per cent during 2002-03 compared with 11.7 per cent in the previous year. The States' own tax receipts are budgeted to increase by 14.7 per cent in 2002-03 compared with 12.8 per cent in the revised estimates for 2001-02. The sales tax receipts, major contributor in the States' resource base, are estimated to rise by 16.6 per cent as against an increase of 8.8 per cent in 2001-02. The States' share in Central taxes is also budgeted to rise by 12.7 per cent in 2002-03 compared with 9.2 per cent in the revised estimates for 2001-02.

States' own non-tax revenues are estimated to show a rise of 19.1 per cent in 2002-03 as compared with a marginal increase (0.9 per cent) in the revised estimates for 2001-02. Grants from the Centre are budgeted to increase by 6.8 per cent compared with a higher growth of 34.1 per cent in the revised estimates for 2001-02. States' own revenue receipts are expected to account for 62 per cent of the aggregate revenue receipts in 2002-03. At this level, States' own revenue receipts would finance 53.6 per cent of revenue expenditure and 44.2 per cent of the aggregate expenditure in 2002-03 as compared with 49.7 per cent and 41.0 per cent, respectively, in the revised estimates for 2001-02 (Graph 4).

Graph 4: States' Own Revenue Receipts and Expenditure



Capital Receipts

During 2002-03, the aggregate capital receipts of States at Rs. 1,18,812 crore are budgeted to be lower by 3.8 per cent than those in the previous year. The decline in capital receipts is mainly on account of budgeted decline in small savings receipts and provident funds (-2.3 per cent), recovery of loans and advances (-57.4 per cent) and market borrowings (-22.1 per cent) (Table 5). However, loans from the Centre and reserve funds are estimated to increase by 16.7 per cent and 19.0 per cent, respectively, over the previous year.

Transfer of Resources from the Centre

The aggregate resource flows from the Centre in the form of States' share in Central taxes, grants and loans (excluding share of small savings collections) at Rs.1,48,010 crore are budgeted to rise by 11.2 per cent in 2002-03 as compared with a rise of 23.8 per cent in the previous year. The deceleration in the growth is mainly on account of lower growth in grants.

The current transfers from the Centre in the form of States' share in Central taxes and grants budgeted at Rs. 1,16,556 crore during 2002-03 would be higher by 9.9 per cent as against 19.8 per cent in the previous year. The current transfers are estimated to account for 38.0 per cent of revenue receipts of States in 2002-03 as compared with 39.2 per cent in the previous year.

Pattern of Expenditure

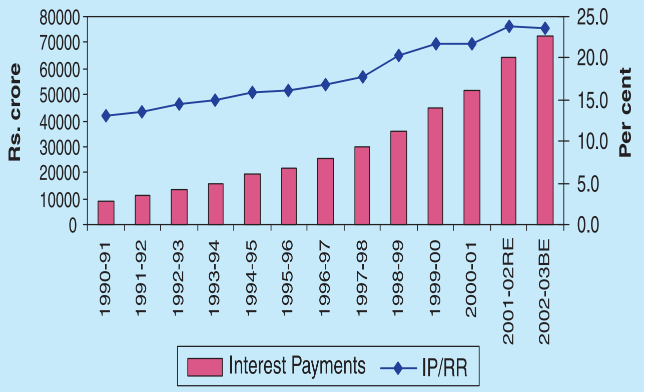
The initiatives towards expenditure compression are reflected in the deceleration of growth in the expenditure of States. In the budget estimates for 2002-03, the total expenditure of States at Rs.4,30,934 crore is projected to grow by 7.3 per cent, as compared with the growth rate of 15.7 per cent in the previous year (Table 2). The growth in revenue and capital expenditures are budgeted to decelerate to 7.2 per cent and 8.0 per cent in 2002-03 from 13.7 per cent and 26.0 per cent, respectively, in the previous year. About 81 per cent of the budgeted increase in the aggregate expenditure would be on account of revenue expenditure as compared with 73.4 per cent in 2000-01. The revenue expenditure would account 82.4 per cent of total expenditure in 2002-03 almost the same as in the previous year.

Disaggregated analysis of expenditure reveals that the growth rate in developmental expenditure at 4.1 per cent in 2002-03 would be lower than the growth of 11.7 per cent in non-developmental expenditure. Within developmental expenditure, the growth in expenditure on social and economic services would decelerate to 3.5 per cent and 5.7 per cent, respectively, in 2002-03 from 13.9 per cent and 9.6 per cent in the previous year. The share of developmental expenditure in the total expenditure would decline from 58.8 per cent in 2001-02 to 57.1 per cent in 2002-03. Under non-developmental expenditure, the major items, *viz.*, interest payments, expenditure on administrative services and pensions taken together are budgeted to account for 30.8 per cent of total expenditure and would absorb 43.3 per cent of total revenue receipts of the States in 2002-03.

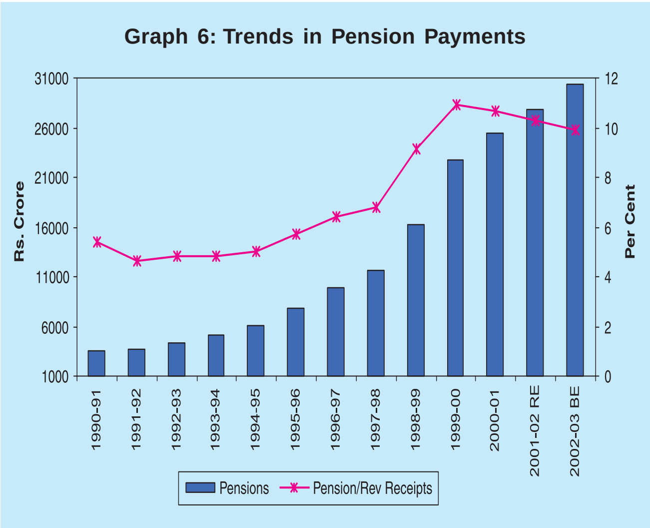
Revenue Expenditure

Revenue expenditure continues to account for an overwhelmingly large proportion (over four-fifth) of States' aggregate expenditure. Revenue expenditure is projected to rise by 7.2 per cent in 2002-03 as against 13.7 per cent in 2001-02. Within revenue expenditure, there was a shift in the composition in favour of non-developmental category. The developmental expenditure is budgeted to rise by 2.7 per cent as compared with 12.5 per cent increase in the non-developmental expenditure. Within the developmental revenue component, the expenditures on account of social and economic services are budgeted to increase by 2.8 per cent and 2.4 per cent, respectively. However, lower expenditure is budgeted in respect of water supply and sanitation (-4.1 per cent), natural calamities (-24.8 per cent) and civil supplies (-13.7 per cent). Under non-developmental head, interest payments are budgeted to rise by 12.1 per cent during 2002-03 and would account for 32.8 per cent of the increase in revenue expenditure.

Graph 5: Trends in Interest Payments of State Governments



Over the years, both interest payments and expenditure on pensions have increased significantly. During the 1990s, the increase in interest payments at an annual average basis worked out to 20.2 per cent, while it was 23.1 per cent in the case of pensions. Reflecting this, the pre-emption of revenue receipts by interest payments went up from 13.0 per cent in 1990-91 to 21.7 per cent in 2000-01, and further to 23.8 per cent in 2001-02. In 2002-03, the ratio of interest payments to revenue receipts is budgeted at 23.6 per cent (Graph 5). Similarly, the ratio of pension payments to revenue receipts has also gone up from 5.4 per cent in 1990-91 to about 10-11 per cent in recent years (Graph 6). The compensation and assignments to local bodies and *panchayat raj* institutions are budgeted at Rs. 6,597 crore in 2002-03 (increase of 23.6 per cent) as against Rs. 5,337 crore in 2001-02. Expenditure on this item account for less than 2.0 per cent of total revenue expenditure.



Capital Disbursements

The capital disbursements of States at Rs.75,768 crore are budgeted to rise by 8.0 per cent over the previous year. Of this, capital outlay estimated at Rs.43,684 crore would be higher by 14.0 per cent over the revised estimates for 2001-02. At this level, capital outlay would absorb 42.5 per cent of total borrowing requirements (GFD) as compared with 36.0 per cent in 2001-02. Under developmental capital outlay, expenditures towards education (including sports, art and culture) and rural development at Rs.752 crore and Rs.3,339 crore, respectively, are estimated to decline by 2.5 per cent and 3.7 per cent, respectively, over the revised estimates of 2001-02. The non-developmental capital outlay at Rs.2,173 crore is budgeted to rise by 19.2 per cent over the revised estimates. The repayment of loans to the Centre, budgeted at Rs.12,718 crore, would show a growth of 4.6 per cent over the previous year. However, loans and advances extended by States at Rs.14,288 crore in 2002-03 are estimated to decline by 8.2 per cent over the previous year. This would be mainly due to the decline of 59.6 per cent in loans and advances extended by the States for non-developmental purposes.

State-wise Analysis

An analysis of the budgetary positions of the States reveals considerable variation across the States in the fiscal consolidation initiatives envisaged in their budgets for 2002-03. Even though many States have budgeted lower revenue and fiscal deficits in 2002-03 from the levels in the previous year, the revenue deficit would continue to account for a major portion of the fiscal deficit in a number of States. While the GFD of States is budgeted to show a marginal decline of 3.5 per cent in 2002-03 over the previous year, the State-wise analysis reveals that States such as Jammu and Kashmir, Chhattisgarh, Goa, Rajasthan, Tamil Nadu and Uttaranchal have budgeted higher GFD as compared with the revised estimates for 2001-02. The inter-State differences in the GFD of State Governments presented as ratios of their NSDP are set out in Table D.

Table D : Gross Fiscal Deficit as a Ratio to NSDP

(Per cent)

States	1990-91	1995-96	1997-98	1998-99	1999-2000
1	2	3	4	5	6
1 Andhra Pradesh	3.2	3.4	2.8	5.5	4.5
2 Bihar	7.0	4.1	1.9	4.1	9.7
3 Goa	9.4	3.5	3.5	6.6	-
4 Gujarat	7.4	2.8	4.1	6.3	7.6
5 Haryana	3.2	3.8	3.3	5.9	5.0
6 Karnataka	2.7	2.9	2.5	4.1	5.0
7 Kerala	6.6	3.7	3.2	5.9	7.7
8 Madhya Pradesh	3.8	2.5	2.1	5.2	4.5
9 Maharashtra	2.8	2.9	3.8	4.0	5.5
10 Orissa	6.4	6.0	6.6	9.8	11.4
11 Punjab	7.4	4.0	5.8	7.9	5.8
12 Rajasthan	3.0	6.2	4.5	7.9	8.0
13 Tamil Nadu	4.1	1.8	2.3	4.5	4.6
14 Uttar Pradesh	6.2	4.3	5.8	7.8	6.7
15 West Bengal	5.2	4.0	4.5	6.7	9.5

- : Not Available.

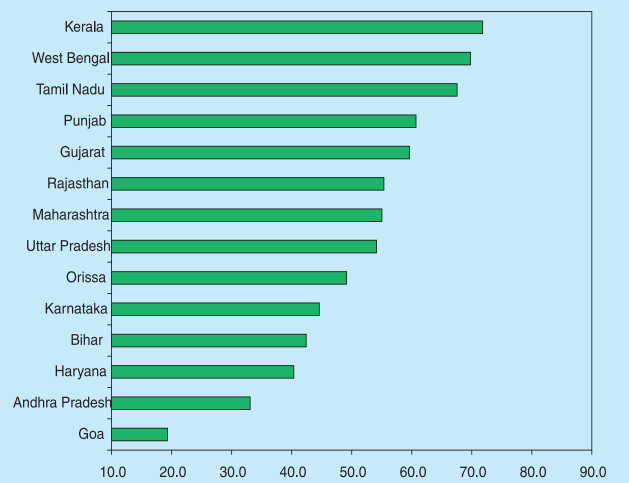
Note : 1. Figures of NSDP from 1993-94 onwards are as per the new 1993-94 series.

2. NSDP data are provisional.

Source: Budget Documents of State Governments and Central Statistical Organisation.

Inter-State variations are also reflected in the revenue account. In their budgets for 2002-03, while the revenue deficit of all the States taken together is estimated to account for 47 per cent of GFD, the State-wise position indicates that revenue deficit would account for more than 60 per of the GFD in the case of seven States (Graph 7).

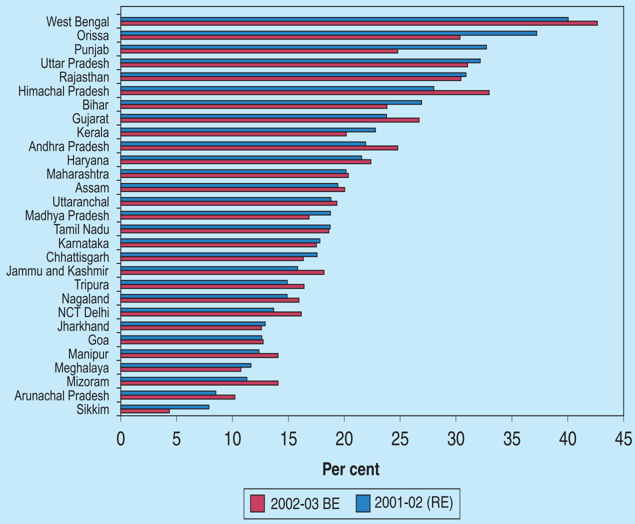
Graph 7: Revenue Deficit as a Percentage of GFD (2002-03 BE)



During 2002-03, the States which have budgeted substantial growth in aggregate receipts are Jharkhand (20.4 per cent), Kerala (19.9 per cent, Tamil Nadu (18.2 per cent), Karnataka (17.1), Chhattisgarh (14.5 per cent), Orissa (12.6 per cent). However, on an average the growth rate in aggregate receipts in the case of all States is budgeted at 7.9 per cent. The revenue receipts of all States taken together are estimated to increase by 13.3 per cent in 2002-03. The States which have proposed significant growth in their revenue receipts over the revised estimates include Punjab (34.5 per cent), Jharkhand (21.4 per cent), Kerala (20.1 per cent) Orissa (18.4 per cent) and Bihar (17.6 per cent).

Revenue expenditure accounts for a large proportion of the aggregate expenditure. Within the revenue expenditure, the interest payment has emerged as an important constituent item in recent years - pre-empting nearly one fourth of the revenue receipts. State-wise analysis indicates that the ratio of interest payments to revenue receipts was more than 30 per cent in the case of four States in 2002-03 (Graph 8).

Graph 8: Interest Payments as a Percentage of Revenue Receipts: State-wise



Comparative position of the States by relative changes in revenue receipts and aggregate expenditure during 2001-02 *vis-à-vis* the revised estimates for the previous year is presented in Table E. It may be seen from the table that ten States have budgeted lower growth rate in both revenue receipts and total expenditure

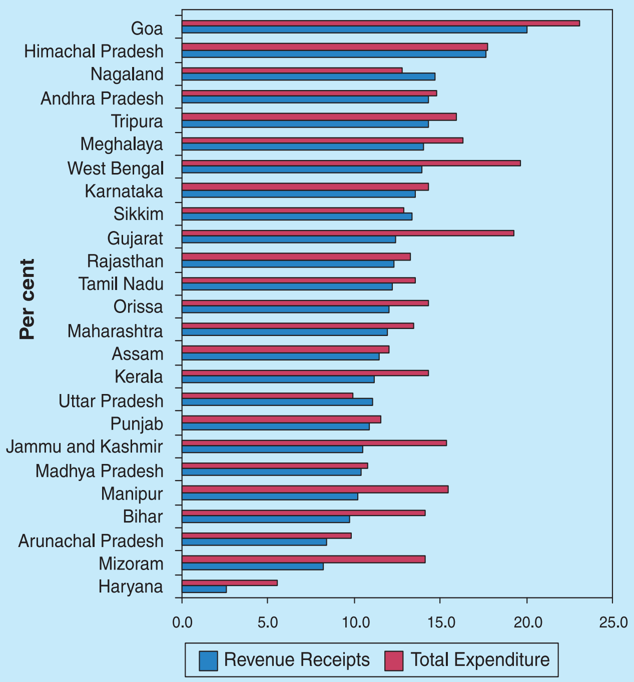
Table E : Relative Changes in the Growth Rate in Revenue Receipts and Total Expenditure of States in 2002-03 (BE) over 2001-02 (RE)

	Lower rate of growth in Total Expenditure	Higher rate of growth in Total Expenditure
Lower rate of growth in Revenue Receipts	Arunachal Pradesh, Gujarat, Goa, Haryana, Manipur, Meghalaya, Mizoram, Tripura, West Bengal, NCT Delhi.	Jammu and Kashmir, Himachal Pradesh.
Higher rate of growth in Revenue Receipts	Assam, Madhya Pradesh, Maharashtra, Nagaland, Orissa, Punjab, Uttar Pradesh.	Andhra Pradesh, Bihar, Karnataka, Kerala, Rajasthan, Sikkim, Tamil Nadu.

Source : Budget Documents of State Governments.

in 2002-03 *vis-a-vis* growth rate in 2001-02. As against this, seven States have budgeted higher growth rate in both revenue receipts and total expenditure, while the same number of States have budgeted higher growth rate in revenue receipts and lower growth rate in total expenditure. Two States have budgeted lower growth in revenue receipts and higher growth rate in total expenditure.

Graph 9: Average Growth in Revenue Receipts and Total Expenditure (1995-96 to 2000-01)



Over the years, the growth rate in total expenditure remained higher than the growth rate of revenue receipts of States. An analysis of the trends in expenditure of States during 1995-96 to 2000-01 shows that the annual average growth rate in total expenditure in the case of all States taken together was 13.6 per cent, while the growth in revenue receipts was lower at 11.8 per cent. There was, however, a significant variation across the States in the growth rates of revenue receipts and aggregate expenditure (Graph 9).

Special Category States[6]

The revenue deficit of special category States together at Rs. 2,776 crore is budgeted to decline by 13.7 per cent in 2002-03 from Rs.3,216 crore in 2001-02. The revenue deficit of special category States would account for 29.1 per cent of their GFD in 2002-03 as compared with 33.4 per cent in the revised estimates of the previous year. The overall borrowing requirements (GFD) at Rs.9,531 crore of these States in 2002-03 are estimated to show a marginal decline from the previous year. The capital outlay of these States is estimated to account for 66.5 per cent of GFD as against 61.5 per cent in 2001-02. During 2002-03, four special category States, *viz.*, Arunachal Pradesh, Jammu and Kashmir, Manipur and Mizoram have budgeted lower revenue receipts than the revised

[6] These include Arunachal Pradesh, Assam, Himachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura and Uttaranchal.

estimates for 2002-03. In their budgets for 2002-03, four States, *viz*, Assam, Himachal Pradesh, Manipur and Uttaranchal have budgeted revenue deficit for 2002-03, while seven States have estimated revenue surplus.

On the expenditure front, four States have budgeted a decline in their aggregate expenditure over the revised estimates. The non-developmental revenue expenditure of all special category States is projected to absorb 47.9 per cent of revenue receipts in 2002-03 as against 45.9 per cent in 2001-02. The interest payments accounted for 18.4 per cent of revenue receipts in 2002-03 as compared with 17.2 per cent in 2001-02.

Section VI

States' Debt, Market Borrowings and Guarantees

Debt Position

With increasing fiscal deficit, the aggregate debt of the States has also been growing in recent years. As at the end of March 2002, the combined outstanding debt of State Governments amounted to Rs. 5,89,218 crore. Between end-March 2001 and end-March 2002, the States' debt increased by 18.3 per cent. As a percentage of GDP, the debt stock of States rose to 25.7 per cent at the end of March 2002 from 23.7 per cent at end March 2001. The debt-GDP ratio of States is estimated to increase further to 26.7 per cent by end-March 2003 (Table 8). Component-wise, a significantly high proportion of the outstanding debt of the States relates to loans from the Centre. However, the share of loans from the Centre in the total debt declined from 45.1 per cent as at the end of March 2001 to 40.6 per cent as at end-March 2002 . As against this, the share of special securities issued to NSSF increased from 11.8 per cent to 16.1 per cent over the same period. The share of market borrowings at around 17 per cent of total debt has broadly remained unchanged. The States have relied increasingly on the borrowings from financial institutions. Reflecting this, the share of loans from financial institutions has increased from 4.8 per cent in 1999-2000 to 7.7 per cent in 2001-02. The share of public account borrowings has declined marginally in recent years.

Market Borrowings

The gross and net market borrowings allocated to all States for the fiscal year 2001-02 at Rs.19,030 crore and Rs.17,583 crore, respectively, were higher by 43.1 per cent and 36.5 per cent, over their respective levels in the previous year. As against this, the State Governments raised gross and net market borrowings of Rs.18,707 crore and Rs. 17,261 crore, respectively, during 2001-02 (Statement 22). The States raised an amount of Rs. 8,104 crore (43.3 per cent of gross market borrowings) through traditional tranche method, Rs.1,127 crore (6.0 per cent) through tap-individual method, Rs.6,711 crore (35.9 per cent) through tap-tranche method and Rs.2,765 crore (14.8 per cent) through auctions.

The gross and net market borrowings allocated to States for the fiscal year 2002-03 amount to Rs.17,276 crore and Rs.15,487 crore, respectively. So far (up to January 31, 2003), States have raised Rs. 15,663 crore constituting 90.7 per cent of the allocated gross market borrowings for the full fiscal year. Of this, Rs.12,690 crore (81.0 per cent) was raised through tap-issues at 6.8–7.8 per cent interest rate and Rs.2,973 crore (19.0 per cent) through auctions at interest rate ranging between 6.7 per cent and 8.0 per cent. States that raised funds through the auction route were Andhra Pradesh (Rs. 545 crore), Gujarat (Rs. 445 crore), Jammu and Kashmir (Rs. 70 crore), Karnataka (Rs. 200 crore), Kerala (Rs. 445 crore), Madhya Pradesh (Rs. 247 crore), Maharashtra (Rs. 509 crore), Punjab (Rs. 85 crore), Tamil Nadu (Rs. 275 crore) and West Bengal (Rs. 153 crore).

The average interest rate on market borrowings of States has declined continuously in recent years from 14 per cent in 1995-96 to 11 per cent in 2000-01. This trend continued during the years 2001-02 and

2002-03 so far (Table F). The interest rate on market borrowings of the State Governments varied in the range of 7.8 per cent and 10.5 per cent in 2001-02 as compared with 10.5 per cent and 12.0 per cent in 2000-01. During the year 2001-02, the weighted average interest rate on States' market borrowings was 9.2 per cent as compared with 12.0 per cent for loans from the Centre (Plan loans) and 11.0 per cent for loans against small saving collections. During 2002-03 (up to January 31, 2003), the interest rate on market borrowings has remained in the range of 6.7 per cent to 8.0 per cent as compared with 11.5 per cent in case of loans from the Centre (Plan loans) and 10.5 per cent for loans against small saving collections.

The decline in the interest rate on States' market borrowings reflected general softening of interest rates. The coupon rate for the tap tranche held in August 2002 was fixed 50 basis points over the then prevailing yield of Government of India ten year security. However, in the tranche conducted in December 2002, the spread was lower at 37 basis points.

The declining interest rate on market borrowings by State Governments has some positive implications on the States' debt servicing cost. It is, however, important that the repayment by States on account of market borrowings is expected to show a sharp rise from Rs.1,789 crore in 2002-03 to Rs.21,807 crore in 2011-12 (Table G). With a view to facilitating the redemption liabilities on account of market borrowings, 11 States have set up Consolidated Sinking Fund (CSF). Under the CSF scheme, introduced by the Reserve Bank, the States contribute 1 to 3 per cent of the outstanding market loans each year to the Fund.

Ways and Means Advances (WMA) of States

The Reserve Bank of India has been providing ways and means advances to the State Governments to meet the temporary mismatches in the cash flow of receipts and payments. The WMA limits are fixed by the Reserve Bank from time to time. As per the present

Table F: Market Borrowings and Coupon Rates on State Government Dated Securities

Fiscal Year	Market Borrowings (Rs. crore)		Coupon/Cut-off Yield (Per cent per annum)	
	Gross	Net	Range	Weighted average
1985-86	1,414	973	9.75	9.75
1990-91	2,569	2,569	11.50	11.50
1991-92	3,364	3,364	11.50-12.00	11.82
1992-93	3,805	3,471	13.00	13.00
1993-94	4,145	3,638	13.50	13.50
1994-95	5,123	5,123	12.50	12.50
1995-96	6,274	5,931	14.00	14.00
1996-97	6,536	6,536	13.75-13.85	13.83
1997-98	7,749	7,193	12.30-13.05	12.82
1998-99	12,114	10,700	12.15-12.50	12.35
1999-2000	13,706	12,405	11.00-12.25	11.89
2000-01	13,300	12880	10.50-12.00	10.99
2001-02	18,707	17,261	7.80-10.53	9.20
2002-03*	15,663	13,874	6.67-8.00	7.49

* Up to January 31, 2003.

Note: Interest rate since 1999-2000 include pre-announced and cut-off yield in auctions.

Table G: Repayment Schedule for Market Loans of State Governments (Provisional)*

(Rs. crore)

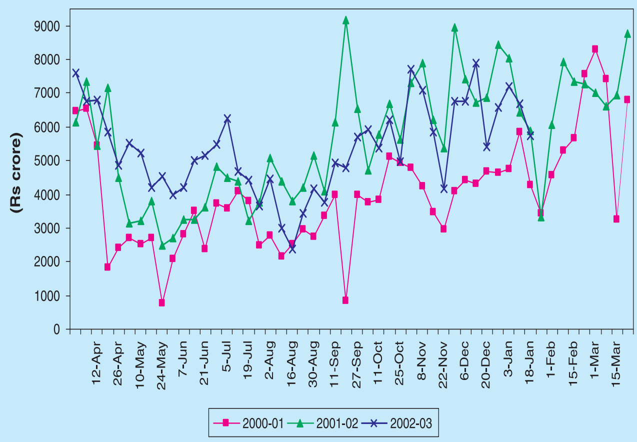
Year	Amount of Repayment
2002-03	1,789
2003-04	4,145
2004-05	5,123
2005-06	6,274
2006-07	6,551
2007-08	11,554
2008-09	14,400
2009-10	16,261
2010-11	15,870
2011-12	21,807

* As at end-March, 2002.

WMA scheme, the normal WMA limits are worked out taking into account the three years' average of revenue receipts and capital expenditure and applying to this base a ratio of 2.4 per cent for non-special category States and 2.9 per cent for special category States. The revised 'WMA Scheme 2002' became effective from April 1, 2002. As per the same, the total normal WMA limits for State Governments have been enhanced by 14 per cent to Rs.6,035 crore from the earlier limit of Rs.5,284 crore. This revision was made on the basis of three years' average of revenue receipts and capital expenditure for the latest three years, *i.e.* 1998-99, 1999-2000 and 2000-01. All other features of the scheme continue to be the same as in the previous WMA Scheme. As per the present Overdrafts Regulation scheme, no State is allowed to run an overdraft with the Reserve Bank for more than 12 consecutive working days. In case the overdraft position continues beyond 12 consecutive working days, the Reserve Bank suspends payments to that particular State. In order to review the existing WMA scheme for the State Governments, an Advisory Committee has been constituted by the Reserve Bank under the Chairmanship of Shri C. Ramachandran. The Committee's recommendations are under consideration.

The WMA/Overdraft position of States during 2001-02 reflected continued pressure on State finances. The recourse to WMA by States during 2001-02 was generally higher than in the previous year (Graph 10). During the year 2001-02, 20 State Governments resorted to overdrafts compared with 19 States in the previous year. While during April-July 2002, the outstanding WMAs were generally higher than those in the comparable period of the previous year, from August 2002, these have generally remained lower than the outstanding WMA in the comparable period of the previous year. The outstanding WMA and overdrafts of State Governments amounted to Rs.5,751 crore, as on January 24, 2003 which was lower by 2.0 per cent as compared with the outstanding amount of Rs. 5,870 crore on January 25, 2002.

Graph 10: Outstanding WMA and Overdrafts to States (Weekly)



Contingent Liabilities

Although contingent liabilities do not form a part of the debt burden of the States, in the event of default by the borrowing entity, the States will be required to meet the debt service obligations. The outstanding guarantees of State Governments have shown a rising trend during the 1990s (Table H and Graph 11). The outstanding guarantees of State Governments increased from Rs.1,32,029 crore (6.8 per cent of GDP) as at end-March 2000 to Rs.1,68,712 crore (8.0 per cent of GDP) as at end-March 2001. However, these are estimated to be lower at Rs.1,66,116 crore (7.2 per cent of GDP) at end-March 2002.

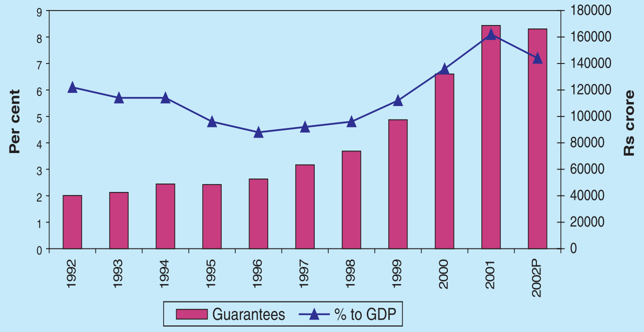
Table H : Outstanding Guarantees of State Governments

End-March	Amount (Rs. crore)	Percentage to GDP
1992	40,159	6.1
1993	42,515	5.7
1994	48,866	5.7
1995	48,479	4.8
1996	52,631	4.4
1997	63,409	4.6
1998	73,751	4.8
1999	97,454	5.6
2000	1,32,029	6.8
2001	1,68,712	8.0
2002 (P)	1,66,116	7.2

P : Provisional.

Note: Based on information received from 17 major States.

Graph 11: Outstanding Guarantees of State Governments



In view of the fiscal implication of rising level of guarantees, many States have taken initiatives to place ceilings on guarantees. The statutory ceilings on guarantees have been placed by States such as Goa, Gujarat, Karnataka, Sikkim and West Bengal, while the States of Assam, Orissa and Rajasthan have imposed administrative ceilings on guarantees. The main features of ceilings on guarantees placed by various States are presented in Table I.

Table I : Main Features of Ceilings on Guarantees

State	Statutory/ Administrative (Year)	Ceiling	Other Important Features
1. Assam	• Administrative ceiling (2000)	• The ceiling on guarantee issued by the Government against loan principals is fixed at Rs.1,500 crore.	
2. Goa	• Statutory ceiling (1993)	• The ceiling on guarantees issued by the Government is currently fixed at Rs. 550 crore.	
3. Gujarat	• Statutory ceiling (1963)	• The ceiling on guarantees issued by the Government was originally fixed at Rs.60 crore in 1963. This ceiling has been revised from time to time. As per the latest revision (March 2001), the ceiling on guarantees has been fixed at Rs.20,000 crore.	
4. Karnataka	• Statutory ceiling (1999)	• The total outstanding Government guarantees as on the first day of April of any year shall not exceed 80 per cent of revenue receipts of the second preceding year as they stood in the books of the Accountant General of Karnataka. • The ceiling on the Government guarantee shall not apply for any additional borrowing for implementation of the Upper Krishna Project.	• The Government will charge a minimum of one per cent as guarantee commission, which shall not be waived under any circumstances.
5. Orissa	• Administrative ceiling (2002)	• The total outstanding Government guarantees as on the first day of April every year shall not exceed 100 per cent of revenue receipts of the second preceding year, as reflected in the books of accounts maintained by the Accountant General. Attempts should be made to bring this gradually to the level of 80 per cent over the next five years.	
6. Rajasthan	• Administrative ceiling (1999)	• The loans of State Government (which do not include other liabilities) and outstanding guarantees issued by the State Government *i.e.*, the total of loans and guarantees on the last day of any financial year shall not exceed double the amount of estimated receipts	

State	Statutory/ Administrative (Year)	Ceiling	Other Important Features
		in the consolidated fund of the State for that financial year and also that the outstanding guarantees issued by the State Government shall not exceed the amount of receipts in the consolidated fund of the State.	
7. Sikkim	• Statutory ceiling (2000)	• The total outstanding Government guarantees as on the first day of April of any year shall not exceed thrice the State's tax revenue receipts of the second preceding year as in the books of the Accountant General of Sikkim.	
8. West Bengal	• Statutory ceiling (2001)	• The total outstanding Government guarantees as on the first day of April of any year shall not exceed 90 per cent of revenue receipts of the second preceding year as they stood in the books of the Accountant General of West Bengal. • The ceiling on the Government guarantee shall not apply for any loan raised by the West Bengal Infrastructure Development Finance Corporation Limited under the guarantee given by the Government and fully availed of by the Government itself for funding different infrastructure projects and for repayment of which there is specific provision in the budget of the State.	• A minimum of one per cent guarantee commission will be charged by the Government, which shall not be waived under any circumstances.

Note: Based on the information received from States up to December 31, 2002.

Section VII

State Finances: Issues and Perspectives

(a) Growing Fiscal and Revenue Deficits

The State Governments' large and increasing fiscal and revenue deficits has been a matter of concern in recent years. This, in turn, has led to accumulation of debt with associated debt service obligations. While various fiscal indicators showed some improvement in the early 1990s, the fiscal position deteriorated in the second half of 1990s. The underlying reasons have been many. These include inadequate increase in tax receipts, negative or negligible returns from public investments due to PSU losses, large subsidy payments, increase in expenditure on salaries due to pay revisions, higher pension outgo, *etc.* Notwithstanding the paucity of resources, the States are required to undertake increasing responsibilities, which include development of social and economic infrastructure, ensuring law and order, *etc.* In the face of decelerating revenues, the States had to resort to high level of borrowings to meet increased expenditure.

It is matter of particular concern that a significantly high proportion of the GFD has originated from the revenue deficit. During the first half of 1990s, the revenue deficit accounted for about one-fourth of the gross fiscal deficit, while in recent years its share has moved up to around 57-59 per cent. This implies that more than one-half of the borrowed funds are utilized to meet the revenue expenditure. Furthermore, over the years, the share of non-developmental expenditure has increased mainly due to larger expenditure on administrative services, interest payments and pensions. In contrast, the share of developmental expenditure has declined from about 70 per cent of the aggregate expenditure during 1985-90 to less than 60 per cent in 2000-01. The declining share of developmental expenditure in total expenditure indicates deterioration in the quality of expenditure. As the States have an important role in the development of social and economic infrastructure, expenditure compression should focus on non-essential expenditure. Therefore, appropriate expenditure management strategy assumes importance for reducing the expenditure on items of non-essential nature. In this context, the steps taken by several States to restrict fresh recruitment and filling up of existing vacancies and also to cut administrative expenditure merit attention.

As a high proportion of expenditure is committed in nature, it is difficult to achieve a significant reduction in the short term. Therefore, fiscal reform measures relating to expenditure compression could yield significant improvement only in the medium term. Moreover, fiscal adjustments based predominantly on expenditure reduction could have adverse implications for the growth process. The States would, therefore, need to make concerted efforts to augment their revenue receipts (both tax and non-tax) so as to ensure adequate funds for developmental activities. In this regard, the near stagnation in tax-GDP ratio of the States at around 8.0 per cent throughout the 1990s is a matter of concern. Strategy focusing on rationalisation of tax rates, better tax compliance, improved efficiency in tax administration and review of tax exemptions would be necessary for augmenting the States' revenue receipts. The proposed introduction of a State-level VAT with effect form April 1, 2003, therefore, assumes critical importance. Further, in view of the increasing importance of services sector in GDP, exploitation of the tax potential of services would enable the States to augment their revenue receipts. In addition, adoption of appropriate user charges for the services provided by the States would go a long way in facilitating higher non-tax receipts.

(b) Increasing Interest Burden

The continuous increase in the stock of States' debt, that too with borrowings at market related interest rates has increased the interest burden of the States over the years. The Eleventh Finance Commission (EFC) while examining the issue of sustainability of debt and fiscal deficit, observed that the proportion of interest payments to revenue receipts of States including devolution and grants should be about 18 per cent. The EFC, therefore, recommended that the States should keep this as their medium term objective. At present, the proportion of interest payments to revenue receipts is higher than that suggested by the EFC in respect of all States together. In some of the individual States, this proportion is even significantly higher. Such high magnitude of interest payments preempts States' revenue receipts and thereby puts constraints on States' developmental activities. The effective cost of borrowings for the States on their past debt is much higher than the rate at which they are able to raise resources at present from the market. In this context, the recent initiatives for restructuring their high cost loans would facilitate reduction in the interest burden of State Governments.

(c) Increasing Pension Payments

The pension payments of the States have shown sharp rise, especially since the second half of 1990s. The salary revisions effected by the States have also led to increased pension liabilities. During the period 1995-96 to 2000-01, the annual average increase in pension expenditure was as high as 27.1 per cent. In 2000-01, pension payments pre-empted more than 10 per cent of the revenue receipts. With the increase in the number of retirees, the pension liabilities are expected to increase and could, therefore, emerge as an important expenditure item for the States. Some of the States have proposed to introduce a new contributory pension scheme for their newly recruited employees. Considering the enormity of the financial burden on the States, reforms of the existing pension schemes assume critical importance.

(d) Public Sector Enterprises Reforms

The State Governments have built tremendous assets in the form of public sector undertakings. However, the receipts on account of dividends and profits from State enterprises have remained negligible. In many cases, State Governments are required to provide large budgetary support to the loss making enterprises, causing additional burden on States' finances. There is an urgent need to realise commensurate returns from these assets. The States would, therefore, need to bestow focused attention on the asset side where they have made investments. In addition, appropriate user charges for the services provided by the Government agencies to the public should be given priority. In this regard, the power sector reforms are very crucial in view of their fiscal implications.

Poor financial performance of public sector undertakings (PSUs) has been an area of concern while considering the large amount of equity support and loans provided by the States. As on March 31, 2001, there were 834 State level PSUs. Out of these, 358 enterprises were loss making and 185 enterprises were non-working. The average rate of return on capital invested in State Electricity Boards (SEBs) that account for the bulk of the States' investments in PSUs has been persistently negative. Many States have envisaged PSU reforms through restructuring, privatisation, disinvestment and closing down the unviable and loss making enterprises. According to the information compiled by the Ministry of Disinvestment, 17 States (Andhra Pradesh, Goa, Gujarat, Haryana, Himachal Pradesh, Jammu & Kashmir, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Manipur, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal) have identified 222 State level PSUs for disinvestment/ winding up/ restructuring. Of these, the process of disinvestment/ winding up/ restructuring has been initiated in 124 State level PSUs. So far, 68 State level PSUs have been closed down and 30 State level PSUs have been privatised. In this context, PSU reforms at the State level in order to convert the viable PSUs into efficient and profitable entities and earn commensurate return on the investments made in them assume importance.

(e) State Government Guarantees

The outstanding guarantees issued by the State Governments have been rising in recent years. As the States' fiscal position has deteriorated in recent years, devolvement on State Governments due to defaults by entities for whom guarantees have been issued would place additional burden on State finances. At the same time, non-adherence to the payment obligations committed by the States in respect of guarantees already provided by them would have adverse implications on the sovereign credibility. In addition, this may pose difficulties for the States to raise resources from the market in future. Moreover, as many banks and financial institutions have exposure to State guaranteed debt, prompt discharge of guarantee related obligations is important from the point of view of health of the financial sector as well.

The issue of fiscal implications arising from guarantees has been engaging the attention of the authorities. To address this issue, a number of States have placed ceilings on issue of guarantees. A few States have also set up guarantee redemption funds and have started charging guarantees fees. A crucial requirement is to put in place appropriate mechanism to have comprehensive information on guarantees issued by the State Governments. At the same time, the States would need to make efforts to broadly identify the corresponding risk under guarantees so as to facilitate appropriate budgetary provision for meeting any obligations arising from invocation of guarantees by the lending institutions. The lending entities would also need to take appropriate care while financing the projects. The lending decision should be based on the intrinsic viability and bankability of the project and, not solely based on the availability of State Government guarantee.

To sum up, the continued emphasis on fiscal reforms at the State level has gained significance, especially in view of the fiscal deterioration of the States in recent years. The State Budgets for 2002-03, while envisaging measures for expediting the fiscal consolidation process, focused on infrastructure development and growth enhancing sectoral policies. Few States have taken initiatives towards fiscal responsibility legislation. Furthermore, a number of States have finalised their medium term fiscal reforms programme in consultation with the Centre. This initiative would set in the direction and timeframe for fiscal reforms. In addition, the States have taken several measures which include setting up of Consolidated Sinking Fund, Guarantee Redemption Fund, Expenditure Review/Reform Committee, placing limits on State Government guarantees, restructuring the PSUs, rationalisation of posts and restrictions on fresh recruitment.

As per the draft Tenth Five Year Plan (2002-2007) document released by the Planning Commission, the projected plan outlays are larger for all States as compared to the Ninth Plan. This would require, in addition to Central assistance, considerable efforts on the part of the States. The Planning Commission, while stressing the need for fiscal and other reforms at the State level, has observed that "…. a joint effort by the Centre and States is needed to fulfill the Tenth Plan objectives. Along with the Centre, States need to reform more and much faster, and raise substantially higher levels of their own resources to mobilize the financial resources essential for the much needed productive investments. The only way for States to relieve fiscal pressures is to increase all round tax and non-tax resource mobilisation efforts, coupled with determined downsizing of staff and administrative expenditure and taking up fiscal reforms to restructure finances and put them on a sustainable basis"[7].

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[7] Draft *Tenth Five Year Plan (2002-07), Volume III,* Planning Commission, Government of India, New Delhi.

Explanatory Note on Data Sources and Methodology

Data Sources

This study is based on the receipts and expenditure data presented in the budget documents of the 28 State Governments and the National Capital Territory of Delhi. The analysis strictly conforms with the data presented in the State Budgets and the accounting classification thereof. Some supplementary information regarding Additional Resource Mobilisation (ARM) efforts and the level of guarantees (contingent liabilities) extended by States are also incorporated. Material received from Planning Commission relating to State-wise Plan outlays are also incorporated. The analysis conforms with the accounting classification into *Revenue* and *Capital Accounts* and their bifurcation into 'Plan' and 'Non-Plan'.

Methodology

As set out in the budget documents, the analysis of the expenditure data is also disaggregated into developmental and non-developmental expenditure. All expenditures relating to *Revenue Account*, *Capital Outlay* and *Loans and Advances* are categorised into general services, social services and economic services. Broadly, the social and economic services constitute developmental expenditure, while expenditure on general services is treated as non-developmental. This reclassification is done without altering the total receipts, expenditure and overall balance presented in the budget.

The overall deficit (conventional deficit) used in the analysis is financed by the cash deficit, which is the difference between the closing balance and opening balance, the increase/decrease in Cash Balance Investment Account and the increase/decrease in WMA extended by the Reserve Bank of India.