

In line with the recommendations of the Thirteenth Finance Commission (ThFC) supported by a revival of growth in 2010-11, State governments announced various policy measures in their budgets for 2011-12. The emphasis appears to be on mobilising higher own revenue receipts through various tax measures, while specific policy measures have been announced to address the rise in prices of essential commodities and petroleum products. Many States have accorded priority to strengthening the public distribution system, which has been supplemented by tax exemptions/reductions for foodgrains and certain essential commodities. The policy announcements in the State budgets also cover specific initiatives aimed at developing social and economic sectors and also promote infrastructure development on a PPP basis. The States and the Centre have also tried to create an environment for effective implementation of the proposed Goods and Services Tax in the near future. The States have introduced amendments to their original Fiscal Responsibility and Budget Management Acts, setting out targets for their fiscal indicators in pursuance of the revised fiscal roadmap recommended by the ThFC.

1. Introduction

3.1 Presented against the backdrop of better economic growth performance in 2010-11, the State budgets for 2011-12 indicated the intent of the State governments to continue their progressive exit from the expansionary fiscal policy of the crisis years (2008-09 and 2009-10). On the revenue side, the focus has been on tax enhancing measures while measures such as exemption/reduction in value added tax (VAT) rates on food and petroleum products and excise duties on petroleum products have been announced to tackle the situation of price rise in essential commodities. On the expenditure side, besides increasing expenditure on food security and strengthening the PDS, States have proposed higher allocations for various Plan schemes (Centrally sponsored schemes and State plan schemes), particularly relating to education, health, transportation, housing and employment generation. Some States have announced the creation of physical and human infrastructure such as roads and bridges and health care services on a public-private partnership (PPP) basis. This Chapter briefly discusses policy initiatives and schemes that have been proposed by State governments, the Government of India and the Reserve Bank of India, which impinge on State finances.

2. State Governments

3.2 The broad thrust of policy proposals announced in State budgets for 2011-12 is to continue the fiscal consolidation process which was re-started in 2010-11, in line with the recommendation of the Thirteenth Finance Commission (ThFC).

Revenue Measures

3.3 Policy measures are broadly aimed at augmenting tax revenues. While some of the States have desisted from implementing any new tax measures by declaring their budgets as 'tax-free' budgets, others have gone in favour of expanding the tax base as well as increasing the rates of taxation. The broad fiscal stance of the States has been towards enhancing their own tax collections while continuing with their existing pattern of expenditures. The major tax policy initiatives include (i) increasing the VAT rate on certain commodities such as tobacco and allied products (Assam, Gujarat, Goa, Jammu and Kashmir, Meghalaya, Delhi), liquor products (Assam, Goa), crude oil (Assam), carbonated soft drinks (Maharashtra), sweetmeats and savories (NCT Delhi), mobile phones (Gujarat), consumer durables (Odisha) and aviation turbine fuel (Rajasthan); (ii) introducing new taxes such as environment and

health cess (Rajasthan); (iii) rationalising taxes such as revision of the Passenger Goods Taxation Act (Jammu and Kashmir), revision in the entry tax rate to make it consistent with the VAT rate (Assam and Odisha), rationalisation/revision of motor vehicle tax (Assam, Kerala, Manipur, Maharashtra and Mizoram), amendments in the VAT Act and e-services for luxury and profession tax (Meghalaya), amendments/revisions in the Entertainment Tax Act (Uttarakhand), rationalisation of the stamp duty structure through the introduction of e-stamping (Uttarakhand, Himachal Pradesh, Jharkhand and Puducherry), upward revision in stamp duty rates (Goa, Maharashtra and Tamil Nadu) and levy of stamp duty on monthly payment of salaries to all regular Government officials including the Council of Ministers and Parliamentary Secretaries and on all bills in respect of payment made by various Departments and offices to private parties (Mizoram); (iv) widening the tax net to include services like construction of commercial complexes and colonies, TV/radio programme production, architects/interior decorators, chartered accountants and advertisement hoardings (Jammu and Kashmir); and (v) improving tax compliance through e-governance (Tamil Nadu, NCT Delhi, Arunachal Pradesh, Bihar, Jharkhand and Puducherry) and increasing penalty fees (Kerala). Besides these changes, North Eastern States have announced an increase in VAT rate from 4 per cent to 5 per cent, as decided by the Empowered Committee of State Finance Ministers.

3.4 States also undertook certain tax measures, both on the supply as well as on the demand side, to tackle high food inflation. Measures taken on the demand side include tax exemption for cereals (Jammu and Kashmir, and Maharashtra), pulses and condiments (Maharashtra), exemption from entry tax for certain primary food items (Odisha) and tax exemptions for daily household goods (Chhatisgarh). Measures taken on the supply side to promote agricultural production include exemption of VAT on items such as green houses, drip and sprinkler systems, pesticides, insecticides and weedicides and toll exemption for animal and poultry feed, milch animals and beehives (Jammu and Kashmir).

3.5 The sharp increase in global crude oil prices during 2011-12 and its impact on the under-recoveries of oil marketing companies necessitated an upward revision in the domestic retail price of administered petroleum products by the Central government in June 2011. Commensurately, the Central government eliminated customs duty on crude oil and reduced excise duty on diesel. Several State governments also announced VAT exemptions/reductions on petroleum products to contain the rise in their prices (Table III.1).

3.6 On the non-tax front, revenue enhancing measures announced by the States include (i) rationalisation of the license fee for retail sale of liquor (Goa and Assam), (ii) rationalisation of forest royalties (Manipur), and (iii) introduction of daily lotteries (Kerala, Arunachal Pradesh) and e-lottery (Arunachal Pradesh).

Expenditure Measures

3.7 The expenditure measures of the States in their budgets for 2011-12 have focused on improving their infrastructure for the delivery of public goods like educational and health services. Announcement of social security measures like scholarships for students, old age pensions, and insurance for vulnerable groups have also been observed in the budgets. While expenditures aimed at increasing investments would work towards improving the growth climate, there is scope for controlling the tendency of several States to undertake measures that provide short-term assistance to various segments of the population, which may impose fiscal stress. In addition to tax exemptions/reduction in taxes on food items to contain the rising food prices, State Governments have also continued to allocate resources in 2011-12 to improve agricultural production. Development expenditure on social and economic services, particularly education, medical and public health, family welfare, irrigation, roads and bridges and rural development were priority areas for expenditure allocation during 2011-12, although the growth in expenditure in some of these sectors is budgeted to be lower.

Policy Initiatives

Table III.1: State-wise Measures to Contain Price rise in Administered Petroleum Products

States	Diesel	Petrol	LPG Cylinder	Kerosene	Expected Loss to the Government
I. Non-Special Category					
Andhra Pradesh			₹25 subsidy per cylinder to all domestic consumers paid to oil marketing companies (OMCs)		N.A.
Bihar	Reduction in VAT rate by 0.36 per cent to provide a relief of 14 paise per litre				₹370 million
Goa	Reduction in VAT by 2 per cent to provide relief of 70 paise per litre	Reduction in VAT by 2 per cent to provide relief of 80 paise per litre			₹500 million
Kerala	Reduction in sales tax rate by 2.09 per cent	Cumulative reduction in sales tax rate by 3.19 per cent (between May 2011 and December 2011)			Revenue Neutral
Maharashtra	Reduction in VAT rate by 2 per cent to relief of 72 paise per litre			Reduction in VAT rate by 2 per cent to relief of 26 paise per litre	₹5 billion
Odisha			Reduction in VAT rate for domestic consumption	Reduction/ abolition in VAT for kerosene supply through PDS outlets	₹400 million
Rajasthan	Reduction in VAT rate by 2 per cent to provide a relief of 54 paise per litre		Abolition of VAT rate of 4 per cent; subsidy of Relief of ₹13.42 per cylinder; ₹25 per cylinder for domestic use paid to OMCs	PDS Kerosene exempted from entry tax	N.A.
Uttar Pradesh	No waiver in the current year. Earlier in 2008-09, VAT was lowered on diesel from 21 per cent to 17.23 per cent.		State had abolished VAT of 4 per cent on LPG in 2008-09.		N.A.
Uttarakhand	No VAT on increased price.	In September, 2011, waiver of 25 per cent VAT on increased prices to provide a relief of 78 paise per litre (September 2011) relief of 45 paise per litre in the prices of petrol through VAT reduction (November 2011)	VAT on LPG was already nil.	Kerosene oil was exempted from 4.5 percent VAT	₹727.8 million
II. Special Category					
Arunachal Pradesh	No tax has been imposed on the petroleum products so far				
Manipur				Exemption from VAT on kerosene for below poverty line (BPL) families	N.A.
Meghalaya	Exemption from VAT to Provide relief of 50 paise per litre		Exemption from VAT to provide relief of ₹20.13 per cylinder	Exemption from VAT to provide relief of 67 paise per litre	₹95.2 million
Memo:					
NCT Delhi			Subsidy of ₹40 per month to each BPL/AAY card holder not claiming kerosene at subsidized rate		

N.A.: Not Available

3.8 Given the significance of agriculture and allied activities in an environment of high food inflation, almost all major States have proposed enhancement of irrigation potential with a view to increase agricultural productivity. In order to assist farmers, State governments of Assam, Kerala, Karnataka and Maharashtra have announced interest subsidy on agricultural loans from co-operative credit institutions. Tamil Nadu has proposed establishing of multipurpose cold storages and chain arrangements; and modern fish processing and packaging houses.

3.9 State governments have announced certain sector-specific policy initiatives to promote industrial growth and industrialisation. Karnataka has announced policies for semi-conductors, bio-tech, ICT, and electronic and hardware to enhance the State's competitiveness in these areas. Initiatives taken by other States include providing interest relief and promoting investment for the establishment of industrial units (Madhya Pradesh), allocating finances to develop salt industry (Gujarat) and allowing rebates on electricity bills for powerlooms (Maharashtra). Steps are also being taken to promote tourism in many States (Himachal Pradesh, Uttarakhand, Rajasthan, Kerala) and the North-Eastern States. A large number of States are taking up construction of roads and bridges and facilitating power generation, which are important inputs for industrial development. Jharkhand has established the 'Jharkhand Accelerated Road Construction Company Ltd' while Bihar government has proposed to set up 'Bihar Urban Infrastructure Development Corporation' and 'Educational Infrastructure Development Corporation' during 2011-12.

3.10 In social sector, several measures have been proposed in the State budgets for 2011-12 to promote education, health, housing, social security, women empowerment, and welfare of SCs and STs. A number of States have announced the setting up of new

colleges, universities, dedicated institutes, hostels, hospitals, primary health centres, and training institutes to improve educational, health and employment facilities in their States. The new policy measures towards social welfare announced in the State budgets include (i) subsidy for supply of rice to BPL families and increase in the budgetary allocation for neglected areas of the State⁴ (West Bengal); (ii) increase in pensions for senior citizens, widows and the handicapped (Uttar Pradesh), (iii) making interest-free loan available to the farmers' children for higher education (Karnataka), (iv) providing free treatment up to ₹0.2 million in all government hospitals and private hospitals (Kerala) under *Rajeev Arogyasree Scheme*⁵ and (v) scholarships for children of BPL families (Uttar Pradesh). The State government of Assam has proposed the establishment of the Assam Scheduled Caste Development Council and the Assam Employment Generation Corporation.

3.11 States have also announced measures that empower women and enable them to reap the benefit of growth. Salient measures include (i) introducing a monetary benefit scheme to encourage the birth of girl child (Punjab) (ii) providing equal entitlement to widows (equivalent to that of a son) and inclusion of their names along with their husbands in the land records (Uttar Pradesh), (iii) providing license to women NGOs for the public distribution system to ensure that women participate in food security (Jharkhand) and (iv) implementing schemes that arrest dropout rate of girl students in schools and enhance their employment prospects (Jammu and Kashmir).

3.12 Some States have also announced measures to promote financial inclusion/banking services and the use of information technology for delivery of various services during 2011-12. These services include (i) operation of post-matric scholarships scheme through online banking facility (Andhra

⁴ Paschimanchal including Jangalmahal, Uttarbanga, including Hill Region and Sundarban areas.

⁵ A total of 5.2 million families including 3.2 million BPL families and 2 million APL families having annual income less than ₹250,000 will be benefited under this scheme.

Pradesh) and (ii) implementation of e-governance projects for public distribution system, issue of driving licenses, registration of vehicles, and Integrated Financial Management System (Haryana).

3.13 Development of infrastructure and other services through public-private partnerships (PPP) has been another priority area in terms of policy initiatives of the States in 2011-12. The PPP mode is envisaged for (i) promoting tourism (Arunachal Pradesh) (ii) four-laning of roads (Haryana) (iii) constructing citizen service centres to provide value added services to rural citizens (Andhra Pradesh), (iv) establishing modern check gates (Odisha), (v) constructing expressway, bridges, roads, and electricity (Uttar Pradesh), (vi) setting up poultry farms and agro-processing industries (Punjab), (v) establishing diagnostic facilities in major district level hospitals (Tamil Nadu), and (vi) developing commercial deep sea fishing, fish processing parks, solar parks (Tamil Nadu).

Institutional Measures and Other Major Policy Initiatives

3.14 The institutional measures adopted by the State governments such as Fiscal Responsibility and Budget Management (FRBM) Acts, Value Added Tax (VAT), New Pension Schemes (NPS), and setting up of Consolidated Sinking Fund (CSF) and Guarantee Redemption Fund (GRF) have helped them to consolidate their finances in the last decade (Table III.2).

3.15 The ThFC has worked out a fiscal consolidation roadmap for the States requiring them to eliminate their revenue deficit and achieve a fiscal deficit of 3 per cent of their respective GSDP, latest by 2014-15. It has also recommended a combined States' debt target of 24.3 per cent of GDP to be reached during this period. The States were required to amend or enact their FRBM Acts to conform to these recommendations. Accordingly, all states, barring Goa, have amended their FRBM Acts/Rules, setting out annual deficit/debt targets in line with the ThFC recommendations (Annex 1). The FRBM Acts

are expected to contribute to further improving the State finances, provided the macroeconomic scenario remains favourable.

3.16 States have announced measures to strengthen their local bodies in their budgets for 2011-12. These include higher devolution of funds to local bodies/Panchayati Raj institutions as per the recommendations of their respective State Finance Commissions (Assam); earmarking funds for development of municipal wards where the inmates are predominantly SCs (Haryana); conducting elections to autonomous district councils after more than two decades (Manipur); and raising funds to the tune of ₹12 billion by the Punjab Municipal Infrastructure Development Company (PMIDC) for various infrastructure development projects in urban local bodies.

3. Government of India

3.17 The Constitution Amendment Bill for goods and services tax (GST) was introduced in March 2011. The drafting of model legislation for Centre and State GST in concert with the States is under progress. The Centre has made significant progress on the GST Network (GSTN) which will be set-up as a National Information Utility (NIU) to build the necessary IT infrastructure for the introduction of GST. The key business processes of registration, returns and payments are in advanced stages of finalisation. The National Securities Depository Limited (NSDL) has been selected as the technology partner for incubating the NIU that will establish and operate the IT backbone for GST. By June 2011, NSDL was to set up a pilot portal in collaboration with 11 States prior to its rollout across the country. The NIU is expected to become operational by August 2012.

3.18 The Central Government has asked State governments to urgently review and enforce a reformed Agriculture Produce Marketing Act so that government-regulated *mandis* for vegetables and fruits do not prevent retail enterprises from integrating with the farmers.

Table III.2: Institutional Reforms by State Governments*

State	Value Added Tax (VAT) Implemented	Fiscal Responsibility and Budget Management Act #	New Pension Scheme (NPS) introduced	Ceilings on Guarantee Imposed	Consolidated Sinking Fund (CSF)	Guarantee Redemption Fund (GRF)
1 Andhra Pradesh	April 2005	June 2005	September 2004	Yes	Yes	Yes
2 Arunachal Pradesh	April 2005	March 2006	No	Yes	Yes	No
3 Assam	May 2005	September 2005	February 2005	Yes	Yes	No
4 Bihar	April 2005	April 2006	September 2005	Yes	Yes	No
5 Chhattisgarh	April 2006	September 2005	November 2004	Yes	Yes	No
6 Goa	April 2005	May 2006	August 2005	Yes	Yes	Yes
7 Gujarat	April 2006	March 2005	April 2005	Yes	Yes	Yes
8 Haryana	April 2003	July 2005	January 2006	Yes	Yes	Yes
9 Himachal Pradesh	April 2005	April 2005	May 2003	Yes	No	No
10 Jammu and Kashmir	April 2005	August 2006	No	No	No	No
11 Jharkhand	April 2006	May 2007	December 2004	No	No	No
12 Karnataka	April 2005	September 2002	April 2006	Yes	No	No
13 Kerala	April 2005	August 2003	No	Yes	Yes	No
14 Madhya Pradesh	April 2006	May 2005	January 2005	Yes	No	Yes
15 Maharashtra	April 2005	April 2005	November 2005	Yes	Yes	No
16 Manipur	July 2005	August 2005	January 2005	Yes	Yes	Yes
17 Meghalaya	April 2006	March 2006	No	Yes	Yes	No
18 Mizoram	April 2005	October 2006	No	Yes	Yes	Yes
19 Nagaland	April 2005	August 2005	No	Yes	Yes	Yes
20 Odisha	April 2005	June 2005	January 2005	Yes	Yes	Yes
21 Punjab	April 2005	October 2003	No	Yes	No	No
22 Rajasthan	April 2006	May 2005	January 2004	Yes	No	No
23 Sikkim	April 2005	September 2010	April 2006	Yes	No	No
24 Tamil Nadu	January 2007	May 2003	April 2003	Yes	Yes	No
25 Tripura	October 2005	June 2005	No	Yes	Yes	No
26 Uttarakhand	October 2005	October 2005	October 2005	Yes	Yes	Yes
27 Uttar Pradesh	January 2008	February 2004	April 2005	No	No	No
28 West Bengal	April 2005	July 2010	No	Yes	Yes	No
Sum-up	28	28	19	25	19	10

: All States barring Goa have amended their FRBM Acts, the details of which are given in Annex 1.

Source: Information received from respective State Governments and Reserve Bank records.

3.19 A comprehensive PPP policy has been formulated for the Centre and the State Governments for further developing PPPs. The Central government has engineered a major directional change in public policy by its focus on inclusive development. The creation of legal entitlements for an individual's right to work has added to resilience and dynamism in the rural economy of the country.

3.20 The right to information and the right to education are effective tools of empowerment for removing social imbalances. After detailed consultations with all stakeholders including State governments, the National Food Security Bill (NFSB)

has been tabled in the Parliament in December 2011. The existing Integrated Child Development Scheme and the mid-day meal programme would become entitlements for beneficiaries under the proposed Act.

3.21 To move beyond the formal R&D paradigm, a National Innovation Council has been set up to prepare a roadmap for innovations in India. The process of setting up State Innovation Councils in each State and Sectoral Innovation Councils aligned to Central Ministries is underway. The Central government has been providing special grants to recognise excellence in universities and academic institutions. Grants have been proposed by the Centre

during 2011-12 for setting up new branches (Aligarh Muslim University in West Bengal and Kerala; *Mahatma Gandhi Antarrashtriya Hindi Vishwavidyalaya* in Kolkata and Allahabad) and augmenting the funding for existing institutions (Kerala Veterinary and Animal Sciences University at Pookode; IIT, Kharagpur; IIM, Kolkata; Maulana Azad Education Foundation; Centre for Development Economics, Delhi School of Economics; and Madras School of Economics).

3.22 In order to boost development in the North-east region and special category States, the allocation for special assistance was almost doubled to ₹80 billion for 2011-12, which includes an amount of ₹54 billion as untied Special Central Assistance.

3.23 The Central government also provided funds to Ladakh and Jammu regions for projects identified by the task force, to assess infrastructure needs of the State of Jammu and Kashmir. To boost development of backward regions, the allocation under the Backward Regions Grant Fund was increased by over 35 per cent, from ₹73 billion to ₹98.9 billion.

3.24 As only six States had introduced the system of e-stamping facility, the Central Government proposed to launch a new scheme with an outlay of ₹3 billion to provide assistance to States to modernise their stamp and registration administration and roll out e-stamping in all districts in the next three years.

4. Reserve Bank of India

3.25 The market borrowing programme of the State governments was conducted smoothly during 2010-11. The gross market borrowings were lower at ₹1,040 billion than those of the previous year (₹1,311 billion). Although the weighted average yield of gross borrowings of the States during 2010-11 was higher than a year ago, reflecting tight monetary policy, the spread of State government securities over comparable Central government securities continued to narrow, reflecting more evenly distributed auctions of State government securities.

Based on the recommendations of the Advisory Committee on Ways and Means Advances (WMA) and Overdrafts (OD) to State Governments (Chairman: Shri M.P. Bezbaruah), a revised WMA/OD Scheme was put in place with effect from 2006-07. For the year 2010-11, the WMA/OD Scheme was kept unchanged. Pursuant to the signing of the agreement between the Government of Jammu and Kashmir and the Reserve Bank of India to operationalise an arrangement for cash management from April 1, 2011, the WMA limit for the States including Jammu and Kashmir and the Union Territory of Puducherry is placed at ₹102.40 billion for the financial year 2011-12. The rates of interest on Normal and Special WMA and OD continued to be linked to the repo rate.

5. Conclusion

3.26 With the improvement in the macroeconomic environment in 2010-11 and the requirement to correct imbalances that appeared in 2008-09 and 2009-10, State governments have announced various measures aimed at higher tax collections in their budgets in 2011-12. The improvement in revenue account of States is envisaged through tax measures that would ensure faster progress towards fiscal consolidation. On the expenditure side, the focus on short term schemes for social assistance has continued during the current year. Among these schemes, policy measures have aimed at protecting the public from rising prices of essential commodities, particularly food articles; extending various kinds of scholarships and providing insurance for specific vulnerable groups of the population. In addition, the State governments have shown interest in developing and strengthening the physical infrastructure and information technology network with a view to achieve and sustain higher growth rates and improve the delivery of public goods. The social sector expenditure policies have aimed at improving the quality of human capital by making them employable and thus achieving inclusive growth. Studies have shown that fiscal consolidation based on revenue side measures is

not sustainable. Consolidations based on cuts in public expenditure are found to be more effective⁶. They send convincing signals regarding the political will of the fiscal retrenchment and ensure its medium-run viability. Expenditure reforms in many countries have achieved large fiscal adjustments by reducing spending on transfers, subsidies and public consumption while ensuring that allocations for education and health remain adequate⁷. Some short-run fiscal adjustments may be necessary to avoid the possibility of a crisis, but at the same time more fundamental adjustments in the tax system, and

the structure of the expenditure and the financial sector must be on the agenda for reforms⁸. Thus, the fiscal consolidation needs to be balanced in nature. While expenditure on social sector is important, cutting down unproductive expenditures is equally important. Fiscal consolidation emanating only from the revenue side is fraught with uncertainties as it may lead to greater imbalances in case of economic downturns. Keeping this in view, there is a need for the States to rationalise their expenditures without compromising on the quality of services.

⁶ Barrios, S., S Langedijk, and L R Pench (2010), "EU Fiscal Consolidation after the Financial Crisis: Lessons from Past Experiences", European Economy Economic Paper No.418, Directorate General for Economic and Financial Affairs, Brussels.

⁷ Hauptmeier, Sebastian, Martin Heipertz and Ludger Schuknecht (2007), "Expenditure Reform in Industrialised Countries: A Case Study Approach", Working Paper Series No 634, European Central Bank, May.

⁸ Singh N., and T. N. Srinivasan. 2004. Fiscal Policy in India: Lessons and Priorities. Presented at the NIPFP-IMF conference on Fiscal Policy in India, New Delhi, 16–17 January 2004.