# State Finances: A Study of Budgets of 2003-04[1]

## Introduction

The fiscal performance of the State Governments as reflected in the movements in the key deficit indicators, *viz.,* revenue deficit (RD), gross fiscal deficit (GFD) and primary deficit (PD), has been an area of concern in recent years. As documented in earlier research studies in the Reserve Bank, a number of factors have been responsible for the disparity in the growth rates of receipts and expenditure and the consequent widening of the fiscal gap of State Governments. These include a growing interest burden, increasing pension liabilities, large administrative expenditure, losses incurred by State Public Sector Undertakings, inappropriate user charges and deceleration in Central transfers. The persistently large revenue deficit has led to a higher fiscal deficit and spiraling debt. Consequently, a vicious cycle of deficit, debt and debt service payments has emerged. The fiscal stress, in turn, has seriously constrained the States' ability to discharge their primary responsibility of developing social and economic infrastructure.

Recognising this, many State Governments have undertaken fiscal reforms. The Government of India has also initiated measures to encourage the States' fiscal consolidation efforts. Reserve Bank's Annual Report (2002-03) has observed *"It is increasingly recognised that it is the State finances where the Government sector's interface with the people is most significant. Issues in the reform of fiscal policy in the States have a direct bearing on the quality of life."*

Against the above backdrop, the present study reviews State finances in respect of 2001-02 (Accounts), 2002-03 (Revised Estimates) and 2003-04 (Budget Estimates)[2]. The remainder of the Study is organised into five sections. An overview of the fiscal developments is presented in Section I. The policy initiatives proposed in the budgets for 2003-04 as also the measures initiated by the Central Government and the Reserve Bank are documented in Section II. A brief analysis of the State finances in respect of 2001-02 (Accounts), 2002-03 (Revised Estimates) and 2003-04 (Budget Estimates) is provided in Section III. The trends in public debt, market borrowings and guarantees of the State Governments are discussed in Section IV. Section V concludes with a discussion on emerging issues in State finances.

## Section I : Overview

### *Key Deficit Indicators*

Deterioration in State finances, as measured by key deficit indicators, that had set in rather sharply since 1998-99 was arrested, to an extent, in 2000-01 and 2001-02 (Table 1). In 2002-03 (Revised Estimates), while gross fiscal deficit and primary deficit showed deterioration to 4.7 per cent and 1.7 per cent of GDP, respectively, the revenue deficit recorded a marginal improvement to 2.5 per cent. The deterioration in GFD during 2002-03, however, was accompanied by a qualitative improvement in the composition. Illustratively, while 87 per cent of the increase in GFD in 2001-02 was driven by the revenue deficit, in 2002-03, the increase in GFD was mainly on account of higher capital outlay and

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1. Prepared in the Division of State and Local Finances of the Department of Economic Analysis and Policy (DEAP).

2. An analysis of the consolidated fiscal position of State Governments based on the State budgets for 2003-04 has already been published in the Reserve Bank of India (RBI) Annual Report 2002-03 and the article published in the November 2003 issue of the Reserve Bank Bulletin. This study provides a detailed State-wise analysis covering the budgetary data as well as additional information obtained from State Governments and the Government of India.

net lending. The GFD in the revised estimates for 2002-03, at 4.7 per cent of GDP, was also higher than the budget estimates for the year at 4.0 per cent of the GDP. States were, by and large, able to contain their revenue expenditure at the budgeted level in 2002-03. The large and growing GFD of the States pushed up their outstanding debt, which rose from 25.7 per cent of GDP in 2001-02 to 27.9 per cent of GDP in 2002-03. Measures envisaged in the State Budgets for 2003-04 reflect continued efforts towards revenue augmentation, expenditure management and public sector reforms. Reflecting these measures, the consolidated revenue deficit of States is budgeted to decline from 2.5 per cent of GDP in 2002-03 to 1.8 per cent of GDP in 2003-04. With the containment of RD, the GFD and PD of the States are budgeted to decline from 4.7 per cent and 1.7 per cent of GDP in 2002-03 to 4.2 per cent and 1.2 per cent, respectively, in 2003-04.

***Pattern of Revenue Receipts***

During 2001-02, the revenue receipts of States had recorded a sharp deceleration to 7.4 per cent from 14.8 per cent in 2000-01. This was mainly due to deceleration in the devolution of taxes from the Centre. During 2002-03, on the other hand, revenue receipts recorded an increase of 15 per cent mainly due to higher growth in States' own taxes and grants from the Centre. The budget estimates for 2003-04 have envisaged a growth rate of 13.7 per cent in States' revenue receipts. This increase is expected mainly due to higher growth rates in States' own revenue receipts. This emerging trend towards increased reliance on States' own revenue generation augurs well for fiscal consolidation.

***Pattern of Revenue Expenditure***

The growth in revenue expenditure of States had declined to 8.0 per cent in 2001-02 from 11.7 per cent in 2000-01 mainly due to compression in developmental expenditure. This trend was reversed in 2002-03 with an increase of 12.8 per cent in revenue expenditure mainly on account of acceleration in developmental expenditure, while the growth rate in non-developmental expenditure declined. The growth rate in revenue expenditure (both developmental and non-developmental components) is budgeted to decline in 2003-04.

***Capital Outlay***

The growth in capital outlay of States had declined sharply during 2001-02 to 3.7 per cent from 22.0 per cent in the previous year. The revised estimates for 2002-03, however, showed a significant acceleration to 28.8 per cent over 2001-02. This upward trend is expected to be strengthened in the budget estimates for 2003-04 as reflected in a growth of 34.0 per cent.

***Policy Initiatives***

Over the years, States have shown increasing awareness about the urgent need for fiscal correction and many of them have initiated a number of measures towards revenue augmentation, containment of expenditure and institutional reforms. The Central Government has also initiated measures to encourage and facilitate fiscal reforms at the State level. On the revenue front, the policy initiatives include strengthening of tax efforts and rationalisation of user charges relating to power, water and transport. On the expenditure side, containment of revenue expenditure is sought to be achieved through restrictions on fresh recruitment/creation of new posts, and cutback in administrative expenditure. Some States have also proposed to introduce contributory pension scheme for newly recruited staff, which could be expected to provide some relief over time.

The fiscal consolidation efforts have been intensified through institutional reforms such as

fiscal responsibility legislation by some States. Under the States' Fiscal Reform Facility, a number of States have drawn up Medium Term Fiscal Reforms Programme (MTFRP). A number of States have carried forward their efforts to restructure their public sector undertakings. In addition, power sector reforms have assumed critical importance. In this regard, the policy initiatives include constitution of State Electricity Regulatory Commissions, unbundling of Electricity Boards, increasing power tariff, measures for reducing transmission and distribution losses and one-time settlement of outstanding dues of Electricity Boards to Central Public Sector Undertakings (CPSUs).

## Section II : Policy and Other Developments

The need for comprehensive fiscal reforms at the level of States has been widely recognised. As noted before, the States have initiated several measures towards fiscal consolidation, covering revenue augmentation, expenditure containment, public sector restructuring and institutional reforms. Importantly, most of these policy initiatives were by the States' own efforts. In addition, the Central Government has taken several initiatives to facilitate and strengthen this reform process. The constitution of the Twelfth Finance Commission on November 1, 2002, entrusted with the task of making recommendations relating to transfer of resources from the Centre to the States, was an important development during 2002-03. As the banker and debt manager to the State Governments, the Reserve Bank has also been sensitising the State Governments on various fiscal matters. These measures are discussed in the following paragraphs.

### (i) State-level Budgetary Policy Initiatives

#### *Tax Reforms*

In order to strengthen their finances, States have initiated measures towards enhancement / rationalisation of various taxes such as land revenue, vehicle tax, entertainment tax, sales tax, electricity duty, professional tax and luxury tax. Recognising that competitive sales tax reduction designed to attract investment has led to revenue losses, the States have placed an accent on harmonising the inter-State tax regime and switch over to State-level value added tax (VAT). The proposed transition from the existing sales tax system to a VAT system, which is at present in use in over 120 countries, is viewed as a historic reform of the domestic trade tax system. Apart from avoiding cascading of taxes, the introduction of VAT is expected to increase revenues as the coverage expands to value addition at all stages of sale in the production and distribution chain. Preparatory work towards this end is in progress. In view of the apprehensions expressed by a large number of States regarding the loss of revenue following the proposed introduction of VAT, the Union Budget for 2003-04 envisaged that the Central Government would compensate 100 per cent of the loss in the first year, 75 per cent in the second year and 50 per cent in the third year of implementation of VAT. Implementation of VAT has, however, been postponed subsequent to the Union Budget. Furthermore, the Union Budget 2003-04 proposed a Constitutional amendment to enable levy of tax on services by the Central Government as a specific and important source of revenue for both the Centre and the States. This Constitutional amendment, and the consequent legislation would provide the Central Government the necessary authority to levy the tax and give sufficient powers to both the Central and the State Governments to collect the proceeds for revenue sharing.

#### *Non-tax Measures*

States have also undertaken measures to enhance non-tax revenues which include, *inter alia*, revision of tuition fees, medical fees, irrigation water rates and tariffs on urban water supply. The MTFRP finalised by several States have

emphasised indexation of user charges in services such as transporatation, irrigation, *etc*.

### *Expenditure Management*

On the expenditure front, a number of States have proposed to continue their efforts towards containment of revenue expenditure through restrictions on fresh recruitment/creation of new posts and curbs on the increase in administrative expenditure. Some States have proposed introduction of a contributory pension scheme for their newly recruited staff. State-wise details of the policy initiatives envisaged in the recent budgets of States are presented in Annex 1.

### *Institutional Reforms*

The institutional reforms proposed by the States are essentially to strengthen the process of fiscal consolidation. Notably, there are signs of intensification of these efforts. Some States have initiated measures to provide statutory backing to fiscal reforms through enabling legislation. The objective is to eliminate revenue deficit and contain fiscal deficit in the medium term. Five States *viz.,* Karnataka (Karnataka Fiscal Responsibility Act, 2002), Kerala (Kerala Fiscal Responsibility Act, 2003), Punjab (Punjab Fiscal Responsibility and Budget Management Act, 2003), Tamil Nadu (Tamil Nadu Fiscal Responsibility Act, 2003) and Uttar Pradesh (Uttar Pradesh Fiscal Responsibility and Budget Management Act, 2004) have already enacted Fiscal Responsibility legislations. The Fiscal Responsibility Bill has also been introduced in the legislature of Maharashtra (Annex 2).

### *Public Sector Reforms*

Persistent losses and budgetary support by States have been a heavy drag on State finances. Several States have shown interest in undertaking a comprehensive review of the functioning of the State Public Sector Undertakings (SPSUs), including the possibility of closing down of non-viable units after providing for suitable safety nets to the employees, including Voluntary Retirement Scheme (VRS). Many States have encouraged private sector participation in the transport and power sectors. In order to strengthen administrative machinery, many States have initiated measures to computerise their records and streamline their day-to-day functioning.

### *Power Sector Reforms*

In strengthening the fiscal reform programmes being pursued by State Governments, the power sector reforms have assumed critical importance. The State Electricity Boards (SEBs) account for the bulk of the States' investments in PSUs, and poor financial performance of SEBs has aggravated the problems in State finances. The subsidies provided by the State Governments to partly compensate the SEBs for the subsidised sale of electricity to agriculture and domestic sectors have been on the rise in recent years. In addition to direct loans to SEBs, the State Governments have also provided substantial guarantees in respect of SEBs' loans from financial institutions.

Measures taken by the State Govenments in the area of power sector reforms include 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 as well as measures for reducing transmission and distribution losses.

Twenty-one States have constituted State Electricity Regulatory Commissions (SERCs) for determining the power tariff structure. Of these, SERCs of 17 States have become operational, and 16 have issued tariff orders. The State-wise details of the initiatives taken by State Governments in the power sector reforms and restructuring are presented in Annex 3.

Based on the recommendation of the Ahluwalia Committee (2001), a scheme for one-time settlement of outstanding dues of the State Electricity Boards (SEBs) to CPSUs was finalised. In this regard, Tripartite Agreements (TPA) have been signed amongst the Government of India, the Reserve Bank and 28 State Governments. Under the scheme, the State Governments have issued 15-year bonds during 2003-04 with retrospective effect from October 1, 2001 worth Rs.28,984 crore to the CPSUs in exchange of the outstanding dues at a nominal tax-free interest rate of 8.5 per cent per annum repayable over 10 years after a moratorium period of five years. Subject to the approval of the Reserve Bank, 10 per cent of the bonds can be off-loaded in the market each year for trading.

**(ii) Centre's Initiatives**

Recognising the nexus between the Centre and State finances, the Central Government has also initiated measures to encourage fiscal reforms at the State level. Based on the recommendations of the Eleventh Finance Commission, towards this end, the Central Government has set up an Incentive Fund with a corpus of Rs.10,607 crore earmarked over a period of five years for encouraging fiscal reforms in the States. The release of resources from the Incentive Fund is based on a single monitorable fiscal indicator, *i.e.,* the ratio of revenue deficit to revenue receipts. The Government of India had drawn up a scheme called the 'States Fiscal Reforms Facility' (2000-01 to 2004-05), under which the States draw up a MTFRP by setting targets for broad fiscal indicators in the medium term and by covering various aspects such as fiscal consolidation, public sector enterprises reform, power sector reforms and fiscal transparency. The Planning Commission is also extending support to the MTFRP by ensuring that the Annual Plan framework is consistent with it. The Monitoring Committee under MTFRP has approved the fiscal reforms programme of 23 States, and MoUs have been signed with 16 States. Incentive grants to the tune of Rs.3,722 crore have been released.

The Government of India has decided to share the cost of reforms in States such as voluntary retirement schemes and downsizing of PSUs of States, through a blend of grants and open market borrowings. The Centre would finance 80 per cent of such costs in the case of special category States and 60 per cent in the case of non-special category States. This facility will, however, not be available to those States which are beneficiaries of any Structural Adjustment Loan from any multilateral/bilateral agencies in that particular year.

The initiatives regarding the Constitutional amendment envisaged in the Union Budget for 2003-04 to grant the Central Government the power to levy tax on services, and to give sufficient powers to both the Central and the State Governments to collect its proceeds, is expected to facilitate revenue augmentation.

The immediate concern about the current high level of interest payments has prompted the introduction of a debt swap scheme by mutual agreement between the Central and the State Governments (Box 1 and Section IV). Recognising the need for reducing the interest burden of the States, all loans from the Centre to the State Governments bearing coupons in excess of 13 per cent are to be swapped with market borrowings and small savings proceeds at prevailing interest rates over a period of three years ending in 2004-05.

**(iii) Reserve Bank's Initiatives**

As a banker and debt manager to the State Governments, the Reserve Bank has been taking initiatives to facilitate States in addressing their fiscal problems (Box 2). The Reserve Bank provides a forum for State Governments for discussing various relevant issues through its

**Box 1**
**Debt Swap Scheme**

The Union Budget for 2003-04 announced a debt swap scheme that would enable States to prepay their high cost debt to the Centre through additional market borrowings and proceeds from Small Savings. Under the scheme, mutually agreed between the Centre and the State Governments, States are allowed to retire loans amounting to Rs.1,00,000 crore from the Centre bearing coupons in excess of 13 per cent. These loans would be swapped with additional market borrowings of the States and their net small savings proceeds (upto specified limits) at the prevailing interest rates, over a period of three years ending in 2004-05. Accordingly, during 2002-03, the States prepaid Central loans of Rs.13,766 crore under the scheme, of which Rs.10,000 crore were from market borrowings (allocated under the debt swap scheme in addition to the normal borrowing allocations) and the rest through small savings proceeds. As per the Interim Budget 2004-05 of the Union Government, the total debt swap was placed at Rs.46,602 crore in the revised estimates for 2003-04. As per the Reserve Bank records additional market borrowings under the debt swap scheme amounted to Rs.26,623 crore during 2003-04. Thus, so far, of the total debt swapped amounting to Rs.60,368 crore, around 61 per cent have been financed through additional market borrowings at interest rates below 6.5 per cent, *i.e.,* at less than half of the earlier cost. The remaining loans have been financed through issue of special securities to the National Small Savings Fund (NSSF) at interest rates fixed at 9.5 per cent, *i.e.,* at less than three-fourth of the earlier cost. Clearly, therefore, this scheme has helped States to reduce their interest burden.

The debt swap scheme, *ipso facto,* is debt neutral. It only results in a change in the level and composition of capital expenditure and receipts. On the expenditure side, repayment of loans to the Centre shows an increase while on the receipts side, gross market borrowings would be higher. As far as the financing of the States' fiscal deficit is concerned, while (net) market borrowings would increase, (net) loans from the Centre would show a decline. Over a period of time, savings by way of lower interest payments are expected to reduce the pressure on the States' revenue account and thereby on their overall borrowing requirement.

It may be added that the data on transactions under the debt swap scheme are not separately provided in the budget documents of the State Governments. Data on the *actual* transactions in respect of market borrowings under the scheme are, however, available as per the Reserve Bank records, which may differ from the *estimates* provided in the budget documents. Illustratively, total repayments of loans to the Centre are budgeted at Rs.25,909 crore in 2003-04 whereas, actual repayments of loans to the Centre through additional market borrowings under the debt swap scheme, as per the Reserve Bank records, are placed at Rs.26,623 crore. Taking into account other repayments, the actual total repayment of loans to the Centre during 2003-04 is likely to be much higher than the budget estimates. As a corollary, it may not be possible to work out the precise impact of transactions under the debt swap scheme on the capital account of the State Governments.

**Box 2**
**Reserve Bank's Recent Initiatives on State Finances**

| Reserve Bank's Initiatives | Status of Initiatives |
|---|---|
| Setting up a Consolidated Sinking Fund (CSF). | The CSF 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. Subsequently, Reserve Bank allowed two States to raise up to 50 per cent of their gross borrowings through this route. | The States that have gone in for borrowing through auction/ tap issue so far, include Punjab, Andhra Pradesh, Arunachal Pradesh, Chhattisgarh, Jammu and Kashmir, Tamil Nadu, Karnataka, Madhya Pradesh, Maharashtra, West Bengal, Kerala, Gujarat and Uttar Pradesh. 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. As discussed in the Conference of State Finance Secretaries held on June 7, 2002, Maharashtra and Kerala have been permitted, on a case by case basis, to raise up to 50 per cent their allocation through auction in the fiscal year 2002-03. Presently States have been permitted to raise upto 50 per cent of their allocation through auction |
| 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 WMA / Overdraft Scheme has been modified on the basis of Committee's recommendations as also consultations of States have been made effective from March 3, 2003. The Report of the Committee has been published and available on the Reserve Bank's website. |
| 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. |
| Constitution of Group to Study the Pension Liabilities of the State Governments. | In February 2003, the Reserve Bank constituted a Group to Study Pension Liabilities of the State Governments (Chairman: Shri B.K. Bhattacharya). The Group submitted its Report in October 2003. The Report has been published in February 2004. |
| Committee to Frame a Model Fiscal Responsibility Legislation at State Level. | Following the decision taken in the Conference of State Finance Secretaries held in August 2003, the Reserve Bank constituted a Committee to Frame A Model Fiscal Responsibility Legislation at State Level. The Report is being finalised. |

biannual Conferences of State Finance Secretaries. The Reserve Bank provides Ways and Means Advances (WMA) and Overdrafts (OD) facilities to the State Governments to help them tide over the problem of temporary mismatches in their receipts and payments. The Reserve Bank revised the scheme of WMA for the States, effective March 3, 2003 based on the recommendations of the Ramachandran Committee (2002) and after due consultations with the State Governments. As per the revised scheme of WMA effective from March 3, 2003, the total normal WMA limit for State Governments have been enhanced by 18.8 per cent to Rs.7,170 crore from the earlier limit of Rs.6,035 crore[3].

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 Reserve Bank permitted these States to raise higher amounts (up to 50 per cent of the total market borrowings) through auction route during 2002-03. Under the auction route, States will have the flexibility to decide on the method, timing and maturity of the borrowings. This will enable the better managed States to gain from lower borrowing costs *vis-à-vis* the combined borrowing programme, thus providing more incentives for sound fiscal management.

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, the participating State has to contribute 1 to 3 per cent of its outstanding market borrowings each year. So far, eleven States have set up the CSF.

As a part of prudent fiscal management, the Reserve Bank has continued efforts to sensitise the State Governments towards the problems posed by increasing volumes of guarantees. The Reserve Bank constituted a *Technical Committee on State Government Guarantees* and subsequently, a *Group to Assess the Fiscal Risk of State Government Guarantees,* which submitted their reports in February 1999 and July 2002, respectively. Both the reports are also available on the official website of the Reserve Bank (www.rbi.org.in).

The issue of growing pension liabilities of the States has also assumed crucial importance in view of their unfunded and non-contributory nature, thus causing an increasing burden on the State exchequer in recent years. Illustratively, pension payments now pre-empt about 10 per cent of revenue receipts as compared to less than three per cent during the early 1980s. Recognising the fiscal implications of increasing pension liabilities of the State Governments, in the Eleventh Conference of State Finance Secretaries in January 2003, it was decided to undertake a comprehensive examination of all the issues relating to States' pension liabilities. Accordingly, in February 2003, the Reserve Bank constituted a *Group to Study Pension Liabilities of the State Governments* (Chairman: Shri B.K. Bhattacharya) (Annex 4). The Group submitted its Report in October 2003, which was presented to the Thirteenth Conference of the State Finance Secretaries (The Report is available on the Reserve Bank's website). The Report recommends, *inter-alia,* alternative pension models for new employees based on a mix of defined contribution and defined benefit schemes as also funding of pension obligations.

Recognising the need for rule-based fiscal reform process, the Centre and several States have enacted fiscal responsibility legislations. In the Twelfth Conference of State Finance Secretaries held in August 2003, it was felt that in view of the deteriorating fiscal position of States, the

3. The total normal WMA limit was further enhanced to Rs.8,140 crore with effect from April 1, 2004.

process of providing statutory backing to the reform process could be adopted by other States as well. To facilitate this, the Reserve Bank constituted a *Committee of State Finance Secretaries to Frame A Model Fiscal Responsibility Legislation at the State Level.* The Committee's Report is being finalised.

**(iv) Twelfth Finance Commission**

The Twelfth Finance Commission which was constituted on November 1, 2002 is expected to make recommendations regarding distribution of net tax proceeds between the Union and the States, and to review the principles governing grants-in-aid to the States as also review the fiscal reform facility introduced by the Central Government (Box 3).

**Box 3**
**Twelfth Finance Commission**

In pursuance of the provisions of Article 280 of the Constitution of India, and of the Finance Commission (Miscellaneous Provisions) Act, 1951, the Twelfth Finance Commission was constituted in November 2002 with Dr. C. Rangarajan as the Chairman. As per the terms of reference, the Commission shall make recommendations on the following:

(i) the distribution of the net proceeds of taxes between the Union and the States, and the allocation between the States of the respective shares of such proceeds;

(ii) principles governing grants-in-aid of the revenues of the States out of the Consolidated Fund of India and grants under Article 275 of the Constitution; and

(iii) measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities on the basis of the recommendations made by the Finance Commission of the State.

The Commission shall review the finances of the Central and State Governments and suggest a plan for restructuring of the public finances, restoring budgetary balance, achieving macro economic stability and debt reduction along with equitable growth. While making recommendations the Commission shall have regard, among other considerations, to taxation efforts of the Central and State Governments as against the targets; potential for additional resources mobilisation; monitoring expenditure on the non-salary component of maintenance and upkeep of capital assets; adjustment of user charges and relinquishing of non-priority enterprises through privatisation or disinvestment, *etc*. In addition, the Commission shall review the fiscal reforms facility introduced by the Central Government on the basis of the recommendations of the Eleventh Finance Commission and suggest measures for effective achievement of its objective. The Commission may, after making an assessment of the debt position of the States as on the March 31, 2004, suggest such corrective measures, as are deemed necessary, consistent with debt sustainability and macro-economic stability. The present arrangements for financing of Disaster Management through the National Calamity Contingency Fund and the Calamity Relief Fund would also be reviewed by the Commission.

The Commission shall submit its Report by July 31, 2004 covering a period of five years commencing April 1, 2005.

## Section III :
## Analysis of State Budgets

### (i) State Finances: 2001-02 (Accounts)

The year 2000-01 stands out as the first year when the steady deterioration of the State finances witnessed in the second half of 1990s was arrested. This process of improvement was strengthened, at least in part, in 2001-02. During 2001-02, the GFD of the States was higher by 7.2 per cent over the previous year. However, as a proportion of GDP, GFD at 4.2 per cent was an improvement, *albeit*, a marginal one over the previous year. The increase in RD was higher at 10.5 per cent in 2001-02 and it was placed marginally higher in terms of GDP at 2.6 per cent. The increase in GFD emanated mainly from RD, accounting for 87 per cent of the increase. A noteworthy development of 2001-02 was the decline in PD, both in absolute terms as well as in terms of GDP (Table I & Graph 1).

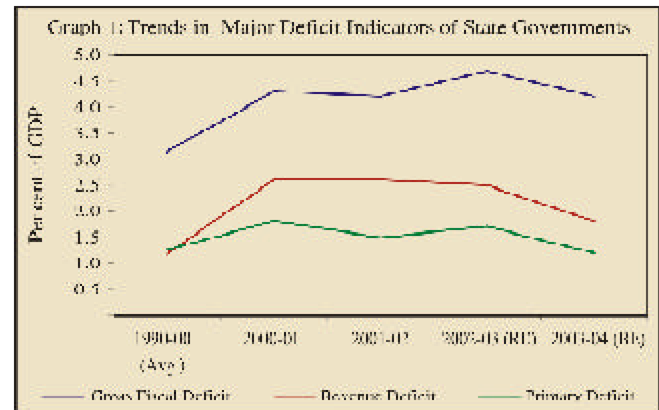
**Table I :**
**Major Deficit Indicators of State Governments**

(Rs. crore)

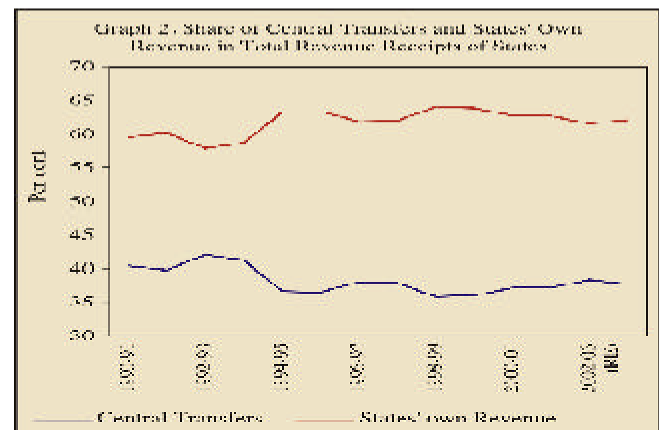
| | 2003-04 (BE) | 2002-03 (RE) | 2002-03 (BE) | 2001-02 | 2000-01 |
|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 |
| Gross Fiscal Deficit | 1,16,175 (4.2) | 1,16,636 (4.7) | 1,02,700 (4.0) | 95,994 (4.2) | 89,532 (4.3) |
| Revenue Deficit | 48,326 (1.8) | 61,240 (2.5) | 48,079 (1.9) | 59,188 (2.6) | 53,569 (2.6) |
| Primary Deficit | 33,251 (1.2) | 42,445 (1.7) | 30,414 (1.2) | 33,488 (1.5) | 37,830 (1.8) |

RE: Revised Estimates BE: Budget Estimates
**Note**: Figures in brackets are per cent of GDP.

During 2001-02, the revenue receipts of States were higher by 7.4 per cent over the previous year, facilitated mainly by States' own tax receipts and, to an extent, grants from the Centre. The States' own revenue receipts (States' own tax and non tax revenue receipts) accounted for more than sixty per cent of the increase in revenue receipts, while the balance was on account of current devolution and transfers from the Centre. Under States' non-tax revenues, receipts on account of dividends and profits and interest showed decline in 2001-02 from the previous year.



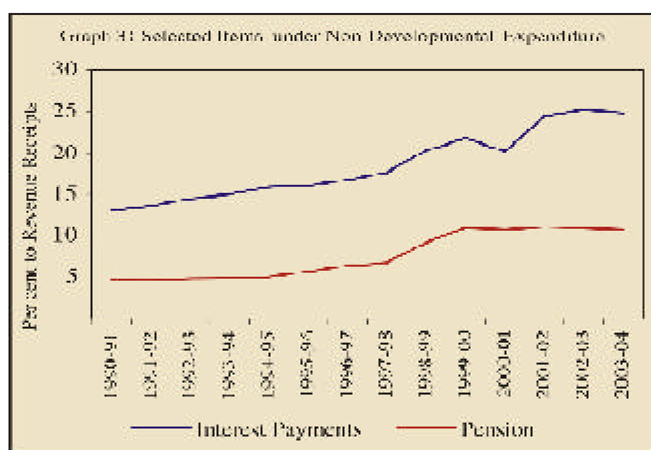

Total current transfers comprising shareable taxes and grants from the Centre accounted for around 37 per cent of total revenue receipts in 2001-02, almost the same as in the previous year. (Graph 2).




The capital receipts of States in 2001-02 showed an increase of 5.9 per cent over the previous year, led mainly by market borrowings, loans from the Centre and loans from banks and financial institutions. Under non-debt receipts, recovery of loans and advances showed an increase of 12.6 per cent in 2001-02 over the previous year. In financing the GFD, the small savings receipts (special securities issued to NSSF)[4] and market borrowings accounted for a significant share (Table 5).

4. With the change in the accounting system with effect from 1999-2000, States' share in small savings collections which was included earlier under Loans from the Centre is shown separately as special securities issued to the NSSF.

The aggregate expenditure of the States in 2001-02 was higher by 8.7 per cent over the previous year. Of this increase, revenue expenditure accounted for 78 per cent, while the balance was on account of capital expenditure. The disaggregation of expenditure into developmental and non-developmental components reveals that the share of non-developmental expenditure in the total increased from 34.2 per cent in 2000-01 to 36.6 per cent in 2001-02. Within non-developmental expenditure, interest and pension payments taken together pre-empted more than one-third of revenue receipts in 2001-02 (Graph 3).




**Revised Estimates: 2002-03**

The year 2002-03 marked a reversal of the trend in containing fiscal deficit as witnessed in the previous two years. Indeed, the gains in containing fiscal deficit in the previous two years dissipated in 2002-03. It is noteworthy, however, that the revenue deficit during this period was contained and in fact brought down, *albeit,* modestly. The outturn in the revised estimates for 2002-03 showed that the major deficit indicators, *viz.,* GFD and PD were higher than the level in the previous year (Table I). The GFD and PD increased sharply by 21.5 per cent and 26.7 per cent, respectively. In terms of GDP, GFD and PD were placed higher at 4.7 per cent and 1.7 per cent, respectively, in 2002-03. RD as a proportion to GDP was, however, placed marginally lower at 2.5 per cent than in the previous year. It is important to note that capital outlay and net lending accounted for about 45 per cent each of the total increase in GFD, while the RD accounted for only 10 per cent of the increase.

In absolute terms, the increase in RD in 2002-03 was less pronounced than that in the GFD and PD. This was mainly due to higher growth in revenue receipts (15.0 per cent) as compared with the corresponding increase in revenue expenditure (12.8 per cent) in 2002-03. Revenue receipts formed 11.9 per cent of GDP in 2002-03 as compared with 11.2 per cent in the previous year. A major proportion of the increase in revenue receipts (54 per cent) was contributed by States' own revenue receipts, particularly States' own taxes. States' own taxes were placed at 5.9 per cent of GDP in 2002-03 as compared with 5.6 per cent in the previous year. Within current transfers from the Centre, the increase of 28.9 per cent in Central grants was significant. On the other hand, the States' own non-tax revenue showed an increase of 11.4 per cent in the revised estimates of 2002-03 over the previous year. The rise in non-tax revenue was mainly contributed by State lotteries, dividends and profits and economic services (Table 3).

The increase in capital receipts of States in 2002-03 was mainly on account of market borrowings, special securities issued to the National Small Savings Fund (NSSF) and Loans from the Centre (Table 5).

The gross devolution and transfers from the Centre in 2002-03 were higher by 19.3 per cent over the previous year. The increase was mainly due to grants from the Centre (Table 18). Gross transfers from the Centre accounted for 5.8 per cent of GDP in 2002-03 as compared with 5.3 per cent in the previous year.

The aggregate expenditure in 2002-03 showed a substantial rise of 17.3 per cent over the previous year. Revenue expenditure contributed

more than 61.8 per cent of the total increase in aggregate expenditure while the rest was on account of capital expenditure. Revenue expenditure formed 14.4 per cent of GDP in 2002-03 as compared with 13.8 per cent in the previous year. Component-wise details of aggregate expenditure of States, however, reveal that in 2002-03, the increase in capital expenditure was more than the increase in revenue expenditure. While revenue expenditure increased by 12.8 per cent, the capital expenditure was higher by as much as 39.9 per cent. The increase in capital expenditure during 2002-03 was mainly on account of capital outlay and repayment of loans to the Centre - the latter reflecting, *inter-alia,* transactions under the debt-swap scheme (Box 1). The increase in capital outlay was 28.8 per cent in 2002-03, which was significantly higher than the average increase of around 12 per cent during the previous three years. Repayment of loans to the Centre increased by as much as 61.5 per cent in 2002-03 as compared with an annual average increase of 14.5 per cent during the previous three years. Of the total increase in capital expenditure in 2002-03, capital outlay and repayment of loans to the Centre accounted for 37.3 per cent and 33.7 per cent, respectively. It is important to note that even after excluding repayments of loans to the Centre, capital expenditure showed a significant increase of 33.9 per cent in 2002-03 as compared with only 8.1 per cent in the previous year.

Reflecting the sharp rise in capital expenditure, its share in the aggregate expenditure rose from 16.6 per cent in 2001-02 to 19.7 per cent in 2002-03. The share of capital expenditure net of repayments of loans to the Centre, however, rose moderately from 12.9 per cent of aggregate expenditure in 2001-02 to 14.8 per cent in 2002-03.

The disaggregation of total expenditure into developmental and non-developmental components showed that non-developmental expenditure recorded a higher growth than developmental expenditure in 2002-03. Consequently, the share of developmental component in total expenditure declined from 57.4 per cent in 2001-02 to 56.0 per cent in 2002-03 implying a further deteriora-tion in the quality of expenditure (Table II).

**Table II : Expenditure Pattern of State Governments**

(Rs. Crore)

| | 2003-04 (BE) | 2002-03 (RE) | 2002-03 (BE) | 2001-02 |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| 1 Developmental Expenditure | 2,68,888 (55.1) | 2,47,827 (56.0) | 2,46,122 (57.1) | 2,16,696 (57.4) |
| 2 Non-Developmental Expenditure | 1,77,819 (36.4) | 1,60,683 (36.3) | 1,60,404 (37.2) | 1,38,080 (36.6) |
| 3 Others* | 41,651 (8.5) | 34,130 (7.7) | 24,392 (5.7) | 22,534 (6.0) |
| **Total Expenditure (1+2+3)** | **4,88,360 (100.0)** | **4,42,641 (100.0)** | **4,30,919 (100.0)** | **3,77,311 (100.0)** |

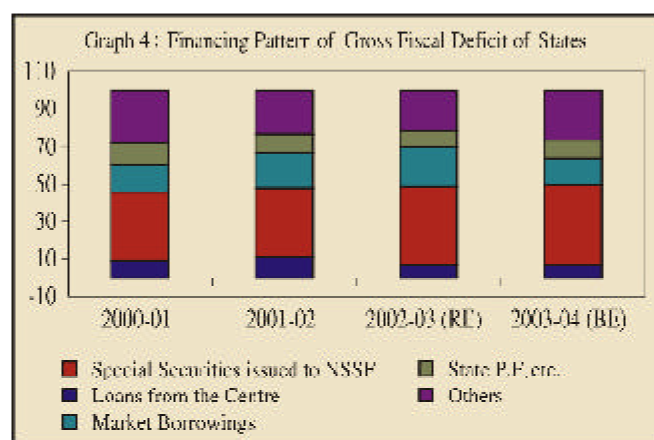
* Includes expenditure towards compensation and assignments to local bodies, grants-in-aid contribution, reserve with finance department, discharge of internal debt and repayment of loans to the Centre.

**Note:** : Figures in brackets are per cent of total expenditure

The decomposition of gross fiscal deficit reveals that the revenue deficit continued to account for a significant proportion of GFD, even though the increase in revenue deficit during 2002-03 was low. The share of revenue deficit in the GFD declined to 52.5 per cent in 2002-03 from 61.7 per cent in the previous year. The share of capital outlay and net lending, on the other hand, increased from 33.6 per cent and 4.7 per cent in 2001-02 to 35.6 per cent and 11.9 per cent, respectively, in the revised estimates for 2002-03 (Table 7).

The financing pattern of the GFD of States indicates that the share of small savings receipts and market borrowings increased during 2002-03,

while those of loans from the Centre and other sources of financing (including loans from Financial Institutions (FIs), Provident Funds, Reserve Funds, deposits and advances) showed a decline. The increase in the share of market borrowings reflect additional market borrowings allocated under the debt swap scheme (Graph 4 and Table 8).




***Revised Estimates vis-a-vis Budget Estimates: 2002-03***

A comparative analysis of the revised estimates *vis-à-vis* budget estimates for 2002-03 indicates a significant deviation in the major deficit indicators of the State finances. The GFD of States in the revised estimates was higher than the budget estimates by about 14 per cent.

The revenue receipts of States in the revised estimates for 2002-03 experienced a shortfall of the order of 4.3 per cent *vis-à-vis* the budget estimates due to slippage in the States' share in Central taxes (of 8.4 per cent), States' non-tax receipts (of 4.9 per cent) and States' taxes (of 4.9 per cent). On the contrary, grants from the Centre were higher than the budget estimates.

The deviation in the total expenditure in revised estimates from the budget estimates was on account of higher capital expenditure (15.4 per cent), mainly due to repayment of loans to the Centre including repayments under the debt swap scheme. The capital expenditure net of repayment of loans to the Centre, however, showed an increase of only 3.6 per cent. On the other hand, capital outlay in the revised estimates for 2002-03 fell short of budget estimates (Table 6).

The deviations between accounts and the budget estimates in the recent years are presented in Table III. It may be noted that the deviation between accounts and the budget estimates in respect of revenue receipts have invariably been larger than those in respect of revenue expenditure. Within revenue receipts, while States' own revenue receipts accounted for 55 per cent of the shortfall in 2001-02, current transfers from the Centre accounted for the balance. Under States' own revenue receipts, Sales Tax alone accounted for 35 per cent of the shortfall in total revenue receipts.

**Table III : Deviation of the Accounts from the Budget Estimates of State Governments**

(Per cent)

| Items | 1998-99 | 1999-2000 | 2000-01 | 2001-02 |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| **Revenue Receipts** | **-13.1** | **-5.9** | **-2.8** | **-10.3** |
| *of which,* | | | | |
| (i) States' own Revenue | -11.7 | -5.8 | -4.9 | -9.3 |
| (ii) Current Transfers from Centre | -15.6 | -6.1 | 0.9 | -12.0 |
| **Revenue Expenditure** | **-4.1** | **0.1** | **0.3** | **-5.4** |
| **Capital Receipts** | **26.5** | **17.1** | **9.8** | **9.6** |
| **Capital Expenditure** | **2.0** | **4.9** | **-7.6** | **-9.0** |

**Source:** Budget documents of States.

### (iii) Budget Estimates: 2003-04

The States' budgets for 2003-04 envisage continued efforts towards fiscal consolidation through augmentation of revenue and containment of expenditure. Reflecting this, the key deficit indicators show improvement both in absolute terms and in terms of GDP. The budgeted decline of 21.1 per cent in RD translates to a lower

RD-GDP ratio of 1.8 per cent relative to that of 2.5 per cent in 2002-03. The improvement in revenue account will enable a reduction in GFD and PD.

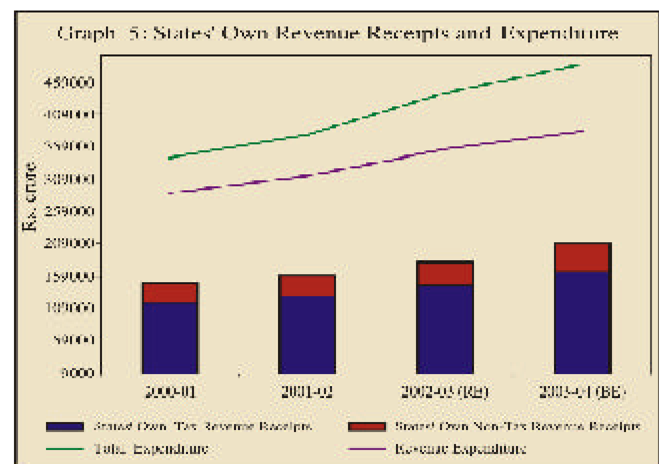
### (A) Pattern of Receipts

Aggregate receipts comprising revenue and capital account of States are budgeted to be higher by 10 per cent over the previous year. Revenue receipts would account for 92 per cent of the increase in aggregate receipts, while the balance would emanate from capital receipts. Revenue receipts would account for 12.2 per cent of GDP in 2003-04 as compared with 11.9 per cent in the previous year. The share of revenue receipts in the aggregate receipts is budgeted to increase from 67 per cent in 2002-03 to 69 per cent in 2003-04. The share of capital receipts in aggregate receipts is estimated to decline commensurately. These are discussed in detail below.

#### *Revenue Receipts*

Revenue receipts of the States in 2003-04 are budgeted to show an increase of 13.7 per cent as compared with 15.0 per cent in the previous year. The budget estimates of revenue receipts for 2003-04 are inclusive of additional resource mobilisation proposed through tax revenue measures (Rs. 2,404 crore) and non-tax revenue measures (Rs.170 crore). Out of the total increase budgeted in revenue receipts, States' own revenue receipts (States' own tax and non tax) would contribute 66.5 per cent, while the rest would be accounted for by States' share in Central taxes and grants from the Centre. Total tax receipts comprising States' own taxes and States' share in Central taxes at Rs.2,29,313 crore would be higher by 13.2 per cent than the revised estimates for 2002-03. At this level, tax receipts would account for about 69 per cent of total revenue receipts, while non-tax receipts would account for the rest. States' own taxes would form 6.1 per cent of GDP in 2003-04 as compared with 5.9 per cent in the previous year.

Under non-tax receipts, the growth rate in Central grants is budgeted to decline while States' own non-tax receipts would be higher in 2003-04 over the revised estimates for 2002-03. Consequently, the share of States' own revenue receipts in financing the total expenditure of States is expected to be higher in 2003-04 than the revised estimates (Graph 5). This increasing reliance on States' own sources for revenue generation augurs well for fiscal consolidation.



Graph 5: States' Own Revenue Receipts and Expenditure

#### *Capital Receipts*

The capital receipts of States are budgeted to increase by 2.4 per cent in 2003-04 as compared with the 21.1 per cent growth in 2002-03. The deceleration in capital receipts in 2003-04 mainly reflects a reduction in market borrowings and subdued growth in special securities issued to the NSSF, following an upsurge in their respective levels in the previous year. Recovery of loans is also budgeted to decline further in 2003-04 on top of a substantial reduction in 2002-03 (Table 5).

#### *Transfers of Resources from the Centre*

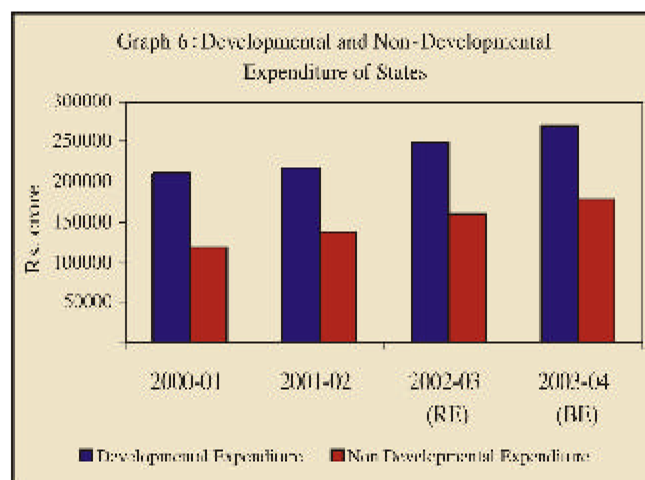
The gross transfers from the Centre in the form of States' share in Central taxes, grants and loans from the Centre (excluding States' share in small savings collections) are budgeted higher at

Rs.1,60,111 crore in 2003-04, an increase of 11.9 per cent over the revised estimates for 2002-03. This growth in Central transfers is led by the growth in Central grants (Table 18). Relative to GDP, however, gross transfers would remain at the same level (5.8 per cent) in 2003-04 as in the previous year.

The current transfers from Centre to States are budgeted to account for about 79 per cent of the total transfers, which is roughly about the same as in the previous year.

### (B) Pattern of Expenditure

The growth rate in aggregate expenditure is budgeted to decline from 17.3 per cent in 2002-03 to 10.3 per cent in 2003-04. Revenue expenditure would account for nearly 60 per cent of the total increase in aggregate expenditure while the balance would be on account of capital disbursements. Revenue expenditure would account for 13.9 per cent of GDP in 2003-04 as compared with 14.4 per cent in 2002-03. The share of revenue expenditure in aggregate disbursements would decline to 78.3 per cent in 2003-04 from 80.3 per cent in the previous year, while the share of capital disbursements would show a contemporaneous increase. The deceleration in revenue expenditure is primarily due to slowdown in interest payments and lower provision for 'Energy'. On the other hand, the deceleration in capital expenditure is mainly due to a lower order of increase in repayment of loans to the Centre and an absolute decline in loans and advances extended by the State Governments. Furthermore, the decomposition of total expenditure into developmental and non-developmental components shows that the share of developmental expenditure in total expenditure is expected to decline further from 56.0 per cent in 2002-03 to 55.1 per cent in 2003-04 (Graph 6).




#### *Revenue Expenditure*

Revenue expenditure in 2003-04 is budgeted to rise by 7.7 per cent as against 12.8 per cent in 2002-03. The deceleration in revenue expenditure in the budget estimates for 2003-04 is reflected in most of the major expenditure heads. Non-developmental items would, however, account for the major portion (62.0 per cent) of the increase in revenue expenditure in 2003-04. Within the non-developmental component, the growth in interest payments is budgeted to decline from 18.7 per cent in 2002-03 to 11.8 per cent in 2003-04. On the other hand, within the developmental component, the provisions for 'Energy' show a substantial decline of 15.4 per cent in the budget estimates for 2003-04 as compared to an increase of 6.3 per cent in the previous year (Table 4). Provisions for 'Rural Development' are budgeted to increase by 29.6 per cent in 2003-04 on top of a rise of 22.7 per cent in the previous year. The expenditure on 'Education' is also budgeted to increase by 7.2 per cent, slightly lower than that of 8.0 per cent in 2002-03.

#### *Capital Expenditure*

In the budget estimates for 2003-04, capital expenditure is budgeted to rise by 21.0 per cent as against 39.9 per cent in the previous year. The major component *i.e.,* the capital outlay is

budgeted to increase by 34.0 per cent in 2003-04 higher than 28.8 per cent in 2002-03. The rise in capital outlay in 2003-04 is mainly on account of the expenditures towards education, sports, art and culture (35.3 per cent), rural developmental (73.4 per cent) and food storage and warehousing (16.2 per cent). The other components such as discharge of internal debt and repayment of loans to the Centre are budgeted to increase by 52.7 per cent and 17.2 per cent as against the growth of 36.2 per cent and 61.5 per cent, respectively in 2002-03[5]. The loans and advances extended by States, however, are estimated to decline by 14.5 per cent in 2003-04 as against the growth rate of 46.4 per cent in 2002-03.

**(C) Financing Pattern of Gross Fiscal Deficit**

The financing pattern of GFD indicates that the small savings receipts (Special securities issued to NSSF) would continue to contribute a major share in 2003-04. As per the budget estimates for 2003-04, the share of the small savings receipts, loans from banks and financial institutions and State provident funds in financing the GFD would be higher. On the other hand, the share of market borrowings and loans from the Centre in financing the States' GFD is budgeted to decline in 2003-04 from the previous year (Table 8).

**(iv) State-wise Analysis**

State-wise data are presented in Statements 1 to 24 and Appendices I to IV. An analysis of major fiscal indicators as set out in Statement 1 reveals that there are considerable variations across the States. The non-special category States accounted for around 90 per cent of the aggregate expenditure and special category States accounted for the rest. The proportion of RD in GFD is budgeted to decline further in 2003-04, although it would continue to remain high. Among the non-special category States, this ratio is budgeted in the range of 12 - 81 per cent. This ratio moved in the range of 15 - 78 per cent in 2002-03 and 43 - 103 per cent in 2001-02. In the budget estimates for 2003-04, the ratio of revenue deficit to GFD shows a decline in most of the non-special category States with the notable exceptions of Kerala and Orissa. Secondly, the preemption of revenue receipts by non-developmental revenue expenditure is also budgeted to decline from 54 per cent in 2002-03 to 52.8 per cent in 2003-04 in respect of non-special category States and from 48.7 per cent to 46.5 per cent, respectively, in the case of special category States. In the case of non-special category States, this ratio varied between 31 - 84 per cent in 2003-04, broadly the same as in 2002-03. Thirdly, the ratio of gross Central transfers to aggregate expenditure is budgeted to show a marginal increase in respect of non-special category States as against a decline in the case of special category States in 2003-04. In respect of non-special category States, this ratio varies in the range of 9.8 - 57.9 per cent, while in case of special category States it is placed in the range of 33.4 - 83.4 per cent in 2003-04.

**(A) Major Deficit Indicators**

State-wise analysis reveals that in 2003-04, States such as Uttar Pradesh, Orissa, Kerala, Chhattisgarh and Rajasthan have budgeted substantial increase in their GFD over the previous year (Statement 4).

The State-wise GFD as ratios of their respective NSDP are set out in Table IV. It may be observed that the inter-State variation in the GFD-NSDP ratio, as measured by the coefficient of variation declined substantially in 2001-02.

5. These relate to data provided in the budget documents of the State Governments. As explained in Box 1, if the actual data on repayments of loans to the Centre through additional market borrowings under the debt swap scheme, according to Reserve Bank records, are taken into account, the aggregate capital expenditure during 2003-04 is likely to be higher than the budget estimates.

**Table IV : Gross Fiscal Deficit as a ratio to NSDP: Major States**

(Per cent)

| States | 1997-98 | 1998-99 | 1999-2000 | 2000-01 | 2001-02 |
|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 |
| 1. Andhra Pradesh | 2.8 | 5.5 | 4.4 | 5.8 | 5.0 |
| 2. Bihar | 3.2 | 6.9 | 9.5 | 11.7 | 8.7 |
| 3. Goa | 3.0 | 5.2 | 5.9 | 6.4 | 6.1 |
| 4. Gujarat | 4.1 | 6.3 | 7.5 | 8.7 | 6.2 |
| 5. Haryana | 3.3 | 5.8 | 5.0 | 4.7 | 5.2 |
| 6. Karnataka | 2.5 | 4.0 | 5.0 | 4.5 | 6.0 |
| 7. Kerala | 5.4 | 5.9 | 8.0 | 6.1 | 4.7 |
| 8. Madhya Pradesh | 3.4 | 6.7 | 5.7 | 4.2 | 5.1 |
| 9. Maharashtra | 3.8 | 3.9 | 5.4 | 4.2 | 4.5 |
| 10. Orissa | 6.4 | 9.3 | 10.9 | 9.8 | 10.5 |
| 11. Punjab | 5.7 | 7.6 | 5.9 | 6.7 | 7.9 |
| 12. Rajasthan | 4.5 | 7.9 | 7.7 | 6.1 | 7.3 |
| 13. Tamil Nadu | 2.3 | 4.5 | 4.8 | 4.0 | 3.6 |
| 14. Uttar Pradesh | 6.3 | 8.7 | 7.6 | 6.7 | 6.0 |
| 15. West Bengal | 4.5 | 6.7 | 10.0 | 8.5 | 8.2 |
| **Coefficient of Variation** | **33.1** | **25.6** | **34.7** | **34.4** | **29.3** |

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

2. NSDP Data are provisional and available up to 2001-02.

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

Inter-State variations are also reflected in the revenue account of the individual States (Statement 2). The revenue deficit accounted for 61.7 per cent of the consolidated GFD of States in 2001-02 and 52.5 per cent in 2002-03. There were, however, wide variations across the States. State-wise revenue deficit - GFD ratios are presented in the Table V.

**Table V : State-wise Share of Revenue Deficit in Gross Fiscal Deficit**

(Per cent)

| | 2001-02 | 2002-03 (RE) | Variations (Col. 3 over 2) |
|---|---|---|---|
| 1 | 2 | 3 | 4 |
| **Non-Special Category States** | | | |
| Andhra Pradesh | 42.9 | 43.1 | 0.3 |
| Bihar | 58.4 | 50.0 | -8.4 |
| Chhattisgarh | 50.8 | 33.1 | -17.7 |
| Goa | 55.4 | 25.0 | -30.4 |
| Gujarat | 103.4 | 58.0 | -45.4 |
| Haryana | 38.5 | 49.3 | 10.8 |
| Jharkhand | -6.1 | 15.1 | 21.2 |
| Karnataka | 56.0 | 59.1 | 3.2 |
| Kerala | 79.7 | 66.7 | -13.0 |
| Madhya Pradesh | 86.8 | 33.1 | -53.7 |
| Maharashtra | 75.1 | 56.6 | -18.5 |
| Orissa | 71.4 | 45.9 | -25.5 |
| Punjab | 76.2 | 69.4 | -6.8 |
| Rajasthan | 66.0 | 62.6 | -3.4 |
| Tamil Nadu | 57.8 | 73.0 | 15.2 |
| Uttar Pradesh | 62.5 | 60.6 | -1.9 |
| West Bengal | 75.0 | 77.6 | 2.5 |
| NCT Delhi | -69.8 | -78.9 | -9.1 |
| **Special Category States** | | | |
| Arunachal Pradesh | -10.2 | -187.6 | -177.4 |
| Assam | 60.9 | 43.8 | -17.0 |
| Himachal Pradesh | 56.9 | 74.3 | 17.4 |
| Jammu and Kashmir | -98.3 | -52.4 | 45.9 |
| Manipur | 47.4 | 2.2 | -45.2 |
| Meghalaya | 15.2 | 10.8 | -4.4 |
| Mizoram | 61.7 | 13.4 | -48.3 |
| Nagaland | -12.3 | -25.0 | -12.7 |
| Sikkim | -213.9 | -447.2 | -233.3 |
| Tripura | -10.1 | 10.1 | 20.3 |
| Uttaranchal | 23.5 | 64.7 | 41.3 |

**Note:** (-) Indicates surplus.
**Source:** Budget Documents of State Governments.

## (B) Revenue and Expenditure Analysis: State-wise

Comparative position of the States by relative changes in revenue receipts and aggregate expenditure during 2003-04 *vis-à-vis* the previous year is presented in Table VI. It may be seen from the table that States like Bihar, Gujarat, Jammu and Kashmir, Karnataka, Nagaland, Rajasthan, Tamil Nadu, Tripura, Uttaranchal and NCT Delhi have witnessed lower growth in total expenditure and higher growth in revenue receipts in 2003-04 as compared with the previous year.

**Table VI: Frequency Table of States in terms of growth rate in Revenue Receipts and Total Expenditure (2003-04 (BE) over 2002-03 (RE))**

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

**Source** : Budget Documents of State Governments.

An analysis of the growth rate of total expenditure across States also reveals wide variations. The States which have shown substantial growth in their budgeted expenditure in 2003-04 over the previous years are Uttaranchal (35.2 per cent), Uttar Pradesh (31.6 per cent), Chhattisgarh (26.0 per cent), Assam (19.9 per cent) and Andhra Pradesh (16.0 per cent). On the revenue front, the States which have budgeted substantial growth in revenue receipts are Uttaranchal, Chhattisgarh, Andhra Pradesh and Uttar Pradesh (Statement 2).

### *States' Own Revenue Receipts*

The States' own revenue receipts comprising States' own tax and non-tax revenues reflects the States' budgetary flexibility in financing their expenditure

The share of States' own revenue receipts as a proportion of total expenditure has remained around 42 per cent in recent years. However, in financing the expenditure through their own resources, there are wide variations among the States. The State-wise position is presented in Table VII.

### *Revenue Expenditure*

During 2003-04, revenue expenditure is budgeted to record a lower growth of 7.7 per cent as against 12.8 per cent during 2002-03 (RE). Among the States, three States, namely, Assam, Chhattisgarh and Uttaranchal budgeted more than 20 per cent growth in revenue expenditure. Another 5 States recorded more than 10 per cent growth. Under revenue expenditure, pension payments and interest payments have shown substantial growth in recent years. Pension payments as a percentage of revenue receipts increased from below 6 per cent in 1995-96 to as high as about 11 per cent in 2001-02. The State-wise analysis indicates that in 2001-02, pension payments accounted more than 15 per cent of revenue receipts in case of 4 States (Kerala, Bihar, Tamil Nadu and West Bengal). In the case of five States, interest payments pre-empted more than one-fourth of the revenue receipts during 1996-2002 (Table VIII). During 2003-04 there were eight States in which interest payments is budgeted to account for more than 25 per cent of the total revenue receipts.

**Table VII: State-wise position of States Own Revenue Receipts**

| | As a Percentage of Revenue Expenditure | | | As a Percentage of Total Expenditure | | |
|---|---|---|---|---|---|---|
| | 2001-02 | 2002-03 (RE) | 2003-04 (BE) | 2001-02 | 2002-03 (RE) | 2003-04 (BE) |
| **Non-Special Category States** | | | | | | |
| 1. Andhra Pradesh | 62.6 | 63.2 | 63.0 | 49.8 | 49.4 | 48.9 |
| 2. Bihar | 22.3 | 22.0 | 27.6 | 18.9 | 17.4 | 21.4 |
| 3. Chhattisgarh | 55.3 | 50.3 | 49.1 | 48.3 | 42.0 | 39.5 |
| 4. Goa | 81.2 | 87.6 | 89.8 | 72.5 | 74.3 | 75.9 |
| 5. Gujarat | 57.3 | 56.4 | 61.0 | 50.7 | 45.3 | 49.3 |
| 6. Haryana | 76.7 | 75.8 | 77.9 | 61.9 | 63.9 | 64.8 |
| 7. Jharkhand | 50.6 | 41.8 | 50.3 | 38.3 | 33.0 | 37.4 |
| 8. Karnataka | 58.8 | 59.6 | 65.1 | 49.9 | 48.6 | 52.9 |
| 9. Kerala | 55.5 | 61.0 | 61.5 | 49.2 | 52.7 | 54.6 |
| 10. Madhya Pradesh | 43.9 | 47.3 | 53.1 | 37.2 | 37.0 | 41.2 |
| 11. Maharashtra | 67.8 | 68.4 | 76.6 | 61.1 | 57.6 | 66.3 |
| 12. Orissa | 32.0 | 35.4 | 32.6 | 26.2 | 27.4 | 26.6 |
| 13. Punjab | 61.2 | 63.8 | 68.5 | 49.6 | 52.5 | 54.0 |
| 14. Rajasthan | 45.0 | 46.2 | 47.4 | 37.8 | 36.3 | 37.0 |
| 15. Tamil Nadu | 67.6 | 60.4 | 66.8 | 58.7 | 52.6 | 55.9 |
| 16. Uttar Pradesh | 38.1 | 37.9 | 40.0 | 31.8 | 30.6 | 27.3 |
| 17. West Bengal | 31.1 | 33.3 | 39.5 | 25.9 | 27.5 | 30.0 |
| 18. NCT Delhi | 114.4 | 131.1 | 130.1 | 66.9 | 59.6 | 70.0 |
| **Average** | **56.7** | **57.9** | **61.1** | **46.4** | **44.9** | **47.4** |
| **Special Category States** | | | | | | |
| 1. Arunachal Pradesh | 10.2 | 15.3 | 14.3 | 7.6 | 10.4 | 10.3 |
| 2. Assam | 30.7 | 28.9 | 27.2 | 24.6 | 23.0 | 22.6 |
| 3. Himachal Pradesh | 24.3 | 21.0 | 21.6 | 19.6 | 18.0 | 17.2 |
| 4. Jammu and Kashmir | 18.9 | 20.4 | 22.9 | 14.4 | 15.0 | 17.2 |
| 5. Manipur | 6.0 | 8.0 | 11.7 | 3.8 | 5.1 | 7.8 |
| 6. Meghalaya | 19.9 | 18.8 | 19.9 | 16.5 | 14.3 | 15.2 |
| 7. Mizoram | 5.7 | 6.9 | 7.7 | 4.8 | 5.4 | 6.5 |
| 8. Nagaland | 6.9 | 7.2 | 9.0 | 5.0 | 5.1 | 6.5 |
| 9. Sikkim | 72.6 | 72.3 | 74.3 | 63.3 | 61.9 | 64.8 |
| 10. Tripura | 14.1 | 13.4 | 14.5 | 10.4 | 9.8 | 10.2 |
| 11. Uttaranchal | 37.3 | 32.7 | 29.0 | 32.0 | 24.1 | 21.7 |
| **Average** | **22.4** | **22.3** | **22.9** | **18.4** | **17.5** | **18.2** |
| **ALL STATES** | **50.9** | **51.0** | **54.3** | **42.5** | **40.9** | **42.6** |

**Source**: Derived from Budget Documents of States.

**Table VIII: Categorisation of States based on Interest Payments to Revenue Receipts Ratio (Average 1996-2002)***

| Range (Per cent) | States |
|---|---|
| Above 25 | Orissa, Rajasthan, Punjab, West Bengal, Uttar Pradesh, |
| 15-25 | Andhra Pradesh, Assam, Bihar, Chhattisgarh, Gujarat, Haryana, Himachal Pradesh, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu |
| 10-15 | Goa, Jammu and Kashmir, Jharkhand, Karnataka, Manipur, Mizoram, Nagaland, Tripura, Uttaranchal, NCT Delhi |
| Below 10 | Arunachal Pradesh, Meghalaya, Sikkim |

* Based on Accounts data.

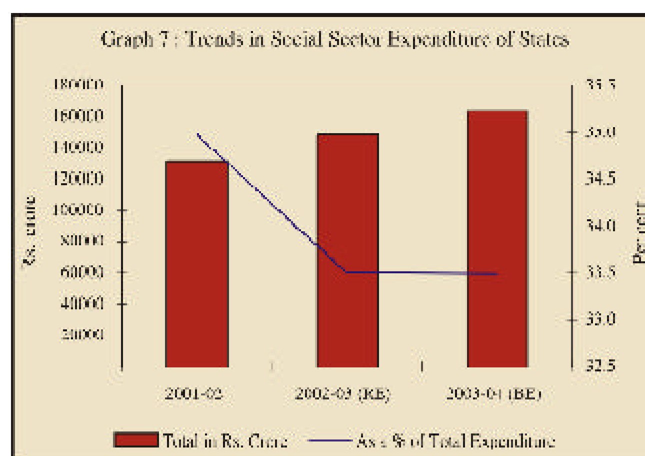
### *Capital Expenditure*

During 2003-04, capital expenditure of all the States together is budgeted to record a relatively higher growth of 21.0 per cent, on top of a growth of 39.9 per cent recorded in 2002-03 (RE)[6]. The average rate of growth during 2002-03 and 2003-04 was quite high for Uttar Pradesh and West Bengal, while Maharashtra, Orissa and Kerala showed a decline in capital expenditure. Capital expenditure of as many as seven States would record growth above 30.0 per cent in 2003-04.

### *Social Sector Expenditure*

Total social sector expenditure of States during 2002-03 recorded a growth of 12.6 per cent over the previous year. During 2003-04 (BE), social sector expenditure of States is budgeted to increase at a lower rate of 10.0 per cent over 2002-03. Though social sector expenditure of States has witnessed a rising trend over the last few years in absolute terms, as a percentage of total expenditure of States, it declined during 2002-03 (Graph 7).

Social sector expenditure of Haryana and West Bengal declined by 3.3 per cent and 1.1 per cent, respectively in 2002-03 from their respective levels in 2001-02. Other States that registered relatively low growth in social sector expenditure during 2002-03 were Gujarat (2.3 per cent), Karnataka (2.6 per cent). A number of States have budgeted a decline in social sector expenditure during 2003-04 (BE).




During 2002-03, the share of social sector expenditure in total expenditure was highest in Jharkhand (50.0 per cent) followed by Chhattisgarh (46.6 per cent), and Mizoram (40.9 per cent). Social sector expenditure as a percentage of total expenditure showed a rise in case of Assam, Chhattisgarh, Kerala, Madhya Pradesh and Sikkim, while in case of other States it has gone down in 2002-03 as compared to the previous year (Table IX).

6. See Box 1 and footnote 4.

## Table IX: State-wise Social Sector Expenditure

(Rs. Crore)

| States | | | | As a % of Total Expenditure | | |
|---|---|---|---|---|---|---|
| | 2001-02 | 2002-03 (RE) | 2003-04 (BE) | 2001-02 | 2002-03 (RE) | 2003-04 (BE) |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| **Non-Special Category States** | | | | | | |
| Andhra Pradesh | 10,876 | 11,652 | 14,338 | 35.0 | 33.4 | 35.4 |
| Bihar | 5,786 | 6,466 | 6,685 | 38.9 | 36.4 | 35.7 |
| Chhattisgarh | 2,435 | 3,532 | 4,601 | 43.3 | 46.6 | 48.2 |
| Goa | 543 | 721 | 759 | 23.1 | 25.0 | 25.4 |
| Gujarat | 9,029 | 9,235 | 11,141 | 35.2 | 31.8 | 37.4 |
| Haryana | 3,676 | 3,553 | 3,914 | 34.3 | 30.3 | 30.4 |
| Jharkhand | 3,729 | 4,904 | 4,194 | 47.0 | 50.0 | 44.2 |
| Karnataka | 7,642 | 7,837 | 8,700 | 34.8 | 31.3 | 32.2 |
| Kerala | 4,932 | 5,876 | 6,945 | 37.6 | 38.1 | 40.1 |
| Madhya Pradesh | 6,007 | 7,711 | 7,839 | 35.4 | 38.5 | 37.0 |
| Maharashtra | 15,452 | 17,147 | 17,608 | 36.4 | 34.6 | 35.6 |
| Orissa | 4,122 | 4,729 | 5,212 | 34.2 | 33.7 | 33.9 |
| Punjab | 3,401 | 3,913 | 4,477 | 21.7 | 20.9 | 21.2 |
| Rajasthan | 7,730 | 8,394 | 9,846 | 40.7 | 37.6 | 40.2 |
| Tamil nadu | 9,204 | 10,202 | 11,274 | 37.1 | 33.4 | 35.5 |
| Uttar Pradesh | 12,279 | 14,020 | 15,113 | 32.2 | 30.9 | 25.3 |
| West Bengal | 9,587 | 9,485 | 9,375 | 34.1 | 31.0 | 26.3 |
| NCT Delhi | 3,011 | 3,608 | 3,936 | 34.9 | 34.5 | 40.2 |
| **Special Category States** | | | | | | |
| Arunachal Pradesh | 449 | 510 | 412 | 32.5 | 31.2 | 28.0 |
| Assam | 3,035 | 4,151 | 5,797 | 35.5 | 37.1 | 43.3 |
| Himachal Pradesh | 1,912 | 1,979 | 2,197 | 33.7 | 30.2 | 30.0 |
| Jammu & Kashmir | 2,321 | 2,518 | 2,431 | 28.8 | 28.8 | 28.2 |
| Manipur | 550 | 771 | 627 | 26.0 | 31.3 | 27.3 |
| Meghalaya | 565 | 715 | 870 | 40.5 | 37.6 | 42.1 |
| Mizoram | 542 | 615 | 468 | 40.7 | 40.9 | 35.7 |
| Nagaland | 544 | 644 | 689 | 26.9 | 29.6 | 30.2 |
| Sikkim | 314 | 392 | 391 | 16.5 | 17.4 | 18.0 |
| Tripura | 968 | 1,071 | 1,046 | 39.3 | 38.8 | 35.0 |
| Uttaranchal | 1,320 | 1,912 | 2,638 | 40.0 | 34.0 | 34.8 |
| **All States** | **1,31,961** | **1,48,263** | **1,63,523** | **35.0** | **33.5** | **33.5** |

**Note :** Social sector expenditure includes social services, rural development and food storage and warehousing.

In 2003-04, social sector expenditure as a proportion of total expenditure is estimated to be highest for Chhattisgarh at 48.2 per cent, followed by Jharkhand (44.2 per cent), and Assam (43.3 per cent) (Table IX). The share of social sector expenditure in total expenditure of the States *viz.,* Arunachal Pradesh, Bihar, Himachal Pradesh, Jammu & Kashmir, Jharkhand, Madhya Pradesh, Manipur, Mizoram, Tripura, Uttar Pradesh, and West Bengal is budgeted to decline in 2003-04 compared to the previous year.

**Table X : Average Annual Rate of Growth in Debt during 2001-02 to 2003-04**

| Below 10% | Between 10 and 15% | Between 15 and 20% | 20% and Above |
|---|---|---|---|
| **Non Special Category States** | | | |
| — | Bihar, Kerala, Haryana, Punjab, | Andhra Pradesh, Goa, Karnataka, Madhya Pradesh Maharashtra, Orissa, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal | Gujarat, NCT-Delhi |
| **Special Category States** | | | |
| Arunachal Pradesh Mizoram, Sikkim | Assam, Jammu and Kashmir Manipur, Nagaland | Himachal Pradesh, Mizoram, Meghalaya | Tripura |

## Section IV : States' Debt, Market Borrowings and Guarantees

### (i) Debt Position

The large and increasing GFD of States has led to steady accumulation in the outstanding debt of State Governments in recent years. The outstanding debt of States rose by 17.3 per cent at end-March 2003 over the previous year. In terms of GDP, the debt stock of States constituted 27.9 per cent as at the end of March 2003, significantly higher than the level of 25.7 per cent in the previous year. The debt-GDP ratio of States is estimated to increase further to 28.8 per cent by the end of March 2004.

There are considerable variations in the rate of growth of outstanding debt of States. Table X reveals that for majority of the States, the average rate of growth of debt from 2001-02 to 2003-04 was between 10 and 20 per cent.

One important indicator of sustainability of debt is the debt-GDP ratio. Latest data on Net State Domestic Product (NSDP), at current prices, are available for the period 2001-02 (Quick Estimates). Statewise analysis reveals that in the case of three States, *viz.,* Karnataka, Maharashtra and Tamil Nadu, the debt-NSDP ratio was below 30 per cent. The ratio was between 30 to 40 per cent in case of seven States *viz.,* Andhra Pradesh, Goa, Gujarat, Haryana, Kerala, Madhya Pradesh and Meghalaya, while it was above 50 per cent for eight States - the highest (91 per cent) being for Sikkim (Table XI).

As a result of the rising debt level, the interest burden of States increased from 13 per cent of revenue receipts in 1990-91 to as much as 24.4 per cent in 2001-02. In order to reduce the interest burden of State Governments and keeping in view the prevailing soft interest rate scenario, a debt swap scheme was announced by the Government of India (Box 1).

In 2002-03, 25 States (excluding, Maharashtra, Sikkim and West Bengal) prepaid high cost debt from the Centre, partly out of small savings collections and partly through fresh market borrowings of Rs.10,000 crore conducted in two tranches in the months of February and March 2003. The scheme has been continued in

## Table XI : Debt-NSDP Ratio of States for 2001-02: Frequency Distribution

| Below 30% | Between 30 and 40% | Between 40 and 50% | Above 50% |
|---|---|---|---|
| **Non Special Category States** | | | |
| Karnataka, Maharashtra, Tamil Nadu | Andhra Pradesh, Goa, Gujarat, Haryana, Kerala, Madhya Pradesh (includes Chhattisgarh) | Rajasthan, Uttar Pradesh (includes Uttaranchal), West Bengal | Bihar (includes Jharkhand)* Orissa, Punjab |
| **Special Category States** | | | |
| — | Meghalaya | Assam, Tripura | Arunachal Pradesh Himachal Pradesh, Manipur, Mizoram, Sikkim |

* : Data relates to 2000-01.

## Table XII: Market Borrowings of State Governments during 2003-2004*

(Rs. crore)

| State | Gross Borrowings | Repay-ments | Net Borrowings | Gross Amount Raised by Auction | Gross Amount raised through Tap sale | Debt Swap Scheme |
|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| Andhra Pradesh | 3,226 | 393 | 2,833 | 500 | 2,726 | 1,634 |
| Arunachal Pradesh | 131 | 5 | 126 | — | 131 | 110 |
| Assam | 943 | 124 | 819 | — | 943 | 457 |
| Bihar | 2,131 | 309 | 1,822 | — | 2,131 | 1,218 |
| Chhattisgarh | 642 | 48 | 594 | — | 642 | 293 |
| Goa | 240 | 10 | 230 | — | 240 | 120 |
| Gujarat | 3,333 | 138 | 3,195 | — | 3,083 | 2,173 |
| Haryana | 1,165 | 79 | 1,086 | 450 | 1,165 | 751 |
| Himachal Pradesh | 882 | 26 | 856 | — | 882 | 516 |
| Jammu & Kashmir | 522 | 45 | 478 | — | 522 | 389 |
| Jharkhand | 575 | 105 | 470 | — | 575 | 266 |
| Karnataka | 2,779 | 181 | 2,598 | — | 2,779 | 1,197 |
| Kerala | 1,931 | 220 | 1,711 | 450 | 1,481 | 671 |
| Madhya Pradesh | 2,405 | 133 | 2,272 | 220 | 2,185 | 786 |
| Maharashtra | 6,449 | 226 | 6,223 | 700 | 5,749 | 4,538 |
| Manipur | 192 | 15 | 177 | — | 192 | 108 |
| Meghalaya | 166 | 17 | 149 | — | 166 | 77 |
| Mizoram | 101 | 5 | 96 | — | 101 | 66 |
| Nagaland | 227 | 20 | 207 | — | 227 | 87 |
| Orissa | 2,101 | 300 | 1,801 | — | 2,101 | 805 |
| Punjab | 2,056 | 51 | 2,006 | — | 1,867 | 1,411 |
| Rajasthan | 2,714 | 249 | 2,465 | 190 | 2,714 | 1,326 |
| Sikkim | 62 | 7 | 55 | — | 62 | 45 |
| Tamil Nadu | 2,851 | 313 | 2,538 | 250 | 2,601 | 1,338 |
| Tripura | 229 | 20 | 209 | — | 229 | 128 |
| Uttar Pradesh | 5,375 | 766 | 4,609 | — | 5,375 | 3,253 |
| Uttaranchal | 1,366 | 41 | 1,325 | — | 1,366 | 975 |
| West Bengal | 5,729 | 300 | 5,429 | 335 | 5,394 | 4,264 |
| **Total** | **50,521** | **4,145** | **46,376** | **2,895** | **47,626** | **29,000** |

* As per the Reserve Bank records.

2003-04. The States were allocated Rs. 29,000 crore for this purpose.

### (ii) Market Borrowings

The gross and net market borrowings allocated to States for the fiscal year 2003-04 amount to Rs.50,805 crore and Rs.46,659 crore, respectively. This is inclusive of the additional allocation of Rs.29,000 crore towards debt swap scheme. During 2003-04 the State Governments have raised Rs.50,521 crore under the market borrowing programme, of which Rs.26,623 crore was used for repayment raised under the debt swap scheme (Table XII).

In order to elongate the maturity profile of State loans, a 12 year bond was issued on August 25, 2003 through tap sale of 6.20 State Development Loan 2015. During 2002-03, the State Governments raised Rs.30,853 crore through market borrowings (Rs.27,880 crore through tap issuances and Rs.2,973 crore through auctions) - an increase of 65 per cent over Rs.18,707 crore (Rs.15,942 crore through tap issuances and Rs.2,765 crore through auctions) raised during 2001-02 (Box 4).

The declining trend in interest rate on market borrowings of the State Governments continued during the years 2001-02 and 2002-03 (Table XV). The interest rate on market borrowings of the State Governments ranged between 8.0 per cent to 6.6 per cent in 2002-03 as compared with a range of 10.5 per cent to 7.8 per cent in 2001-02. During 2002-03, the weighted average interest rate on States' market borrowings was 7.5 per cent - lower than 9.2 per cent in the previous year. During 2003-04, the interest rate on market borrowings ranged from 5.78 per cent to 6.40 per cent. Southward trend in interest rates on market borrowings of the State Governments was sustained during 2002-03 and 2003-04. The interest rates on tap issues ranged between 6.60-7.80 per cent with a spread fixed in the range of 38-52 basis points over the corresponding secondary market yield of Government of India dated securities in 2002-03. While cut-off yields on auctions ranged between 6.67-8.00 per cent with a spread ranging between 20-76 basis points over the corresponding secondary market yield of Government of India dated securities. During 2003-04, interest rates on tap issues and cut off rate yields on auctions moved down further in the range of 5.85-6.40 per cent and 5.78-6.03 per cent, respectively (Table XIII A and B).

**Table XIII A : 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 | 1,141 | 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 |
| 1999-00 | 13,706 | 12,405 | 11.00-12.25 | 11.89 |
| 2000-01 | 13,300 | 12,880 | 10.50-12.00 | 10.99 |
| 2001-02 | 18,707 | 17,261 | 7.80-10.53 | 9.20 |
| 2002-03 | 30,853 | 29,064 | 6.67-8.00 | 7.49 |
| 2003-04 | 50,521 | 46,376 | 5.78-6.40 | 6.13 |

## Box 4
## Review of Auction and Tap System of State Governments Market Borrowings

The Government of India and the Planning Commission formulate the market borrowing programme of States in consultation with the Reserve Bank. The Reserve Bank under Section 21A of the Reserve Bank of India Act, 1934 manages the public debt of the State Governments.

The Reserve Bank, until 1998, used to complete the combined market borrowings of all the States through traditional tranche method by issuing bonds with a pre-determined coupon and pre-notified amounts for each State. In view of financial sector reforms as also to provide scope for better-managed States to raise resources at market rates, the option of auction system of market borrowings was made available to the States in 1997. Under the auction method (Flexible System), States were encouraged 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. However, as requested by Maharashtra and Kerala, the Reserve Bank permitted these two States to raise up to 50 per cent of their allocation through auction route in 2002-2003. Subsequently, this limit of 35 per cent was raised to 50 per cent for all the States.

Some of the States have preferred to raise borrowings through traditional tranche method alone. Under traditional tranche method, however, the amount to be raised for individual States needs to be notified, and it was becoming difficult to mobilise funds for the notified amounts for some States, as banks and financial institutions started linking their allocations to individual States depending, inter-alia, on their financial position and their track record in making payments in respect of guaranteed bonds. With a view to avoiding risk of under-subscription under the traditional tranche method, the tap tranche method was introduced in 2001-02. Under this method, borrowings for all States are raised, indicating a total targeted amount at a predetermined coupon but without notifying the amounts for individual States.

During 1999-00, Punjab was the only State to raise loan from market through the auction route, but in 2000-01, as many as six States resorted to auctions. In 2001-02, the number of States using auctions for market borrowings increased to 12 which subsequently came down to 10 and 8 during 2002-03, and 2003-04, respectively. Some of the States *viz.,* Andhra Pradesh, Gujarat, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu, and West Bengal have been resorting to auctions regularly.

Market borrowings of all States through auction as a percentage of gross market borrowings declined from around 15 per cent during 2001-02 to around 6 per cent in 2003-04. Maharashtra raised the highest proportion of gross market borrowings (47 per cent) through auction route followed by Kerala and Madhya Pradesh with 36 per cent and 22 per cent, respectively, during 2002-03. During 2003-04, Kerala raised the highest share of its market borrowings through auction (23 per cent), followed by Andhra Pradesh and Maharashtra (15 per cent and 11 per cent, respectively).

The market borrowings of States through tap tranche as a percentage of gross market borrowings increased from 85 per cent in 2001-02 through 90 per cent in 2002-03 to 94 per cent during 2003-04.

The declining trend in interest rates also percolated into lower cut-off yields on market borrowings of States through auctions as States resorted to market borrowings at market rates. The range of cut-off yield declined from 11.57-11.80 per cent during 2000-01 to 5.78-6.03 per cent in 2003-04.

**Source:**

1. Annual Report, Reserve Bank of India, various issues.
2. State Finances: A Study of Budgets, Reserve Bank of India, various issues.
3. Economic Survey, Government of India, various issues.

The weighted average yield also declined from 9.20 per cent in 2001-02 through 7.49 per cent in 2002-03 to 6.13 per cent in 2003-04.

**Table XIII B: Market Borrowings of States through Auctions**

| State | Amount (Rs. Crore) | | | | Cut-off (Per cent) | | | |
|---|---|---|---|---|---|---|---|---|
| | 2000-01 | 2001-02 | 2002-03 | 2003-04 | 2000-01 | 2001-02 | 2002-03 | 2003-04 |
| Andhra Pradesh | 400 | 475 | 250 | 500 | 11.80 | 9.53 | 7.90 | 6.03 |
| Arunachal Pradesh | | 5 | 295 | | | 8.60 | | |
| Chhattisgarh | | 67 | | | | 8.10 | | |
| Gujarat | | 190 | 245 | | | 9.50 | 7.83 | |
| | | 250 | 200 | 250 | | 9.40 | 7.33 | 6.00 |
| Jammu & Kashmir | | 45 | 70 | | | 8.50 | 8.00 | |
| Karnataka | 250 | 315 | 200 | | 11.57 | 9.10 | 7.90 | |
| | | 80 | | | | 7.80 | | |
| Kerala | 200 | 200 | 225 | 250 | 11.75 | 10.53 | 8.00 | 6.02 |
| | | | | 200 | | | | 5.80 |
| Madhya Pradesh | | 105 | 247 | 220 | | 9.5 | 6.94 | 6.00 |
| Maharashtra | 280 | 290 | 279 | 700 | 11.70 | 9.40 | 7.83 | 5.78;6.0 |
| Punjab | | 130 | 85 | 190 | | 9.40 | 6.80 | 5.90 |
| Tamil Nadu | 290 | 320 | 275 | 250 | 11.70 | 9.38 | 7.30 | 6.00 |
| West Bengal | 250 | 250 | 153 | 335 | 11.80 | 9.72 | 7.35 | 5.78 |

**Table XIV : Repayment Schedule of Outstanding State Government Loans**

(As on March 2003)

| Year | Amount |
|---|---|
| 1 | 2 |
| 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 | 16,511 |
| 2010-11 | 15,870 |
| 2011-12 | 22,032 |
| 2012-13 | 30,605 |

**Note :** Outstanding are likely to increase on account of issue of power bonds by State Governments with retrospective effect from October 1, 2001.

The annual repayment schedule of the outstanding State Government loans is weighted heavily at the longer maturity spectrum (Table XIV). As in the case of Centre, the profile of the outstanding stock of the State Governments in terms of interest rate ranges indicates that over two-third of loans are contracted at interest rate of 10 per cent and above. In terms of the maturity profile of loans, the bulk of outstanding loans were with a maturity of 5 to 10 years (end March 2002) (Table XV).

**Table XV : Maturity Profile of Outstanding State Government Loans (As on March 31, 2003) P**

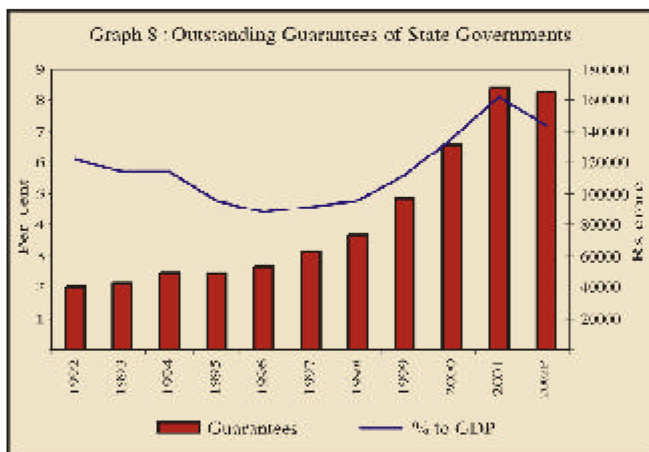
(Rupees crore)

| State | Under 5 years | 5-10 years | Total |
|---|---|---|---|
| 1 | 2 | 3 | 4 |
| 1. Andhra Pradesh | 2,942 | 11,315 | 14,257 |
| 2. Arunachal Pradesh | 30 | 106 | 136 |
| 3. Assam | 960 | 2,717 | 3,678 |
| 4. Bihar | 2,966 | 5,560 | 8,526 |
| 5. Chhattisgarh | — | 803 | 803 |
| 6. Goa | 91 | 521 | 612 |
| 7. Gujarat | 1,360 | 6,291 | 7,651 |
| 8. Himachal Pradesh | 225 | 1,759 | 1,983 |
| 9. Haryana | 723 | 2,016 | 2,739 |
| 10. Jammu and Kashmir | 365 | 1,434 | 1,800 |
| 11. Jharkhand | — | 948 | 948 |
| 12. Karnataka | 1,302 | 5,746 | 7,047 |
| 13. Kerala | 1,904 | 4,606 | 6,510 |
| 14. Maharashtra | 2,282 | 5,150 | 7,432 |
| 15. Madhya Pradesh | 2,078 | 4,567 | 6,644 |
| 16. Manipur | 100 | 252 | 352 |
| 17. Meghalaya | 138 | 413 | 551 |
| 18. Mizoram | 65 | 262 | 326 |
| 19. Nagaland | 199 | 691 | 890 |
| 20. Orissa | 2,111 | 4,769 | 6,880 |
| 21. Punjab | 1,014 | 3,039 | 4,054 |
| 22. Rajasthan | 2,145 | 7,671 | 9,816 |
| 23. Sikkim | 77 | 164 | 241 |
| 24. Tripura | 121 | 462 | 582 |
| 25. Tamil Nadu | 2,324 | 6,676 | 9,000 |
| 26. Uttaranchal | — | 1,178 | 1,178 |
| 27. Uttar Pradesh | 5,601 | 13,547 | 19,148 |
| 28. West Bengal | 2,528 | 6,754 | 9,282 |
| **Total** | **33,648** | **99,418** | **1,33,066** |

P : Provisional.

### (iii) Contingent Liabilities

The outstanding guarantees of State Governments have shown a rising trend during the 1990s. Although contingent liabilities do not directly form a part of the debt burden of the States, in the event of default by the borrowing agency, the States will be required to meet the debt service obligations. 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 (8.1 per cent of GDP) as at end-March 2001. However, these are estimated to be lower at Rs.166,116 crore at end-March 2002 (7.2 per cent of GDP) (Graph 8).

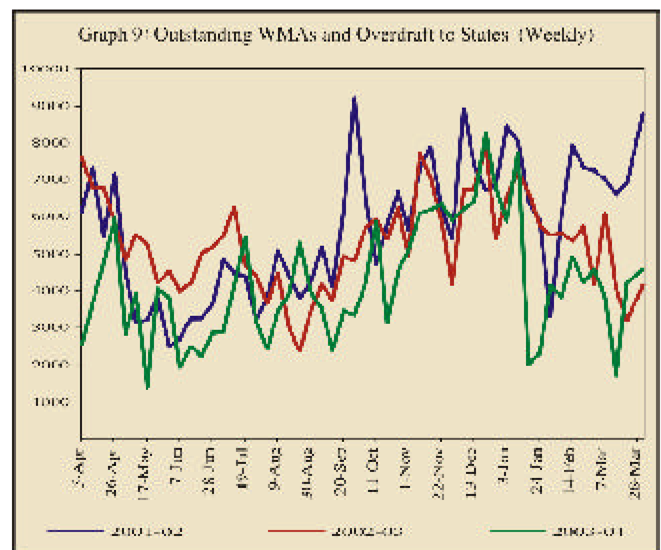



In view of the fiscal implication of rising level of guarantees, many States have taken initiatives to place ceilings on guarantees. Statutory ceilings on guarantees have been instituted by Goa, Gujarat, Karnataka, Sikkim and West Bengal, while some other States, *viz.,* Assam, Orissa and Rajasthan have imposed administrative ceilings on guarantees.

### (iv) Ways and Means Advances (WMA) of States

The Reserve Bank revised the Scheme of Ways and Means Advances for States effective March 3, 2003, based on the recommendations of the Ramachandran Committee (2002) and after consultations with the State Governments (Box 5). As per the revised scheme of WMA effective from March 3, 2003, the total normal WMA limit for State Governments have been enhanced by 18.8 per cent to Rs.7,170 crore from the earlier limit of Rs.6,035 crore. The total normal WMA limit was further enhanced to Rs.8,140 crore with effect from April 1, 2004.

The recourse to WMA and overdrafts (OD) by States during 2002-03 was generally lower than that in the previous year, reflecting improved management of cash flows. The number of States resorting to overdrafts during the year 2002-03 was, however, marginally higher at 21 as compared with 20 such States in the previous year. The recourse to WMA and OD by States during 2003-04 was generally lower than that in the previous year, reflecting improved management of cash flows. The outstanding WMA and OD of State Governments at Rs.4,578 crore as on March 26, 2004 was lower by 16.1 per cent than the level of Rs.5,459 crore on March 28, 2003 (Graph 9).



## Box 5
## Revised Scheme of Ways and Means Advances to State Governments

The Reserve Bank provides WMA to States with a view to help them tide over temporary mismatches in cash flow. The scheme is revised from time to time.

The Reserve Bank had constituted an Advisory Committee in October 2002 to review the existing system of normal WMA, special WMA and overdraft to the State Governments (Chairman Shri C. Ramachandran). Based on the recommendations of the Ramachandran Committee and in consultations with the State Governments, the Reserve Bank revised the scheme of Ways and Means Advances for the State Governments effective from March 3, 2003.

The main features of the revised scheme are as follows:

(i) The revised normal WMA limits, effective from March 3, 2003, have been computed by taking into account the average of revenue receipts for the three fiscal years 1999-00, 2000-01 and 2001-02 and then applying to this average, a multiplication factor of 3.19 per cent for the non-special category States and 3.84 per cent for the special category States respectively.

(ii) The rate of interest charged on normal WMA will be (a) Bank Rate (currently 6.0 per cent) for the period of 1 to 90 days and (b) one per cent above the Bank Rate for the period beyond 90 days as against Bank Rate now.

(iii) The minimum normal WMA limit has been retained at Rs. 50 crore for any State.

(iv) The Special WMA Scheme will continue to be linked to the investments made by State Governments in the Government of India securities, *i.e.,* dated securities and Treasury Bills. A lower and uniform margin of five per cent will be applied now on the market value of the securities for determining the operating limit of Special WMA. Earlier, margins varying from 10 to 15 per cent were applied by the Reserve Bank. The States will have to avail of Special WMA limits first before seeking accommodation under the normal WMA limits.

(v) The rate of interest applicable to Special WMA will be one per cent below the Bank Rate as against the Bank Rate earlier.

(vi) There is no change in the amount of minimum balance to be maintained by the State Governments.

(vii) The number of days that a State can be in overdraft has been extended to 14 consecutive working days from the present 12 consecutive working days.

(viii) The norm of restricting overdraft to 100 per cent of the normal WMA limit will continue. If the overdraft exceeds this limit for five consecutive working days for the first time in a financial year, the Reserve Bank will advise the State to bring down the overdraft level within the 100 per cent of WMA limit. If, however, such irregularity occurs on a second or subsequent occasion in the financial year, the Reserve Bank will stop payments notwithstanding the above provision, which permits the State overdraft upto 14 days.

(ix) No State Government will be allowed to be in overdraft for more than 36 working days in a quarter. If this is not adhered to, payments will be stopped. This regulation, however, was made applicable from April 1, 2003.

(x) The rate of interest on overdraft will be: (a) overdraft up to 100 per cent of normal WMA limit - three per cent above the Bank Rate, and (b) overdraft exceeding 100 per cent of the normal WMA limit - six per cent above the Bank Rate. Under the earlier scheme, the rate of interest on overdraft was two per cent above the Bank Rate.

The Scheme will be reviewed in its totality on receipt of the recommendations of the 12th Finance Commission.

## Section V : Issues and Perspectives

### (i) Widening Resource Gap of the States

The emergence of deficit in the revenue account since the mid-1980s and its subsequent enlargement especially in the second half of the 1990s has inevitably led to increasing pre-emption of high cost borrowed funds to finance the current consumption of the State Governments. The significant fiscal deterioration in the second half of the 1990s has been due partly to inadequate increase in tax receipts, negative or negligible returns from public investments, and partly to increase in expenditure on account of interest payments, higher salary-outgo on account of pay revisions and higher pension outgo.

States have undertaken a number of measures to contain their expenditure growth and to augment their tax receipts. Reflecting this, the ratio of States' own tax revenue to GDP showed signs of improvement in the recent years - from 5.6 per cent in 2001-02 to 5.9 per cent in 2002-03 and is budgeted at 6.0 per cent in 2003-04. In view of the committed nature of certain expenditure, however, States have been, at times, constrained to cut back their developmental expenditures. Such fiscal adjustments based predominantly on expenditure reduction could have adverse implications for the growth process. Fiscal empowerment through revenue augmentation in order to facilitate higher developmental expenditure is, therefore, crucial as suggested in the successive Annual Reports of the Reserve Bank in the recent past. States would need to make efforts to enhance their own revenues - both tax and non-tax in order to enhance budgetary flexibility.

It is imperative that States augment their tax receipts through better tax administration, improved tax compliance and rationalisation of the tax structure. In the tax reform process, the implementation of VAT at the national level still remains a major challenge. The wide ranging tax exemptions and concessions extended to various sectors of the economy need to be rationalised after a thorough examination of the effectiveness of such concessions in promoting the intended objectives or in augmenting the growth of the particular sectors for which they have been extended. In view of increasing importance of the services sector in GDP, the enactment and implementation of the proposed constitutional amendment to integrate services into the tax net in a comprehensive manner would facilitate higher revenue flows to the States. Moreover, there is a need for further reform and reorientation of levies such as stamp duties, registration fees, etc. These fees and duties need to be made 'tax payer-friendly'. Adoption of appropriate user charges for the services provided by the States would also help States augment their resource base. In this direction, the States have initiated measures towards setting up State Electricity Regulatory Commission in order to determine electricity tariff in a rational and remunerative manner. Furthermore, some States have also increased user charges. While some initiatives have been taken by the State governments recently, these have not translated into any significant rise in their non-tax revenue receipts, as yet.

### (ii) State Level Public Sector Undertakings (PSU) Reforms

The restructuring of public sector enterprises is another critical area for improving the health of State finances. Although the need for privatisation in many countries originated in the worsening fiscal situation and widening public sector resource gaps, the issue of privatisation gained importance in view of its potential role in increasing the overall efficiency in the economy and greater consumer welfare. Public enterprises constitute an important sector of the Indian economy, and over the years State Governments

have built huge assets in the form of public sector undertakings. However, receipts on account of dividends and profits from State enterprises have often remained negligible due to poor operational performance. In many cases, State Governments are required to provide large budgetary support to the loss making enterprises, causing additional burden on their finances. The restructuring of PSUs in India that is being done with the objective of enhancing future profitability and market confidence has highlighted the issues of corporate governance, financial restructuring and business and technological restructuring. 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 large investments. In recent years, many States have envisaged PSU reforms through restructuring, privatisation, disinvestment and closing down of unviable and loss making enterprises. In addition, appropriate user charges for the services provided by the Government agencies to the public would need attention on priority through appropriate institutional reforms. In this regard, power sector reforms are crucial in view of their significant fiscal implications.

### (iii) Transparency

In the context of the fiscal challenges faced by the States, the issue of transparency in Government budgetary operations assumes critical significance for sound fiscal management and attainment of macroeconomic balance. Transparency in Government fiscal operations would need to be strengthened in tandem with the process of fiscal consolidation and the financial sector reforms so as to enhance credibility of the fiscal stance of the Government. The need for adequate availability of information through State budgets is not only to aid policy makers or to enhance transparency at the State level, but also for investors to take 'informed' decisions. States would need to enhance transparency in reporting and provide comprehensive information on fiscal developments including data on subsidies and guarantees. In addition, public dissemination of fiscal data on a more frequent basis, say quarterly basis, would be desirable. Non-transparent fiscal practices are known to destabilise the financial balance, breed inefficiency in allocation and utilisation of resources and foster inequity.

### (iv) Debt Sustainability

The large and increasing GFD of States has led to a steady rise in the outstanding debt of State Governments in recent years and this has raised the issue of financial sustainability of State debt. Unsustainable debt leads to increased vulnerability by aggravating debt servicing burden, besides impacting on the States' ability to undertake developmental activities. Concerns on sustainability also arise from the fact that Government in future may have problems in marketing their debt. With States increasingly accessing the market for resources, those with poor fiscal position may fail to get adequate market response to their bond issues or it would reflect in the increased risk-premia. Furthermore, difficulties in honouring debt-service obligations could have adverse implications on overall financial stability as well.

An important initiative to address the problem of increasing interest burden has been the introduction of debt swap scheme in 2002-03. Under the scheme, high cost loans from the Government of India are being swapped through additional market borrowings and small savings receipts at relatively lower interest rates. This will, overtime, reduce the debt service burden of States.

### (v) Discretionary versus Rule-based Fiscal Policy

With growing fiscal imbalances across the States since late 1980s, it is widely recognised

that discretionary policy may not contribute to fiscal sustainability. This has brought to the fore the need for a rule-based fiscal adjustment backed by necessary legal and institutional framework so as to contain fiscal deficits within prudent limits. Recognising this, five States (Karnataka, Kerala, Punjab, Tamil Nadu and Uttar Pradesh) have already enacted Fiscal Responsibility Legislations, and a Fiscal Responsibility Bill has been introduced in the State Assembly of Maharashtra. In order to facilitate similar initiatives in other States, the Reserve Bank has constituted a Group of State Finance Secretaries with a view to formulate a Model Fiscal Responsibility Bill for consideration by the State Governments.

Attempt in achieving fiscal correction without any institutional arrangement including statutory backing (through say, fiscal responsibility legislation), may not always be successful. Adoption of fiscal policy rules built under fiscal responsibility legislation commits the government to a deficit or debt reduction path, and provides thereby for greater fiscal discipline. The legislative framework of fiscal policy would, however, need to capture the critical aspects of fiscal consolidation, budget management and supporting institutional arrangements.

**(vi) State Government Guarantees**

Although contingent liabilities do not directly form a part of the debt burden of the States, in the event of default by the borrowing agency, the States will be required to meet the debt service obligations. Faced with a situation of deteriorating State finances leading to an erosion in public investment, Governments have often resorted to loan guarantees to promote investment in long-term projects in infrastructure by reduction of the credit risk to the investor. Like most financial instruments, guarantees also involve a risk-return trade-off.

In the context of public sector reforms, the issue of growing contingent liabilities in the form of guarantees for accessing finances to meet the needs of PSUs, especially those in the area of infrastructure, besides the explicit liabilities, have assumed crucial importance. These exposures are often costly, and could pose risks of default if the institutions supported by funds do not improve their performance. It is vital that limits are placed on the value of guarantees that could be given by State Governments and adhered to in the framework of a law.

The outstanding guarantees of State Governments have shown a rising trend during the 1990s, although there has been some decline in the last two years. The element of risk is particularly high for investments with large funding requirements, long gestation periods and low returns. While guarantees do not involve immediate cash outgo, guarantees invoked in the event of a default become State Government liabilities. Apart from the magnitude of contingent liabilities, an important dimension which has implications for the stability of fiscal operations of the governments is the quality of guarantees extended and the element of risk embedded therein. Since Government's off-budget liabilities could pose potential threats to fiscal and financial stability of the system, adoption of appropriate accounting practices to gauge the Government's likely payment obligations is necessary.

In view of the above, the Reserve Bank, as the banker and debt manager, has been sensitising the State Governments on the issue of guarantees through the bi-annual State Finance Secretaries' Conference. Following the decision taken in these Conferences, a Committee, *viz., Technical Committee on State Government Guarantees* (1999) and a *Group to Assess the Fiscal Risk of Guarantees* (2002) were constituted by the Reserve Bank with the State Finance Secretaries as members. Following their recommendations, many State Governments have initiated measures including placing ceiling on guarantees and setting up of guarantee redemption fund.

**(vii) Issues in Expenditure Management**

An important constraining factor is the budgetary inflexibility faced by the States owing to the persistent rise in expenditure on certain committed items such as, expenditure on administrative services, interest payments and pensions. This has put pressure on the resources of the Government and has resulted in a higher share of non-developmental revenue expenditure. This has also placed constraints on the ability of the States to undertake developmental activities. The deterioration in the quality of expenditure is evident in the declining share of developmental expenditure from about 70 per cent of the aggregate expenditure during 1985-90 to 57 per cent in 2001-02. As the States have an important role in the development of social and economic infrastructure, appropriate expenditure management strategy assumes importance.

The level of government expenditure in the social sector is of great significance in a developing economy. The role of the State government is particularly important under the existing federal fiscal arrangements wherein the States have been entrusted with the basic responsibilities of providing social infrastructure. The aggregate social sector expenditure of State Governments has declined from 6.6 per cent of GDP in the latter half of the 1980s to 5.7 per cent of GDP in 2001-02. This is a matter of concern and this disturbing trend needs to be reversed.

To conclude, the fiscal reform measures initiated by the State Governments have the potential to improve and strengthen the State finances. It is important, therefore, that these measures are implemented expeditiously. A meaningful fiscal consolidation would necessitate rule-based fiscal framework backed by appropriate legislation, as underscored by the international experience. In this regard, it would be useful if the initiatives undertaken by some of the State Governments are emulated by the rest.

## Explanatory Note on Data Source 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 to the data presented in the State Budgets and the accounting classification thereof Some supplementary information regard-ing Additional Resource Mobilisation (ARM) efforts and the level of guarantees (contingent liabilities) provided by States are also furnished. Some material received from the Planning Commission relating to State-wise Plan outlays are also incorporated. The analysis conforms to 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 expenditures, while expenditure on general services is treated as non-developmental. This reclassification is done without altering the total receipts, expenditures 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 the Cash Balance Investment Account and the increase/decrease in WMA extended by the Reserve Bank of India.

## Annex 1 : Major Policy Initiatives Proposed in the State Budgets for 2003-04

| States | Fiscal Measures | Institutional Measures | Sectoral Measures |
|---|---|---|---|
| 1. Andhra Pradesh | l Continuation of the policy to bring down the establishment cost as a percentage of total revenue receipts.<br><br>l Rigorous risk assessment before giving guarantee as well as adequate precautions to ensure proper use of funds by the public enterprises to avoid devolvement of liabilities on the Government. | l Centre for Good Governance has been commissioned to undertake a State Financial Accountability assessment and suggest systemic improvements.<br><br>l Taken up the designing and installation of an Integrated Financial Information System (IFIS) that will link all treasuries, banks, departments, Accountant General and the Reserve Bank for better financial and accounting management. | l Proposal to promote micro irrigation projects through drip irrigation systems for which Rs.100 crore have been provided.<br><br>l Hike in Plan allocation for setting up of industrial infrastructure projects, including SEZ and Pharma City projects. |
| 2. Arunachal Pradesh | l Proposes to sustain the economy measures imposed in the previous budget.<br><br>l Proposes an provision of Rs.5 crore in the Budget for guarantee redemption. | | l Proposes a scheme under which landless educated youth will be provided land and the requisite inputs for horticulture plantations. |
| 3. Assam | l Proposal for an ADB technical assistance programme for budgetary procedure reforms, computerisation, and expenditure management systems has been initiated.<br><br>l The State has initiated a programme for computerisation of its treasuries, in order to facilitate more efficient and effective management of its expenditures and cash flows.<br><br>l Proposal to make a provision of Rs.96 crore for the Consolidated Sinking Fund. | l For reform and restructuring of the power sector and to enable fixation of electricity tariff in a transparent and participatory manner, the State Government has constituted the Assam Electricity and Regulatory Commission (AERC).<br><br>l The State Government will also bring about legislative measures in the form of a comprehensive Electricity Reform Act (ERA) for Assam to enable further reforms through restructuring of the State power sector. | l Thrust to be given to the development of tourism infrastructure and tourism services with private sector participation. |
| 4. Bihar | l Initiatives to increase taxes, reorganisation of PSUs, and reforms in power sector. | | |

| States | Fiscal Measures | Institutional Measures | Sectoral Measures |
|---|---|---|---|
| 5. Chhattisgarh | ı A provision of Rs.20 crore for Voluntary Retirement Scheme.<br><br>ı An estimated Rs.50 crore to be raised through sale and disinvestments of assets. | | ı Investment Promotion Committee has been constituted to facilitate investment.<br><br>ı Technology Promotion Fund has been set up. |
| 6. Goa | ı Guarantee Redemption Fund to be made operational in the next financial year.<br><br>ı In order to build up a corpus for repayment of debt, the State has invested more than Rs.20 crore in the Sinking Fund. | | ı To set up Krishi Ghars which will act as collection, sorting, storage and selling centres for agriculture and horticulture products. |
| 7. Gujarat | ı Formation of a Cabinet Committee to restart the privatisation and restructuring of PSUs.<br><br>ı Balance to be brought about between the cost and recovery of fee to ensure that efficient and quality services are provided by the Government. | ı The Gujarat Power Industry (Reorganisation and Regulation) Bill-2003 to be introduced for controlling power theft and regulation and reorganisation of power industry.<br><br>xl The Indian Power (Gujarat Amendment) Bill, 2003 also to be introduced.<br><br>ı Reconstruction Project and to strengthen and modernise the network of power transmission and distribution. | ı Apparel Park to be set up at Surat.<br><br>ı Under *Vasant Krishi Vikas Yojana,* participation of private sector will be sought for converting the Government Wasteland and unproductive land into tillable land through reclamation.<br><br>ı Three Regional Emergency Response Centres to be set up at Ahmedabad, Surat and Rajkot. |
| 8. Himachal Pradesh | ı Organisational structure and staffing pattern in Government Departments and PSUs is being rationalised.<br><br>ı Consolidated Sinking Fund has been constituted.<br><br>ı Guarantee Redemption Fund has also been constituted to meet the payment obligations of State Guarantees. | ı Second State Finance Commission has been constituted.<br><br>ı Online Treasuries Information System is being implemented. | ı Special Economic Zone to be set up in Gurgaon District to facilitate foreign direct investment and exports from the State. |

| States | Fiscal Measures | Institutional Measures | Sectoral Measures |
|---|---|---|---|
| 9. Jharkhand | | l Jharkhand State Electricity Tariff Commission to be set up.<br><br>l Reconstitution of Jharkhand State Electricity Board to bring about power sector reforms and encourage private sector participation.<br><br>l Power distribution to be privatised in Ranchi, Jamshedpur and Dhanbad. | |
| 10. Karnataka | l Intends to enhance revenue through rationalisation of taxes and additional of taxes and additional resource mobilisation such as levy tax on new profession and on all categories of self employed persons.<br><br>l Proposes to levy a more efficient betting tax on lotteries through a new enactment.<br><br>l Proposes to prune non-plan non-developmental expenditure. Rightsizing Government expenditure. | l Proposes to enforce measures to step up revenue collection efficiency from power sector. Budgetary support to power sector be linked with actual outcomes in the sector. | l Proposes to strengthen irrigation through incorporating a new Special Purpose Vehicle -Cauvery Neeravari Nigama to raise resources from the market. The SPV will undertake works such as repair, renovation and refurbishment of the irrigation assets by raising resources from the market.<br><br>l Proposes to enhance allocations mainly to agriculture, rural development and education. |
| 11. Kerala | l Creation of a Sinking Fund for redeeming outstanding Open Market Borrowings.<br><br>l Allocation of Rs.84 crore for restructuring of PSUs based on the plans drawn up by the Enterprise Reforms Committee and approved by the Government. | l Declare 2003-04 as Development Year with an aim to get all Government Departments and agencies engaged in development work to complete existing schemes and take up new schemes announced in the Budget. | l Creation of a Price Stabilisation Fund of Rs.50 crore to provide income stability to farmers.<br><br>l Allocation of Rs.100 crore for KINFRA for financing Government participation in GIM projects where required.<br><br>l Proposals to set up Food Park, Herbal Park, Cold chain facility, warehousing facility, Quality Testing Labs to develop food processing industry in the State.<br><br>l Constitution of a Traditional Industries Support Fund to finance a comprehensive revitalisation plan for traditional industries. |

| States | Fiscal Measures | Institutional Measures | Sectoral Measures |
|---|---|---|---|
| 12. Madhya Pradesh | | | ı Restructuring of State Electricity Board into three companies, *viz.,* Generation, Transmission and Distribution company.<br><br>ı Emphasis on food processing industries. |
| 13. Maharashtra | ı Intends to pursue fiscal reforms through enhancing revenue resources and containing expenditure.<br><br>ı Emphasis on the need for a legal framework for enforcing fiscal discipline. | ı Proposes to formulate a Social Responsibility Bill which would complement Fiscal Responsibility legislation for assuring the constitutional guarantees of equality, fraternity and dignity. | ı Setting up a Special Economic Zone in the State for which the State has formulated a draft of a new enabling legislation to be called Maharashtra Special Economic Zone Act. The proposed Act would provide for a legal framework for expeditious approvals and streamlining of procedures essential for efficient conduct of business. |
| 14. Manipur | ı Proposes to rationalise tax and user charges structure. | ı Proposes to introduce Manipur Public Demand Recovery Bill, 2003 to enable more effective recovery of outstanding loans. | ı The Government has notified the *Information Technology Policy of Manipur 2003* for development of the sector in the State. |
| 15. Meghalaya | ı Enhancing the productivity and efficiency of non-tax revenues, fee enhancement and collection, rationalisation of user charges.<br><br>ı Reforms of Public sector enterprises by disinvestments, winding up or restructuring to reduce budgetary support.<br><br>ı Improvement in cost recoveries and reduction in implicit subsidies. | ı Focus on power sector reforms by setting up State Tariff Regulatory Commission, taking feasible actions towards unbundling, recovery of dues.<br><br>ı The State has signed a Tripartite agreement for One Time Settlement of SEB dues. | ı Committee on project management has been constituted to identify long pending projects, to oversee shelf of projects, inventory control, *etc.* |
| 16. Mizoram | ı Continue with the existing economy measures already in place. | | ı Proposal to strengthen the Co-operative Credit movement in the State for socio-economic upliftment of productive societies, private artisans and farmers. |

| States | Fiscal Measures | Institutional Measures | Sectoral Measures |
|---|---|---|---|
| 17. Orissa | ı The State Government has provided an amount of Rs.60 crore in the Budget for administering Voluntary Retirement Scheme in PSUs. | | ı Two Special Economic Zones to be established. |
| 18. Punjab | ı Proposes to generate additional revenues through tax and non-tax measures.<br><br>ı Proposes to contain non-plan revenue expenditure through restructure of major departments of the Government.<br><br>ı Rationalisation of taxes and user charges. | ı Enacted Fiscal Responsibility and Budget Management Act.<br><br>ı Initiatives towards Voluntary Retirement Scheme. | |
| 19. Rajasthan | ı Rs.116 crore set aside for local bodies as per the recommendation of the Second State Finance Commission. | | ı Proposal to establish Agro Food Park in Jodhpur and Kota.<br><br>ı An investment of Rs.14.7 crore through Rajasthan Renewable Energy Corporation for the development of non-conventional energy sources. |
| 20. Sikkim | ı Disinvestments of all non-performing assets with the public sector units to be considered. | ı A high level Board of Investment has been constituted to facilitate processing of investment proposals through a single window mechanism. | ı Proposal to constitute Agriculture Export Committee with pre-determined annual export target under each Zilla Parishad to coordinate the grass root activities. |
| 21. Tamil Nadu | ı Enactment of Fiscal Responsibility Legislation to strengthen the fiscal discipline in the State.<br><br>ı Proposes to introduce the Value Added Sales Tax Act from 2003-04.<br><br>ı Initiatives towards implementation of the recommendations made by Tax Reforms and Revenue Augmentation Commission.<br><br>ı Proposes to review all non-tax revenue and initiatives towards adequate cost recovery of services. | ı Constitution of Infrastructure Development Fund with a specific allocation from the budget.<br><br>ı Disinvestment Policy on the lines set out by the Government of India.<br><br>ı Implemented Voluntary Retirement Scheme for employees in the State PSUs and co-operative institutions to facilitate the restructuring.<br><br>ı Proposes to bring reform in power sector *viz.*, efficiency improvement, improving quality of energy | ı Establishment of New Power Generation Projects to strengthen the power sector.<br><br>ı A special thrust would be on the manufacturing sector.<br><br>ı Proposes to reinvigorate the agriculture, horticulture, floriculture, irrigation and rural development. |

| States | Fiscal Measures | Institutional Measures | Sectoral Measures |
|---|---|---|---|
| | l Proposes to undertake detailed studies regarding the pension reforms and a Contributory Pension Fund Scheme for all new employees appointed after April 1, 2003.<br><br>l Proposes to initiate measures towards implementation of recommendations of Staff and Expenditure Reforms Commission. | supply, reduction in costs and prevention of theft.<br><br>l Restructuring the State transport Corporations through amalgamations. | |
| 22. Tripura | l Plan has ben drawn up for improved fiscal management and sustainability.<br><br>l Power sector reforms and containment of non-plan revenue expenditure within limits would be undertaken as part of this plan. | l Under the proposed power sector reforms Regulatory Commission to be set up. | l The incentive package and the investment promotion policy to be reviewed with a view to attract investments in the State. |
| 23. Uttar Pradesh | l Proposes to introduce the Fiscal Responsibility and Budget Management Bill in the Legislature. Subsequently, the Bill has been enacted.<br><br>l Setting up of a sub Committee which would suggest measures to enhance the revenues of State.<br><br>l Proposes to strengthen the tax compliance, computerisation and simplification of rules and procedures. | l Introduction of *Rapid Economic Development Scheme* which would speed up the development of Infrastructure sectors. | l Proposes initiatives towards setting up Farm management Council, Agri Export Zone and Seed Development Council to strengthen agricultural sector.<br><br>l Setting up of Uttar Pradesh Development Council aiming at development of special industries and simplification of procedures.<br><br>l Setting up of four Special Economic Zone to promote exports. |
| 24. West Bengal | l To strengthen the initiatives undertaken by the WBSEB to prevent theft of power, and the transmission and distribution loss. | | l An additional fund of Rs.10 crore to be provided for expansion of infrastructure for information technology. |
| 25. NCT Delhi | l In order to contain fiscal deficit the Government has initiated a number of measures. Delhi Vidut Board (DVB) has been unbundled into six companies. A consultant has been selected to suggest the restructuring of DTC. A road map for reforms of DJB is being drawn up. | | l Constituted Delhi Rural Development Board to formulate a unified co-ordinated area plan for rural areas. |

## Annex 2 : Fiscal Responsibility Legislation of States

| Item/State | Karnataka (Act) | Kerala (Act) | Tamil Nadu (Act) | Punjab (Act) | Uttar Pradesh (Act) | Maharashtra (Bill) |
|---|---|---|---|---|---|---|
| 1. Gross Fiscal Deficit | Not more than 3% of GSDP by 2006. | To 2% of GSDP by 2007. | Not more than 2.5% of GSDP by 2007. | Contain rate of growth of GFD to 2% per annum in nominal terms, till GFD is below 3% of GSDP. | Not more than 3% of all GSDP by 2009. | — |
| 2. Revenue Deficit | Nil by 2006 | Nil by 2007 | Ratio of RD to revenue receipt below 5% by 2007. | Reduce RD to revenue receipts by at least 5 percentage points until revenue balance is achieved. | Nil by 2009 | Ensuring that after a period of 5 years from the appointed day, RD to be brought to nil. |
| 3. Limiting Guarantees | Limit the guarantees within prescribed ceiling under the Government Guarantees Act. | | Cap outstanding risk weighted guarantees to 100% of the total revenue receipts in the proceeding year or at 10 % of GSDP. | Cap outstanding guarantees on long-term debt to 80% of revenue receipts of the previous year and guarantees on short-term debt to be given only for working capital or food credit. | Not to give guarantee for any amount exceeding the limit prescribed under any rule or law made by the Government for the purpose. | Amount of risk in guarantees issued in a year shall not exceed 1.5 per cent of the expected revenue receipts and to classify the guarantee obligations according to risk of devolvement. |
| 4. Total liabilities | Total liabilities not to exceed 25% of GSDP by 2015. | | | Ratio of debt to GSDP to 40% by 2007. | Total liabilities not to exceed 25% of GSDP by 2018. | Restriction on borrowing. |
| 5. Expenditure | | | | | As per the targets to be given in the MTFRP. | Achieving non-salary development expenditure not less than 60 per cent of the total expenditure. |
| 6. Medium-Term Fiscal Plan (MTFP) | MTFP would include- i) Four year rolling target for prescribed target, ii) Assessment of the sustainability, and iii) evaluation of performance of prescribed fiscal indicators. | MTFP to review periodically the progress of public expenditure with reference to fiscal target, evaluation of the current trend to budgetary allocations. | MTFP include- i) State objectives, ii) Evaluation of fiscal indicators, iii) Strategic priorities for ensuing year, and iv) Economic trends and future prospects. | MTFP include i) three-year rolling target for prescribed target, ii) Assessment of the sustainability, and iii) recent economic trends and future prospects. | MTFP would include- i) Five-year rolling targets, ii) medium term fiscal objectives, iii) Strategic priorities, iv) evaluation of performance of prescribed fiscal indicators. | Multi-year framework and presenting three years forward estimates of revenue and expenditure. |

| Item/State | Karnataka (Act) | Kerala (Act) | Tamil Nadu (Act) | Punjab (Act) | Uttar Pradesh (Act) | Maharashtra (Bill) |
|---|---|---|---|---|---|---|
| 7. Compliance | Half yearly review of receipts and expenditure in relation to budget estimates along with remedial measures to achieve the budget target. GFD/ RD may exceed the limits on unforeseen grounds due to national security or natural calamity. | Public Expenditure Review Committee which would submit a review report giving full account of each item where the deviation from the fiscal target have occurred during the previous year. | Independent external body to carry out periodic review for compliance for the provision of the Act. Target GFD/ RD may exceed the limits on unforeseen grounds due to national security or natural calamity. | Quarterly review of receipts and expenditure in relation to budget estimates along with remedial measures to achieve the budget target. GFD/ RD may exceed the limits on unforeseen grounds due to national security or natural calamity. | a) Half-yearly review of receipts and expenditure in relation to budget. The review report to reflect clearly deviation from the budget targets and remedial measures.<br>b) GFD/RD may exceed the limits on unforeseen grounds due to national security or natural calamity. | Constitution of Fiscal Advisory Board to advise Government on matters relating to implementation of the fiscal responsibility legislation. |
| 8. Pension | | | | | | Present to the legislature every year estimated yearly pension liabilities worked out on actuarial basis for the next ten years. |
| 9. Fiscal transparency | Certain fiscal management principles and measures for fiscal transparency. | Measures to ensure grater transparency in its fiscal operations. | Measures to ensure greater transparency in its fiscal operations. | Measures to ensure greater transparency in its fiscal operations. | Budget to be made more transparent by better disclosure statements to be included in the budget documents. | Bringing budget transparency by identifying all liabilities (past & present), constitution of a Doubtful Loans and Equity Fund. |

## Annex 3 : 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 privatisation strategy is being finalised. The APERC has issued two-tariff orders. The State has signed MoU with Government of India. Reform law has been enacted. State has created distribution zones/companies. |
| Arunachal Pradesh | The State notified the State Electricity Regulatory Commission (SERC). |
| Assam | Single member SERC has been constituted. The SERC has become operational and issued tariff order. |
| 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 for which the Power Finance Corporation (PFC) has sanctioned a grant. 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 the Government of India and has been introduced in the State Assembly. The State has signed MoU with the Government of India. |
| 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. The State has signed MoU with the Government of India. State has created distribution zones/companies. |
| Himachal Pradesh | The State Government is committed to undertake reforms with technical and financial assistance of Power Finance Corporation (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. SERC has been constituted. |
| 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. The distribution zones/ companies have been created in the State. |

| States | Status of Reforms and Restructuring |
|---|---|
| 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 the 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 functionally unbundled. The State has signed MoU with the Government of India. State has created distribution zones/companies. |
| Maharashtra | 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 functionally unbundled. The State has signed MoU with the Government of India. State has created distribution zones/companies. |
| 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. Power distribution has been privatised. 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. Privatisation of distribution. |
| 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. State created distribution distribution zones/companies. |
| Tamil Nadu | The State has set up the SERC. SERC has become operational and issued tariff order. The State proposes to undertake reforms with the technical and financial assistance from PFC. The State has signed MoU with the Government of India. Efforts are underway towards unbundling/corporatisation and reforms Ordinance/Bill enactment. |
| 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. |
| Uttaranchal | The SERC has been constituted and become operational. SERC issued tariff order. The State has signed MoU with the Government of India. Efforts are underway towards unbundling/ corporatisation and reforms Ordinance/Bill enactment. |
| 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 the reforms in power sectors. |

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

***Source :*** 1. *Annual Reports on the Working of State Electricity Boards and Electricity Departments,* Planning Commission, Government of India, various issues.
2. Mid-Year Review, Ministry of Finance, Government of India, November 2003.

## Annex 4 : Group to Study the Pension Liabilities of the State Governments: Summary of Recommendations

The issue of ever increasing pension liabilities of the State Governments has assumed critical importance in recent years, especially in the context of the fiscal deterioration of States. At present, the State Government pension schemes are non-contributory in nature and as the pension liabilities have not been backed by any funding arrangements, they, perforce, are to be met through budgetary resources, thereby causing heavy drag on the State exchequer. The aggregate expenditure on pension payments of the State Governments has increased sharply from Rs.3,593 crore in 1990-91 to Rs.27,849 crore in 2001-02. The pension payments, which formed less than 3 per cent of the revenue receipts in the early 1980s, rose to about 10 per cent of the revenue receipts in recent years. Increasing pension payment has, therefore, been an important factor in constraining the States' ability to undertake developmental activities.

Against the above background, the issue of growing pension liabilities of the States came up for discussion during the Conference of State Finance Secretaries held in the Reserve Bank in January 2003. Recognising the fiscal implications of increasing pension liabilities of the State Governments, a comprehensive examination of all the issues relating to States' pension liabilities was considered crucial. Accordingly, in February 2003, the Reserve Bank constituted a Group to Study Pension Liabilities of the State Governments (Chairman: Shri B. K. Bhattacharya).

Major recommendations of Group are set out below:

1. Introduction of contributory pension scheme/s for the new employees of the State Governments in place of the existing non-contributory defined benefit pension scheme. The Group recommended alternative pension models for the State Governments: i) pure Defined Contribution (DC) scheme in which the new employees and the State Governments each would contribute 10 per cent of the basic pay and dearness allowance to an individual account. The contributions will be vested in a Fund which will be invested in accordance with specified guidelines. The employee at the time of retirement will get an amount which will be the aggregate total of the employee's contribution, Government's (employer's) contribution and the earnings (on investment made by the Fund) attributed to the employee's Account; (ii) a Defined Contribution - Defined Benefit (DC-DB) scheme - a contributory scheme with guarantee of an appropriate level of pension fixed by individual State Governments, and (iii) a two Tier scheme- the defined benefit in the first Tier of DC-DB scheme could be reduced from the present level of 50 per cent to an appropriate level of say 30 per cent and supplemented by a mandatory Defined Contribution (DC) scheme, wherein both the employees and the State Governments make contributions.

2. The contributions under the proposed scheme/s and also the earnings from the Pension Funds may be granted Income Tax exemption.

3. The proposed new pension scheme/s should be made mandatory for all new employees of the State Governments and the date of its applicability may be decided by the respective State Governments.

4. The State Governments may explore all the possibilities of extending the new scheme even to the existing employees, on an optional basis.

5. To have some immediate and medium-term effect on State finances, the Group felt that a few parametric changes in the current pension scheme for both the existing employees and pensioners become inevitable.

6. The Group recommended immediate withdrawal of fixing the pension on the basis of only last one month's pay, wherever it exists now. Further, the basic pension may be determined on the basis of the average pay for a longer period, say for 36 months.

7. In the case of employees taking voluntary early retirement, the practice of adding 5 years on a notional basis while calculating the basic pension may be done away with.

8. The Group recommended continuation of the present practice of price indexation, while doing away with wage indexation facility, wherever it exists.

9. There should be regular mutual consultation between the Central Government and the State Governments on the issue of increase in the rates of Dearness Allowance.

10. The maximum permissible commutation amount should be brought down from 40 per cent of Basic Pension to 33 1/3 per cent (1/3rd).

11. The present discount rate used while calculating the Commutation Factor could be enhanced and could be linked to the rate of return on General Provident Fund.

12. The pension burden relating to the employees of grant-in-aid institutions (GIA) / Local Bodies (LBs) to be recruited in future should be shifted to the respective institutions/bodies. For existing employees, States may explore the possibility of collecting contributions from the employees as well as the institutions concerned towards the pension liability. The GIA/ and LBs should consider having their own pension scheme/s of a contributory type.

13. In order to at least partially meet the pension burden of the existing employees and pensioners, there is a need for setting up a "Dedicated Pension Fund" through levying a cess on /collecting contributions from all the existing employees, retaining a portion of increased salary and dearness allowance (DA) arising from the revisions in salary and DA, and taking steps to augment the Fund.

14. Reduction in the leave encashment period in a phased manner, with advance intimation to all concerned is also recommended.

15. The "Pension Fund" to be created under the proposed revised schemes should be kept completely outside the States' Consolidated Fund and the Public Account.

16. The individual State Governments should consider having their own separate Pension Funds or Joint Pension Funds for a group of States. The smaller States could either have a Joint Pension Fund or may consider joining the proposed Tier-II of the Central Government Pension Scheme.

17. The Group recommended that annual actuarial evaluation of the Pension Funds may be adopted by the States.

18. There could be several Pension Fund managers for each Fund, subject to the guidelines of the Pension Fund Regulatory and Development Authority (PFRDA).

19. In respect of a pure DC scheme and DC component of a 2 tier scheme, the State Governments may consider providing investment options to their employees, similar to those available to the Central Government employees.

20. There should be comprehensive system of periodic verification of the records of pensioners by all the State Governments.

21. While introducing various parametric changes, the State Governments may simultaneously take appropriate measures to improve the medical facilities available to the pensioners.

22. The State Governments should put in place proper arrangements (including computerisation) to collect, update, and monitor comprehensive information/data relating to pensioners and employees without further delay.

23. The Group suggested that the recommendations may be implemented with the involvement of all the stakeholders.