STATE FINANCES: A STUDY OF BUDGETS OF 2004-05[1]

Overview

The State Government budgets for 2004-05[2] were presented against the backdrop of persistent structural weaknesses in their finances and an exacerbation of fiscal stress in 2003-04, following a transitory moderation during the previous three years. In view of the Parliamentary and Legislative Assembly elections scheduled during April-May 2004, many State Governments first presented Vote-on-Account budgets, and the regular budgets, subsequently. These budgets were presented in an environment marked by a growing recognition of the urgent need for fiscal consolidation and the progressive implementation of fiscal and institutional reforms by a number of States. Notwithstanding these initiatives, the evolving fiscal scenario reaffirmed the existence of vulnerabilities in State Government finances.

As documented in various studies and reports including those of the Reserve Bank, the structural weaknesses in the finances of State Governments had become clearly manifest during the 1990s. These were reflected in the persistent expansion of the revenue deficit (RD) and gross fiscal deficit (GFD), large accumulation of debt, mounting debt service burden, rising share of committed but non-developmental expenditures, low and declining non-tax revenues and increasing contingent liabilities. Recognising the urgent need for fiscal correction, a number of State Governments had initiated an array of reforms in the late 1990s covering taxation, user charges on public services, public sector enterprises, expenditure management, contingent liabilities and more recently, the enactment of fiscal responsibility legislation. The Central Government also introduced measures to encourage and facilitate fiscal reforms at the State level; such measures included, *inter alia*, the Fiscal Reforms Facility and the Debt Swap Scheme.

Some signs of improvement in State finances were evident in the initial years of the present decade, facilitated, *inter alia*, by a moderation in the rate of growth of revenue expenditure. All the major deficit indicators, as ratios to GDP, recorded a decline over the period 2000-01 to 2002-03. This positive development, however, turned out to be transitory, with the revised estimates of 2003-04 showing a sharp deterioration in fiscal imbalances.

Slippages were witnessed for the State Governments in respect of the major deficit indicators in the revised estimates for 2003-04 from their budgeted levels. The RD increased to 2.6 per cent of GDP in the revised estimates for 2003-04, which was substantially higher than that of 1.8 per cent in the budget estimates and 1.7 per cent during the latter half of the 1990s. The persistent and rising RD resulted in the widening of the GFD. The GFD of the State Governments was placed at 5.1 per cent of GDP in the revised estimates for 2003-04 as compared with 4.2 per cent in the budget estimates and an average of around 3.5 per cent during the second half of the 1990s.

The fiscal imbalances led to a steady accumulation of debt[3] and consequently, the debt-GDP ratio increased by over seven percentage

1. Prepared in the Division of State and Local Finances (DSLF) of the Department of Economic Analysis and Policy (DEAP), with the technical support of the Regional Offices, the Division of Econometrics and the Division of Central Finances of DEAP.
2. An analysis of the consolidated fiscal position of State Governments based on the budgets of 26 States (some of which were Vote on Account) for 2004-05 has been published in the Reserve Bank of India Annual Report, 2003-04. This Study covers 29 State budgets. It provides further details on the consolidated fiscal position as also a State-wise analysis covering budgetary data as well as additional information obtained from the State Governments and the Government of India.
3. In this Study, the debt of the State Governments comprises of Internal Debt (including market borrowings and securities issued to the National Small Savings Fund), Loans and Advances from the Centre, Small Savings, State Provident Funds, Insurance and Pension Funds, Trusts and Endowments.

points to 29.1 per cent over the five-year period ended March 31, 2004. Interest payments on debt pre-empted over 25 per cent of revenue receipts in 2003-04, accentuating the resource constraint. The composition of outstanding liabilities of the State Governments shows a sharp decline in the share of loans from the Centre and upsurge in the shares of loans from National Small Savings Fund (NSSF), market loans and negotiated loans from banks and other institutions.

Apart from the increasing level of debt, the outstanding guarantees of State Governments increased from 4.4 per cent of GDP as at end-March 1996 to 8.1 per cent per cent of GDP as at end-March 2001 and were placed at 7.5 per cent (Rs.1,84,294 crore) of GDP at end-March 2003.[4] Such contingent liabilities could add to the already high debt burden in the event of default by the borrowing entity.

One of the factors that had engendered the sharp increase in the resource gaps during 2003-04 was the issue of power bonds by State Governments to Central Public Sector Undertakings under the One-Time Settlement Scheme for dues of the State Electricity Boards. Some State Governments also stepped-up current assistance to the State Electricity Boards and enhanced capital outlay on irrigation projects during the year. Since all such expenditures are part of 'Economic Services', the share of developmental expenditure witnessed an increase during the year, in conjunction with the expansion in fiscal deficit. It is, in fact, estimated that around half of the increase in the GFD-GDP ratio in 2003-04 over the budget estimates was on account of transactions relating to the power sector. There was, however, no let-up in the increase in non-developmental expenditures nor any improvement in non-tax revenue mobilisation by the State Governments during 2003-04, highlighting the persistence of structural infirmities in their finances. An econometric analysis of the GFD of fifteen major State Governments over the 1990-91 to 2003-04, as set out in *Box 1*, in fact, corroborated the predominance of the structural component as well as the underlying variation between expenditure and revenue elasticities.

A positive aspect, however, has been that the States' own tax revenue, at 5.9 per cent of GDP in 2003-04, continued to show an upward movement, *albeit* gradual, since the 1990s, in contrast to the trends in respect of the Centre's gross tax revenues. The improvement in own tax revenues was reflected across most State Governments. Within own tax revenues, however, the shares of State Excise Duties and Profession Tax have recorded a clear decline. It is also well recognised that the consolidated position on the tax front camouflages inter-State variations. The own tax-GSDP ratios were amongst the highest in the case of Karnataka and Tamil Nadu during 2003-04, whereas those in respect of Bihar and West Bengal were relatively lower. Moreover, a distinction is usually drawn between the tax capacity of a State Government and its tax effort; while the former relates to the level of economic activity in the State, the latter connotes the initiatives that the State has taken to, *inter alia*, expand the tax base, rationalise the tax structure and improve tax administration. An empirical exercise in respect of fifteen major States, as presented in *Box 2*, also showed marked differentials in tax efforts of the State Governments.

A milestone in the process of tax reforms would be the implementation of Value Added Tax (VAT) at the State level. As announced in the Union Budget for 2004-05, the scheduled date for implementation of VAT is April 1, 2005. The experience of Haryana, the only State to implement VAT so far, highlights the positive implications of such initiatives. Even so, there are a number of issues that are germane to the implementation of VAT in India, which are well recognised by the Empowered Committee of State Finance Ministers on VAT. Indeed, many of the associated international practices relating to VAT may have to be judiciously modified to suit the fiscal-federal framework of India. Some of these issues are summarised in *Box 3*.

The States' own non-tax revenues have been an area of persistent concern. A major reason

4. The data on guarantees are based on information received from seventeen States for all the years.

underlying the sluggish growth in non-tax revenues is the levy of inadequate user charges. This is reflected in poor cost recovery towards provision of public services. In fact, calculations undertaken in subsequent Sections show that cost recovery in the case of education and health services have hovered around 1 per cent and 5 per cent, respectively, in the recent period. The cost recovery in respect of economic services such as irrigation, roads and power is found to be higher than that of social services, but still remain quite low. A related issue that assumes significance in this context is that of power subsidies. These subsidies have increased manifold over the years and even after subventions (financial support) from State Governments and cross-subsidisation, the magnitude of the 'uncovered' subsidy leaves little scope for the State Electricity Boards (SEBs), but to default on payments. It is expected that the One-Time Settlement Scheme would help the SEBs to start afresh and carry forward the process of power sector reforms. In fact, a sharp increase in cost recovery is expected in the power sector during 2004-05 which as reflected in the upsurge in non-tax receipts coupled with a substantial decline in non-Plan revenue expenditure from the high levels in the previous year.

Apart from inappropriate user charges, low or negative returns from investment have adversely affected the growth of States' own non-tax revenues.

The evolving pattern of expenditure in 2003-04 indicated a sharp increase in developmental expenditure as a ratio to GDP. This largely reflected higher (revenue and capital) expenditure on the power sector (which is recorded under 'Economic Services'). The increase in developmental expenditure during 2003-04 was evident across most State Governments. Non-developmental expenditure, as a ratio to GDP, also maintained its steady upward trend to 6.4 per cent of GDP in 2003-04. The ratio of non-developmental expenditure to GSDP was relatively high in the case of Bihar, Orissa, Punjab and Uttar Pradesh. Within non-developmental expenditure, interest payments absorbed over 25 per cent of revenue receipts at the consolidated level, which was substantially higher than that of 18 per cent recommended by the Eleventh Finance Commission (EFC) from the viewpoint of debt sustainability over the medium term.

The weaknesses in the finances of the State Governments have invited, in some cases, adverse reaction from the financial markets as manifested in the widening spread and under-subscription to market loans of some of the States. The spread between the rate of interest on State market loans and Central market loans of ten-year maturity in the secondary market has widened from 25 basis points in 2000-01 to 50 basis points in the recent period. The under-subscription to the State market loans also brings to the fore various factors that impact on their liquidity. These factors include the health of the finances of the State Governments, the credibility of their prospective policy actions and transparency of their budgets. Some issues in this regard are highlighted in *Box 4*.

In the context of the urgent need for fiscal correction, a significant initiative on the part of five State Governments *viz.*, Karnataka, Kerala, Punjab, Tamil Nadu and Uttar Pradesh has been the enactment of fiscal responsibility legislation. It is indeed noteworthy that except for Uttar Pradesh, the other four State Governments recorded a decline in the revenue deficit during 2003-04 over the previous year. In the case of Karnataka, the debt-GSDP ratio was estimated at 29.0 per cent in 2003-04 as compared with the target of 25 per cent to be attained by 2015[5] . The positive experience of these State Governments is expected to motivate other States to expeditiously enact fiscal responsibility legislation.

The liquidity management of the State Governments since 2003-04 was facilitated by periodic enhancement of the limits of Ways and

5. According to the Fiscal Responsibility Legislation of Karnataka, total liabilities are defined as liabilities under the Consolidated Fund and the Public Accounts of the State Government. This definition differs from that adopted in this Study as explained in Footnote 3.

Means Advances (WMA) as also higher mobilisation of Small Savings and enhanced market borrowings. Apart from WMA from the Reserve Bank, a number of States took recourse to WMA from the Central Government to tide over liquidity mismatches; the magnitude of such advances to some State Governments have been persistently large. The budgetary transactions of the State Governments have generally resulted in large negative opening cash balances. An opening cash deficit portends *ex ante* liquidity problems, which could exacerbate by the extent to which total receipts fall short of total expenditures during the year, unless compensated by Additional Resource Mobilisation. This would, in turn, necessitate the drawing down of cash/investment balances or recourse to WMA/Overdrafts from the Reserve Bank.

The budget estimates for 2004-05 portray an endeavour to carry forward the fiscal reform process through a renewed emphasis on fiscal empowerment and expenditure containment. The budgetary proposals include rationalisation of the tax structure, amnesty schemes for the recovery of tax arrears, computerisation of tax departments, restructuring of staff position in government departments, introduction of a pension scheme based on defined contribution and power sector reforms. Additional Resource Mobilisation of Rs.2,046 crore has been envisaged during 2004-05.

It is, however, evident that a part of the envisaged reduction in fiscal imbalances would simply be a correction of the 'high base effect' of developmental (revenue and capital) expenditures incurred in the previous year. In fact, excluding the transactions in respect of the power sector, revenue expenditure is estimated to increase by 7.4 per cent in 2004-05 as compared with 15.4 per cent in the previous year. The volume of power subsidies, although still quite large, is estimated to decline from 1.6 per cent of GDP in 2000-01 to 1.1 per cent in 2004-05[6].

The expected improvement in the States' fiscal position during 2004-05 would also be contingent upon the acceleration in their share in Central tax revenue and the revenue mobilisation efforts of the State Governments. Accordingly, the revenue deficit is budgeted to decline from 2.6 per cent of GDP in 2003-04 to 1.4 per cent of GDP in 2004-05 which is, in fact, lower than the average level of 1.7 per cent recorded during the latter half of the 1990s. The GFD is estimated to have come down from 5.1 per cent of GDP in 2003-04 to 3.6 per cent of GDP in 2004-05 which is only slightly higher than the level that prevailed, on an average, during the second half of the 1990s. The revenue deficit would account for 39.1 per cent of the GFD in 2004-05 as compared with over 50 per cent in the previous year and 44.7 per cent in the second half of the 1990s.

Apart from the envisaged fiscal correction, the State budgets for 2004-05 assume special significance in the context of the regular Union Budget 2004-05 and the adoption of the National Common Minimum Programme (NCMP) in July 2004.

The regular Union Budget for 2004-05, which was presented in July 2004, after the presentation of some of the State budgets, has, *inter alia*, provided for higher devolution of resources to the States and has proposed specific measures to alleviate their debt-service burden. According to the State budgets, however, gross devolution and transfer of resources from the Centre would decline to 5.5 per cent of GDP in 2004-05 from 5.7 per cent in the previous year and 6.8 per cent, on an average, during the first half of the 1990s. The budgeted reduction in the transfer of resources from the Centre, as a ratio to GDP, during 2004-05 mainly reflects the decline in Non-Plan grants.

It is also pertinent to note that the Report of the Twelfth Finance Commission, submitted to the Hon'ble President of India recently, would provide the framework for devolution of resources from the

6. Economic Survey 2003-04, Government of India.

Centre over the five-year period beginning fiscal 2005-06. This would, in conjunction with the role of the States envisaged in the ensuing Mid-Term Appraisal of the Tenth Five-Year Plan (2002-07), form the policy frame for fiscal federalism over the medium term. Some of the major issues in fiscal federalism that have emerged in the international arena are highlighted in *Box 5*.

The NCMP has, *inter alia*, called for the raising of public spending on education and health and has placed highest priority on the development of infrastructure - areas where the States play an important and ubiquitous role. It has, however, been well recognised, at various fora, that the developmental role of the States is being circumscribed by the underlying stress on their finances. In fact, social sector expenditure (comprising social services, rural development and food storage and warehousing) of the State Governments is estimated to decline to 5.4 per cent of GDP in 2004-05 from 5.9 per cent in the previous year. Within social sector expenditures, provisions for education and health (as a ratio to aggregate disbursements) are also estimated to decline from 2.52 per cent and 0.72 per cent in 2003-04 to 2.37 per cent and 0.67 per cent, respectively, in 2004-05.

Another important issue in the context of the developmental role of the States is the efficiency of government expenditures. In view of resource constraints for State Governments, it is worthwhile to examine whether the same developmental outcome could be attained with smaller government expenditure. A number of international studies have been undertaken since the late 1990s to measure the efficiency of government expenditures in a cross-country framework. Most studies underscore the need to enhance the efficiency of Government expenditures to ensure improved delivery of public services. Some of the measurement issues relating to the efficiency of government expenditure are discussed in *Box 6*.

The evolution of expenditures of the State Governments over the future would be shaped by the changes in the demographic profile of the country. In particular, with increase in share of ageing population, expenditures on health care and pensions are likely to expand at very high rates. In this context, the demographic issues that impinge upon the sustainability of State Government finances are set out in *Box 7*.

Against this backdrop, the present study analyses the State Government budgets for 2004-05. Section I summarises the major policy initiatives proposed in the State Government budgets for 2004-05 as well as the measures undertaken by the Central Government and the Reserve Bank in the context of State Government finances. Section II presents an analysis of the consolidated fiscal position of the State Governments for the years 2002-03 (Accounts), 2003-04 (Revised Estimates) and 2004-05 (Budget Estimates). Section III discusses the State-wise fiscal scenario. This is based on an analysis of fifteen fiscal indicators classified broadly into (i) resource gap; (ii) revenue performance; (iii) pattern of expenditure; and (iv) debt position. The analysis of fiscal indicators is undertaken separately for Special and Non-Special Category States. In the case of each category, the State Governments are placed in an ascending order for each fiscal indicator. The State Governments have then been ranked into four quartiles for each fiscal indicator for the years 2000-03 (average) and 2003-04. The State Governments are also grouped according to different quartiles for each fiscal indicator for 2000-03 (average) and 2003-04. The relative strengths and weaknesses of the financial position of the State Governments become clearer in this form of analysis. Emerging issues in State Government finances are discussed in the concluding Section. The detailed State-wise data on revenue receipts, revenue expenditure, capital receipts and capital expenditure are set out in Appendices I, II, III and IV, respectively.

Section I
Policy Initiatives

(A) State-level Policy Initiatives

The State Government budgets for 2004-05 seek to carry forward the reform process initiated in the recent past. The State-wise details of these initiatives are set out in *Annex 1*. A brief summary of these measures is presented in this Section.

(i) Revenue Mobilisation Measures

A number of State Governments have placed special emphasis on fiscal empowerment and, in this context, have underscored the need to increase the magnitude and efficiency of tax revenue mobilisation[7] . The general approach is to rationalise and simplify the tax structure, broaden the tax base and impose moderate rates of taxation. Some State Governments such as Kerala, Maharashtra and Jammu and Kashmir have announced one-time settlement/amnesty schemes for recovery of tax arrears. State Governments such as Andhra Pradesh have appointed expert committees to recommend tax reform measures, and those such as Tamil Nadu are already implementing the accepted suggestions of such expert committees. Preparations for the introduction of VAT are also underway in many States. A renewed drive for computerisation of tax/ budget departments, treasuries and check-posts (for implementing VAT) is also evident in a number of States.

(ii) Expenditure Management

Most State Governments have reiterated the need to contain unproductive expenditures and reorient spending towards developmental purpose. Some State Governments such as Punjab have called for restructuring of the staff position in each government department and have indicated that future employment in the government would be project-specific and need-based. The recommendations of a Public Reforms Committee covering, *inter alia*, Voluntary Retirement Scheme and privatisation, is under consideration by the Government of Assam, whereas an Expenditure Review Committee is proposed to be constituted by the Government of Tamil Nadu, to review, on an on-going basis, the expenditure in respect of each department. States such as Punjab have proposed disinvestment on a selective basis in respect of loss-making Public Sector Undertakings. Some State Governments such as Punjab and Rajasthan have announced the introduction of a new pension scheme based on defined contribution.

(iii) Institutional Reforms

State Governments which have already enacted Fiscal Responsibility Legislation (FRL) (*i.e.*, Karnataka, Kerala, Tamil Nadu, Punjab and Uttar Pradesh) have formulated medium term fiscal plans to bring about an orderly correction of their financial positions. Some of the other State Governments like Assam, Himachal Pradesh and Rajasthan have proposed to enact FRL. Provisions to empower local bodies, on the basis of the recommendations of the respective State Finance Commissions, are also evident in the case of a number of State Governments including Haryana, Himachal Pradesh, Punjab and Sikkim. Power sector reforms initiated by the State governments in the late 1990s include the constitution of State Electricity Regulatory Commissions (SERCs) for determining the tariff structure, unbundling of State Electricity Boards into separate entities for power generation, transmission and distribution, raising power tariffs and measures for reducing transmission and distribution losses. A number of States including Karnataka and Punjab are also expected to carry forward the process of power sector reforms. It may, however, be mentioned that the NCMP had envisaged a review of the Electricity Act, 2003, in view of the concerns expressed by a number of States, and an extension of the mandatory date (June 10, 2004) for unbundling and replacing the State Electricity Boards.

(iv) Other Measures

Many States including Andhra Pradesh, Tamil Nadu and Mizoram have announced measures to provide a boost to infrastructure projects. States such as Gujarat, Haryana and Tamil Nadu have proposed to set up Special Economic Zones/Agro-Export Zones. Some State Governments such as Andhra Pradesh have also made budgetary provisions for the supply of free power to farmers, as also for the waiver of outstanding arrears of agricultural consumers. States like Assam have provided for land revenue exemption for flood-affected people.

7. The details of Additional Resource Mobilisation proposed by the States are given in Statement 24.

(B) Centre's Initiatives

Following the recommendations of the Eleventh Finance Commission, the Government of India set up an Incentive Fund during 2000-01 to encourage State Governments to initiate fiscal reforms. The corpus of the Fund was Rs.10,607.72 crore and an equal amount of Rs.2,121.54 crore was available for release to the State Governments in each year of the period 2000-01 through 2004-05. Releases from the Incentive Fund to the State Governments were based on a single monitorable fiscal objective *viz.*, a minimum improvement of 5 percentage points in the ratio of revenue deficit to revenue receipts in each year till 2004-05 over the base year (1999-2000). The revenue surplus States were required to show an improvement of 3 percentage points in the ratio of Balance from Current Revenues to non-Plan revenue expenditure. In order to attain this objective, the State Governments were required to formulate a Medium-Term Fiscal Reforms Programme (MTFRP) encompassing fiscal consolidation, public sector enterprises reforms, power sector reforms and fiscal transparency. Based on the MTFRP, the States sign a Memorandum of Understanding (MOU) with the Government of India. As of end-December 2004, the MTFRP had been finalised by 27 States while the MOUs were signed in the case of 22 States. A total amount of Rs.5,363 crore till end-December 2004 had been released from the Incentive Fund.

The Union Budget for 2003-04 had announced a Debt Swap Scheme (DSS) that would enable States to prepay their high-cost debt to the Centre through additional market borrowings and proceeds from Small Savings (upto specified limits) at the prevailing interest rates, over a period of three years ending 2004-05. Of the total outstanding high-cost loans amounting to Rs.1,14,317 crore as at end-March 2002, Rs. 92,369 crore *i.e.*, 80.8 per cent, (comprising Rs. 41,965 crore of Small Savings loans and Rs.50,404 crore of market loans) has been swapped so far. The balance of outstanding high-cost loans that remains to be swapped is Rs. 21,948 crore.

The Union Budget for 2004-05 has further reduced the interest on loans from the Centre from 10.5 per cent to 9 per cent with effect from April 1, 2004; States are expected to benefit from this measure to the extent of Rs.375 crore during 2004-05. The Union Budget has also proposed that the DSS would be extended by allowing States to raise fresh loans and repay their old high-cost loans to NABARD and some other agencies. It was also proposed to consult the States on the issue of allowing them to increase their open market borrowings and reduce their dependence on loans from the Centre.

(C) Reserve Bank's Initiatives

As the banker and debt manager to the State Governments, the Reserve Bank has been providing Ways and Means Advances and Overdrafts facility to the State Governments on the basis of mutual agreements to tide over temporary mismatches in cash flows, and has been periodically revising the Scheme in the light of evolving circumstances.

The Reserve Bank has also introduced flexibility in the market borrowing programme of the State Governments by allowing the States to directly access the market upto specified amounts of gross market borrowings. The Reserve Bank has been organising the conferences of State Finance Secretaries in a structured manner since 1997, wherein a consensual approach among the Central Government, State Governments and the Reserve Bank has evolved on issues relating to State finances. The Reserve Bank constituted a committee to frame Model Fiscal Responsibility Legislation at the State level; the report of the committee was discussed at the 14th Conference of State Finance Secretaries held in August 2004 and is in the process of finalisation. The Reserve Bank has continued its efforts to sensitise the States about the problems posed by increasing volume of guarantees. A Standing Committee has been constituted within the Reserve Bank to collect and monitor information on State Government guaranteed advances and bonds from the investors' side on a periodic basis. Following the discussion at the last conference of State Finance Secretaries, the Reserve Bank has constituted a Working Group on the methodology of compilation of data on State Government liabilities. A summary of recent initiatives of the Reserve Bank relating to State Government finances is set out in *Annex 2*.

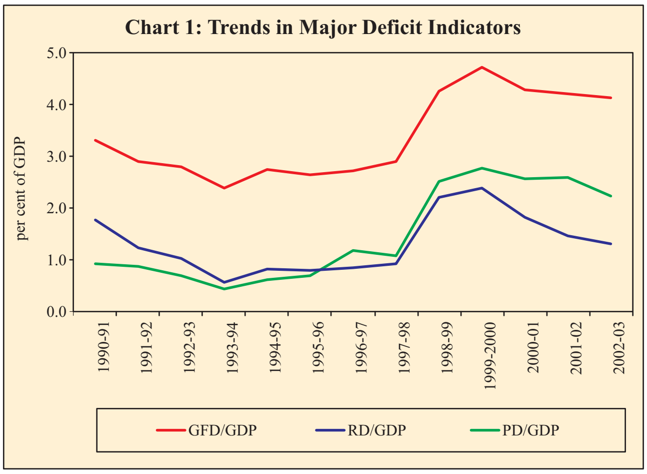
Section II
Consolidated Fiscal Position of State Governments

(A) Accounts: 2002-03

The improvement in the consolidated fiscal position of the State Governments that was evident since 2000-01 continued during 2002-03. All the major deficit indicators, as a ratio to GDP, recorded a decline over the previous year (Table I). The reduction in fiscal imbalances during the year was facilitated by the sustained uptrend in States' own tax revenues coupled with a contraction in revenue expenditure, as a ratio to GDP. The composition of expenditure, however, indicated that the developmental component, as a ratio to GDP, had declined further, while the non-developmental component has increased (Also see Appendix Tables 1-4).

A notable feature of the consolidated fiscal position of the State Governments during 2002-03 was the reduction in revenue deficit or in government dis-savings. The increase in capital outlay as well as reduction in recovery of loans, however, offset the decline in revenue deficit, resulting in an increase in the overall borrowing requirements (GFD). Notwithstanding the increase in GFD, a sustained correction of the current (*i.e.*, non-interest) fiscal stance was evident in the reduction in the primary deficit, for the second year in succession. The fact that this correction was largely concentrated in the revenue account was reflected in the improvement in primary revenue balance which recorded surplus position during 2002-03, for the second year in a row. In fact, the primary revenue balance financed over 21 per cent of interest payments during 2002-03 as against around 5 per cent in the previous year, indicating the impact of fiscal reform measures.

Notwithstanding the downward movement, the levels of the GFD and the revenue deficit, as a ratio to GDP, remained higher in 2002-03 than their respective levels in the 1990s, reflecting the need for sustained efforts at fiscal correction (Chart 1).



GFD: Gross Fiscal Deficit
PD: Primary Deficit
RD: Revenue Deficit
GDP: Gross Domestic Product

Table I : Major Deficit Indicators - 1990-91 to 2002-03

(Rs. crore)

Item	1990-95 (Average)	1995-00 (Average)	1999-00 (Accounts	2000-01 (Accounts)	2001-02 (Accounts)	2002-03 (Accounts)
1	2	3	4	5	6	7
Gross Fiscal Deficit			91,480	89,532	95,994	102,123
	(2.8)	(3.5)	(4.7)	(4.3)	(4.2)	(4.1)
Revenue Deficit			53,797	53,569	59,188	55,111
	(0.7)	(1.7)	(2.7)	(2.6)	(2.6)	(2.2)
Primary Deficit			46,309	37,830	33,488	31,981
	(1.6)	(1.4)	(2.4)	(1.8)	(1.5)	(1.3)
Primary Revenue Balance			8,625	1,867	-3,318	-15,031
	(-1.0)	(-0.4)	(0.4)	(0.1)	(-0.1)	(-0.6)

'-' : indicates surplus.
Note : Figures in brackets are percentage to GDP.
Source : Data on fiscal variables have been compiled from budget documents of State Governments. Data on GDP is from Central Statistical Organisation (CSO).

The reduction in the revenue deficit in 2002-03 over the previous year was largely on account of higher realisation of Sales Tax revenue as well as an increase in the States' share in Central tax revenue. The States' own tax revenue, as a ratio to GDP, showed some improvement in 2002-03 from the levels in the previous year as well as in the 1990s (Table II). Current devolution and transfers from the Centre (Shareable taxes and Grants) as well as States' own non-tax revenue, as ratio to GDP, however, continued to be lower than the levels in the past (Chart 2).

previous year though it remained higher than the levels prevailing in the 1990s. The steady increase in interest payments imparted downward rigidity to revenue expenditure. (Table III and Chart 3). On balance, therefore, improvement in fiscal empowerment (*via* an increase in revenue receipts) was the key factor underlying the reduction in the revenue deficit.

Under capital disbursements, repayments of loans to the Centre showed a large increase in 2002-03, reflecting the transactions under the DSS. Capital outlay on irrigation and flood control was also enhanced during 2002-03. Total capital outlay as a ratio to GDP, however, remained almost unchanged at 1.5 per cent, indicating the absence of adequate efforts to step-up expenditure towards infrastructure development over the years. Under capital receipts, a substantial increase in Small Savings (securities issued to NSSF) was evident during 2002-03 (Table IV).

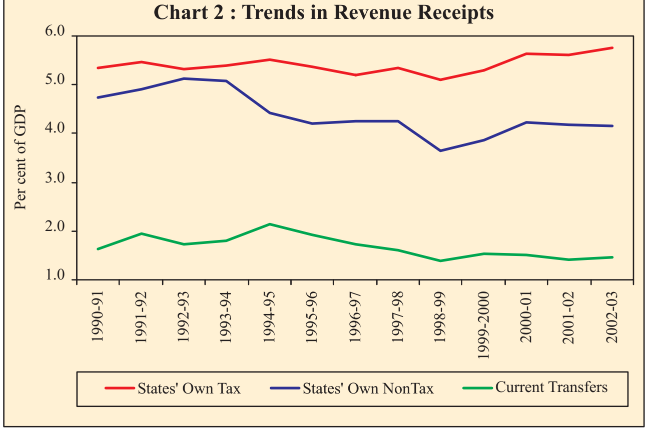
Table II : Trends in Receipts - 1990-91 to 2002-03

(per cent of GDP)

Item	1990-95 (Average)	1995-00 (Average)	2000-01 (Accounts)	2001-02 (Accounts)	2002-03 (Accounts)
1	2	3	4	5	6
Total Receipts (1+2)	16.1	15.2	16.7	16.4	**17.3**
1. Total revenue receipts (a+b)	12.1	10.9	11.4	11.2	**11.4**
(a) States own Revenue	7.3	6.9	7.1	7.0	**7.3**
States own tax	5.4	5.3	5.6	5.6	**5.8**
States own non tax	1.8	1.6	1.5	1.4	**1.5**
(b) Central Transfers	4.9	4.0	4.2	4.2	**4.1**
Shareable taxes	2.6	2.4	2.4	2.3	**2.3**
Central Grants	2.3	1.6	1.8	1.9	**1.8**
2. Capital Receipts (a+b)	4.0	4.2	5.3	5.2	**5.9**
(a) Loans from Centre@	1.2	1.0	0.9	1.1	**1.1**
(b) Others Capital Receipts	2.9	3.2	4.4	4.1	**4.8**

BE : Budget Estimates
RE : Revised Estimates.
@ : With the change in the system of accounting with effect from 1999-2000, States' share in Small Savings, which was earlier included under loans from the Centre, is now included under internal debt and shown as special securities issued to the National Small Saving Fund (NSSF) of the Central Government. The data for the years prior to 1999-2000 as reported in this table, however, exclude loans against small savings for the purpose of comparison.
Source : Same as Table I.

Chart 2 : Trends in Revenue Receipts



The increase in revenue expenditure, *albeit* lower than that in revenue receipts, primarily emanated from a step-up in interest payments. The trends in revenue expenditure, as a ratio to GDP, showed a decline in 2002-03 over the

On the whole, however, while the ratio of non-developmental expenditure (comprising, *inter alia*, interest payments, pensions and administrative services) to GDP increased in 2002-03 *vis-à-vis* the previous year, the ratio of developmental expenditure to GDP continued to decline in 2002-03 (Chart 4).

Table III : Trends in Expenditure - 1990-91 to 2002-03

(per cent of GDP)

Item	1990-95 (Average)	1995-00 (Average)	2000-01 (Accounts)	2001-02 (Accounts)	2002-03 (Accounts)
1	2	3	4	5	6
Total Expenditure (1+2 =3+4+5)	**16.0**	**15.3**	**16.7**	**16.5**	**17.0**
1. Revenue Expenditure	**12.8**	**12.6**	**14.0**	**13.8**	**13.6**
of which					
Interest payments	1.7	2.0	2.5	2.7	2.8
2. Capital Expenditure	**3.2**	**2.7**	**2.7**	**2.7**	**3.4**
of which					
Capital outlay	1.6	1.4	1.5	1.4	1.5
3. Developmental Expenditure	**10.8**	**9.6**	**10.1**	**9.5**	**9.2**
4. Non Developmental Expenditure	**4.3**	**4.9**	**5.7**	**6.1**	**6.2**
5. Others *	**0.9**	**0.7**	**0.9**	**1.0**	**1.6**
Memo item					
Non plan Non Developmental Expenditure	4.3	4.8	5.6	6.0	6.0

* : Includes discharge of internal debt, repayments of loans to Centre, compensation and assignments to local bodies, etc.
Source : Same as Table I.

Chart 3: Trends in Major Components of Expenditure

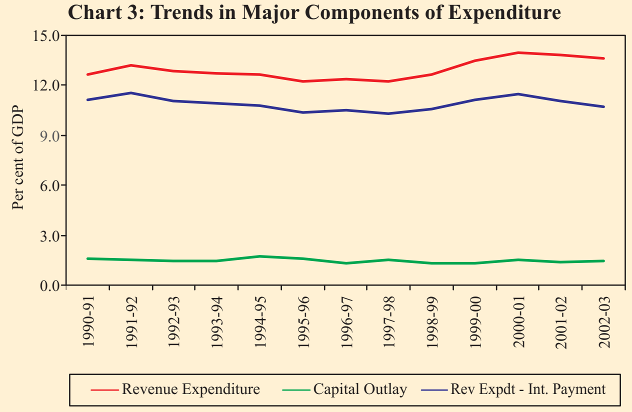


Chart 4: Development and Non Development Expenditure

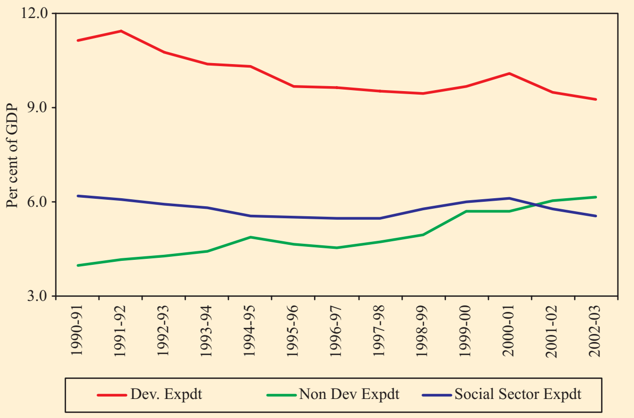


Table IV : Variation in Major Items: 2002-03 (Accounts) over 2001-02 (Accounts)

Item	Variation		Contri-bution* (per cent)
	Amount	Per cent (Rs. Crore)	
1	2	3	4
I. Revenue Receipts	**24,664**	**9.6**	**100.0**
of which:			
Sales Tax	9,153	11.9	37.1
Share in Central Taxes	4,440	8.5	18.0
II. Revenue Expenditure	**20,588**	**6.5**	**100.0**
of which:			
Power	-1,175	-7.7	-5.7
Interest Payments	7,636	12.2	37.1
III. Capital Receipts	**26,523**	**22.4**	**100.0**
of which:			
Special Securities Issued to NSSF	16,595	46.6	62.6
Recovery of loans	-3,861	49.7	- 14.6
IV. Capital Disbursements	**22,563**	**36.1**	**100.0**
of which:			
Repayments of Loans to Centre	14,461	105.7	64.1
Capital Outlay on Irrigation & Flood Control	2,492	25.5	11.0

* : Denotes percentage share in relevant total.
Source : Compiled from the budget documents of State Governments.

Another issue of concern has been the deviation of the accounts data from the revised estimates (Table V). Within revenue receipts, the shortfall in current transfers from the Centre has been higher than that in respect of States' own revenue, in recent years. Since the revenue deficit has sometimes been

Table V : Deviation of Accounts from the Revised Estimates - 1998-99 to 2002-03

(Per cent)

Items	1998-99	1999-2000	2000-01	2001-02	2002-03
1	2	3	4	5	6
Revenue Receipts	**-6.7**	**-3.5**	**-4.7**	**-5.6**	**-4.6**
of which:					
(i) States Own Revenue	-4.2	-2.1	-0.7	-2.7	-1.7
(ii) Current Transfers from Centre	-10.8	-6.0	-10.7	-10.2	-9.4
Revenue Expenditure	**-4.1**	**-3.9**	**-3.1**	**-5.0**	**-5.6**
Revenue Deficit	**7.8**	**-5.3**	**4.4**	**-2.2**	**-10.0**
Capital Receipts	**5.5**	**1.9**	**-2.0**	**-4.3**	**0.9**
Capital Expenditure	**-6.9**	**-2.1**	**-15.0**	**-11.0**	**-2.7**

Source: Same as Table IV.

placed lower in the Accounts than in the Revised Estimates, it is evident that the shortfall in current devolution and transfers from the Centre has been associated with a contraction in revenue expenditure. In the capital account, deviations in respect of expenditures have been usually higher than in receipts. Persistent deviations between the estimates and the accounts data particularly in respect of revenue receipts of the State Governments are a matter of concern since it undermines the credibility of the budget estimates and makes a proper assessment of the likely fiscal outcome for the year very difficult.

On the whole, 2002-03 was marked by a reduction in fiscal imbalances enabled by States' own tax revenue augmentation coupled with the containment of revenue expenditure, as a ratio to GDP. The downward rigidity of committed but non-developmental expenditures such as interest payments and pensions, however, implied that the correction was largely effected in developmental outlays.

(B) Revised Estimates: 2003-04

The revised estimates for 2003-04 showed a marked deterioration in the key deficit indicators from their respective levels in the budget estimates (Table VI). These slippages emanated largely from higher revenue and capital expenditures in respect of the power sector coupled with a decline in revenue receipts (Also see Appendix Tables 1-4).

Table VI : Major Deficit Indicators - 2003-04 (BE and RE)

(Rs. crore)

Item	2003-04 BE	2003-04 RE	Variation (%) RE over BE
1	2	3	4
Gross Fiscal Deficit (GFD)	116,176 (4.2)	141,010 (5.1)	21.4
Revenue Deficit	48,326 (1.8)	72,126 (2.6)	49.2
Primary Deficit	33,256 (1.2)	57,042 (2.1)	71.5
GFD *net of Power Bonds*		112,026 (4.0)	

BE - Budget RE – Revised Estimates.

Note : 1. Power Bonds figures are as per RBI records.
2. Figures in parentheses are percentage to GDP.

Source : Same as Table I.

The widening of the revenue deficit in the revised estimates was primarily on account of three factors *viz.*, (i) a shortfall in States' own taxes, mainly in respect of State Excise Duties; (ii) a decline in grants from the Centre, mainly in respect of Centrally Sponsored Schemes; and (iii) a substantial increase in revenue expenditure on power projects (Table VII). The increase in revenue expenditure in the power sector largely reflected enhanced assistance provided by the Government of Uttar Pradesh to (meet the losses of) its State Electricity Board (SEB); the increase in the revenue expenditure of Uttar Pradesh in respect of the power sector, in fact, contributed over 60 per cent of the increase in consolidated revenue expenditure.

In the capital account, Maharashtra accounted for most of the increase in capital outlay. The enhanced capital outlay in the case of Maharashtra was mainly in respect of 'irrigation and flood control' (under the Maharashtra Krishna Valley Development Corporation). Loans and advances also increased in the revised estimates mainly reflecting enhanced loans to the power sector in the case of Kerala, Orissa and West Bengal. The increase in recovery of loans was largely concentrated in respect of Uttar Pradesh; in fact, Uttar Pradesh accounted for nearly 100 per cent of the total increase in recovery of loans in the revised estimates. The increase in capital outlay and loans

Table VII: Major Items of Variation: 2003-04 Revised Estimates over 2003-04 Budget Estimates

(Amount in Rs. crore)

Items	Variation: Amount	Variation: Per cent	Contribution * (per cent)
1	2	3	4
I. Revenue Receipts	**-4,363**	**-1.3**	**100.0**
of which:			
State Excise	-1,357	-6.2	31.1
Grants from Centre	-2,538	-4.0	58.2
II. Revenue Expenditure	**19,436**	**5.1**	**100.0**
of which:			
Power	17,553	128.7	90.3
III. Capital Receipts	**65,482**	**44.6**	**100.0**
of Which:			
Market Loans (Gross)	27,552	130.6	42.1
Special Securities issued to NSSF	10,764	21.4	16.4
Power Bonds and Other Bonds	12,847	217.5	19.6
Recovery of Loans	12,521	383.1	19.1
IV. Capital Disbursements	**46,301**	**43.8**	**100.0**
of which:			
Capital Outlay on Irrigation and Flood Control	7,212	56.1	15.6
Loans to Power Projects	6,496	78.6	14.0
Discharge of Internal Debt	5,118	59.0	11.1
Repayments of Loans to Centre	27,626	106.6	59.7

* : Denotes percentage share in relevant total.
Source : Same as Table IV.

and advances coupled with the slippage in the revenue deficit, thus, resulted in a higher GFD in the revised estimates for 2003-04 (Appendix Tables 5-6).

It may be important to mention that under the One-Time Settlement Scheme for dues of the SEBs, power bonds amounting to Rs.28,984 crore (as per RBI records) were issued by 26 State Governments to the CPSUs in September 2003 (with retrospective date of October 1, 2001). According to the budget documents, the total amount of power and other bonds[8] (the break-up is not available in respect of all State Governments) were placed at Rs.18,755 crore in the revised estimates for 2003-04 as compared with Rs.5,908 crore in the budget estimates for the year. Accordingly, the variation in the revised estimates of 2003-04 over the budget estimates underestimates the actual amount of power bonds issued in September 2003.

Net expenditure on the power sector (*i.e.*, revenue and capital expenditure *less* revenue receipts and recovery of loans) accounted for 29.2 per cent of the GFD of the State Governments in the revised estimates for 2003-04 which was higher than that of 25.2 per cent in the budget estimates and 20.3 per cent in 2002-03 (Table VIII). Correspondingly, from the financing side, the issue of power and other bonds accounted for 13.3 per cent of the GFD in the revised estimates for 2003-04 as against 5.1 per cent in the budget estimates and negligible amounts in the previous years.

Table VIII : Transactions Relating to the Power Sector*

(Rs crore)

Items	2001-02	2002-03	2003-04 BE	2003-04 RE	Variation Cols. 5-4
1	2	3	4	5	6
1. Revenue Account					
a. Expenditure	15224	14049	13634	31187	17553
b. Receipts	773	961	1224	1199	-25
c. Net Revenue expenditure (a-b)	14451	13088	12410	29988	17578
2. Capital Account					
d. Capital Outlay*	2671	2997	9210	9341	131
e. Loans and Advances	5438	5930	8267	14763	6496
f. Recovery of loans and advances	2198	1275	662	12973	12311
g. Net capital expenditure (d+e-f)	5911	7652	16815	11132	-5683
3. Total power expenditure (net) (c+g)	**20362**	**20740**	**29225**	**41120**	**11895**
4. GFD of States	95994	102123	116176	141010	24834
5. Item 3 as per cent of Item 4	**21.2**	**20.3**	**25.2**	**29.2**	**4.0**
6. Power Bonds and Other Bonds @	**0.3**	**3.6**	**5907**	**18754**	**12847**
7. Item 6 as per cent of Item 4	**–**	**–**	**5.1**	**13.3**	**8.2**

BE - Budget RE – Revised Estimates.
* : Relates to Energy.
@ : Net of Repayments
Source : Same as Table IV.

8. The reporting of data pertaining to power bonds has not been uniform and transparent across the States.

Excluding the transactions relating to the power sector, the revenue deficit would have been placed at 1.5 per cent in the revised estimates (instead of 2.6 per cent), whereas the GFD would have been placed at 3.6 per cent[9] (instead of 5.1 per cent).

Reflecting the deterioration in the revenue account, decomposition of GFD showed that the share of revenue deficit increased to 51.1 per cent in the revised estimates for 2003-04 as compared with 41.6 per cent in the budget estimates and around 25 per cent, on an average, in the first half of the 1990s (Table IX and Appendix Table 7).

The financing pattern of GFD indicated a substantial increase in market borrowings, primarily on account of additional allocations under the Debt Swap Scheme (DSS)[10]. Correspondingly, repayment of loans to the Centre exceeded its budgeted level by a large margin. In fact, repayments of loans to the Centre surpassed gross loans from the Centre in the revised estimates for 2003-04. Small Savings (Securities issued to NSSF) continued to predominate the financing of GFD at over 40 per cent in 2003-04. Higher 'other' borrowings in the revised estimates largely reflected the issue of power bonds, as mentioned earlier (Table IX and Appendix Table 8).

The trends in the pattern of receipts showed that while States' own tax revenue, at 5.9 per cent of GDP in the revised estimates for 2003-04, was slightly higher than its levels since the 1990s, the States' own non-tax revenues declined from 1.8 per cent to 1.5 per cent of GDP over this period (Table X). Some improvement in current transfers from the Centre was also evident in 2003-04 over the previous year, although it remained below the position in the first half of the 1990s.

The evolving pattern of expenditure indicated sharp increase in developmental expenditure, as a ratio to GDP, in 2003-04. This largely reflected higher revenue and capital expenditure on the power sector and enhanced capital outlay on irrigation (which are recorded under 'Economic Services'), as explained earlier. Non-developmental expenditure, as a ratio to GDP, also maintained its upward trend to 6.4 per cent of GDP in 2003-04. Within non-developmental expenditure, interest payments accounted for around 25 per cent of revenue receipts which was

Table IX : Decomposition and Financing Pattern of Gross Fiscal Deficit - 1990-91 to 2003-04

(Per cent)

Item	1990-95 (Average)	1995-00 (Average)	2000-02 (Average)	2002-03 (Accounts)	2003-04 BE	2003-04 RE
1	2	3	4	5	6	7
Decomposition						
(1+2+3)	100.0	100.0	100.0	100.0	100.0	100.0
1. Revenue Deficit	24.7	44.7	60.7	54.0	41.6	51.1
2. Capital Outlay	55.3	43.2	34.2	35.8	48.0	43.6
3. Net Lending	20.0	12.1	5.1	10.2	10.4	5.3
Financing						
(1+2+3+4+5)	100.0	100.0	100.0	100.0	100.0	100.0
1. Small Savings	-	5.8	36.8	51.2	43.4	43.4
2. Market Borrowings	16.0	16.1	16.0	27.9	15.2	32.0
3. State Provident Fund	14.3	13.4	10.2	7.0	7.6	6.8
4. Loans from Centre	49.0	40.6	13.5	-0.9	6.7	-15.2
5. Others*	20.7	24.0	23.6	14.8	27.1	33.0

BE - Budget RE – Revised Estimates.

* : Includes Reserve Funds, Deposits, Loans from banks and other institutions.

Source : Same as Table IV.

9. This figure is obtained after excluding *all* transactions relating to the power sector, as reported in the budget documents. Total transactions relating to the power sector would, in any case, differ from the amount of power bonds issued in connection with the One-Time Settlement Scheme. As indicated in Table VI, GFD *net* of power bonds works out to 4.0 per cent of GDP in 2003-04.

10. The DSS has been discussed in detail in Reserve Bank's Study entitled "State Finances: A Study of Budgets of 2003-04" as well as in the Reserve Bank's Annual Report 2003-04.

Table X : Trend in Receipts - 2002-03 to 2003-04

(per cent of GDP)

Item	2002-03 (Accounts)	2003-04 BE	2003-04 RE
1	2	3	4
Total Receipts (1+2)	17.2	17.6	**19.6**
1. Total revenue receipts (a+b)	11.4	12.1	**11.9**
(a) States own Revenue	7.3	7.5	**7.3**
States own tax	5.8	6.0	**5.9**
States own non tax	1.5	1.5	**1.5**
(b) Central Transfers	4.1	4.6	**4.6**
Shareable taxes	2.3	2.3	**2.4**
Central Grants	1.8	2.3	**2.2**
2. Capital Receipts (a+b)	5.9	5.4	**7.7**
(a) Loans from Centre	1.1	1.2	**1.2**
(b) Others Capital Receipts	4.8	4.2	**6.5**

BE - Budget RE – Revised Estimates.
Source : Same as Table I.

substantially higher than that of 18 per cent recommended by the Eleventh Finance Commission (EFC) from the viewpoint of debt sustainability over the medium term.

Pensions too, have been a drag of State finances, pre-empting 10.7 per cent of revenue receipts in 2003-04 as compared with 7.8 per cent, on an average, in the second half of the 1990s. Thus, it is evident that while the sharp increase in the deficit indicators during 2003-04 partly reflected one-off factors (*viz.*, power sector dues), the intrinsic weaknesses in the State budgets continued to weigh heavily on their financial health.

In sum, the revised estimates for 2003-04 revealed a significant deterioration in fiscal imbalances mainly on account of transactions in respect of the power sector. Notwithstanding the one-off factors in 2003-04, tentative empirical exercises indicate that the deficits at the State Government levels have been largely structural (Box 1).

Box 1
Structural *versus* Cyclical Deficits of Major Indian States

Cyclically adjusted government budget balances have become increasingly popular as a means of analysing the fiscal situation and changes in discretionary policies. As actual budget balances reflect both cyclical developments and discretionary measures, they are not very useful in assessing the orientation of underlying fiscal policy and the possible structural imbalances in the budget. Hence, in policy analysis, cyclically adjusted budget figures are used to construct indicators of the structural budget balance and the discretionary element of fiscal policy. In addition, a change in the cyclically adjusted government budget balance can be used to provide an early warning of the need for budgetary adjustment and changes in the future course of policy.

Beginning with the pioneering work of Mueller and Price (1984), it has become a common practice amongst international organisations to decompose the budget deficit into structural and cyclical components. The most popular method of measuring structural, or cyclically adjusted, budget balances is the gap-elasticities approach. Generally, the measurement of the cyclically adjusted budget balance, in the first step, involves the construction of a reference path for real GDP to obtain estimates for output that could be obtained in the absence of cyclical fluctuations. The difference between the actual output level and estimated reference output gives a measure of the output gap in a particular year. In the second step, these output gaps, together with the government revenue and expenditure elasticities, are used to calculate what government revenues and expenditure would have been had output been at the reference path level. It is important to correct for cyclical changes because the budget balance tends to deteriorate endogenously during recessions as a result of automatic stabilisers and progressive tax systems. The resulting cyclically adjusted budget balance corresponds to the underlying budgetary position implied by the reference output path. It should be emphasised that the OECD, IMF and EU in their estimates of cyclical deficit assume that only expenditures related to unemployment are sensitive to cyclical output movements.

Following the methodology suggested by Mueller and Price (1984), structural and cyclical deficits for fifteen major states were estimated. Data on State finances from the Handbook of Statistics on State Finances and output figures reported by the Central Statistical Organisation were used in the empirical analysis. Potential output was estimated using Hodrick- Prescott filter on real GSDP series. Minimal difference between real actual GSDP and real potential GSDP was the guiding criteria in choosing the base year for calculation of structural and cyclical deficit for each of the states. For all States taken together, the amplitude of cyclical deficit as a proportion of output was lower in the second half of the 1990s than that in the first half. Fiscal drag which indicates the built-in budget balance has also deteriorated for the majority of the States over the same period. Predominance of fiscal drag obtained from the estimates indicates the presence of structural rigidities at the State level, which is reflected in the higher expenditure elasticities than the revenue elasticities. Cyclical deficit on an average varied within a range of –9.0 percent to 6.0 percent of gross fiscal deficit for the fifteen major states during the period 1990-91 to 2003-04. Measured as a percentage of Gross SDP, cyclical deficit on an average accounted for -0.2 percent of GSDP in the post 1990 period for the fifteen major states while the structural component was placed, on an average, at 4.9 per cent. This indicates that fiscal deficit of the Indian States is mostly structural in character.

References:

1. Mueller, P., and R. W. R. Price, (1984) "Structural budget deficits and fiscal stance," *OECD Economics and Statistics Department, Working Paper No. 15* (Paris: OECD, July).
2. Pattnaik, R. K., S.M. Pillai, and Sangeeta Das (1997)." Budget Deficit in India: A Primer on Measurement", *RBI Staff Studies.*
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4. Blejer, M.I. and A. Cheasty, (1991)"The Measurement of Fiscal Deficits: Analytical and Methodological Issues", *Journal of Economic Literature* 29, 1991. pp. 1644-1678

(C) Budget Estimates: 2004-05

A substantial correction of fiscal imbalances is attempted in the budget estimates for 2004-05. All the major deficit indicators are estimated to decline in 2004-05 from their respective levels in the revised estimates of the previous year (Table XI and Chart 5).

Table XI : Major Deficit Indicators - 2003-04 (RE) and 2004-05 (BE)

(Rs. crore)

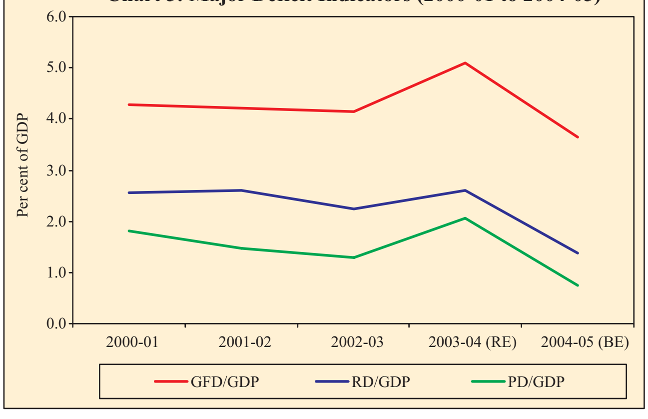
Item	2003-04 RE	2004-05 BE
1	2	3
Gross Fiscal deficit	141,010 (5.1)	111852 (3.6)
Revenue Deficit	72,126 (2.6)	43718 (1.4)
Primary Deficit	57,042 (2.1)	20994 (0.7)
GFD *net of Power Bonds*	112,026 (4.0)	

BE: Budget Estimates RE: Revised Estimates.

Note : 1. Power Bonds figures as per RBI records.
2. Figures in brackets are percentage to GDP.

Source: Data on fiscal variables have been compiled from budget documents of State Governments. The GDP data for 2004 -05 has been worked out from the budget estimates of the GFD-GDP ratio for 2004-05 as provided in the Union Budget.

Chart 5: Major Deficit Indicators (2000-01 to 2004-05)



The envisaged fiscal correction in 2004-05 is expected to emanate from an increase in revenue receipts and would be facilitated by a reduction in expenditure on the power sector from its upsurge in the previous year. The analysis of the budget estimates for 2004-05, however, needs to take cognisance of the fact that, over the past years, the budget estimates have usually deviated from the revised estimates, reflecting poor fiscal marksmanship.

The revenue deficit is budgeted to decline from 2.6 per cent of GDP in 2003-04 to 1.4 per cent of GDP in 2004-05 which is, in fact, lower than the average of 1.7 per cent during the latter half of the 1990s. Facilitated by the proposed reduction in the revenue deficit, the GFD is estimated to be concomitantly reduced from 5.1 per cent of GDP in 2003-04 to 3.6 per cent of GDP in 2004-05 which is only slightly higher than the level that prevailed, on an average, during the second half of the 1990s.

The primary deficit is also budgeted to record a substantial decline in 2004-05 indicating the correction envisaged in the current fiscal stance. The primary revenue surplus is estimated to increase to Rs.47,139 crore in 2004-05 which would finance nearly half of the interest payments during the year as compared to around 14 per cent in the previous year.

The decomposition of GFD indicates that the share of the revenue deficit would decline substantially to 39.1 per cent in 2004-05 from 51.1 per cent in the previous year (Table XII).

Table XII : Decomposition and Financing Pattern of Gross Fiscal Deficit - 2003-04 (RE) and 2004-05 (BE)

(Per cent)

Item	2003-04 RE	2004-05 BE
1	2	3
Decomposition		
(1+2+3)	100.0	100.0
1. Revenue Deficit	51.1	39.1
2. Capital Outlay	43.6	54.2
3. Net Lending	5.3	6.7
Financing		
(1+2+3+4+5)	100.0	100.0
1. Small Savings	43.4	57.0
2. Market Borrowings	32.0	24.6
3. State Provident Fund	6.8	9.3
4. from Centre Loans	-15.2	-7.4
5. Others*	33.0	16.5

BE: Budget Estimates RE: Revised Estimates.
* : Includes Reserve Funds, Deposits, Loans from banks and other institutions.
Source : Same as Table IV.

In the case of non-Special Category States, only Karnataka and NCT, Delhi is budgeted to record a revenue surplus during 2004-05. In the case of the remaining Non-Special Category States, the revenue deficit would preempt over 70 per cent of the GFD in the case of Kerala, Orissa and West Bengal. Among the Special Category States, Assam, Himachal Pradesh, Manipur, Mizoram and Uttaranchal would record a revenue deficit during 2004-05.

Revenue Receipts

The State Government budgets for 2004-05 have proposed Additional Resource Mobilisation (ARM) comprising Rs.1,976 crore under tax revenue and Rs.340 crore under non-tax revenue. Concessions of Rs.270 crore have also been proposed by the States. The details of ARM from select sources of revenue are set out in Table XIII and Statement 24.

Table XIII : ARM Proposed by State Governments during 2004-05

(Rs. crore)

Sr. No.	Source of Revenue	Amount
1	2	3
1.	Stamp & Registration Fees	119
2.	Sales Tax	670
3.	State Excise Duties	530
4.	Tax on Vehicles	216
5.	Electricity Duties	99
6.	Other Taxes	342
7	Total Tax Revenue (1 to 6)	1,976
8.	Non-Tax Revenue	340
9.	Total (7+8)	2316
10.	Concessions	270
11.	ARM , net of Concessions (9-10)	2,046

Source : Compiled from budget documents of State Governments and other supplementary information received from the State Governments.

The rate of growth of States' own tax revenue, inclusive of ARM, is estimated to decline to 14.0 per cent in 2004-05 from 14.5 per cent in the previous year. The increase in Sales Tax revenue is estimated to account for nearly one-third of the total increase in revenue receipts (Table XIV).

Notwithstanding the budgeted increase in Sales Tax revenue, the States' own tax-GDP ratio would remain unchanged at the previous year's level of 5.9 per cent in 2004-05 (Table XV).

Table XIV : Major Items of Variation: 2003-04 (RE) and 2004-05 (BE)

Item	Variation		
	Amount (Rs. Crore)	Per cent	Contribution * (per cent)
1	2	3	4
I. Revenue Receipts	**44417**	**13.5**	**100.0**
of which:			
Sales Tax	14268	14.5	32.1
States' Share in Central Taxes	12590	19.3	28.3
II. Revenue Expenditure	**16010**	**4.0**	**100.0**
of which:			
Education	3745	5.4	23.4
Power	-11472	-36.7	-71.7
Interest Payments	6891	8.2	43.0
Administrative Services	3025	10.0	18.9
Pensions	3091	8.8	19.3
Miscellaneous General Services	5342	81.1	33.4
III. Capital Receipts	**-34385**	**-16.2**	**100.0**
of which:			
Market Borrowings (Gross)	-16667	-34.3	48.5
Recovery of Loans	-8815	-55.8	25.6
Power Bonds and Other Bonds	-16249	-86.6	47.3
IV. Capital Disbursements	**-18698**	**-12.3**	**100.0**
of which:			
Capital Outlay on Irrigation & Flood Control	-3117	-15.5	16.7
Discharge of Internal Debt	2142	15.5	-11.5
Repayment of loans to Centre	-11274	-21.1	60.3
Loans for Power Projects	-6735	-45.6	36.0

* : Denotes percentage share in relevant total.
Source : Compiled from the budget documents of State Governments.

Excluding Sales Tax revenue (which is the predominant tax), the trends in the shares of other taxes in States' own tax revenues over the period 2000-01 to 2004-05 are shown in Chart 6. It may be observed that while the share of Stamps and Registration fees has increased over this period, the shares of Profession Tax and Electricity Duties have recorded a clear decline.

The trends in the States' own tax revenues indicate that there is potential as well as need for substantially stepping-up their tax efforts (Box 2). The expected implementation of the VAT during 2005-06 would be an important initiative in this regard (Box 3).

The States' own non-tax revenue would, however, show a marginal increase to 1.6 per cent

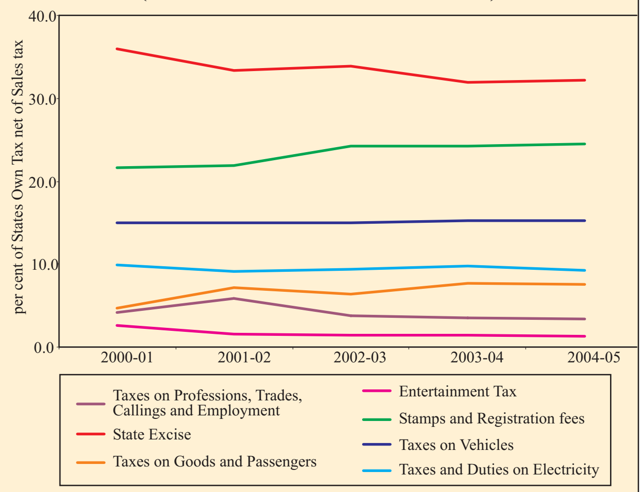
Table XV: Trends in Receipts - 1990-91 to 2004-05

(Per cent of GDP)

Item	1990-95 (Average)	2003-04 RE	2004-05 BE
1	2	3	4
Total Receipts (1+2)	16.1	19.6	17.7
1. Total revenue receipts (a+b)	12.1	11.9	12.0
(a) States own Revenue	7.3	7.3	7.5
States own tax	5.4	5.9	5.9
States own non tax	1.8	1.5	1.6
(b) Central Transfers	4.9	4.6	4.5
Shareable taxes	2.6	2.4	2.5
Central Grants	2.3	2.2	2.0
2. Capital Receipts (a+b)	4.0	7.7	5.7
(a) Loans from Centre@	1.2	1.2	1.1
(b) Others Capital Receipts	2.9	6.5	4.6

BE: Budget Estimates RE: Revised Estimates.
@ : With the change in the system of accounting with effect from 1999-2000, States' share in small savings, which was earlier included under loans from the Centre, is now included under internal debt and shown as special securities issued to the National Small Saving Fund (NSSF) of the Central Government. The data for the years prior to 1999-2000 as reported in this table, however, exclude loans against small savings for the purpose of comparison.
Source : Same as Table XI.

Chart 6: Components of Revenue Receipts
(as % of States' Own Revenue less Sales Tax)



of GDP in 2004-05. The expected growth in States' own non-tax revenues during 2004-05 would mainly emanate from increases in interest receipts (by Rs.2,700 crore) and receipts from State lotteries (Rs.3,245 crore). At the same time, revenue expenditure on State lotteries is expected to increase by Rs.3,087 crore, and as a consequence, the growth in net receipts from State lotteries would be Rs.158 crore during 2004-05. The States' own non-tax revenue, net of lottery expenditure is, however,

Box 2
Tax Efforts of State Governments in India

Mobilisation of adequate tax revenue has assumed special significance in the context of the imperatives to reduce fiscal imbalances at the State Government level. In the extant literature on the subject, a distinction is usually drawn between tax capacity and tax effort. Tax capacity is usually related to ‘activity variables’ such as income or the tax base. An increase in the level of activity variables would enhance tax capacity. On the other hand, tax effort refers to the various administrative and legislative efforts to expand the base, rationalisation of the tax structure and reduction in the incidence of tax avoidance and evasion. Thus, it would be possible for a large/high-income economy/ State to have a high tax capacity but low tax effort if it does not take initiatives to maximise its tax revenue ‘potential’. The need to make this distinction assumes significance in the context of improving the efficiency of tax revenue mobilisation.

One of the empirical studies on the tax effort of the Indian States is that of Jha *et al.* (1995). The authors assume that the key (‘activity’) variables that influence the tax capacity of a State are (i) State Domestic Product to represent the level of economic activity, (ii) proportion of agricultural income to SDP to proxy the degree the backwardness of the economy and (iii) per capita real rural household consumption to identify the level of poverty. Tax capacity is defined as the ratio of actual tax collected in that State to the average tax collected across States, while tax effort is defined as the residuals of the cross section regression equations obtained after regressing tax receipts on various explanatory variables. The period of estimation pertains to the early 1980s to the early 1990s, *i.e.*, prior to the initiation of reforms.

Adopting the methodology of Jha *et al*, the tax capacity and tax efforts for fifteen major States in India were estimated using cross-section (for two time points 1993-94 and 2002-03) and panel data (for the period 1993-94 to 2002-03). The results are presented in Tables 1 to 3.

The key results of the empirical exercise (using panel data) are that Punjab, Karnataka, Andhra Pradesh and Haryana were usually the top performers in terms of tax efforts, whereas, West Bengal, Bihar, Orissa were usually placed at the lower end of the scale. The results reflected better initiatives at tax reforms in the higher ranked States.

Table 1: Tax Capacity and Tax Effort across 15 Major States in India in 1993-94

	Aggregate			Percapita		
State	Tax Effort	Tax Capacity	Rank	Tax Effort	Tax Capacity	Rank
Andhra Pradesh	4	123	5	1	92	9
Assam	0	20	15	-34	59	14
Bihar	-8	63	12	-4	34	15
Gujarat	1	130	4	18	125	4
Haryana	1	52	13	8	141	3
Karnataka	36	81	9	45	75	11
Kerala	-9	85	8	-25	163	2
Maharashtra	-8	96	7	7	59	13
Madhya Pradesh	0	257	1	27	113	6
Orissa	-30	37	14	-114	94	8
Punjab	3	69	11	2	165	1
Rajasthan	-21	78	10	-59	111	7
Tamil Nadu	12	141	3	18	114	5
Uttar Pradesh	-11	153	2	-39	69	12
West Bengal	-17	114	6	-26	86	10

Table 2 : Tax Capacity and Tax Effort across 15 Major States in India in 2002-03

	Actuals			Per capita		
State	Tax Effort	Tax Capacity	Rank	Tax Effort	Tax Capacity	Rank
Andhra Pradesh	10	127	6	14	94	9
Assam	-6	23	15	-13	54	13
Bihar (Undivided)	-10	62	11	-39	42	15
Gujarat	-21	129	5	-21	154	2
Haryana	4	60	12	28	121	6
Karnataka	21	92	7	27	94	8
Kerala	-8	88	9	-1	149	3
Madhya Pradesh (Undivided)	7	88	8	-6	72	11
Maharashtra	3	247	1	-2	156	1
Orissa	12	28	14	11	47	14
Punjab	9	58	13	-38	105	7
Rajasthan	-5	74	10	-19	85	10
Tamil Nadu	11	143	3	6	143	4
Uttar Pradesh (Undivided)	4	148	2	-6	57	12
West Bengal	-66	131	4	-13	129	5

Note : The Tax Effort and Tax Capacity are expressed in terms of indices.

Table 3 : Average Tax Capacity and Tax Efforts Across 15 Major States During 1993-94 to 2002-03

	Actuals			Percapita		
State	Tax Effort	Tax Capacity	Rank	Tax Effort	Tax Capacity	Rank
Andhra Pradesh	9	124	5	5	97	9
Assam	-10	21	15	-24	51	13
Bihar (Undivided)	-34	69	11	-22	34	15
Gujarat	-10	136	4	-5	154	2
Haryana	17	46	12	14	134	4
Karnataka	21	97	8	21	106	7
Kerala	4	77	9	16	120	6
Madhya Pradesh (Undivided)	-10	98	7	-11	71	11
Maharashtra	3	256	1	-9	173	1
Orissa	-11	32	14	-11	51	14
Punjab	34	42	13	6	132	5
Rajasthan	-9	76	10	-8	79	10
Tamil Nadu	8	153	2	8	142	3
Uttar Pradesh (Undivided)	-7	153	3	-6	54	12
West Bengal	-40	121	6	-65	103	8

Note : The Tax Effort and Tax Capacity are expressed in terms of indices.

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Box 3
Implementation of VAT: India and the International Experience

Value added tax (VAT), a tax on the value added at each stage of production and distribution of a commodity, is inherently efficient than the sales tax or excise duty or any turnover tax. Operationally, application of VAT at a particular stage implies payment of tax by the producer or distributor on the value of his output but with a rebate (or credit) on the taxes paid by him on the inputs. The inherent efficiency of VAT lies in the taxation of value added portion only rather than full value of output at each stage of the production and distribution process thereby avoiding any 'tax' on tax that is normally associated with the cascading effect of sales tax or excise duty where entire value of output is taxed at any one or more stages. As the effective tax rate works out lower in case of VAT, it does not create an undue incentive for vertical integration and does not distort undertaking of efficient resource allocation. VAT application being on the value added makes it neutral to choice of production technique without creating any bias against use of any factor of production. VAT tends to minimise tax evasion with an in-built system of multi-stage tax distribution and a cross-auditing practice, whereby firms necessarily have to properly account for input taxes so as to avail the rebate.

The origin of VAT can be traced as far back as the writings of F Von Siemens, who proposed it in 1918 as a substitute for then newly established German turnover tax. Since then numerous economists have recommended it in different contexts. However, VAT was first introduced in France in 1954 to replace turnover taxes and it became the first European country to implement VAT on an extensive scale. VAT was introduced by the European Commission countries by 1970. Development of VAT in other countries has been gradual. Until the 1960s it was not adopted by many countries, but over the years the tax has come to occupy an important place in the fiscal domain of nearly all industrialised countries and in a large number of Latin American, Asian and African countries. As many as 50 countries have switched over to VAT during last decade, bringing the total number of such countries to more than 110. In India, it was introduced on the recommendation of L. K. Jha Enquiry Committee (1978) on Indian Indirect Taxation.

In India, Rule 56-A of the Central Excise and Salt Rules (1944) introduced in 1962 allowed manufacturers of certain goods to seek credit for the input excises paid from the duty paid of the final good under Proforma Credit Scheme. The Indirect Taxation Enquiry Committee, 1978 recommended wider commodity coverage of Rule 56-A and the introduction of VAT at the manufacturing stage (MANVAT) to tackle the cascading effect of excise taxation. As recommended by the Long Term Fiscal Policy Statement (1985), a modified system of VAT (MODVAT) was introduced in stages to extend the Proforma Credit Scheme to all excisable commodities except petroleum, tobacco and textile products. The essential feature of MODVAT was that credit on input taxes was available only in cases where the final product was dutiable. With a view to retain revenue neutrality in MODVAT, the Government raised the duty rates on final products to ensure against loss of collection of excise duties. The Tax Reforms Committee (1991) recommended genuine VAT and accordingly a single *ad valorem* excise rate of 16 per cent was introduced under Central Value Added Tax (CENVAT) in the Union Budget 2000-01. Additionally, however, special excise duty rates were introduced in some commodities (three rates initially at 8 per cent, 16 per cent and 24 per cent but later converged to 16 per cent) where MODVAT credit (paid on account of credit on excise paid on inputs) could not be availed. Consequently, 80 per cent of the revenue in respect of the *ad valorem* duties comes from the single rate of 16 per cent and about 17 per cent from the combined rate of 32 per cent. Despite advantages of VAT, its spread internationally as well as some initiatives at the Central level in India, the implementation of VAT by the States in India has raised some apprehensions.

Presently, different States in India levy sales taxes on a wide range of commodities at different rates with diverse procedures and rules for its collection, while the Central Government prescribes the ceiling rate on sales tax on goods in inter-State trade. The Central Government also levies additional excise duties on textiles, sugar and tobacco in lieu of the sales tax with the proceeds being distributed across the States. In most of the cases, sales taxes are levied on commodities which are also subject to Central excise duties. Multiple taxation on such commodities not only lack co-ordination among Centre and State Governments, but also lead to the cascading effect. Mostly sales taxes on inputs are not rebated and therefore tend to lead to reverse flow of resources to richer States when they sell the goods to the poor States as the cumulative impact of the cascading effect is passed on. Typically, the varied inter-State sales tax system on certain occasions have led to unhealthy 'rate war' in terms of competitive reductions in sales tax rates to attract trade and industry thereby leading to sub-optimal allocation of resources. Sales taxes discourage horizontal integration and encourage vertical integration which harm the growth of small scale ancillary units. Although State laws provide relief through exemptions in regards to sales tax when inputs are sold to manufacturers, such concessions are limited and lack uniformity. This lacuna has hindered indirect tax reform system in India and represents a classic case for a switch over to VAT independently by the Central Government and the State Governments. The Tax Reforms Committee 1991 had recommended conversion of sales tax into a form of State VAT within the manufacturing sector without any need for sales tax at more than two rates since the distributional and other non-revenue objectives to be performed by the Central taxes. The inter-State conference in 1999 decided to end all sales tax-based incentives to industry, enforce floor rates of sales tax effective January 1, 2000 and switch over to VAT effective from April 1, 2001.

The apprehensions about revenue loss, however, delayed the introduction of State VAT. The Empowered Committee (EC) of State Finance Ministers in India has been constituted to steer the States towards a regime of harmonised VAT. The Central Government's assurance of full compensation for revenue loss due to phasing out of Central sales tax (100 per cent compensation in the first year followed by 75 per cent and 50 per cent in the following two years) after States switch over to VAT has reactivated the process. The zero-rating system on interstate sales would be ushered in the next two years. 17 States have announced their readiness to implement VAT regime from April 1, 2005 in place of sales tax and other related State taxes on goods. The remaining States are expected to join by November 2005. According to the Government, the tax reforms in the States are expected to raise the revenues of the States by 20 per cent. As per the information in the website of Ministry of Finance, Government of India (January 2004), the VAT system in the States will have only four rates (the zero rate, 1 per cent, 4 per cent and a general rate of 12.5 per cent) uniformly applicable in all the States. VAT would cover all business transactions except small businesses below a threshold limit (decided by the States) and those medium size businesses that opt for a composition of tax on turnover instead of VAT. Most essential goods would be exempt from VAT or would fall in the rate of 4 per cent. The VAT rate of 4 per cent would be applicable for 250 commodities (agro-products and industrial inputs), 12.5 per cent for 217 items and one per cent for gold and precious metals. Operationally, VAT on output would be adjusted for VAT on input purchases of raw materials or goods purchased for resale. The uniform application of VAT is expected to boost fair trade and enable complete self-assessment by the tax payer. The system of input tax credit would enhance production efficiency with investment decisions no longer based on tax differentials and tax holidays. VAT system would anchor price rise as it weeds out the tax on tax. An interstate VAT Information Exchange System is expected to be set up to help in checking misuse of zero-rating.

The debate on the proposed VAT system still continues. Some analysts feel that harmonisation should not be 'total' as demonstrated by the VAT system of the European Union. The total uniformity, they argue, undercuts the States' fiscal power and weakens their accountability in spending by severing the link between the power to spend and the power to tax. They also feel a different tax rate on input (4 per cent) from the rest compromises on the merit of VAT of doing away with the distinction between commodities by use (EPW, 2004). The general VAT rate also is higher than the general sales tax of 8 to 10 per cent prevailing in most of the States. It also remains to be seen how the proposal of the Kelkar Task Force for a 'unified goods and services tax' to be levied in the Centre and the States is integrated with VAT system of the States. Notwithstanding the debate, the VAT system at the State level is expected to refine the sales tax system and improve the efficiency in the allocation of resources. The EC has assured in its Meeting in the first week of January 2005 that most of the states would be ready for introduction of VAT by April 1, 2005. It would also release a White Paper on implementation of VAT shortly.

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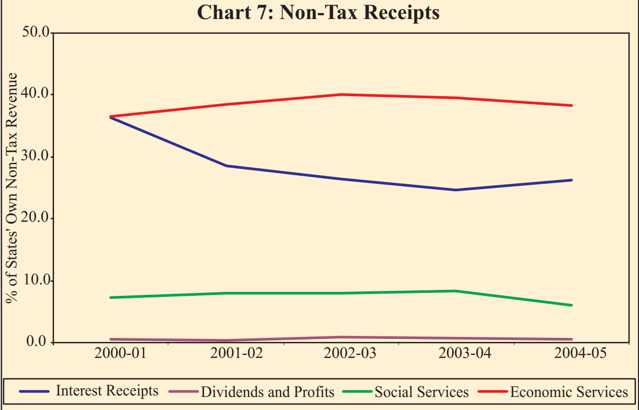
budgeted to be stagnant at the previous year's level of 1.3 per cent of GDP.

The trends in shares of the major components of States' own non-tax revenues during 2000-01 to 2004-05 are depicted in Chart 7. It may be observed that the share of interest receipts declined steeply upto 2003-04. The share of dividends and profits has remained abysmally low indicating that the returns from investment have continued to be almost negligible over this period. In fact, the Eleventh Finance Commission had observed that the average rate of return on capital invested in the State Electricity Boards, that account for the bulk of the States' investment in Public Sector Undertakings, has been persistently negative.

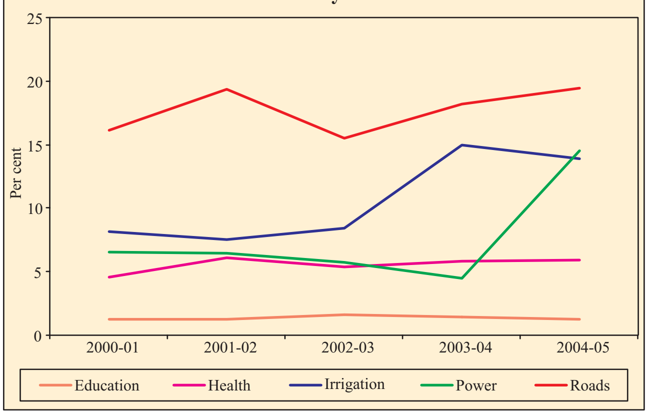
Chart 7: Non-Tax Receipts



It is also evident from Chart 8 that the receipts from social services (education, health) have been much lower than those from economic services (irrigation, power and roads). In fact, low cost recovery in respect of public services has been a perennial concern in State Government finances, which essentially stems from the levy of inappropriate user charges (Table XVI).

It may be observed that while there has not been much change in cost recovery in respect of education and health, a sharp improvement in cost recovery is expected in the case of the power sector during 2004-05. This appears to be mainly on account of a substantial decline in non-plan revenue expenditure mainly in respect of Madhya Pradesh and Uttar Pradesh from their high levels in the previous year. The increase in non-plan revenue expenditure by these two States in the power sector during 2003-04 reflected enhanced assistance to their SEBs.

Chart 8: Cost Recovery of Select Services *



* : Ratio of Non-tax Revenue to Non-plan Revenue Expenditure

Table XVI : Cost Recovery of Select Services*

(Per cent)

Item	2000-01 Accounts	2001-02 Accounts	2002-03 Accounts	2003-04 RE	2004-05 BE
1	2	3	4	5	6
Social Services					
Education	1.2	1.2	1.6	1.5	1.2
Health	4.6	6.1	5.4	5.8	5.9
Economic Services					
Irrigation	8.2	7.5	8.4	15.0	13.9
Power	6.5	6.4	5.8	4.4	14.5
Roads	16.1	19.3	15.5	18.2	19.5

BE: Budget Estimates RE: Revised Estimates.
* : Ratio of Non-tax Revenue to Non-plan Revenue Expenditure
Source : Compiled from budget documents of State Governments.

Power Subsidies

The expected improvement in cost recovery in respect of the power sector assumes significance in the context of the announcement of free power for certain sections by some State Governments, and the long-standing problem of power subsidies. According to Economic Survey (2003-04) published by the Government of India, power subsidy increased from Rs.7,449 crore in 1991-92 to Rs.31,941 crore in the revised estimates for 2003-04 and further to Rs.33,797 crore in the Annual Plan estimates for 2004-05 (Table XVII). As a ratio to GDP, power subsidy would decline from 1.6 per cent in 2000-01 to 1.1 per cent in 2004-05.

Table XVII : Subsidies provided by State Electricity Boards

(Rs. Crore)

Year	Subsidy to Agricultural Consumers	Subsidy to Domestic Consumers	Subsidy on Inter-state sales	Gross subsidy (2+3+4)	Subvention received from State	Net Subsidy (5-6)	Surplus from Other Sectors	Uncovered subsidy (7-8)
1	2	3	4	5	6	7	8	9
1991-92	5938	1310	201	7449	2045	5404	2173	3231
2000-01 (P)	24074	9968	386	34428	8820	25607	3435	22172
2001-02 (P)	24013	10347	227	34587	8680	25907	3698	22209
2002-03 (P)	21845	8534	189	30568	12996	17572	4797	12775
2003-04 (RE)	22793	8210	938	31941	11427	20514	5668	14846
2004-05 (AP)	24012	8967	818	33797	11141	22656	6424	16232

P Provisional RE Revised Estimates AP Annual Plan

Source : Economic Survey, Government of India 2002-03 and 2003-04.

Power subsidy to agricultural consumers accounts for over 70 per cent of the gross subsidy provided by SEBs. The SEBs attempt to recover the losses due to subsidised power supply to agricultural and domestic consumers by way of cross-subsidisation mainly to the industrial and commercial consumers, as also *via* subventions (financial support) from State Governments. While the absolute levels of subventions have declined in recent years, cross-subsidies have shown an increase.

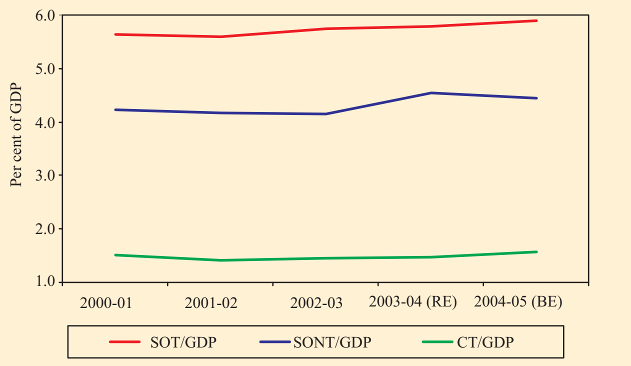
The ratio of subventions from State Governments to power subsidy to agricultural consumers was placed at 50 per cent in 2003-04 as compared with 34 per cent in 1991-92. The ratio of cross-subsidies to power subsidy to agricultural consumers was placed at 27 per cent in 2004-05 as against 37 per cent in 1991-92.

It may also be observed that even after subventions and cross-subsidisation, SEBs have an estimated 'uncovered' subsidy of Rs.16,232 crore in 2004-05 as compared with Rs.3,231 crore in 1991-92. Although subventions from State Governments have declined in recent years, these remain at a high level of over Rs.11,000 crore, which has an immediate adverse impact on the resource gap of the State Governments. In addition to direct loans to SEBs, State Governments have also provided substantial guarantees in respect of SEB loans from financial institutions.

Current Devolution and Transfers from the Centre

Current devolution and transfers from the Centre are estimated at 4.5 per cent of GDP in 2004-05 as compared with 4.6 per cent in the previous year and 4.9 per cent, on an average, during the first half of the 1990s (*i.e.*, prior to the industrial deceleration). The estimated reduction in current transfers from the Centre, as a ratio to GDP, in 2004-05 from the previous year's level essentially reflects the decline in Non-Plan grants (as a ratio to GDP) (Chart 9).

Chart 9: States' Own Revenue and Current Transfers



SOT: States' Own Tax SONT: States' Own Non-Tax
CT: Current Transfers GDP: Gross Domestic Product

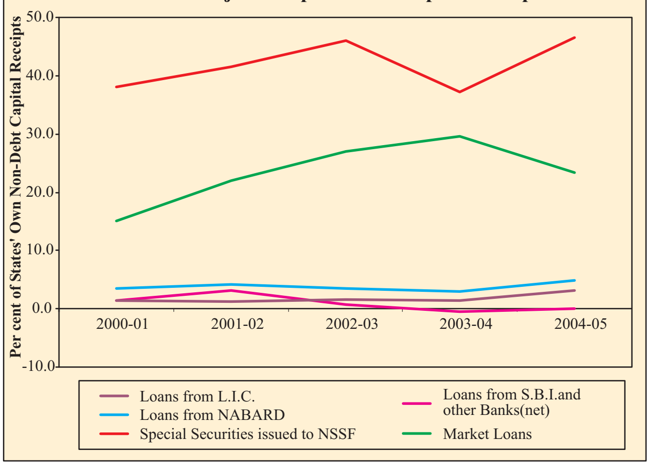
Capital Receipts

Capital receipts are budgeted to decline by 16.2 per cent in 2004-05 as against a growth of 46.8 per cent in the previous year (Table XIV). Most of the reduction in capital receipts in 2004-05 is due to the substantial decline in gross market borrowings and power bonds and recovery of loans from their high levels in the previous year. In 2003-04 high level of gross market borrowings was the outcome of additional allocations under the DSS. Besides, a large volume of power bonds were issued under the One-Time Settlement Scheme. The estimated reduction in recovery of loans during 2004-05 is mainly in respect of Uttar Pradesh.

Gross loans from the Centre is estimated to record a marginal increase of 6.1 per cent in 2004-05 as against a growth of 17.9 per cent in the previous year. As ratio to GDP, gross loans from the Centre would, however, decline marginally to 1.1 per cent in 2004-05 from 1.2 per cent in the previous year. Loans from Centre do not include loans to States against Small Savings, following the change in the accounting system with effect from 1999-2000. After excluding loans against Small Savings for purposes of comparability, loans from Centre were placed at an average of 1.2 per cent of GDP during the first half of the 1990s, which is only slightly higher than the budget estimates for 2004-05 (Table XV).

Loans from financial institutions have experienced decline (as per cent of States Own Capital receipts) over the last 2-3 years but are poised for improvement in 2004-05 (B.E.) (Chart 10).

Chart 10: Major Components of Capital Receipts



NSSF: National Small Saving Fund

Loans against Small Savings receipts, followed by market borrowings, would continue to be the major source of financing the GFD during 2004-05 (Table XII).

Market Borrowings

The net allocations of market borrowings to the State Governments, as per Reserve Bank Records, have increased since 2002-03 (Table XVIII and Statement 22). Additional allocations have, however, witnessed a sharp decline over this period, whereas, allocations under the DSS have declined somewhat consequent to an upsurge during 2003-04. The total allocation for DSS over 2002-03 to 2004-05 is placed at Rs.61,274 crore. Taking cognizance of repayments, gross allocation of market loans is budgeted to decline to Rs.42,010 crore in 2004-05 (Appendix Table 9). Around 77 per cent of the gross allocated amount has been raised during 2004-05 so far. The amount raised under the DSS during 2002-03 to 2004-05 (so far) works out to Rs.50,404 crore. The rates of interest on market loans which had declined since the mid-1990s upto 2003-04, firmed up somewhat during 2004-05 so far. Open market loans of some of the State Governments have faced problems of under-subscription in recent years. Further, the number of States that have opted for the auction route to raise market loans has declined since 2002-03. Factors that influenced the liquidity of the market for State Government bonds include the health of the finances of the State Governments, the credibility of their prospective policy actions and transparency of their budgets (Box 4).

Table XVIII : Market Borrowings

(Rs. Crore)

Sr. No.	Item	2002-03	2003-04	2004-05
	1	2	3	4
1.	Net Allocation	12,722	12,767	13,969
2.	Additional Allocation	6,422	4,893	644
3.	Allocation under DSS	10000	29,000	22,274
4.	Total (1+2+3)	29,144	46,660	36,887
5.	Repayments	1,789	4,145	5,123
6.	Gross Allocation	30,933	50,805	42,010
7.	Amount Raised under DSS	10,000	26,623	13,781*
8.	Total Amount Raised	30,853	50,521	32,488
	Through:			
	(a) Tap Issues	27,880	47,626	31,603
	(b) Auctions	2973	2,895	885
		(13)	(8)	(3)
Memo Items				
i.	Coupon/Cut-Off Yield Range (%)	6.67-8.00	5.78-6.40	5.60-7.36
ii.	Weighted Average Interest Rate (%)	7.49	6.13	6.32

* Raised upto December 13, 2004

Note : 1. Figures in brackets represent number of States opting for the auction route.

2. The data on market borrowings as per RBI records may differ from that reported in the budget documents of the State Governments.

Source : As per Reserve Bank records.

The weighted average maturity of the State Governments securities issued during the year increased to 11.05 years in 2003-04 from 10 years in 2002-03. In the composite portfolio of outstanding loans of the State Governments, securities in the maturity range of 6-10 years

Box 4
Factors Influencing the Liquidity of the Government Bond Market: An Emerging Markets Perspective

Notwithstanding the significant growth in government domestic bond markets in emerging market economies in recent years, insufficient liquidity has circumscribed the development of these markets. A liquid government bond market facilitates (i) the financing of the government deficit at low costs; (ii) the pricing of other financial assets; and (iii) the conduct of monetary policy. The liquidity of a market could be ascertained by its relative tightness, depth and resilience. Tightness of a market could be gauged by bid-ask spreads, the depth of a market by its ability to handle large transactions without causing sharp changes in prices and the resilience by the speed with which price fluctuations are ultimately diffused.

It has been observed that the size of the economy need not necessarily impede the liquidity of the government bond market. The experience of Taiwan shows that the entry of foreign banks and securities firms helped to create a level playing field in the existing small market with relatively few (and monopolistic) players. Another way to enhance liquidity is to allow (highly rated) offshore banks and domestic companies to hold and issue local currency bonds, as in the case of Singapore.

An important factor influencing the liquidity of government bonds is the extent of interest rate deregulation. While emerging market economies have witnessed interest rate liberalisation, instances of policy interventions to set the interest rate at the 'appropriate' level are also evident. Such interventions usually stem from the objective to signal the monetary policy stance or from concerns relating to the impact of an interest rate hike on the sustainability of government debt as also on the balance sheets of banks and financial institutions (which hold such bonds). The resultant under-allocation to the announced amount of bond floatation is filled, in some cases, by an underwriting agency at a rate lower than the average auction rate. When central banks are also debt managers to government debt, policy coordination between the fiscal and monetary authorities becomes even more important for the purposes of the development of the government bond market.

Broadening the investor base by permitting the entry of foreign institutional investors (such as pension and insurance funds) or by promoting mutual or gilt funds also help to improve the liquidity of government bond markets.

A well-developed money market is also important for the liquidity of the government bond market, since it reduces liquidity risks for bondholders by providing access to immediate cash. High reserve requirements, however, impede the development of the money market.

One of the main factors that influence the liquidity of the primary market is the health of the finances of the Government, the credibility of its prospective policy actions and the transparency of the budget. Liquidity also depends upon the extent to which the government precommits to set a set of issuing policies that encourage investors to bid in a desirable way. Different auction techniques (multiple or uniform price), limits on participation to draw a judicious balance between the objectives of broadening the investor base and operational convenience, as well as, the nature and extent of central bank participation also influence the liquidity of the primary market.

Liquidity of secondary markets could be enhanced by repo transactions since these allow market participants to borrow against their securities portfolio, generally below the unsecured borrowing rate. Developing certain benchmarks with high liquidity characteristics is also considered important. For instance, a policy of 'passive consolidation' of bonds was adopted in India by reopening existing highly demanded loans. Thirdly, the extent and frequency to which bondholders are required to mark their portfolio to the market is an important determinant of the liquidity of the government bond market. Absence of mark-to-market practices encourages investors not to book accrued gains or losses in their portfolio, reducing the incentives to trade. Broadening the range of debt instruments to, say, include inflation-indexed bonds and zero-coupon bonds in order to cater to the preferences of investors, is also an important initiative. A modern system of payment and settlements could also help to enhance secondary market liquidity in Government bonds.

In India, developing a deep and liquid secondary market in government securities has been the main objective of the Reserve Bank in the recent period. To that end, the Reserve Bank has initiated legal and regulatory reforms, infrastructure and technology improvement, safe settlement system and market dissemination of information on all trades in the wholesale market. It also improved methods of issuance such as reopenings and price-based auctions thereby improving fungibility, introduced derivatives such as interest rate swaps and enlarged the repo markets. Repos conducted by the Reserve Bank are, however, restricted to Central Government bonds. Liquidity support facilities to the primary dealers and timely open market operations have also been felt necessary to prevent the drying-up of liquidity in the secondary markets. In all these areas, the dilemmas have been resolved through a phased sequencing towards a clear ultimate objective.

In the ultimate analysis, the liquidity in the market for State Government bonds would be greatly influenced by credible institutional and fiscal reforms and a durable improvement in the financial position of the States.

References:

1. Bank for International Settlements (2002), "The Development of Bonds Markets in Emerging Economies", *BIS Papers No.11*, June.

2. Reserve Bank of India, Annual Report, Various issues.

constituted the largest share (53.9 per cent), followed by 0-5 years (32.1 per cent) and above 10 years (14.0 per cent) (Table XIX and XX). The State-wise and scrip-wise details of outstanding market loans are presented in Statement 25.

Devolution and Transfer of Resources from the Centre

Gross devolution and transfer of resources *(i.e.,* shareable tax revenue, grants and loans) from the Centre are estimated to increase by 9.4 per cent to Rs.1,73,088 crore in 2004-05 as compared with a growth of 22.2 per cent in the previous year. As a ratio to GDP, gross devolution and transfers from the Centre would decline to 5.5 per cent in 2004-05 from 5.7 per cent in the previous year and from the average level of 6.8 per cent, during the first half of the 1990s. Gross devolution and transfers from the Centre would finance 31.4 per cent of the aggregate disbursements of the State Governments in 2004-05 as compared with 28.6 per cent in the previous year (Appendix Table 18). The prospective mechanism of devolution of transfer of resources from the Centre to the States has been recommended by the Twelfth Finance Commission, whose Report has been submitted to the Hon'ble President of India recently. The international experience in this regard indicates the emergence of several issues which have a significant bearing on sub-national Government finances and fiscal federalism. These issues include the general asymmetry in the devolution of expenditure responsibilities *vis-a-vis* revenue raising powers, the impact of overall macroeconomic imbalances as well as administrative weaknesses at the sub-national level on the feasible degree of decentralisation and the need to promote market discipline in respect of sub-national government borrowings (Box 5).

Revenue Expenditure

Revenue expenditure is budgeted to decelerate to 4.0 per cent in 2004-05 from 19.9 per cent in the previous year. Total revenue expenditure net of power sector, is, however, expected to grow at 7.4

Box 5
Major Issues in Sub-national Government Finances and Fiscal Federalism: The International Experience

Cross-country evidence over the past few decades suggests a fairly clear tendency towards increasing decentralisation of expenditure responsibilities to subnational governments. The same trend, *albeit* to a lesser degree, is evident in the case of revenue-raising responsibilities. Several issues have emerged in this context.

The design of intergovernmental fiscal relations is significantly influenced by non-economic (political, social and cultural) and economic factors. The formulation of fiscal federal relations usually takes cognisance of various (sometimes competing) objectives, namely allocative efficiency, income redistribution, and macroeconomic management. The implicit weights assigned to these objectives in different countries, and their changing profile over time, mirror the country's social and political history, extant conditions, apart from the degree of macroeconomic imbalances.

On theoretical considerations, a decentralisation of expenditure responsibilities should in principle lead to allocative efficiency gains, by facilitating a closer correspondence between expenditure priorities and the preferences of the people concerned. On pragmatic grounds, however, these theoretical efficiency gains may not materialise (fully) on account of administrative weaknesses at the sub-national level and in particular, the lack of modern and transparent public expenditure management systems.

The international experience generally underscores the need to accompany a decentralisation of expenditure responsibilities with revenue decentralisation, with a view to promoting fiscal responsibility and political responsibility of the subnational government. Taxes with relatively low mobility, a fairly even distribution of the base over the national territory, and relative stability over the cycle, are usually most suitable for decentralisation. Accordingly, personal income tax, general retail sales taxes and certain excises are generally assigned to regional governments whereas property tax, business license fees and user fees are generally assigned to local governments. In general, tax-induced distortions could be minimised by ensuring the harmonisation of the definition of tax bases and precluding large variations in tax rates across the nation.

Since administrative infirmities of the subnational governments could circumscribe effective revenue decentralisation, strengthening of administrative capacities should preferably precede a decentralisation of the administration of the taxes.

The trade-off between objectives of decentralisation and distribution may be accentuated in countries characterised by large regional disparities in income. In such instances, a system of equalisation-oriented vertical transfers from the centre (as in Australia) or a horizontal redistribution mechanism (as in Germany) could become necessary. The formulation of such mechanisms should, however, need to ensure that these are cost effective and do not discourage the tax efforts of the sub-national governments.

Trade-offs are also evident between decentralisation and the efficacy of macroeconomic stabilisation programmes. Consequently, the pace of decentralisation needs to be determined by the degree of fiscal or macroeconomic imbalances. In countries with large macroeconomic imbalances, cross-country experience indicates the significance of imposing a hard budget constraint on the sub-national governments, while providing an adequate *ex ante* balance between expenditure responsibilities and own revenues plus clearly defined transfers from the centre, coupled with prohibition of borrowing.

In countries that do not face serious macroeconomic or fiscal imbalances, there is a need to associate decentralisation of revenues and expenditures with the greater involvement of the sub-national governments in macroeconomic management. In these countries, sub-national governments may be permitted to borrow, within clearly specified limits, relating to their prospective ability to service the debt. Furthermore, such borrowing should be subject to market discipline and undertaken without central government guarantee.

References:

1. Ter-Minassian T. *(ed)* (1997), "Fiscal Federalism in Theory and Practice", International Monetary Fund.

2. Garrett Thomas.A and Gary A. Wagner, (2004), "State Government Finances: World War II to the Current Crisis", *Federal Reserve Bank of Saint Louis Review*. Vol. 86. No2 March/April.

Table XIX : Maturity Profile of Outstanding State Government Market Loans (At end-March 2004)

(Percentage to Total Amount outstanding)

State	0-5 years	6-10 years	Above 10 years	Total Amount Outstanding (Rs. crore)
1	2	3	4	5
1. Andhra Pradesh	34.7	59.3	6.0	17,090
2. Arunachal Pradesh	16.0	44.7	39.3	262
3. Assam	35.0	54.1	11.0	4,496
4. Bihar	37.1	51.9	11.0	10,243
5 Chhattisgarh	0.0	66.4	33.6	1,445
6. Goa	31.0	53.5	15.5	843
7. Gujarat	26.1	59.5	14.4	10,846
8. Himachal Pradesh	19.8	65.2	15.0	2,839
9. Harayana	32.7	52.9	14.4	3,825
10. Jammu and Kashmir	25.3	65.9	8.9	2,277
11. Jharkhand	0.0	83.1	16.9	1,523
12. Karnataka	29.0	54.6	16.4	9,645
13. Kerala	38.5	52.7	8.8	8,221
14. Maharashtra	27.4	52.4	20.2	13,655
15. Madhya Pradesh	37.7	46.8	15.5	8,867
16. Manipur	31.4	41.0	27.6	529
17. Meghalaya	39.3	44.6	16.1	700
18. Mizoram	29.6	53.8	16.6	422
19. Nagaland	36.6	49.4	14.0	1,098
20. Orissa	37.5	47.0	15.5	8,681
21. Punjab	29.8	55.3	15.0	6,059
22. Rajasthan	33.9	54.0	12.1	12,282
23. Sikkim	56.1	28.7	15.2	296
24. Tripura	34.8	46.1	19.2	792
25. Tamil Nadu	32.0	57.4	10.6	11,537
26. Uttaranchal	0.0	76.3	23.7	2,543
27. Uttar Pradesh	39.8	46.2	14.0	23,739
28. West Bengal	27.4	54.0	18.6	14,711
Total	**32.1**	**53.9**	**14.0**	**1,79,465**

***Source*:** As per Reserve Bank records.

per cent compared to 15.4 per cent in the previous year. As a ratio to GDP, revenue expenditure would decline to 13.4 per cent from 14.5 per cent in the previous year, but would still remain higher than that of 12.8 per cent, on an average, during the first half of the 1990s (Table III and XXI).

Table: XX: Maturity Profile of Outstanding State Market Loans and Power Bonds (As at end-March 2004)

(Rs. crore)

Year	State Loans	Power Bonds	Total Outstanding
1	2	3	4
2004-05	5,123		5,123
2005-06	6,274		6,274
2006-07	6,551	1,480	8,031
2007-08	11,555	2,961	14,515
2008-09	14,400	2,961	17,361
2009-10	16,511	2,961	19,472
2010-11	15,870	2,961	18,830
2011-12	22,032	2,961	24,993
2012-13	30,628	2,961	33,589
2013-14	25,790	2,961	28,751
2014-15	4,036	2,961	6,997
2015-16	13,462	2,961	16,423
2016-17	7,233	1,480	8,713
Total	**1,79,465**	**29,606**	**2,09,071**

***Source*:** As per Reserve Bank records.

The deceleration in revenue expenditure during 2004-05 would be largely on account of sharp decline in expenditure on the power sector (Table XIV). Provisions in respect of interest payments, pensions, miscellaneous general services (including lotteries) and education, are, however, budgeted to increase in 2004-05. Interest payments and pensions are, however, expected to preempt lesser portion of revenue receipts in 2004-05 compared to the previous year (Chart 11).

Chart 11: Interest Payments and Pensions

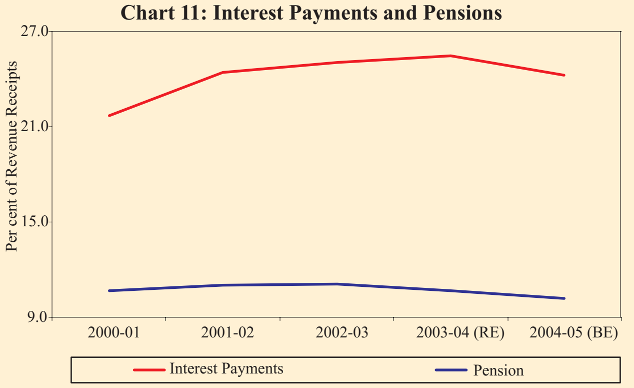
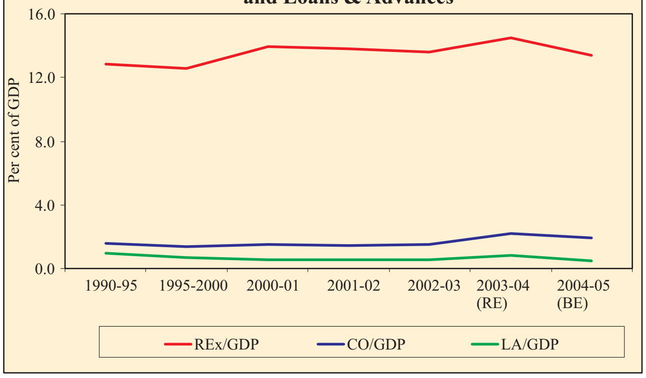


Chart 12: Trends in Revenue Expenditure, Capital Outlay and Loans & Advances



REx: Revenue Expenditure CO: Capital Outlay
LA: Loans and Advances GDP: Gross Domestic Product

Capital Disbursements

Capital disbursements would decline by 12.3 per cent in 2004-05 as against an increase of 78.8 per cent in the previous year. Over 60 per cent of the decline in capital disbursements would be on account of repayments of loans to the Centre (Table XIV). In contrast, loans and advances for power projects by the State Governments would contribute 36 per cent of the decline in capital disbursement. The decline observed in the budget estimates emanates mainly from the higher base in capital expenditure in the previous year on account of higher provisions towards one-time settlement of power dues of SEBs. Capital outlay on irrigation and flood control is also budgeted to decline in 2004-05. As a consequence, the ratio of capital outlay to GDP would be placed at 1.9 per cent in 2004-05 as compared with 2.2 per cent in the previous year and 1.6 per cent, on an average, in the first half of the 1990s (Chart 12).

Developmental and Non-Developmental Expenditure

Total developmental (revenue plus capital) expenditure would be placed lower at 9.2 per cent of GDP than 10.9 per cent in the previous year and 10.8 per cent, on an average, in the first half of the 1990s. Within developmental expenditure, Social Sector expenditure (comprising social services, food storage and warehousing) would be placed at 5.4 per cent of GDP in 2004-05 as compared with 5.9 per cent in the previous year. On the other hand, in 2004-05, non-developmental expenditure would remain at the previous year's level of 6.4 per cent of GDP, which would be higher than that of 4.3 per cent in the first half of the 1990s (Chart 13, Table III and Appendix Tables 10-17).

Non-Plan Non-Developmental expenditure, as ratio to GDP, would be placed at the previous year's level of 6.3 per cent (Table XXI).

The evolution of expenditures of the State Governments in the future would need to take cognisance of the demographical changes in the country and corresponding implications for social security, health care, pensions and related expenditure (Box 6).

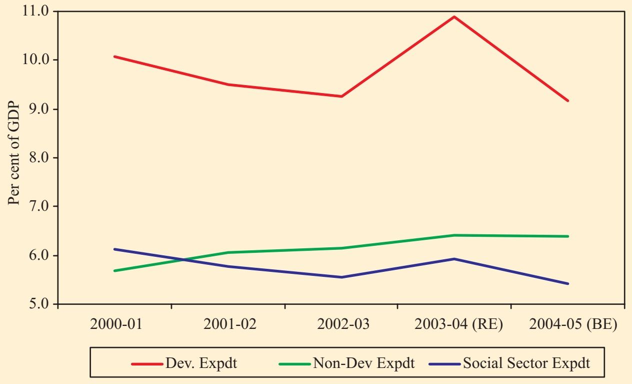
Table XXI: Pattern of Expenditure

(per cent of GDP)

Item	2003-04 RE	2004-05 BE
1	2	3
Total Expenditure *1+2 = 3+4+5*	**20.0**	**17.7**
1. Revenue Expenditure	**14.5**	**13.4**
of which Interest payments	3.0	2.9
2. Capital Expenditure	**5.5**	**4.3**
of which Capital outlay	2.2	1.9
3. Developmental Expenditure	**10.9**	**9.2**
4. Non Developmental Expenditure	**6.4**	**6.4**
5. Others *	**2.7**	**2.1**
Memo item *Non-Plan Non Developmental Expenditure*	**6.3**	**6.3**

BE: Budget Estimates RE: Revised Estimates
* : Includes discharge of internal debt, repayments of loans to Centre, compensation and assignments to local bodies, etc.
Source : Same as Table XI.

Chart 13: Development and Non-Development Expenditure



Debt Position [11]

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 17.5 per cent at end-March 2004 over the previous year. In terms of GDP, the debt stock of States constituted 29.1 per cent as at end- March 2004, higher than the level of 27.8 per cent in the previous year. The debt-GDP ratio of States is estimated to increase further to 29.2 per cent by end-March 2005 (Appendix Table 19). The

Box 6
Measuring the Efficiency of Government Expenditures

An important objective of public sector reforms is to enhance the efficiency of government expenditures so that the intended goals could be achieved at the least possible cost. The issue assumes significance in the context of the need to maintain consistency between provision of public services, containment of the government budget deficit and to ensure overall macroeconomic stability. The impetus to the process of assessing and enhancing government efficiency was provided by the initiation of wide-ranging institutional reforms in public services by the Government of New Zealand in the late 1980s, aimed at improving the efficiency of the public sector. These reforms included, *inter alia*, the development of output-oriented budgets using a wide range of output indicators and to transform government institutions to reflect the distinction between outputs (the goods and services produced by the government) and outcomes (the goals that the government wants to achieve with the outputs).

There are, in general, two alternative non-parametric methodologies to measure the efficiency of expenditures *viz.*, Full Disposal Hull (FDH) analysis and Data Envelopment Analysis (DEA). Both the approaches entail the estimation of efficiency frontiers using a sample of combinations of input (either government expenditure, say, on education or health *or* equivalent physical indicator, say, teacher-student ratio or number of hospital beds per capita) and output (attainment level of the objective, say, literacy rate or life expectancy) indicators. Sometimes, prior to the construction of the frontier, econometric techniques are used to ascertain whether a statistically significant relationship exists between the input and output indicators. Under both the approaches, those combinations that entail less output for the same level of input or more input for the same level of output do not form part of the efficiency frontier. In contrast to the FDH analysis, DEA analysis assumes, the existence of a convex efficiency frontier. The efficiency frontier in the DEA approach is constructed using linear programming methods. A convex efficiency frontier implies that a linear combination of any two points on the frontier cannot lie within (or be less efficient than) the frontier. In both approaches, the distance between an input-output combination in the sample, from the efficiency frontier, either in input terms or in output terms, provides its efficiency score.

The major advantages of FDH are that it imposes only weak restrictions on the efficiency frontier while allowing for a comparison of efficiency levels among different combinations. The only assumption made is that inputs and/or outputs can be freely disposed of, so that it is possible with the same technology to lower outputs while maintaining

11. It is increasingly being recognised that the absence of unanimity on the definition and composition of State Government liabilities could be circumscribing the formulation of appropriate corrective strategy. Following the discussions at the 14th Conference of State Finance Secretaries at the Reserve Bank, a Working Group on the methodology of compilation of data on State Government liabilities, has been constituted. The members of the Group include representatives from select State Governments, the Central Government, the office of the Comptroller and Auditor General of India and the Controller General of Accounts. The definition of State Government liabilities used in Studies such as this, may be modified in the future in the light of the recommendations of the Working Group.

the level of inputs and to increase the inputs while maintaining outputs at the same level. This assumption guarantees the existence of a continuous FDH, for any sample. On account of the convexity assumption, DEA is more stringent than FDH - a combination that is efficient under DEA will be efficient under FDH, but not necessarily vice versa. Thus, smaller efficiency scores are obtained under DEA than under FDH. As compared to parametric methods, both the approaches suffer from a limitation *i.e.,* correction for random factors unrelated to efficiency is not possible and therefore statistical noise is included in the measure of inefficiency.

There are a number of empirical studies on the efficiency of government expenditures. For instance, Karras (1996) finds that government services are overprovided in Africa underprovided in Asia and optimally provided elsewhere.

Harbison and Hanushek (1992) survey 96 studies of education production functions in developing countries. They find that in most studies of developing countries, teacher education, teacher experience and the availability of facilities have a positive and significant impact on education output, and that the effect of expenditure per pupil is significant in half the studies while the pupil-teacher ratio and teacher salary have no discernable impact on education output.

Tanzi and Schuknecht (1997) found that in a sample of industrial countries, higher public spending does not significantly improve social welfare. Afonso and M.St.Aubyn (2004) use both the approaches to assess the efficiency of expenditure on education and health for a sample of OECD countries and find that efficient outcomes seem to cluster around a small number of core countries *viz.*, Finland, Japan, Korea and Sweden.

Gupta *et al.* (1997), using FDH analysis find that, on average, governments in African countries are less efficient in the provision of health and education services than the governments in Asia and the western Hemisphere with those in Asia appearing as most efficient. The authors suggest that the observed inefficiencies in Africa are unrelated to the level of private spending, but may be the result of relatively high government wages (in the case of education spending) and the intrasectoral allocation of government resources. Furthermore, no apparent relationship is observed between input efficiency scores and public spending as a share of GDP. The results need to take cognizance of the lagged impact of public spending on output indicators. Moreover, the results underscore the need for interpreting the positive relationship between government spending on education and health indicators, as obtained from econometric techniques, with caution, particularly when the initial level of spending is already high. Thus, the Study suggests that increasing budgetary allocations for education and health may not be the only or most effective way to increase education and health output and that more attention should be given to increasing the efficiency of expenditure.

References:

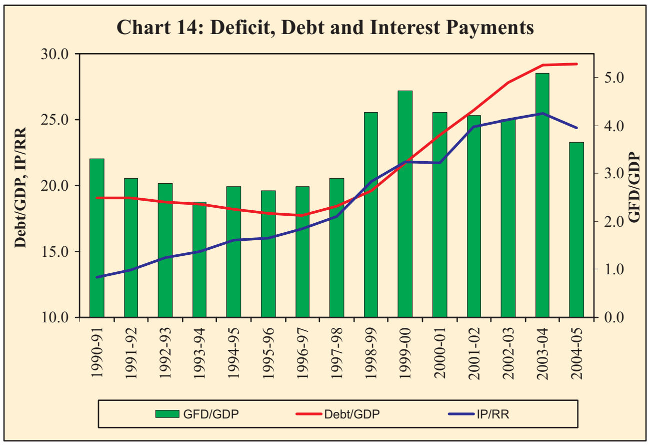
1. Afonso A. and M. St. Aubyn (2004), “Non-parametric Approaches to Education and Health Expenditure Efficiency in OECD Countries”, *OECD Working Paper*, January.

2. Gupta S., K. Honjo and M. Verhoeven (1997), “The Efficiency of Government Expenditure: Experience from Africa”, *IMF Working Paper No.WP/97/153.*

3. Premchand A. (1993), “Public Expenditure Management”, International Monetary Fund.

Statewise analysis is provided in the subsequent section.

Interest payments on the debt of State Governments have also mounted, and have pre-empted an increasing proportion of revenue receipts. The ratio of interest payments to revenue receipts is placed at around 25 per cent in 2004-05 as compared with 18 per cent recommended by the EFC from the viewpoint of ensuring debt sustainability in the medium term. The burden of interest payments tends to exacerbate the revenue

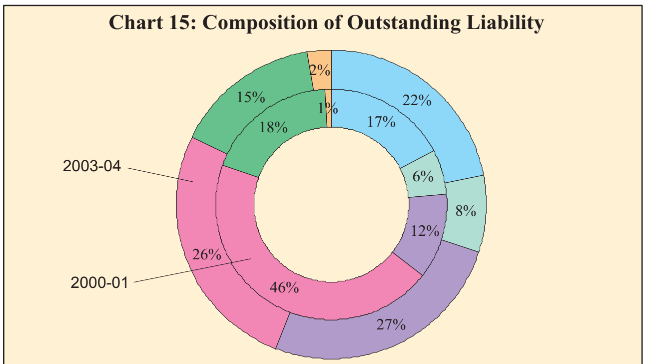


GFD: Gross Fiscal Deficit
IP: Interest Payments
RR: Revenue Receipts
GDP: Gross Domestic Product

deficit and, in turn, the GFD. Consequently, a vicious circle of deficit, debt and interest payments has been a permanent feature of State Government finances.

As mentioned earlier, a number of initiatives have been taken by the State and Central Governments to strengthen and facilitate fiscal reforms at the State level. A notable initiative has been the introduction of the Debt Swap Scheme which has enabled the States to pre-pay their high cost debt to the Centre. The impact of all these initiatives is evident from the reduction in the average interest rate of debt from 13.2 per cent in 1999-2000 to 12.2 per cent in 2003-04 and further to 11.3 per cent in 2004-05.

The composition of outstanding liabilities of the State Governments shows a sharp decline in the share of loans from the Centre with an upsurge in the shares of loans from NSSF, market loans and negotiated loans from banks and other institutions (Chart 15).



*Includes Insurance and Pension Funds, Trusts & Endowments and Compensation and Other Bonds

It needs to be highlighted that the budget documents of the State Governments do not provide sufficient details of their outstanding liabilities including the amounts under various categories and associated terms and conditions (such as rate of interest and maturity structure). Such lacunae are particularly evident in the case of negotiated loans from banks and financial institutions. Consequently, an in-depth analysis of their debt position remains circumscribed.

Contingent Liabilities

The outstanding guarantees of State Governments have shown a rising trend during the 1990s. Contingent liabilities do not directly form part of the debt burden of the States. In the event of default by the borrowing agency, however, the States will be required to meet the debt service obligations. The outstanding guarantees of State Governments are estimated to increase from Rs.1,65,386 crore (7.2 per cent of GDP) as at end-March 2002 to Rs.1,84,294 crore (7.5 per cent of GDP) as at end-March 2003.

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 a number of States including Goa, Gujarat, Karnataka, Sikkim and West Bengal, while some other States, *viz.*, Assam, Orissa and Rajasthan have imposed administrative ceilings on guarantees.

Liquidity Management

A revised Scheme of Ways and Means Advances (WMA) was effected on March 3, 2003 based on the recommendations of the Ramachandran Committee and after consultations with the State Governments. The total normal WMA limit for the State Governments, under the revised Scheme, was enhanced by 18.8 per cent from Rs.6,035 crore to Rs.7,170 crore with effect from March 3, 2003. The total normal WMA limit was increased further by 13.5 per cent to Rs.8,140 crore with effect from April 1, 2004, on account of higher average revenue receipts of the State Governments in the preceding three years (Table XXII).

Table XXII : Normal WMA Limits (1999 to 2004)

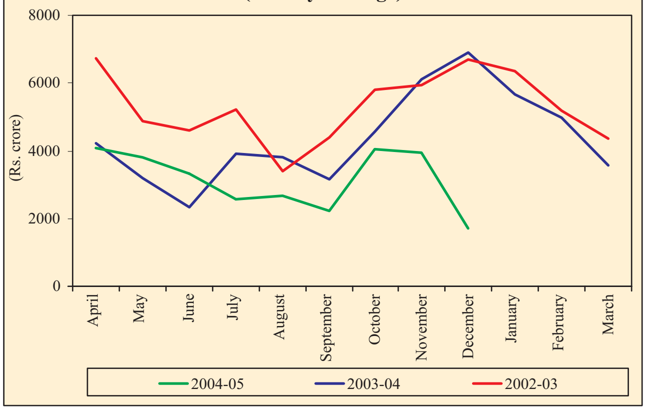
Period	Amount (Rs Crore)	Increase over earlier limits (%)
1	2	3
August 1996 to February 1999	2,234	100.0
March 1999 to Jan 2001	3,941	76.4
February 2001 to March 2002	5,283	34.1
April 2002 to March 2, 2003	6,035	14.2
March 3, 2003 to March 31 2004	7,170	18.8
April 2004 to till date	8,140	13.5

Source : As per RBI records.

Most of the State Governments reduced their recourse to normal WMA and overdrafts (OD) during 2003-04. This partly reflected a substantially higher (by around 53 per cent) utilisation of special WMA by the State Governments, mainly on account of the change in the provision under the revised Scheme that special WMA should be availed before taking recourse to normal WMA. The rate of interest charged on special WMA is one percentage point less than that on normal WMA. Higher mobilisation of Small Savings and enhanced market borrowings (other than those under the Debt Swap Scheme) also facilitated the reduction in recourse to normal WMA. Furthermore, the frequency of overdrafts declined in the case of most States during 2003-04. Even so, the number of occasions as well as the number of days on which ODs were resorted during 2003-04 remained high, particularly by Assam, Manipur, Kerala, Orissa and Punjab.

During 2004-05 so far (upto December 31, 2004), the average utilisation of WMA and OD since July 2004 has been lower than that in the corresponding period of the previous year (Chart 16). The frequency of resort to overdrafts has also been, in general, lower during 2004-05 (so far) than that in the (full) previous year. Even so, a few State Governments such as Assam, Kerala and West Bengal have resorted to overdrafts much more frequently than the other State Governments during 2004-05 so far. Furthermore, the number of days during which Arunachal Pradesh, Nagaland and Uttaranchal resorted to overdrafts during 2004-05 so far, exceeded that in respect of the (full) previous year.

Chart 16: Utilisation of WMA and Overdraft (Weekly Average)



While the trends in the actual recourse to WMA/OD by the States from the Reserve Bank are generally encouraging so far, budgetary data for 2004-05 however, indicate that the potential for the emergence of liquidity pressures remains large (Table XXIII).

Apart from the WMA from the Reserve Bank, the Central Government also provides WMA to the State Governments, which unlike the former is, however, not a direct source of monetary expansion. It is generally perceived that the Centre's WMA are utilised by the State Governments over and above WMA availed from the Reserve Bank and are sometimes used for smoothening liquidity mismatches.

Data on Centre's (gross) WMA to the State Governments, as reported in the budget documents of the State Governments, during 2000-01 to 2004-05 (Budget Estimates) are set out in Table XXIV. The total amount of such advances has varied between Rs.1,301 crore and Rs.3,329 crore over this period. There are, however, wide inter-State variations in the recourse to these advances. Seventeen out of the 29 State Governments have accessed these advances in different years during this period.

Among the Special Category States, these advances have been persistent and usually large in the case of Manipur and Assam. Non-Special

Table XXIII : State-wise Availment of WMA and OD from the Reserve Bank

Sr. No.	States	WMA		OD			
		2004-05*	2003-04	2004-05*		2003-04	
		Number of days	Number of days	Number of occasions	Number of occasions	Number of occasions	Number of days
1	2	3	4	5	6	7	8
	Non-Special Category States						
1	Andhra Pradesh	0	173	0	0	6	30
2	Bihar	3	92	0	0	5	44
3	Goa	213	270	3	13	8	48
4	Gujarat	82	203	0	0	4	21
5	Haryana	0	24	0	0	0	0
6	Karnataka	61	196	0	0	6	33
7	Kerala	268	328	15	124	27	178
8	Madhya Pradesh	100	261	0	0	10	59
9	Maharashtra	68	207	5	22	5	39
10	Orissa	99	315	0	0	19	168
11	Punjab	200	291	7	90	14	131
12	Rajasthan	85	303	0	0	16	94
13	Tamil Nadu	22	38	0	0	1	2
14	Uttar Pradesh	260	321	10	79	10	100
15	West Bengal	275	362	14	114	21	140
16	Chhattisgarh	0	0	0	0	0	0
17	Jharkhand	0	31	0	0	0	0
	Special Category States						
1	Arunachal Pradesh	32	0	2	5	0	0
2	Assam	225	337	10	102	20	235
3	Himachal Pradesh	144	327	4	27	14	109
4	Manipur	140	268	1	117	14	201
5	Meghalaya	6	31	0	0	0	0
6	Mizoram	142	131	1	1	3	5
7	Nagaland	81	12	3	18	0	0
8	Tripura	24	25	0	0	0	0
9	Uttaranchal	90	78	2	16	3	13

* : As on December 31, 2004.
Source : As per Reserve bank records

Category States like Punjab, Kerala and Orissa have also accessed these advances to different degrees, but not to the same extent as Manipur. Six States *viz.*, Assam, Kerala, Madhya Pradesh, Manipur, Nagaland and Punjab have *budgeted* for such advances in 2004-05. This probably reflects their anticipation of continued short-term (liquidity) pressures on their budgets. Furthermore, States like Assam, Manipur, Kerala, Orissa and Punjab which accessed a relatively higher amount of WMA from the Centre, are also the ones in respect of which the number of occasions as well as the number of days on which overdrafts were resorted to from the Reserve Bank, remained high during 2003-04.

Another issue that has a bearing on the liquidity management by the State Governments relates to their negative opening cash balance. Almost all (Special Category as well as Non-Special Category) State Governments have recorded a negative opening cash balance in the budget estimates for 2004-05, aggregating Rs.10,575 crore, and varying between (-) Rs 2.7 crore (Meghalaya) and (-) Rs.1,241.3 crore (Jammu and Kashmir). Many State Governments have recorded negative opening cash balance in the past as well. An opening cash deficit portends *ex ante* liquidity problems, which could exacerbate by the extent to which total receipts fall short of total expenditures (*i.e.*, the conventional budget deficit) during the year, unless alleviated by ARM. This would, in turn, necessitate the drawing down of cash/investment balances or recourse to WMA/OD from the Reserve Bank. In fact, excluding ARM, most State Governments would close the year 2004-05 with higher negative cash balance, perpetuating the initial problem.

Table XXIV : Ways and Means Advances from Centre

(Rs. crore)

	States	2000-01	2001-02	2002-03	2003-04 RE	2004-05 BE
	1	2	3	4	5	6
1	Andhra Pradesh	75	329	135	-	-
2	Arunachal Pradesh	-	-	-	-	-
3	Assam	200	675	470	50	50
4	Bihar	-	-	-	-	-
5	Chhattisgarh	-	-	-	-	-
6	Goa	-	-	-	-	-
7	Gujarat	550	91	-	1	1
8	Haryana	-	-	-	-	-
9	Himachal Pradesh	110	187	-	-	-
10	Jammu and Kashmir	-	-	-	-	-
11	Jharkhand	-	-	-	-	-
12	Karnataka	-	-	-	500	-
13	Kerala	-	203	178	200	200
14	Madhya Pradesh	-	-	312	-	250
15	Maharashtra	-	-	25	-	-
16	Manipur	196	433	573	445	500
17	Meghalaya	-	-	65	-	-
18	Mizoram	-	37	-	-	-
19	Nagaland	-	70	27	-	100
20	Orissa	250	382	695	700	-
21	Punjab	250	305	-	200	200
22	Rajasthan	-	-	198	-	-
23	Sikkim	-	-	-	-	-
24	Tamil Nadu	-	-	-	-	-
25	Tripura	-	-	-	-	-
26	Uttar Pradesh	-	-	1	-	-
27	Uttaranchal	-	-	-	-	-
28	West Bengal	200	227	650	-	-
29	NCT Delhi	-	-	-	-	-
	Total	**1,831**	**2,940**	**3,329**	**2,096**	**1,301**

BE : Budget Estimates RE: Revised Estimates

Source : Compiled from budget Documents of State Governments.

Section III
Emerging Fiscal Scenario: State-Wise Analysis

This section presents the emerging fiscal situation, State-wise, as evident from the revised estimates for 2003-04 and contrasts the same with the position prevailing, on an average, during the triennium 2000-01 through 2002-03 (Accounts). The discussion is based on the analysis of 15 fiscal indicators which are classified into four broad groups *viz.*, (a) resource gap; (b) revenue performance; (iii) expenditure pattern; and (d) debt position. Most of the fiscal indicators are expressed in terms of GSDP at current prices, as provided by the Central Statistical Organisation (CSO). Since the GSDP data are available upto 2002-03, State-wise estimates of GSDP for 2003-04 have been worked out on the basis of the respective average growth rates for the five-year period ended 2002-03 (or the last available five years). State-wise data on these fiscal indicators for 2000-03 and 2003-04 are presented in Tables XXV A and B respectively. The median level of each fiscal indicator in respect of both the categories of States is also highlighted in the Tables. The detailed State-wise information are set out in Statements 1-25.

The analysis of fiscal indicators is undertaken separately for Special and Non-Special Category States. For each category of States, comparisons are made over time (change in the level of a fiscal indicator for a given State Government) as well as space (the relative position of a State Government amongst the remaining States, for a given fiscal indicator). At each of the above-specified time periods, the State Governments are placed (separately, for Special and Non-Special Categories) in an ascending order for each fiscal indicator. The State Governments have then been ranked into four quartiles for each fiscal indicator for the years 2000-03 and 2003-04. Given that there are 18 Non-Special Category States and 11 Special Category States, the size of the second and third quartiles for each category of States has been adjusted for expositional convenience. The indicator relating to the difference between the average interest rate on debt and the growth rate of GSDP, has not been classified into quartiles. In order to facilitate a qualitative assessment of the data presented in Tables XXV, the placement of each State in different quartiles across all the specified fiscal indicators for the years 2000-03 and 2003-04 is presented in Tables XXVI A and B respectively. These Tables indicate, at a glance, whether a particular State Government is in, say, the highest developmental expenditure bracket or, say, the lowest own non-tax revenue mobilisation group. The State Governments are also grouped according to different quartiles for each fiscal indicator in respect of each of the two time periods (Tables XXVII A and B). These Tables present, at a glance, say, those States which have the highest debt-GSDP ratios or, say, the lowest own tax-GSDP ratios.

Table XXV A : Fiscal Indicators 2000-2003 (Average)

(Per cent)

States	GFD/ GSDP	RD/ GSDP	PD/ GSDP	RD/ GFD	RD/ RR	OTR/ GSDP	ONTR/ GSDP	CT/ GSDP	DEV/ GSDP	NON DEV/ GSDP	SSE/ GSDP	CO/ GSDP	DEBT/ GSDP	IP/ RR	PRB/ GSDP	R-G
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Non Special Category																
1. Andhra Pradesh	**4.8**	2.1	1.6	44.0	15.0	7.9	2.0	4.3	12.8	**6.4**	7.1	2.1	28.2	22.4	-1.1	4.7
2. Bihar	8.9	5.0	3.6	56.3	23.4	5.3	1.0	15.1	17.6	12.7	12.7	2.5	75.5	25.2	-0.3	13.8
3. Chhattisgarh	2.1	0.4	0.1	211.0	0.0	5.5	2.1	5.1	10.0	4.4	6.8	1.6	-	15.4	-1.6	-
4. Goa	5.0	**2.6**	1.9	51.4	12.2	**7.0**	12.3	2.2	14.9	11.6	7.0	2.4	32.2	14.6	**-0.5**	1.4
5. Gujarat	5.6	4.5	2.3	80.3	34.0	7.4	2.9	2.8	14.2	5.8	7.2	**1.9**	29.2	24.6	1.3	5.7
6. Haryana	3.6	1.3	0.8	37.3	10.3	8.2	2.7	1.7	10.3	6.0	5.5	1.9	26.3	**22.2**	-1.5	2.0
7. Jharkhand	4.0	0.2	2.2	4.5	1.4	4.6	2.0	7.6	12.6	5.5	9.0	3.1	-	12.9	-2.4	-
8. Karnataka	4.7	2.4	2.2	50.1	16.8	9.0	1.2	**4.0**	12.9	5.9	**7.0**	2.1	24.9	18.0	-0.2	6.0
9. Kerala	5.3	4.3	1.9	81.1	34.5	8.3	0.8	3.2	9.9	7.8	7.2	0.8	**35.6**	27.0	0.9	0.1
10. Madhya Pradesh	4.3	2.3	1.3	54.7	15.6	6.9	2.1	7.0	13.8	6.6	8.5	2.1	38.0	18.8	-0.7	14.4
11. Maharashtra	4.2	3.2	1.9	76.0	27.9	8.0	1.9	1.5	9.9	5.9	5.9	1.4	19.8	20.7	0.8	7.0
12. NCT Delhi	2.8	-2.5	1.5	-88.2	-27.5	7.2	1.1	0.7	8.4	3.4	4.7	1.2	13.4	14.8	-3.8	0.7
13. Orissa	8.0	5.0	1.7	61.8	28.9	5.9	1.8	9.9	14.6	11.0	9.8	2.2	60.1	35.9	-1.3	7.2
14. Punjab	6.2	4.6	2.0	73.8	33.7	7.2	4.6	1.9	9.4	10.8	4.8	1.3	45.3	30.5	0.4	2.3
15. Rajasthan	6.3	4.0	**1.8**	63.8	27.5	6.7	**1.9**	6.1	12.7	8.4	9.0	2.0	42.8	30.6	-0.5	8.5
16. Tamil Nadu	3.7	2.5	1.3	65.8	**18.9**	8.9	1.2	3.0	10.1	6.3	6.4	1.1	22.6	18.5	0.1	**5.9**
17. Uttar Pradesh	5.4	3.2	1.2	**59.4**	22.7	6.1	1.0	6.9	**10.5**	8.6	6.8	1.3	41.2	29.2	-0.9	8.2
18. West Bengal	7.2	5.4	3.1	75.4	57.5	4.2	0.6	4.7	9.4	7.3	6.0	0.7	38.0	44.3	-1.3	4.0
Special Category																
1. Arunachal Pradesh	11.7	-2.6	5.6	-23.6	-5.0	1.5	3.5	47.2	45.7	18.3	20.0	14.3	51.8	11.4	-8.5	**2.3**
2. Assam	4.0	2.0	0.8	48.6	11.1	4.9	1.8	11.8	13.8	8.6	9.4	1.6	35.8	17.2	-1.1	3.7
3. Himachal Pradesh	12.8	8.3	6.1	64.1	35.8	5.7	1.2	16.5	23.4	12.9	13.3	4.5	63.4	28.8	1.6	3.5
4. Jammu & Kashmir	8.6	0.2	**2.5**	-30.9	1.1	5.1	**1.7**	**31.7**	28.1	19.0	13.7	**8.0**	58.8	15.9	-5.9	1.3
5. Manipur	**8.6**	3.5	2.1	39.7	9.5	1.7	1.3	33.7	27.3	**18.0**	16.2	5.0	**57.3**	17.5	-2.9	4.8
6. Meghalaya	5.3	-0.8	2.1	-19.4	-2.7	**3.3**	2.3	23.8	24.0	11.1	**14.3**	4.8	30.8	11.1	-4.1	2.8
7. Mizoram	20.2	10.3	13.4	49.3	21.4	1.1	2.5	45.3	49.0	20.9	29.2	8.8	73.5	14.0	3.5	-1.0
8. Nagaland	9.6	0.4	4.6	4.0	1.6	1.4	1.1	33.2	**26.8**	18.7	14.0	9.0	57.3	**14.6**	-4.8	-10.4
9. Sikkim	4.1	13.6	-3.8	-805.9	-9.6	7.8	83.0	55.0	55.8	94.2	28.7	17.7	75.2	6.0	-21.5	0.2
10. Tripura	8.3	**0.7**	4.1	**8.8**	**2.4**	2.5	1.6	25.3	24.7	12.6	15.6	7.5	43.2	14.3	**-3.5**	-4.3
11. Uttaranchal	3.6	1.3	0.7	22.4	5.6	5.6	1.5	10.3	14.4	6.1	8.5	10.1	-	15.4	-1.6	-

(-) indicates surplus.

Source: Compiled from budget documents of State Governments. GSDP data has been obtained from Central Statistical Organisation (CSO).

GSDP – Gross State Domestic Product
GFD – Gross Fiscal Deficit
PD – Primary Deficit
RD – Revenue Deficit
OTR – Own Tax Revenue
ONTR – Own Non-Tax Revenue
CT – Current Transfers from the Centre
DEV – Development Expenditure
SSE – Social Sector Expenditure
CO – Capital Outlay
DEBT – Debt
IP – Interest Payments
RR – Revenue Receipts
PRB – Primary Revenue Balance
R-G – Interest rate on debt minus rate of Growth of GSDP
NONDEV – Non-Development Expenditure

The discussion of trends is set out below.

I. Non-Special Category States

(A) Indicators of Resource Gap

Over the period 2000-03 to 2003-04, many of the State Governments witnessed deterioration in the GFD-GSDP ratio and the PD (Primary Deficit) -GSDP ratio. Notable exceptions to this trend were Andhra Pradesh, Bihar, Goa, Haryana and Karnataka.

The RD (Revenue Deficit)-GSDP and the RD-RR (Revenue Receipts) ratios, however, declined in 2003-04 in respect of most State Governments, except in the case of Uttar Pradesh and Madhya Pradesh, primarily on account of the sizable increase in assistance to their State Electricity Boards during 2003-04.

The RD-GFD, which indicates the extent of preemption of borrowings by current expenditure, also showed a decline in the case of most State Governments, except Haryana and Uttar Pradesh.

Table XXV B : Fiscal Indicators 2003-04 (R.E.)

(Per cent)

States	GFD/ GSDP	RD/ GSDP	PD/ GSDP	RD/ GFD	RD/ RR	OTR/ GSDP	ONTR/ GSDP	CT/ GSDP	DEV/ GSDP	NON/ DEV GSDP	SSE/ GSDP	CO/ GSDP	DEBT/ GSDP	IP/ RR	PRB/ GSDP	R-G
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Non Special Category																
1. Andhra Pradesh	4.2	1.6	0.3	39.1	10.6	7.9	2.3	5.1	12.7	6.9	7.7	2.1	32.3	25.2	-2.2	2.8
2. Bihar	7.2	1.9	1.4	27.0	8.2	5.9	0.8	17.1	17.8	13.3	12.4	3.3	87.3	24.6	-3.9	7.2
3. Chhattisgarh	5.3	1.6	2.8	30.2	9.0	7.3	3.1	7.6	16.9	5.8	11.0	3.5	-	14.3	-1.0	-
4. Goa	4.4	0.9	1.4	20.2	5.2	7.3	7.9	2.0	15.5	6.2	7.4	3.5	32.8	17.5	-2.1	-4.1
5. Gujarat	6.6	2.3	2.8	35.0	17.2	**7.5**	3.6	2.3	14.0	6.0	6.1	2.8	35.3	28.0	-1.4	4.0
6. Haryana	1.8	1.2	-1.1	67.1	9.3	8.5	3.0	1.8	9.0	6.3	4.2	0.4	27.3	22.4	-1.8	0.5
7. Jharkhand	4.8	-0.4	1.9	-8.5	-1.9	6.6	3.4	11.7	17.8	8.8	12.6	4.5	-	13.3	-3.3	-
8. Karnataka	4.5	1.1	1.5	23.7	6.1	10.4	2.7	4.3	**13.2**	8.1	6.9	3.1	29.0	17.0	-1.9	2.2
9. Kerala	**6.0**	3.9	2.4	65.0	29.3	9.1	0.9	3.3	11.3	8.0	7.0	0.7	**38.1**	26.6	0.4	-0.6
10. Madhya Pradesh	10.0	6.2	6.0	61.3	35.3	7.8	1.8	7.8	18.0	8.8	8.4	3.5	53.1	**23.1**	2.1	7.9
11. Maharashtra	6.1	2.8	3.4	46.4	24.3	8.1	1.2	2.3	10.9	6.5	6.3	3.0	23.3	22.9	0.2	5.1
12. NCT Delhi	3.9	-2.1	**2.2**	-55.0	-25.2	6.7	1.2	0.6	9.1	3.0	4.5	1.2	16.9	19.3	-3.8	-0.8
13. Orissa	11.5	6.2	4.6	53.9	30.6	6.6	**1.9**	11.7	18.5	13.2	10.8	2.1	70.8	33.9	-0.7	4.5
14. Punjab	6.8	4.1	2.4	61.3	25.9	7.7	5.6	2.8	11.4	11.2	5.7	1.7	49.4	27.3	-0.2	0.2
15. Rajasthan	8.5	3.9	3.4	**46.3**	23.4	8.2	2.0	6.6	16.2	9.3	10.4	3.7	54.0	30.6	**-1.2**	4.6
16. Tamil Nadu	4.6	**2.2**	1.8	48.1	**16.2**	9.6	1.1	3.1	10.7	7.0	**7.2**	**2.3**	28.4	20.5	-0.6	**3.7**
17. Uttar Pradesh	9.9	9.7	4.7	97.7	60.7	6.6	0.9	8.4	21.2	10.2	7.5	0.4	50.1	32.8	4.4	6.4
18. West Bengal	7.2	5.0	2.2	70.4	53.9	4.7	0.6	**4.0**	8.6	**7.9**	5.3	0.5	45.4	53.3	0.1	1.6
Special Category																
1. Arunachal Pradesh	23.9	1.7	17.6	7.0	2.8	1.6	5.4	52.5	63.5	20.0	28.4	22.1	61.6	10.6	-4.6	3.0
2. Assam	8.0	4.2	3.2	53.0	16.4	6.1	**2.2**	17.4	22.1	11.7	15.3	3.1	41.4	18.4	-0.5	4.0
3. Himachal Pradesh	12.7	8.4	4.3	66.4	38.7	5.6	1.4	14.7	20.1	14.4	12.2	4.3	71.7	38.5	0.0	0.9
4. Jammu & Kashmir	-0.1	-9.0	-5.3	11513.4	-22.5	5.4	1.7	33.0	22.8	**17.2**	11.8	8.7	56.2	12.9	-14.2	2.9
5. Manipur	21.1	7.2	13.7	34.0	17.5	1.8	1.6	37.6	42.9	19.2	22.0	13.5	**64.3**	18.1	-0.2	2.9
6. Meghalaya	6.0	-2.3	2.2	-38.1	-6.5	**3.8**	2.7	28.4	29.3	11.9	17.9	6.0	33.7	10.8	-6.0	**0.7**
7. Mizoram	19.4	**1.5**	11.6	**7.6**	**2.5**	1.3	2.4	54.6	54.0	24.5	30.1	16.8	87.2	**13.2**	-6.3	-0.8
8. Nagaland	**8.8**	-2.0	**4.1**	-23.0	-5.3	1.5	1.1	**35.4**	27.8	19.1	14.2	**10.8**	66.9	12.3	-6.7	-2.0
9. Sikkim	8.6	-12.6	1.3	-147.2	-13.2	6.1	30.8	58.4	61.1	42.8	33.7	21.2	73.0	7.6	-19.9	- 1.4
10. Tripura	7.6	-1.1	3.7	-14.7	-4.0	2.7	1.4	23.4	22.3	12.5	13.9	8.6	44.2	14.1	**-5.0**	-6.8
11. Uttaranchal	16.3	9.5	10.4	58.5	35.2	7.9	2.8	16.4	**28.0**	14.0	**15.8**	77.5	-	21.9	3.6	-

(-) : indicates surplus
Note : Figures in bold pertain to median States for the given indicator.
Source : Compiled from budget documents of State Governments.

While the GFD-GSDP ratio in the case of Haryana was placed at only 1.8 per cent in 2003-04, more than 67 per cent of the overall borrowings was pre-empted by current expenditure. In the case of Uttar Pradesh, the GFD-GSDP ratio was placed at 9.9 per cent in 2003-04 and the extent of pre-emption of borrowings by current expenditure was as high as 98 per cent, reflecting the sizable assistance to its State Electricity Board during the year.

As far as the five State Governments that have enacted Fiscal Responsibility Legislation (FRL) are concerned, the GFD-GSDP ratio increased during 2003-04 in respect of all except Karnataka. In fact, the GFD-GSDP ratio in 2003-04 were higher by around 2 percentage points (Tamil Nadu) to around 7 percentage points (Uttar Pradesh) than the targeted levels to be attained over the next three to five years, as envisaged in their respective FRLs. On the other hand, the RD-GSDP ratio declined in the case of Karnataka, Kerala, Punjab and Tamil Nadu. The RD-GSDP ratios during 2003-04 were higher than the envisaged target values ('nil') by 1 percentage point (Karnataka) to 9.7 percentage points (Uttar Pradesh).

In general, during 2003-04, resource gaps (in terms of GSDP) were the highest for Madhya Pradesh, Orissa and Uttar Pradesh. In respect of these States, the GFD-GSDP ratio ranged between 10 to 11.5 per cent while the RD-GSDP ratio ranged between around 6.2 to 9.7 per cent during 2003-04. In contrast, resource gaps were among the lowest in the case of Goa and Delhi. The GFD-

Table XXVI A : Quartile Position 2000-03 (Average)

States	GFD/ GSDP	RD/ GSDP	PD/ GSDP	RD/ GFD	RD/ RR	OTR/ GSDP	ONTR/ GSDP	CT/ GSDP	DEV/ GSDP	NON DEV/ GSDP	SSE/ GSDP	CO/ GSDP	DEBT/ GSDP	IP/ RR	PRB/ GSDP
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
I. Non-Special Category															
1. Andhra Pradesh	**Q2**	Q2	Q2	Q1	Q2	Q3	Q3	Q3	Q3	**Q2**	Q3	Q3	Q2	Q3	Q2
2. Bihar	Q4	Q4	Q4	Q2	Q3	Q1	Q1	Q4	Q4	Q4	Q4	Q4	Q4	Q3	Q3
3. Chhattisgarh	Q1	Q1	Q1	Q4	Q1	Q1	Q3	Q3	Q2	Q1	Q2	Q2	-	Q1	Q1
4. Goa	Q3	**Q2**	Q3	Q2	Q2	**Q2**	Q4	Q2	Q4	Q4	Q3	Q4	Q2	Q1	**Q2**
5. Gujarat	Q3	Q3	Q4	Q4	Q4	Q3	Q4	Q2	Q4	Q1	Q3	Q3	Q2	Q3	Q4
6. Haryana	Q1	Q1	Q1	Q1	Q1	Q4	Q4	Q1	Q2	Q2	Q1	**Q2**	Q2	**Q2**	Q1
7. Jharkhand	Q2	Q1	Q4	Q1	Q1	Q1	Q3	Q4	Q3	Q1	Q4	Q4	-	Q1	Q1
8. Karnataka	Q2	Q2	Q3	Q2	Q2	Q4	Q2	**Q2**	Q3	Q2	**Q2**	Q3	Q1	Q2	Q3
9. Kerala	Q3	Q3	Q3	Q4	Q4	Q4	Q1	Q2	Q1	Q3	Q3	Q1	**Q3**	Q3	Q4
10. Madhya Pradesh	Q2	Q2	Q2	Q2	Q2	Q2	Q3	Q4	Q3	Q3	Q3	Q3	Q3	Q2	Q2
11. Maharashtra	Q2	Q3	Q3	Q4	Q3	Q3	Q3	Q1	Q2	Q2	Q1	Q2	Q1	Q2	Q4
12. NCT Delhi	Q1	Q1	Q2	Q1	Q1	Q3	Q2	Q1	Q1	Q1	Q1	Q1	Q1	Q1	Q1
13. Orissa	Q4	Q4	Q2	Q3	Q3	Q2	Q2	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q2
14. Punjab	Q3	Q4	Q3	Q3	Q4	Q3	Q4	Q1	Q1	Q4	Q1	Q2	Q4	Q4	Q3
15. Rajasthan	Q4	Q3	**Q2**	Q3	Q3	Q2	**Q2**	Q3	Q3	Q3	Q4	Q3	Q4	Q4	Q3
16. Tamil Nadu	Q1	Q2	Q1	Q3	**Q2**	Q4	Q2	Q2	Q2	Q2	Q2	Q1	Q1	Q2	Q3
17. Uttar Pradesh	Q3	Q3	Q1	**Q2**	Q3	Q2	Q1	Q3	**Q2**	Q3	Q2	Q2	Q3	Q3	Q2
18. West Bengal	Q4	Q4	Q4	Q3	Q4	Q1	Q1	Q3	Q1	Q3	Q2	Q1	Q3	Q4	Q4
II. Special Category															
1. Arunachal Pradesh	Q4	Q1	Q4	Q1	Q1	Q1	Q4	Q4	Q4	Q3	Q4	Q4	Q2	Q1	Q1
2. Assam	Q1	Q3	Q1	Q4	Q4	Q3	Q3	Q1	Q1	Q1	Q1	Q1	Q1	Q4	Q4
3. Himachal Pradesh	Q4	Q4	Q4	Q4	Q4	Q4	Q1	Q1	Q1	Q2	Q1	Q1	Q3	Q4	Q4
4. Jammu & Kashmir	Q3	Q2	**Q3**	Q1	Q2	Q3	**Q3**	**Q3**	Q3	Q4	Q2	**Q3**	Q3	Q3	Q1
5. Manipur	**Q3**	Q4	Q2	Q3	Q3	Q2	Q1	Q3	Q3	**Q3**	Q3	Q2	**Q3**	Q4	Q3
6. Meghalaya	Q2	Q1	Q2	Q2	Q1	**Q3**	Q3	Q2	Q2	Q1	**Q3**	Q1	Q1	Q1	Q2
7. Mizoram	Q4	Q4	Q4	Q4	Q4	Q1	Q4	Q4	Q4	Q4	Q4	Q3	Q4	Q2	Q4
8. Nagaland	Q3	Q2	Q3	Q2	Q2	Q1	Q1	Q3	**Q3**	Q3	Q2	Q3	Q2	**Q3**	Q2
9. Sikkim	Q1	Q1	Q1	Q1	Q1	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q1	Q1
10. Tripura	Q2	**Q3**	Q3	**Q3**	**Q3**	Q2	Q2	Q2	Q2	Q2	Q3	Q2	Q1	Q2	**Q3**
11. Uttaranchal	Q1	Q3	Q1	Q3	Q3	Q4	Q2	Q1	Q1	Q1	Q1	Q4	-	Q3	Q3

Note : Bold quartile pertains to median state for the given indicator.

Table XXVI B : Quartile Position 2003-04 (R.E.)

States	GFD/ GSDP	RD/ GSDP	PD/ GSDP	RD/ GFD	RD/ RR	OTR/ GSDP	ONTR/ GSDP	CT/ GSDP	DEV/ GSDP	NON DEV/ GSDP	SSE/ GSDP	CO/ GSDP	DEBT/ GSDP	IP/ RR	PRB/ GSDP
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
I. Non-Special Category															
1. Andhra Pradesh	Q1	Q2	Q1	Q2	Q2	Q3	Q3	Q3	Q2	Q2	Q3	Q2	Q2	Q3	Q1
2. Bihar	Q3	Q2	Q1	Q2	Q2	Q1	Q1	Q4	Q4	Q4	Q4	Q3	Q4	Q3	Q1
3. Chhattisgarh	Q2	Q2	Q3	Q2	Q2	Q2	Q3	Q3	Q3	Q1	Q4	Q4	-	Q1	Q3
4. Goa	Q1	Q1	Q1	Q1	Q1	Q2	Q4	Q1	Q3	Q1	Q3	Q4	Q2	Q1	Q2
5. Gujarat	Q3	Q3	Q3	Q2	Q3	**Q2**	Q4	Q2	Q3	Q1	Q2	Q3	Q2	Q3	Q2
6. Haryana	Q1	Q2	Q1	Q4	Q2	Q4	Q3	Q1	Q1	Q2	Q1	Q1	Q1	Q2	Q2
7. Jharkhand	Q2	Q1	Q2	Q1	Q1	Q2	Q4	Q4	Q3	Q3	Q4	Q4	-	Q1	Q1
8. Karnataka	Q2	Q1	Q2	Q1	Q1	Q4	Q3	Q3	**Q2**	Q3	Q2	Q3	Q2	Q1	Q2
9. Kerala	**Q2**	Q3	Q3	Q4	Q3	Q4	Q1	Q2	Q2	Q3	Q2	Q1	**Q3**	Q3	Q4
10. Madhya Pradesh	Q4	Q4	Q4	Q3	Q4	Q3	Q2	Q3	Q4	Q3	Q3	Q3	Q4	**Q2**	Q4
11. Maharashtra	Q3	Q3	Q4	Q3	Q3	Q3	Q2	Q1	Q2	Q2	Q2	Q3	Q1	Q2	Q4
12. NCT Delhi	Q1	Q1	**Q2**	Q1	Q1	Q2	Q2	Q1	Q1	Q1	Q1	Q2	Q1	Q2	Q1
13. Orissa	Q4	Q4	Q4	Q3	Q4	Q1	**Q2**	Q4	Q4	Q4	Q4	Q2	Q4	Q4	Q3
14. Punjab	Q3	Q3	Q3	Q3	Q3	Q3	Q4	Q2	Q2	Q4	Q1	Q2	Q3	Q3	Q3
15. Rajasthan	Q4	Q3	Q3	**Q2**	Q3	Q3	Q3	Q3	Q3	Q3	Q3	Q4	Q4	Q4	**Q2**
16. Tamil Nadu	Q2	**Q2**	Q2	Q3	**Q2**	Q4	Q2	Q2	Q1	Q2	**Q2**	**Q2**	Q1	Q2	Q3
17. Uttar Pradesh	Q4	Q4	Q4	Q4	Q4	Q1	Q1	Q4	Q4	Q4	Q3	Q1	Q3	Q4	Q4
18. West Bengal	Q3	Q4	Q2	Q4	Q4	Q1	Q1	**Q2**	Q1	**Q2**	Q1	Q1	Q3	Q4	Q3
II. Special Category															
1. Arunachal Pradesh	Q4	Q3	Q4	Q2	Q3	Q1	Q4	Q4	Q4	Q4	Q4	Q4	Q2	Q1	Q3
2. Assam	Q2	Q3	Q2	Q3	Q3	Q4	**Q3**	Q1	Q1	Q1	Q2	Q1	Q1	Q4	Q3
3. Himachal Pradesh	Q3	Q4	Q3	Q4	Q4	Q3	Q1	Q1	Q1	Q2	Q1	Q1	Q3	Q4	Q4
4. Jammu & Kashmir	Q1	Q1	Q1	Q4	Q1	Q3	Q2	Q3	Q2	**Q3**	Q1	Q2	Q2	Q2	Q1
5. Manipur	Q4	Q4	Q4	Q3	Q4	Q2	Q2	Q3	Q3	Q3	Q3	Q3	**Q3**	Q3	Q4
6. Meghalaya	Q1	Q1	Q1	Q1	Q1	**Q3**	Q3	Q2	Q3	Q1	Q3	Q1	Q1	Q1	Q2
7. Mizoram	Q4	**Q3**	Q4	**Q3**	**Q3**	Q1	Q3	Q4	Q4	Q4	Q4	Q3	Q4	**Q3**	Q2
8. Nagaland	**Q3**	Q2	**Q3**	Q1	Q2	Q1	Q1	**Q3**	Q2	Q3	Q2	**Q3**	Q3	Q2	Q1
9. Sikkim	Q2	Q1	Q1	Q1	Q1	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q1	Q1
10. Tripura	Q1	Q2	Q2	Q2	Q2	Q2	Q1	Q2	Q1	Q1	Q1	Q2	Q1	Q3	**Q3**
11. Uttaranchal	Q3	Q4	Q3	Q4	Q4	Q4	Q4	Q1	**Q3**	Q2	**Q3**	Q4	-	Q4	Q4

Note : Bold quartile pertains to median state for the given indicator.

Table XXVII A : Summary Position of Non-Special Category States for 2000-03 (Average)

INDICATOR	Q1	Q2	Q3	Q4
(A) RESOURCE GAP				
1. GFD/GSDP	RANGE: 2.1 to 3.7 Chhattisgarh, Haryana, Tamil Nadu, Delhi	RANGE: 4.0 to 4.8 Andhra Pradesh, Jharkhand, Karnataka, Madhya Pradesh Maharashtra	RANGE: 5.0 to 6.2 Goa, Gujarat, Kerala Punjab, Uttar Pradesh	RANGE: 6.3 to 8.9 Bihar, Orissa, Rajasthan, West Bengal
2. RD/GSDP	RANGE: -2.5 to 1.3 Chhattisgarh, Haryana, Jharkhand, Delhi	RANGE: 2.1 to 2.6 Andhra Pradesh, Goa, Karnataka, Madhya Pradesh Tamil Nadu,	RANGE: 3.2 to 4.5 Gujarat, Kerala, Maharashtra, Rajasthan, Uttar Pradesh	RANGE: 4.6 to 5.4 Bihar, Punjab, Orissa, West Bengal
3. PD/GSDP	RANGE: -0.1 to 1.3 Chhattisgarh, Haryana, Tamil Nadu, Uttar Pradesh	RANGE: 1.3 to 1.8 Andhra Pradesh, Orissa, Madhya Pradesh, Delhi Rajasthan	RANGE: 1.9 to 2.2 Goa, Karnataka, Kerala, Punjab, Maharashtra	RANGE: 2.2 to 3.6 Bihar, Gujarat Jharkhand, West Bengal
4. RD/GFD	RANGE: -88.2 to 44.0 Andhra Pradesh, Haryana Jharkhand, Delhi	RANGE: 50.1 to 59.4 Bihar, Goa, Karnataka, Madhya Pradesh, Uttar Pradesh	RANGE: 61.8 to 75.4 Orissa, Punjab, Rajasthan, West Bengal, Tamil Nadu	RANGE: 76.0 to 211.0 Chhattisgarh, Gujarat Kerala, Maharashtra
5. RD/RR	RANGE: -27.5 to 10.3 Chhattisgarh, Haryana Jharkhand, Delhi	RANGE: 12.2 to 18.9 Andhra Pradesh, Goa Karnataka, Madhya Pradesh Tamil Nadu	RANGE: 22.7 to 28.9 Bihar, Maharashtra, Orissa, Rajasthan, Uttar Pradesh,	RANGE: 33.7 to 57.5 Gujarat, Kerala, Punjab, West Bengal
(B) REVENUE PERFORMANCE				
6. OTR/GSDP	RANGE: 4.2 to 5.5 Bihar, Chhattisgrah, Jharkhand, West Bengal	RANGE: 5.9 to 7.0 Goa, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh	RANGE: 7.2 to 8.0 Andhra Pradesh, Gujarat, Maharashtra, Punjab, Delhi	RANGE: 8.2 to 9.0 Karnataka, Kerala, Haryana, Tamil Nadu
7. ONTR/GSDP	RANGE: 0.6 to 1.0 Bihar, Kerala, Uttar Pradesh, West Bengal,	RANGE: 1.1 to 1.9 Delhi, Karnataka, Orissa, Rajasthan, Tamil Nadu,	RANGE: 1.9 to 2.1 Andhra Pradesh, Chhattisgarh, Madhya Pradesh, Jharkhand, Maharashtra	RANGE: 2.7 to 12.3 Goa, Gujarat, Haryana, Punjab
8. CT/GSDP	RANGE: 0.7 to 1.9 Haryana, Maharashtra, Punjab, Delhi	RANGE: 2.2 to 4.0 Goa, Gujarat, Karnataka, Kerala, Tamil Nadu	RANGE: 4.3 to 6.9 Andhra Pradesh, Chhattisgarh, Rajasthan, Uttar Pradesh, West Bengal	RANGE: 7.0 to 15.1 Bihar, Madhya Pradesh, Orissa, Jharkhand
9. PRB/GSDP	RANGE -3.8 to 1.5 Chhattisgarh, Haryana, Jharkhand, Delhi	RANGE -1.3 to -0.5 Andhra Pradesh, Goa, Madhya Pradesh, Orissa, Uttar Pradesh	RANGE -0.5 to 0.4 Bihar, Karnataka, Punjab, Rajasthan, Tamil Nadu	RANGE 0.8 to 1.3 Gujarat, Kerala, Maharashtra, West Bengal
(C) EXPENDITURE PATTERN				
10. DEV/GSDP	RANGE: 8.4 to 9.9 Kerala, Punjab, West Bengal Delhi	RANGE: 9.9 to 10.5 Chhattisgarh, Haryana, Maharashtra, Tamil Nadu, Uttar Pradesh	RANGE: 12.6 to 13.8 Andhra Pradesh, Jharkhand, Karnataka, Madhya Pradesh Rajasthan	RANGE: 14.2 to 17.6 Bihar, Goa, Gujarat, Orissa
11. NONDEV/GSDP	RANGE: 3.4 to 5.8 Chhattisgarh, Gujarat, Jharkhand, Delhi	RANGE: 5.9 to 6.4 Andhra Pradesh, Haryana, Karnataka, Maharashtra, Tamil Nadu	RANGE: 6.6 to 8.6 Kerala, Madhya Pradesh, Rajasthan, Uttar Pradesh, West Bengal	RANGE: 10.8 to 12.7 Bihar, Goa, Orissa, Punjab
12. SSE/GSDP	RANGE: 4.7 to 5.9 Haryana, Maharashtra, Punjab, Delhi	RANGE: 6.0 to 7.0 Chhattisgarh, Karnataka, Tamil Nadu, Uttar Pradesh, West Bengal	RANGE: 7.0 to 8.5 Andhra Pradesh, Goa, Gujarat, Madhya Pradesh, Kerala	RANGE: 9.0 to 12.7 Bihar, Jharkhand, Orissa, Rajasthan
13. CO/GSDP	RANGE: 0.7 to 1.2 Kerala, Tamil Nadu, West Bengal, Delhi	RANGE: 1.3 to 1.9 Chhattisgarh, Haryana, Maharashtra, Punjab, Uttar Pradesh,	RANGE: 1.9 to 2.1 Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Rajasthan	RANGE: 2.2 to 3.1 Bihar, Goa, Orissa, Jharkhand
(D) DEBT POSITION				
14. DEBT/GSDP*	RANGE: 13.4 to 24.9 Karnataka, Maharashtra, Tamil Nadu, Delhi	RANGE: 26.3 to 32.2 Andhra Pradesh, Goa, Gujarat, Haryana,	RANGE: 35.6 to 41.2 Madhya Pradesh, Kerala, Uttar Pradesh, West Bengal	RANGE: 42.8 to 75.5 Bihar, Orissa, Punjab, Rajasthan
15. IP/RR	RANGE: 12.9 to 15.4 Chhattisgarh, Goa, Jharkhand, Delhi	RANGE: 18.0 to 22.2 Haryana, Karnataka, Madhya Pradesh, Maharashtra, Tamil Nadu	RANGE: 22.4 to 29.2 Andhra Pradesh, Bihar, Gujarat, Kerala, Uttar Pradesh	RANGE: 30.5 to 44.3 Orissa, Punjab, Rajasthan, West Bengal

* : Data on Chhattisgarh and Jharkhand are not available.

Note : Minus (-) sign indicates surplus.

Table XXVII B : Summary Position of Non-Special Category States for 2003-04 (Revised Estimates)

INDICATOR	Q1	Q2	Q3	Q4
(A) RESOURCE GAP				
1. GFD/GSDP	RANGE: 1.8 to 4.4 Andhra Pradesh, Haryana, Goa, Delhi	RANGE: 4.5 to 6.0 Chhattisgarh, Kerala, Jharkhand, Karnataka, Tamil Nadu	RANGE: 6.1 to 7.2 Bihar, Gujarat, Maharashtra, Punjab, West Bengal	RANGE: 8.5 to 11.5 Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh
2. RD/GSDP	RANGE: -2.1 to 1.1 Goa, Jharkhand Karnataka, Delhi	RANGE: 1.2 to 2.2 Andhra Pradesh, Bihar, Chhattisgarh, Haryana, Tamil Nadu	RANGE: 2.3 to 4.1 Gujarat, Kerala, Maharashtra, Punjab Rajasthan	RANGE: 5.0 to 9.7 Madhya Pradesh, Orissa, Uttar Pradesh, West Bengal
3. PD/GSDP	RANGE: -1.1 to 1.4 Andhra Pradesh, Bihar Goa, Haryana	RANGE: 1.5 to 2.2 Jharkhand, Karnataka, Tamil Nadu, West Bengal, Delhi	RANGE: 2.4 to 3.4 Chhattisgarh, Gujarat Kerala, Punjab, Rajasthan	RANGE: 3.4 to 6.0 Madhya Pradesh, Maharashtra Orissa, Uttar Pradesh
4. RD/GFD	RANGE: -55.0 to 23.7 Goa, Jharkhand Karnataka, Delhi	RANGE: 27.0 to 46.3 Andhra Pradesh, Bihar, Chhattisgarh, Gujarat, Rajasthan	RANGE: 46.4 to 61.3 Madhya Pradesh, Maharashtra, Orissa, Punjab, Tamil Nadu	RANGE: 65.0 to 97.7 Haryana, Kerala, Uttar Pradesh, West Bengal
5. RD/RR	RANGE: -25.2 to 6.1 Goa, Jharkhand Karnataka, Delhi	RANGE: 8.2 to 16.2 Andhra Pradesh, Bihar Chhattisgarh, Haryana Tamil Nadu	RANGE: 17.2 to 29.3 Gujarat, Kerala Maharashtra, Punjab Rajasthan	RANGE: 30.6 to 60.7 Madhya Pradesh, Orissa, Uttar Pradesh, West Bengal
(B) REVENUE PERFORMANCE				
6. OTR/GSDP	RANGE: 4.7 to 6.6 Bihar, Orissa, Uttar Pradesh, West Bengal	RANGE: 6.6 to 7.5 Chhattisgarh, Goa Gujarat, Jharkhand, Delhi	RANGE: 7.7 to 8.2 Andhra Pradesh, Madhya Pradesh, Punjab, Rajasthan, Maharashtra,	RANGE: 8.5 to 10.4 Haryana, Karnataka Kerala, Tamil Nadu
7. ONTR/GSDP	RANGE: 0.6 to 0.9 Bihar, Kerala Uttar Pradesh, West Bengal	RANGE: 1.1 to 1.9 Madhya Pradesh, Maharashtra, Orissa, Tamil Nadu, Delhi	RANGE: 2.0 to 3.1 Andhra Pradesh, Chhattisgarh Haryana, Karnataka Rajasthan	RANGE: 3.4 to 7.9 Goa, Gujarat Jharkhand, Punjab
8. CT/GSDP	RANGE: 0.6 to 2.3 Goa, Haryana Maharashtra, Delhi	RANGE: 2.3 to 4.0 Gujarat, Kerala Punjab, Tamil Nadu West Bengal	RANGE: 4.3 to 7.8 Andhra Pradesh, Chhattisgarh Karnataka, Madhya Pradesh Rajasthan	RANGE: 8.4 to 17.1 Bihar, Jharkhand Orissa, Uttar Pradesh
9. PRB/GSDP	RANGE -3.9 to -2.2 Andhra Pradesh, Bihar, Jharkhand, Delhi	RANGE -2.1 to -1.2 Goa, Gujarat, Haryana, Karnataka, Rajasthan	RANGE -1.0 to 0.1 Chhattisgarh, Orissa, Punjab, Tamil Nadu, West Bengal	RANGE 0.2 to 4.4 Kerala, Madhya Pradesh, Maharashtra, Uttar Pradesh
(C) EXPENDITURE PATTERN				
10. DEV/GSDP	RANGE: 8.6 to 10.7 Haryana, Tamil Nadu, West Bengal, Delhi	RANGE: 10.9 to 13.2 Andhra Pradesh, Karnataka Kerala, Maharashtra, Punjab	RANGE: 14.0 to 17.8 Jharkhand, Goa, Gujarat, Chhattisgarh, Rajasthan	RANGE: 17.8to 21.2 Bihar, Madhya Pradesh, Orissa, Uttar Pradesh
11. NONDEV/GSDP	RANGE: 3.0 to 6.2 Chhattisgarh, Goa Gujarat, Delhi	RANGE: 6.3 to 7.9 Andhra Pradesh, Haryana Maharashtra, Tamil Nadu West Bengal	RANGE: 8.0 to 9.3 Jharkhand, Karnataka Kerala, Madhya Pradesh Rajasthan	RANGE: 10.2 to 13.3 Bihar, Orissa, Punjab, Uttar Pradesh
12. SSE/GSDP	RANGE: 4.2 to 5.7 Haryana, Punjab West Bengal, Delhi	RANGE: 6.1 to 7.2 Gujarat, Karnataka Kerala, Maharashtra Tamil Nadu	RANGE: 7.4 to 10.4 Andhra Pradesh, Goa Madhya Pradesh, Rajasthan Uttar Pradesh	RANGE: 10.8 to 12.6 Bihar, Chhattisgarh Jharkhand, Orissa
13. CO/GSDP	RANGE: 0.4 to 0.7 Haryana, Uttar Pradesh, Kerala, West Bengal	RANGE: 1.2 to 2.3 Andhra Pradesh, Orissa, Punjab, Tamil Nadu, Delhi	RANGE: 2.8 to 3.5 Bihar, Gujarat, Karnataka, Maharashtra, Madhya Pradesh	RANGE: 3.5 to 4.5 Chhattisgarh, Goa Jharkhand, Rajasthan
(D) DEBT POSITION				
14. DEBT/GSDP*	RANGE: 16.9 to 28.4 Haryana, Tamil Nadu, Maharashtra, Delhi	RANGE: 29.0 to 35.3 Andhra Pradesh, Goa Gujarat, Karnataka	RANGE: 38.1 to 50.1 Kerala, Punjab, Uttar Pradesh West Bengal	RANGE: 53.1 to 87.3 Bihar, Orissa, Rajasthan, Madhya Pradesh
15. IP/RR	RANGE: 13.3 to 17.5 Chhattisgarh, Goa Jharkhand, Karnataka	RANGE: 19.3 to 23.1 Haryana, Madhya Pradesh, Maharashtra, Tamil Nadu Delhi	RANGE: 24.6 to 28.0 Andhra Pradesh, Bihar Gujarat, Kerala, Punjab	RANGE: 30.6 to 53.3 Orissa, Rajasthan Uttar Pradesh, West Bengal

* : Data on Chhattisgarh and Jharkhand are not available.

Note : Minus (-) sign indicates surplus.

GSDP ratios of these two State Governments were placed at around 4 per cent during 2003-04. The RD-GSDP ratio of Goa was placed at 0.9 percent while Delhi recorded a revenue surplus in 2003-04.

(B) Revenue Performance

Almost all State Governments, except NCT Delhi, showed improvements in their own tax revenue performance during 2003-04 over the period 2000-03, as reflected in their respective tax-GSDP ratios.

Haryana, Karnataka, Kerala and Tamil Nadu accounted for the highest own tax-GSDP ratios (more than 8.5 per cent), while Bihar, Orissa, West Bengal and Uttar Pradesh occupied the lowest rungs (less than 6.6 per cent) during 2003-04.

Many State Governments showed marginal improvement in own non-tax-GSDP ratio during 2003-04.

Goa, Gujarat and Punjab continued to occupy the highest ranks in terms of own non-tax-GSDP ratio (more than 3.4 per cent) whereas Bihar, Kerala, West Bengal and Uttar Pradesh continued to occupy the lowest positions (less than 1 per cent).

Current transfers (sharable tax revenue and grants) from the Centre, as a ratio to GSDP, increased during 2003-04 in the case of all State Governments except Goa, Gujarat, West Bengal and NCT Delhi.

Bihar, Jharkhand, Orissa and Uttar Pradesh received the highest level of current transfers as a ratio to GSDP (more than 8 per cent) during 2003-04 while Goa, Haryana, Maharashtra and NCT Delhi occupied the lowest positions in terms of the current transfers-GSDP ratio (less than 2.3 per cent).

(C) Pattern of Expenditure

Most State Governments showed an increase in developmental and non-developmental expenditures expressed as ratios to GSDP in 2003-04.

The increase in developmental expenditure reflected, *inter alia*, the higher expenditures in respect of the power sector.

Haryana was among the few State Governments which showed a reduction in developmental outlays as a ratio to GSDP.

Bihar, Madhya Pradesh, Orissa and Uttar Pradesh earned the highest rankings in terms of developmental expenditure-GSDP ratio (over 17.8 per cent) in 2003-04.

A mixed trend is evident in respect of social sector expenditures (comprising social services, rural development, food storage and warehousing) as a ratio to GSDP, with ten State Governments showing an increase and eight State Governments indicating a decline during 2003-04. Amongst all the State Governments, Bihar, Jharkhand and Orissa continued to provide for the highest level of social sector expenditure in terms of GSDP (around 11 per cent) during 2003-04. In contrast, NCT Delhi, Haryana, Punjab and West Bengal formed part of the lowest quartile in terms of the ratio of social sector expenditure to GSDP (4-6 per cent) during 2003-04.

Amongst all the States, the ratio of non-developmental expenditure to GSDP was the highest (over 10.2 per cent) in the case of Bihar, Orissa, Punjab and Uttar Pradesh.

Based on the information received from select States, the proportion of operations and maintenance expenditure in total revenue expenditure exihibited a decline over the years (Table XXVIII). This has implications for the returns from the projects undertaken under the Plans. On the other hand, share of wages and salaries in revenue expenditure increased over the second half of the 1990s and then declined to 29.1 per cent in 2003-04 (Revised Estimates) (Table XXIX). The continuing large share (nearly one-third) of wages and salaries in total revenue

Table XXVIII : Expenditure on Operations and Maintenance

(Rs. crore)

States	1995-96	2000-01	2001-02	2002-03	2003-04 (RE)	2004-05 (BE)
1	2	3	4	5	6	7
Chhattisgarh		61.5	252.8	351.9	375.8	371.5
		(3.8)	(5.1)	(6.4)	(5.3)	(4.9)
Gujarat	425.8	1223.6	909.2	1419.2	2161.8	-
	(4.9)	(5.6)	(4.0)	(6.6)	(9.2)	-
Haryana	158.2	220.3	258.7	317.8	393.2	349.4
	(3.0)	(3.1)	(3.0)	(3.4)	(3.7)	(3.0)
Jharkhand	-	-	72.8	59.1	58.4	76.3
	-	-	(1.2)	(0.8)	(0.8)	(1.0)
Maharashtra*	4266.5	6876.6	7143.2	8257.1	9921.7	13114.8
	(24.9)	(18.4)	(18.7)	(20.4)	(21.5)	(27.4)
Orissa	247.3	427.0	418.4	435.8	524.1	584.9
	(5.3)	(4.8)	(4.2)	(4.4)	(4.1)	(4.2)
Tamil Nadu	1498.3	1866.9	1683.0	2143.7	2664.4	2874.6
	(13.7)	(8.6)	(7.8)	(8.3)	(10.0)	(10.2)
Uttar Pradesh	6046.3	4887.4	6028.4	6033.3	6203.3	6426.1
	(34.4)	(15.7)	(19.0)	(18.3)	(11.7)	(15.0)
Total	**12642.3**	**15563.4**	**16766.4**	**19017.9**	**22302.7**	**23797.6**
	(19.6)	**(12.0)**	**(11.7)**	**(12.4)**	**(11.9)**	**(12.9)**

BE – Budget Estimates RE – Revised Estimates.

* : Includes expenditure under maintenance works, tools & plants, machinery & equipment, material & supplies, grant-in-aid non-salary and suspense

\- : Not available.

Note : Figures in brackets are percentage of Total Revenue Expenditure.

Source : Information received from these States.

Table XXIX : Expenditure on Wages and Salary

(Rs. crore)

States	1995-96	2000-01	2001-02	2002-03	2003-04 (RE)	2004-05 (BE)
1	2	3	4	5	6	7
Chhattisgarh	-	832.6	1924.2	1947.7	2169.1	2516.6
		(51.7)	(39.2)	(35.2)	(30.5)	(33.1)
Gujarat	1299.1	2228.5	2310.4	2460.1	2548.2	-
	(14.8)	(10.1)	(10.2)	(11.5)	(10.8)	-
Haryana	1369.3	2687.1	2920.4	3156.1	3376.8	3574.8
	(25.5)	(37.4)	(33.7)	(33.8)	(31.6)	(30.6)
Maharashtra*	7899.4	18188.1	18474.7	18499.4	20160.5	20497.8
	(46.0)	(48.6)	(48.3)	(45.7)	(43.6)	(42.8)
Orissa	1798.3	3568.8	3517.0	3610.3	4068.2	3942.9
	(38.3)	(40.4)	(35.6)	(36.0)	(32.2)	(28.0)
Punjab	1900.7	4287.3	4132.7	4556.2	5113.3	5449.8
	(33.7)	(36.6)	(32.5)	(30.7)	(29.7)	(28.5)
Rajasthan	-	5100.8	5298.1	5281.9	5766.6	5496.5
		(33.9)	(33.2)	(31.0)	(29.8)	(28.1)
Tamil Nadu	4230.6	8251.2	8261.9	7980.4	8919.1	9477.9
	(38.8)	(37.9)	(38.3)	(31.1)	(33.6)	(33.7)
Uttar Pradesh	4115.5	7724.4	6962.3	7395.1	8617.8	9481.4
	(23.4)	(24.9)	(21.9)	(22.5)	(16.3)	(22.2)
Total	**22612.9**	**52868.9**	**53801.7**	**54887.3**	**60739.5**	**60437.7**
	(32.3)	**(34.1)**	**(33.3)**	**(32.0)**	**(29.1)**	**(33.0)**

BE – Budget Estimates RE – Revised Estimates.

* : Includes Pension & Gratuity

\- : Not available/Not applicable.

Note : Figures in brackets are percentage of Total Revenue Expenditure.

Source : Information received from these States.

expenditure is one of the primary factors underlying the downward rigidity in revenue expenditures.

Most State Governments showed an increase in the ratio of capital outlay to GSDP during 2003-04. The ratio of capital outlay to GSDP declined by 1.5 percentage points in the case of Haryana to 0.4 per cent in 2003-04; the reduction in capital outlay during 2003-04 was mainly reflected under food storage and warehousing as well as irrigation and flood control.

In terms of the ratio of capital outlay to GSDP, Jharkhand and Goa continued to occupy the top quartile, while Kerala and West Bengal continued to form part of the lowest quartile during 2003-04.

At the consolidated level, the proportion of expenditure (revenue expenditure and capital outlay) on education (Table XXX) and also medical and public health and family welfare (Table XXXI) to aggregate disbursements have declined during 2000-01 through 2003-04; some improvement is, however, expected during 2004-05. Expenditure on education and medical and public health services have constituted only 2.5 per cent and 0.72 per cent, respectively, of GDP during 2003-04. The declining share of education and medical expenditures in total expenditures is also evident in many of the States. While there is a certainly a need for qualitatively superior and wider coverage of education and medical services in India, there may also be a need for examining the efficacy of government expenditures (Box 7).

(D) Debt Position

The debt-GSDP ratios of all State Governments continued to show an increase during 2003-04. Such elevated debt levels of State Governments could impact on their resource raising capability from the market. This has been experienced by the State Governments during the current year.

Box 7
Demography and the Sustainability of Government Finances in India

An important demographic event of critical significance in the world today is population ageing *i.e.*, the process by which the share of older individuals in the total population starts becoming larger. The ageing phenomenon initially experienced by developed countries is steadily approaching the developing world. Projections show that over the next five decades, world median age will continue to increase resulting in enhanced old age dependency ratios in all parts of the world. The experience of OECD countries suggests that substantial demographic changes have occurred in the past few decades as evident from the projected old-age dependency ratio of nearly 50 per cent by 2050. This is going to pose a huge fiscal burden in terms of social security, health care, pension and other related expenditures. In this regard, an OECD exercise reveals that total age-related expenditures relative to GDP could rise on average by about 7 percentage points over the period 2000-2050. In turn, this would imply an average decline of 6-7 percentage points in the primary balance to GDP ratio.

India is treading the same path of demographic transition that have been experienced in other parts of the world, *albeit* delayed by a few decades. Population will continue to grow in the next 50 years at a lower rate. The age structure will change dramatically with a doubling of the share of ageing population. In fact, India's population structure will, in 2050, mirror that presently found in the major industrial countries. These epidemiological trends will create pressures for increased spending on medical care in the coming decades. In particular, India is expected to face greater fiscal stress after 2015 on demographic grounds (Lee, 2003).

The case for fiscal consolidation in India is very strong given that the existing nominal debt to GDP ratio is already very high compared to other emerging market economies. Both at the national and sub-national level, the fisc suffers from the chronic malaise of fiscal imbalances. The burden is further aggravated when unfunded pension liabilities, contingent liabilities, government guarantees of state enterprise debts and the prospects of re-capitalisation of a number of state owned financial institutions is taken into account. The challenge facing India, therefore, is a renewed focus on fiscal consolidation as embedded in the objectives of the Fiscal Responsibility and Budget Management Act. As the fiscal challenges arising from ageing will take some time to become evident, the opportunity of strengthening the fisc is new and needs to be pursued with greater resolve.

The challenge to the fisc emanate from several factors. First of all, India's demographics have important ramifications for the approach taken to the provision of medical care and the structure of India's evolving social insurance policy framework. Medical insurance and health care reforms is at a primary stage with the principal medical facilities located in the urban areas. Although there is large contingent of private practitioners, they are mainly city based and the per capita availability of medical care in rural areas is quite low. Moreover, shift in disease patterns further compound the problem. Although they do not necessarily imply a dramatic expansion in the size of the government health care system, the need for a substantial strengthening of both this system in coverage and the regulatory framework in the sector cannot be over emphasised. Even without a national health insurance scheme, the level of primary care expenditure is grossly insufficient and would require at least a doubling of the share of this expenditure in GDP by 2010 (Heller, 2004). Moreover, with an increasingly affluent population, the demand for medical care is expected to rise sharply.

The government's involvement in the education sector has been most extensive in terms of primary schooling, where enrollment rates are virtually universal. It is also the principal provider of secondary education, though the private sector also plays a significant role. Government involvement is far lower in the tertiary sector. Private sector involvement, either through private universities (so-called long distance training), or the acquisition of education at overseas universities, is far more common at this level.

A cursory review of India's social insurance framework suggests enormous gaps, both in coverage and in the regulatory structure. Unemployment insurance basically does not exist, adding to the factors that have made it difficult for enterprises to rationalise work forces. In the health sector, most of the population is covered at best by a limited and poorly staffed public health service. As a consequence, the bulk of health care is provided by the private sector. Moreover, government involvement in higher education is marginal with greater scope for further enhancement. Looking ahead, India will need to develop a framework for provision of mechanisms for social insurance consistent with a modern economy. While the private sector has to play an important part in extending social security services, there has to be a dominant role of the public sector in both regulation of the private sector and in the targeting of the poorest groups.

However, one redeeming feature in the Indian context is the role of private remittances in alleviating the fiscal burden of the states. It may be noted that India and the Philippines have recorded relatively high remittances during the last decade, which are now in excess of 3 per cent of GDP. Private provisions from remittances largely fund expenditure on education and, in many cases, old age dependency. Nevertheless, the bulk of health and medical care of older people should come from public spending on social security. In this regard, public pension reforms and health insurance would play a pivotal role in alleviating the fiscal burden.

In India, initiatives towards pension reforms have been somewhat nascent at both the Central and State Government level. In February 2002, the *High Level Expert Group on New Pension System* submitted its report suggesting modifications in the pension system for Central Government employees. In August 2003, the Union Government approved the proposal to implement the budget announcement of 2003-04 relating to the introduction of a new restructured defined contributory pension system for new entrants to Central Government services, except to Armed Forces. An independent Pension Fund Regulatory and Development Authority have also been set up to regulate and develop the pension market. At the State level, the issue of increasing pension liabilities has also assumed critical importance since their unfunded and non-contributory nature has proved to be a mounting burden on the State budgets. So far, however, only a few State Governments have initiated measures towards the introduction of a contributory pension scheme. A *Group to Study the Pension Liabilities of the State Governments* submitted its report in February 2003, which was published in February 2004.

Fortunately, from, the fiscal point of view, unlike in industrial countries, India does not have a “Beveridgean” social insurance system in place (Heller, 2004). Thus, India’s demographics do not necessarily portend explosion in government social insurance outlays arising from underlying existing policy commitments. This being the case, demographic trends still pose important challenges for the government on social security.

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Table XXX : Expenditure on Education

(Revenue Expenditure & Capital Outlay as Ratio to Aggregate Disbursements)

(per cent)

States	2000-01	2001-02	2002-03	2003-04	2004-05
1	2	3	4	5	6
Andhra Pradesh	13.3	12.5	11.7	10.7	11.4
Arunachal Pradesh	6.4	13.3	12.1	10.2	11.2
Assam	25.5	21.9	22.4	22.1	14.3
Bihar	23.7	20.7	18.4	18.9	17.9
Chhattisgarh	13.1	12.4	11.0	12.1	12.2
Goa	11.9	10.5	12.0	11.8	9.1
Gujarat	13.6	12.7	13.5	10.4	12.5
Haryana	14.6	13.8	13.7	13.7	13.1
Himachal Pradesh	17.0	16.2	14.5	15.1	15.5
Jammu and Kashmir	11.1	11.6	10.9	11.1	10.7
Jharkhand	NA	16.2	19.0	14.2	15.9
Karnataka	17.7	16.0	14.8	12.5	13.8
Kerala	20.0	19.0	17.6	15.6	17.1
Madhya Pradesh	16.3	12.5	12.2	9.4	8.7
Maharashtra	22.3	22.1	18.9	15.0	16.4
Manipur	20.2	13.7	13.3	11.7	13.1
Meghalaya	16.6	17.9	15.3	19.4	17.2
Mizoram	16.2	16.0	14.5	11.9	13.9
Nagaland	13.8	11.0	11.0	10.6	10.2
Orissa	15.9	14.6	14.3	11.7	10.6
Punjab	13.2	11.7	12.1	10.9	11.3
Rajasthan	18.8	18.2	15.5	14.2	14.4
Sikkim	14.2	8.0	7.6	13.6	8.9
Tamil Nadu	18.0	17.3	13.8	13.5	14.3
Tripura	19.3	18.6	19.2	17.7	17.5
Uttar Pradesh	16.8	16.0	14.6	9.2	12.5
Uttaranchal	21.5	21.1	20.0	15.2	17.3
West Bengal	17.1	16.2	15.9	12.0	12.7
NCT Delhi	15.1	13.7	12.1	10.6	12.6
All States (% of Agg. Dis)	**17.4**	**16.1**	**15.0**	**12.6**	**13.4**
All States (% of GDP)	**2.9**	**2.7**	**2.6**	**2.5**	**2.4**

Note : Also includes expenditure on Sports, Art and Culture
Source: Compiled from budget documents of State Governments.

Table XXXI : Expenditure on Medical and Public Health & Family Welfare

(Revenue Expenditure & Capital Outlay as Ratio to Aggregate Disbursements)

(per cent)

States	2000-01	2001-02	2002-03	2003-04	2004-05
1	2	3	4	5	6
Andhra Pradesh	4.7	4.4	4.0	3.8	3.4
Arunachal Pradesh	5.0	4.9	4.5	3.7	4.3
Assam	4.7	4.2	3.7	3.4	3.1
Bihar	5.9	4.9	4.2	3.8	3.2
Chhattisgarh	4.1	4.3	4.0	3.6	3.7
Goa	4.4	3.8	4.0	4.4	3.3
Gujarat	3.4	2.8	3.2	2.5	3.0
Haryana	3.3	3.0	3.3	2.8	2.8
Himachal Pradesh	5.6	4.9	4.5	5.2	5.1
Jammu and Kashmir	4.9	5.5	5.2	5.5	4.8
Jharkhand	NA	4.9	4.2	4.1	3.7
Karnataka	5.1	4.9	4.2	3.5	3.5
Kerala	5.3	5.8	4.8	4.5	4.7
Madhya Pradesh	5.1	4.1	4.1	3.1	3.4
Maharashtra	3.9	4.3	3.7	3.3	3.5
Manipur	4.8	3.4	2.9	3.2	3.7
Meghalaya	5.6	6.6	5.9	4.8	5.2
Mizoram	5.4	5.4	5.0	5.6	4.0
Nagaland	5.2	4.1	4.6	4.0	4.7
Orissa	4.2	3.7	3.8	3.4	3.9
Punjab	4.5	3.9	3.5	3.4	3.1
Rajasthan	5.2	5.2	4.2	3.9	3.9
Sikkim	3.7	2.2	2.0	3.2	2.6
Tamil Nadu	4.9	4.9	4.1	4.0	4.2
Tripura	4.0	3.7	3.8	4.2	3.8
Uttar Pradesh	4.0	3.6	3.8	3.1	4.5
Uttaranchal	3.1	4.4	3.8	3.9	4.3
West Bengal	5.6	5.0	4.9	3.9	3.8
NCT Delhi	7.2	6.7	6.3	5.9	7.0
All States (% of Agg. Dis)	**4.7**	**4.4**	**4.1**	**3.6**	**3.8**
All States (% of GDP)	**0.77**	**0.73**	**0.69**	**0.72**	**0.67**

Source: Compiled from budget documents of State Governments.

Bihar, Orissa, Rajasthan, and Madhya Pradesh occupied the topmost quartile (over 53 per cent) in terms of debt-GSDP ratio in 2003-04. In fact, the debt-GSDP ratio of Bihar and Orissa exceeded 70 per cent in 2003-04.

The FRL of three State Governments *viz.*, Karnataka, Punjab and Uttar Pradesh have incorporated specific targets in respect of their debt-GSDP ratios[12]. The debt-GSDP ratio in the case of Karnataka is placed at 29.0 per cent in 2003-04 as against the target of 25 per cent to be achieved by 2015. In contrast, the debt-GSDP ratio of Punjab is placed at 49.4 per cent in 2003-04 as against a target of 40 per cent in 2006-07. Similarly, the debt-GSDP ratio of Uttar Pradesh is placed at 50.1 per cent in 2003-04 as against a target of 25 per cent by 2017-18.

The PD-GSDP ratio witnessed deterioration in the case of some State Governments during 2003-04, adversely impacting upon the sustainability of their debt.

12. Please see footnote 5. The definitions of debt in the FRL of these State could differ from that adopted in this Study.

The extent of preemption of revenue receipts by interest payments, another indicator of debt sustainability, showed a decline during 2003-04 in the case of only six State Governments, two of which (Karnataka and Punjab) which have enacted FRL.

During 2003-04, the ratio of interest payments to revenue receipts of as many as 14 State Governments (as against 13 States in 2000-03) exceeded 18 per cent as recommended by the Eleventh Finance Commission from the viewpoint of ensuring debt sustainability over the medium term. In fact, this ratio exceeded 50 per cent in the case of West Bengal during 2003-04. On the other hand, the ratio of interest payments to revenue receipts was placed below 18 per cent in the case of Chhattisgarh, Goa, Jharkhand and Karnataka during 2003-04; of these only Karnataka has enacted FRL.

The average nominal interest rate on debt exceeded the growth rate of GSDP at current prices for most State Governments during 2000-03 and 2003-04, indicating the unsustainability of their debt positions.

A simple correlation analysis between the real per capita NSDP and the debt-GSDP ratio showed that the correlation coefficient increased from (-) 0.63 in 2000-01 to (-) 0.79 in 2003-04. The correlation coefficient was statistically significant in each year. This indicates that States with low real per capita income usually have high debt-GSDP ratios.

The guarantees issued by the State Governments reveal an increasing trend in recent years (Table XXXII).

Table XXXII : Outstanding Guarantees of the State Governments

(Rs. crore)

States	2000-01	2001-02	2002-03
1	2	3	4
1. Andhra Pradesh	13138	10237	15337
2. Assam	1100	1854	1101
3. Bihar	1157	997	789
4. Gujarat	17301	18723	19001
5. Haryana	8209	9174	7684
6. Himachal Pradesh	1921	4113	2153
7. Jammu and Kashmir	1143	1033	1033
8. Karnataka	12989	11845	13314
9. Kerala	8756	11937	11410
10. Madhya Pradesh	10482	9670	9670
11. Maharashtra	44954	35520	38002
12. Orissa	3787	5309	5499
13. Punjab	6067	6149	18632
14. Rajasthan	11954	12912	14819
15. Tamil Nadu	12388	12004	11918
16. Uttar Pradesh	6391	6268	3601
17. West Bengal	6982	7641	10331
TOTAL	**168719**	**165386**	**184294**

Source: Information received from 17 State Governments.

II. Special Category States[13]

The summary table pertaining to the special category States based on the quartile position indicated in Table XXVI (A & B) is provided in Table XXXIII A&B.

Six out of the eleven States recorded a revenue deficit during 2003-04; the five revenue surplus States were Meghalya, Jammu & Kashmir Nagaland, Sikkim and Tripura.

Himachal Pradesh, Manipur and Uttaranchal recorded the highest revenue deficits in relation to their respective GSDP (7 – 9.5 per cent).

The GFD-GSDP was the highest in the case of Arunanchal Pradesh, Manipur and Mizoram (19-24 per cent).

The own tax-GSDP ratio was low in the case of Arunanchal Pradesh, Mizoram and Nagaland (1 – 1.6 per cent), and high in the case of Assam, Sikkim and Uttaranchal (6 – 8 per cent).

The own non-tax to GSDP ratio was low in the case of Himachal Pradesh, Nagaland and Tripura (less than 1.4 per cent) and very high in the case of Sikkim (30.8 per cent), essentially reflecting the impact of State lotteries.

13. A distinction is drawn between Special and Non-Special Category States in the context of Plan allocations. The Special Category States are Arunachal Pradesh, Assam, Himachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura and Uttaranchal.

Table XXXIII A : Summary Position of Special Category States for 2000-03 (Average)

INDICATOR	Q1	Q2	Q3	Q4
(A) RESOURCE GAP				
1. GFD/GSDP	RANGE: 3.6 to 4.1 Assam, Sikkim, Uttaranchal	RANGE: 5.3 to 8.3 Meghalaya, Tripura	RANGE: 8.6 to 9.6 Jammu & Kashmir, Manipur, Nagaland	RANGE: 11.7 to 20.2 Arunachal Pradesh, Himachal Pradesh, Mizoram
2. RD/GSDP	RANGE: -13.6 to -0.8 Arunachal Pradesh, Meghalaya, Sikkim	RANGE: 0.2 to 0.4 Jammu & Kashmir, Nagaland	RANGE: 0.7 to 2.0 Assam, Tripura, Uttaranchal	RANGE: 3.5 to 10.3 Himachal Pradesh, Manipur, Mizoram
3. PD/GSDP	RANGE: -3.8 to 0.8 Assam, Sikkim, Uttaranchal	RANGE: 2.1 to 2.1 Manipur, Meghalaya	RANGE: 2.5 to 4.6 Jammu & Kashmir, Nagaland, Tripura	RANGE: 5.6 to 13.4 Arunachal Pradesh, Himachal Pradesh, Mizoram
4. RD/GFD	RANGE: -805.9 to -23.6 Arunachal Pradesh, Jammu & Kashmir, Sikkim	RANGE: -19.4 to 4.0 Meghalaya, Nagaland	RANGE: 8.8 to 39.7 Manipur, Tripura, Uttaranchal	RANGE: 48.6 to 64.1 Assam, Himachal Pradesh, Mizoram
5. RD/RR	RANGE: -9.6 to -2.7 Arunachal Pradesh, Meghalaya, Sikkim	RANGE: 1.1 to 1.6 Jammu & Kashmir, Nagaland	RANGE: 2.4 to 9.5 Manipur, Tripura, Uttaranchal	RANGE: 11.1 to 35.8 Assam, Himachal Pradesh, Mizoram
(B) REVENUE PERFORMANCE				
6. OTR/GSDP	RANGE: 1.1 to 1.5 Arunachal Pradesh, Mizoram, Nagaland	RANGE: 1.7 to 2.5 Manipur, Tripura	RANGE: 3.3 to 5.1 Assam, Jammu & Kashmir, Meghalaya,	RANGE: 5.6 to 7.8 Himachal Pradesh, Sikkim, Uttaranchal,
7. ONTR/GSDP	RANGE: 1.1 to 1.3 Himachal Pradesh, Manipur, Nagaland	RANGE: 1.5 to 1.6 Tripura, Uttaranchal	RANGE: 1.7 to 2.3 Assam, Jammu & Kashmir, Meghalaya	RANGE: 2.5 to 83.0 Arunachal Pradesh, Mizoram, Sikkim
8. CT/GSDP	RANGE: 10.3 to 16.5 Assam, Himachal Pradesh, Uttaranchal	RANGE: 23.8 to 25.3 Meghalaya, Tripura	RANGE: 31.7 to 33.7 Jammu & Kashmir, Manipur, Nagaland	RANGE: 45.3 to 55.0 Arunachal Pradesh, Mizoram, Sikkim
9. PRB/GSDP	RANGE: -21.5 to -5.9 Arunachal Pradesh, Jammu & Kashmir, Sikkim	RANGE: -4.8 to -4.1 Meghalaya, Nagaland	RANGE: -3.5 to -1.6 Manipur, Tripura, Uttaranchal	RANGE: -1.1 to 3.5 Assam, Himachal Pradesh, Mizoram
(C) EXPENDITURE PATTERN				
10. DEV/GSDP	RANGE: 13.8 to 23.4 Assam, Himachal Pradesh, Uttaranchal	RANGE: 24.0 to 24.7 Meghalaya, Tripura	RANGE: 26.8 to 28.1 Jammu & Kashmir, Manipur, Nagaland	RANGE: 45.7 to 55.8 Arunachal Pradesh, Mizoram, Sikkim
11. NONDEV/GSDP	RANGE: 6.1 to 11.1 Assam, Meghalaya, Uttaranchal	RANGE: 12.6 to 12.9 Himachal Pradesh, Tripura	RANGE: 18.0 to 18.7 Arunachal Pradesh, Manipur, Nagaland	RANGE: 19.0 to 94.2 Jammu & Kashmir, Mizoram, Sikkim
12. SSE/GSDP	RANGE: 8.5 to 13.3 Assam, Himachal Pradesh, Uttaranchal	RANGE: 13.7 to 14.0 Jammu & Kashmir, Nagaland	RANGE: 14.3 to 16.2 Manipur, Meghalaya, Tripura	RANGE: 20.0 to 29.2 Arunachal Pradesh, Mizoram, Sikkim
13. CO/GSDP	RANGE: 1.6 to 4.8 Assam, Himachal Pradesh, Meghalaya	RANGE: 5.0 to 7.5 Manipur, Tripura	RANGE: 8.0 to 9.0 Jammun & Kashmir, Mizoram, Nagaland	RANGE: 10.1 to 17.7 Arunachal Pradesh, Sikkim, Uttaranchal
(D) DEBT/POSITION				
14. DEBT/GSDP*	RANGE: 30.8 to 43.2 Assam, Meghalaya, Tripura	RANGE: 51.8 to 57.3 Arunachal Pradesh,Nagaland	RANGE: 57.3 to 58.8 Jammu & Kashmir, Manipur	RANGE: 63.4 to 75.2 Himachal Pradesh, Mizoram, Sikkim
15 IP/RR	RANGE: 6.0 to 11.4 Arunachal Pradesh, Meghalaya, Sikkim	RANGE: 14.0 to 14.3 Mizoram, Tripura	RANGE: 14.6 to 15.9 Jammu & Kashmir, Nagaland, Uttaranchal	RANGE: 17.2 to 28.8 Assam, Himachal Pradesh, Manipur

* : Data on Uttaranchal is not available.

Note : Minus (-) sign indicates surplus

TABLE XXXIII B : Summary Position of Special Category States for 2003-04 (Revised Estimates)

INDICATOR	Q1	Q2	Q3	Q4
(A) RESOURCE GAP				
1. GFD/GSDP	RANGE: -0.1 to 7.6 Jammu & Kashmir, Meghalaya, Tripura	RANGE: 8.0 to 8.6 Assam, Sikkim	RANGE: 8.8 to 16.3 Himachal Pradesh, Nagaland, Uttaranchal	RANGE: 19.4 to 23.9 Arunachal Pradesh, Manipur, Mizoram
2. RD/GSDP	RANGE: -12.6 to -2.3 Jammu & Kashmir, Meghalaya, Sikkim	RANGE: -2.0 to -1.1 Nagaland, Tripura	RANGE: 1.5 to 4.2 Arunachal Pradesh, Assam, Mizoram	RANGE: 7.2 to 9.5 Himachal Pradesh, Manipur, Uttaranchal
3. PD/GSDP	RANGE: -5.3 to 2.2 Jammu & Kashmir, Meghalaya, Sikkim	RANGE: 3.2 to 3.7 Assam, Tripura	RANGE: 4.1 to 10.4 Himachal Pradesh, Nagaland, Uttaranchal	RANGE: 11.6 to 17.6 Arunachal Pradesh, Manipur, Mizoram
4. RD/GFD	RANGE: -147.2 to -23.0 Meghalaya, Nagaland, Sikkim	RANGE: -14.7 to 7.0 Arunachal Pradesh, Tripura	RANGE: 7.6 to 53.0 Assam, Manipur, Mizoram	RANGE: 58.5 to 11513.4 Himachal Pradesh, Jammu & Kashmir, Uttaranchal
5. RD/RR	RANGE: -22.5 to -6.5 Jammu & Kashmir, Meghalaya, Sikkim	RANGE: -5.3 to -4.0 Nagaland, Tripura	RANGE: 2.5 to 16.4 Arunachal Pradesh, Assam, Mizoram	RANGE: 17.5 to 38.7 Himachal Pradesh, Manipur, Uttaranchal
(B) REVENUE PERFORMANCE				
6. OTR/GSDP	RANGE: 1.3 to 1.6 Arunachal Pradesh, Mizoram, Nagaland	RANGE: 1.8 to 2.7 Manipur, Tripura	RANGE: 3.8 to 5.6 Himachal Pradesh, Jammu & Kashmir, Meghalaya	RANGE: 6.1 to 7.9 Assam, Sikkim, Uttaranchal
7. ONTR/GSDP	RANGE: 1.1 to 1.4 Himachal Pradesh, Nagaland, Tripura	RANGE: 1.6 to 1.7 Jammu & Kashmir, Manipur	RANGE: 2.2 to 2.7 Assam, Meghalaya, Mizoram	RANGE: 2.8 to 30.8 Arunachal Pradesh, Sikkim, Uttaranchal
8. CT/GSDP	RANGE: 14.7 to 17.4 Assam, Himachal Pradesh, Uttaranchal	RANGE: 23.4 to 28.4 Meghalaya, Tripura	RANGE: 33.0 to 37.6 Jammu & Kashmir, Manipur, Nagaland	RANGE: 52.5 to 58.4 Arunachal Pradesh, Mizoram, Sikkim,
9. PRB/GSDP	RANGE: -19.9 to -6.7 Jammu & Kashmir, Nagaland, Sikkim	RANGE: -6.3 to -6.0 Meghalaya, Mizoram	RANGE: -5.0 to -0.5 Arunachal Pradesh, Assam, Tripura	RANGE: -0.2 to 3.6 Himachal Pradesh, Manipur, Uttaranchal
(C) EXPENDITURE PATTERN				
10. DEV/GSDP	RANGE: 20.1 to 22.3 Assam, Himachal Pradesh, Tripura	RANGE: 22.8 to 27.8 Jammu & Kashmir, Nagaland	RANGE: 28.0 to 42.9 Manipur, Meghalaya, Uttaranchal	RANGE: 54.0 to 63.5 Arunachal Pradesh, Mizoram, Sikkim
11. NONDEV/GSDP	RANGE: 11.7 to 12.5 Assam, Meghalaya, Tripura	RANGE: 14.0 to 14.4 Himachal Pradesh, Uttaranchal	RANGE: 17.2 to 19.2 Jammu & Kashmir, Manipur, Nagaland	RANGE: 20.0 to 42.8 Arunachal Pradesh, Mizoram, Sikkim
12. SSE/GSDP	RANGE: 11.8 to 13.9 Himachal Pradesh, Jammu & Kashmir, Tripura	RANGE: 14.2 to 15.3 Assam, Nagaland	RANGE: 15.8 to 22.0 Manipur, Meghalaya, Uttaranchal	RANGE: 28.4 to 33.7 Arunachal Pradesh, Mizoram, Sikkim
13. CO/GSDP	RANGE: 3.1 to 6.0 Assam, Himachal Pradesh, Meghalaya	RANGE: 8.6 to 8.7 Jammu & Kashmir, Tripura	RANGE: 10.8 to 16.8 Manipur, Mizoram, Nagaland	RANGE: 21.2 to 77.5 Arunachal Pradesh, Sikkim, Uttaranchal
(D) DEBT POSITION				
14. DEBT/GSDP*	RANGE: 33.7 to 44.2 Assam, Meghalaya, Tripura	RANGE: 56.2 to 61.6 Arunachal Pradesh Jammu & Kashmir,	RANGE: 64.3 to 66.9 Manipur, Nagaland	RANGE: 71.7 to 87.2 Himachal Pradesh, Mizoram, Sikkim
15. IP/RR	RANGE: 7.6 to 10.8 Arunachal Pradesh, Meghalaya, Sikkim	RANGE: 12.3 to 12.9 Jammu & Kashmir, Nagaland	RANGE: 13.2 to 18.1 Manipur, Mizoram, Tripura	RANGE: 18.4 to 38.5 Assam, Himachal Pradesh, Uttaranchal

* : Data on Uttaranchal is not available
Note : Minus (-) sign indicates surplus

The debt-GSDP ratio was the highest in the case of Sikkim and Mizoram (over 70 per cent).

The ratio of interest payments to revenue receipts exceeded 18 per cent in the case of Assam, Himachal Pradesh, Manipur and Uttaranchal, indicating that their debt position tended to be unsustainable.

The average nominal interest rate on debt also exceeded the growth rate of GSDP at current prices in the case of many special-category State Governments, underlining the unsustainability of their debt.

Section IV
Issues and Perspectives

1. Fiscal Consolidation

The emerging trends in the consolidated fiscal position of the State Governments show that (1) there was a steady and sizable deterioration in State Government finances over the 1990s, as reflected in various fiscal indicators; (2) a slow movement towards correction of fiscal imbalances was discernable during the three-year period 2000-01 to 2002-03, facilitated by the reforms undertaken by the States; (3) the underlying weaknesses in State Government finances, however, persisted as the magnitude of fiscal imbalances generally remained much higher than the levels prevailing in the mid-1990s; (4) the direction of fiscal correction saw a reversal during 2003-04 partly on account of one-off factors essentially relating to the settlement of dues of the State Electricity Boards aimed at strengthening the power sector; and (5) the correction envisaged in the budget estimates for 2004-05 seeks to reduce the fiscal imbalances (in relation to GDP) to the levels prevailing around the mid-1990s.

Keeping in view the discernible deterioration in fiscal imbalances in 2003-04 following a phase of brief correction during the previous three years, the need for an orderly fiscal correction, as envisaged in the budget estimates for 2004-05, cannot be over-emphasised. This would be necessary not only from the point of view of the sustainability of fiscal policies at the individual State level, but also from the viewpoint of overall macroeconomic stability, given that the GFD of States has accounted for around 44 per cent of the combined GFD of the Centre and States in recent years.

The envisaged correction in the revenue deficit during 2004-05 is contingent upon, *inter alia*, a decline in the ratio of revenue expenditure to GDP to 13.4 per cent and the persistence of current transfers from the Centre at the previous year's level of around 4.6 per cent of GDP. These projections may be viewed in the context of a steady annual decline of 0.2 percentage points in the revenue expenditure to GDP ratio beginning 2000-01 to 13.6 per cent in 2002-03, followed by a sharp upsurge to 14.5 per cent in the following year mainly on account of the (one-time) transactions relating to the power sector. Similarly, it may be noted that, barring the sharp hike to 4.6 per cent of GDP in 2003-04, current transfers from the Centre have hovered around 4.2 per cent of GDP in the initial three years of the present decade. It is expected that in line with the proposals in the Union Budget 2004-05 and the NCMP, current transfers from the Centre to the States would remain buoyant and facilitate the envisaged fiscal correction at the State level.

It is pertinent to note that except for Uttar Pradesh, the other four States that have enacted Fiscal Responsibility Legislation, had recorded a decline in their revenue deficit in 2003-04 from the respective levels in the previous year. The move towards rule-based fiscal policy appears to be gathering momentum as three more State Governments have announced their intention to enact Fiscal Responsibility Legislation. It would be useful if the remaining States could expedite similar initiatives. It may be recalled that a Working Group comprising Finance Secretaries of States that have already enacted the Fiscal Responsibility Legislation (or placed the bill before the Legislature), and a representative each from the Central Government and the Reserve Bank was constituted in October 2003 to draft a model fiscal responsibility legislation at the State level. The draft report of the Group was discussed at the last conference of State Finance Secretaries in August 2004. The report would be finalised after taking into account the comments of the State Finance Secretaries.

The Centre's Fiscal Reforms Facility, under which States frame their MTFRPs, is also an important initiative to encourage and facilitate fiscal reforms at the State level. The experience with MTFRP, however, indicates, *inter alia*, that the pace of reform at the State level has been slower than expected, as the amount of funds released so far, is relatively small compared to the size of the corpus. It may be worthwhile to review the efficacy of such incentive-based schemes in the context of the expected enactment of fiscal responsibility legislation by the State Governments, progressively in the future.

2. Debt Sustainability

The sharp increase in the debt-GDP ratio from around 22 per cent in 1999-2000 to around 29 per cent in 2003-04 brings the issue of debt sustainability of State Governments to the fore. Interest payments on debt have, in fact, accounted for over 25 per cent of revenue receipts in the revised estimates for 2003-04 as against 18 per cent recommended by the Eleventh Finance Commission from the viewpoint of ensuring debt sustainability in the medium term. Concerns about the sustainability of the debt could possibly have adverse implications in terms of inadequate response of the market to future issues of State Government loans and widening of the spread from benchmark Central Government securities of comparable maturity. In fact, as indicated in the Mid-Term Review of Annual Monetary and Credit Policy for the year 2004-05, "*In the recent period, there have been some instances of under-subscription to the State Government issues despite easy liquidity conditions. This inadequate response on the part of the market participants once again underlines the need for prudent fiscal management at the State level to ensure completion of the approved borrowings of the State Government. In this context, the persistence of large aggregate borrowings of the Central and State Governments continues to be a matter of concern in terms of its possible adverse impact on the desired acceleration in growth that is consistent with stability, as also from the point of view of ensuring efficient monetary and debt management.*"

The repayment schedule of market loans also has a bearing on the future volume of gross borrowings and hence on the sustainability of debt. The repayment of additional allocations of market borrowings to the States during 2002-03 to 2004-05 would add to the pressure on gross market borrowings in the future. It is also evident that the existing humps in the repayment schedule of market loans during the period 2007-08 to 2013-14 have been aggravated to an extent by the issue of power bonds. It may be useful for the remaining States to establish Consolidated Sinking Funds in order to meet such repayments without undue pressure on the budgets. So far, 13 States have set up the Consolidated Sinking Fund.

A related issue of concern is the substantial increase in the liabilities of the State Governments through Small Savings. These high-cost Small Savings loans from the NSSF are outside the purview of Article 293 (3) of the Constitution which requires the State Governments to seek the permission of the Centre to access the market for borrowing as long as they are indebted to the Centre. Similarly, the volume of negotiated loans from banks and financial institutions has witnessed an upsurge in recent years. As a consequence, the overall level of borrowing of the State Governments has remained beyond the purview of any administrative control, which is evident from the unabated increase in the GFD of many of the State Governments. It has been observed that State Governments mobilise substantial amounts of off-budget borrowings through Special Purpose Vehicles (SPVs). In this connection, it is noteworthy that the Fiscal Responsibility Legislation (FRL) of some of the State Governments already contain provisions relating to a cap on the debt-GSDP ratios as also on the guarantees. It is expected that the progressive adoption of such FRL by other State

Governments would invoke discipline with regard to borrowings.

Further, it is being increasingly recognized that a major factor impeding an in-depth analysis of the debt position of the State Government is the absence of unanimity on the definition and composition of debt. Compounding this problem is the lack of uniformity, comprehensiveness and transparency in the reporting of data on various categories of debt in the budget documents of the State Governments. There is also the unresolved issue of compiling data on an 'extended' definition of debt incorporating contingent liabilities, off-budget borrowings and pension liabilities. A Working Group has been recently constituted by the Reserve Bank with representation from select State Governments, the Government of India, the office of the Comptroller and Auditor General of India and the Controller General of Accounts, which would examine some of these issues and work out a model estimation methodology for compilation of data on State Government liabilities.

3. Loans from the Centre *versus* Open Market Loans by States

Central loans to States (excluding Small Savings loans) have hovered around 1.2 per cent of GDP since the 1990s. The Hon'ble Finance Minister in his Union Budget Speech 2004-05 stated, "*I also propose to consult the States on allowing them to increase their open market borrowings and reduce their dependence on loans from the Central Government.*" In this regard, there are some issues that merit attention. As mentioned earlier, there have been some instances in recent years of under-subscription to the market borrowings of the State Governments. A successful transition towards greater reliance on market borrowings by States would, however, be contingent upon the markets perceiving clear evidence of improvement in the financial position of the State Governments.

The spread between the interest rate on Central loans to States and the weighted average yield on Central market loans increased from 1 percentage point in 1997-98 to over 5 percentage points in 2002-03 and is placed at around 3.5 percentage points in 2004-05. Moreover, the average interest rate on Centre's outstanding liabilities is estimated to have declined to 7.5 per cent in 2004-05, and remains lower than the present interest rate on loans from the Centre to the States (9 per cent with effect from April 1, 2004).

It may be added that the international experience seems to indicate that exclusive reliance on market discipline for subnational government borrowings, though appealing in principle, may not be appropriate in some circumstances. This is because the conditions for its effective working (*viz.,* (i) markets are free and open; (ii) adequate information on the borrowers financial profile should be available to potential lenders; (iii) there is no perceived chance of bailouts; and (iv) the borrower should have institutional structures that ensure adequate policy responsiveness to market signals before reaching the point of exclusion from new borrowing) are, on many occasions, not realised in practice in many cases. Market discipline, however, can usefully complement other forms of borrowing controls. In this connection, greater transparency and dissemination of information on recent and prospective developments in the finances of subnational governments is highly desirable.

4. Revenue Mobilisation

Given the downward rigidities in committed expenditures and the need to enhance developmental spending, it is evident that the success of fiscal consolidation efforts at the State level is critically contingent upon fiscal empowerment in respect of revenue mobilisation powers. In fact, the Reserve Bank's Annual Report for 2000-01 had stated that, "*the path to durable fiscal consolidation is through fiscal empowerment i.e. by expanding the scope and size of revenue flows into the budget*." In this context, while it is noteworthy that the States' own tax revenue, as a ratio to GDP, has shown an upward trend since the 1990s, it is at best marginal. In fact, according to the budget estimates for 2004-05, the ratio of States' own tax to GDP is placed at the previous year's level of 5.9 per cent. The State Governments, therefore, need to reinvigorate the efforts to improve its own tax revenues. It is expected that the on-going initiatives at rationalisation of tax structure and computerisation of the tax departments by most State Governments would facilitate the process. The experience of Haryana highlights the positive impact of VAT on tax revenues. The Union Budget 2004-05 announced that VAT would be implemented on April 1, 2005. Many States have already completed the preparatory work relating to the implementation of VAT. A Empowered Committee of State Finance Ministers is examining various aspects of VAT implementation. In the meanwhile, the remaining States may need to expedite the necessary groundwork so that the VAT could be implemented without any further delay. Given the increasing share of 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 also help to boost revenues of the State Governments. Finally, States may need to take corrective measures to address the declining shares of Profession Tax and Electricity Duty in total own tax revenues in the recent period.

Non-tax revenues have clearly been an area of debility in State finances. Inappropriate user charges have led to dismally low cost recoveries, particularly in respect of social services. Cost recovery in respect of economic services is relatively better, although the large volume of power subsidies has been a chronic problem. In this context, it is expected that the on-going power sector reforms, including the setting up of SERCs, would help to bring power tariffs in line with commercial principles over a period of time. Furthermore, it is expected that the one time settlement of dues of the State Electricity Boards during 2003 would help them start afresh based on sound principles of financial management. Improvement in the financial performance of other State Public Sector Undertakings would also be critical to step-up the return on investment from its abysmally low level.

5. Expenditure Management

A disconcerting aspect of State Government finances since the 1990s is that while developmental expenditure and capital outlay, as ratios to GDP, have hovered between 9 -10 per cent and 1.5 - 2 per cent, respectively, non-developmental expenditure (comprising, *inter alia*, interest payments, pensions and administrative services), as a ratio to GDP, has shown noticeable increase over the last few years and was at 6.4 per cent in 2003-04. In fact, during 2004-05, the reduction in the revenue deficit and GFD is expected to be brought about without any change in the ratio of non-developmental expenditure to GDP.

A sizable reduction in non-developmental expenditure may not be feasible in the short-term, given the committed nature of many of its constituent items. Within non-developmental expenditures, pension payments are likely to increase in the future in the context of the demographic changes. It is noteworthy that some of the State Governments have initiated the creation of pension funds based on defined contributions, which could alleviate the pressure on the budget. As far as interest payments are concerned, the Debt Swap Scheme has brought about definite savings on interest costs. Additional savings may be forthcoming in case the Scheme is extended to negotiated loans from NABARD and other agencies as announced in the Union Budget for 2004-05. It is, however, well recognised that such schemes provide only a temporary palliative, and a durable reduction in interest payments would occur *pari passu* with a reduction in outstanding debt. On the other hand, moderation in administrative and establishment expenditures may be feasible if the initiatives taken by some of the States with regard to the restructuring and redeployment of staff, gain wider acceptability and momentum.

As far as developmental outlays are concerned, it is evident that social sector expenditures have declined in terms of GDP. Provisions for education and health, as ratios to GDP, have declined steadily and are placed as low as 2.4 per cent and 0.7 per cent, respectively, in 2004-05. In line with the entrenched developmental role of the States and in the context of NCMP, it is also imperative that States not only increase the coverage but also improve the efficiency of their developmental outlays, particularly in respect of education and health. As explained earlier, this process could be facilitated if the user charges on such public services are appropriately raised to ensure long-term viability.

A reorientation of expenditure towards productive purposes may necessitate the adherence to the principles of public expenditure management. In this context, the international experience indicates a wide variety of techniques including placing of limits on certain expenditures, prioritisation of expenditures, greater decentralisation of executive functions, improved cash management and greater accountability in the delivery of services against specified targets. The adoption of some of these principles could facilitate a qualitatively superior process of fiscal consolidation.

6. Infrastructure Financing

As pointed out in successive Annual Reports of the Reserve Bank, the financing requirements of infrastructure as a whole are massive and pose serious problems in the context of the ability to raise more resources both by the public and private sector.

The India Infrastructure Report (IIR) (1996) had estimated the infrastructure requirements of the Indian economy to be around US $ 215 billion for the period 2001-02 to 2005-06. About 85 per cent was expected to be met through domestic financing and 15 per cent by external saving, equiproportionally divided between debt and equity. The IIR had envisioned the commercialisation of infrastructure projects as a solution to the unlocking of domestic resources.

In India, financing of infrastructure is still dominated by the public sector, except in telecommunications. Budget constraints and sub-optimal pricing are the principal impediments to public investment in infrastructure. Opportunities for private sector financing in areas previously in the exclusive domain of the Government have expanded not only through the sale equity in State enterprises but also through inviting private parties for undertaking greenfield projects. Private sector participation in infrastructure financing has, however, been grossly inadequate. There is a lack of commercialisation in infrastructure sectors due to inadequate reforms in the area of user charges, cross subsidisation, lack of structured financing options to mitigate the risks involved and underdeveloped financial and capital markets. It is, however, important to note that the Government has significantly shifted away from the direct production of public goods and is also focusing on the regulatory and policy framework and private-public partnership to generate adequate provision of public goods.

In the above context, it may be pertinent to recall the observations in the Reserve Bank's Annual Report (1996-97), "*Currently, the private sector finds regulatory environment and legal as well as institutional framework non-transparent and complex for its entry. The problem is compounded by mix-up of the roles as between the owner and regulator in public domain. These factors in conjunction with the virtual domination of public sector in long-term contractual saving in household sector, and lack of securitisation of debt seem to have contributed to inadequacies in investment in infrastructure. Injection of resources in public sector to expeditiously complete the ongoing projects on a selective basis and a more transparent as well as a definitive policy on ownership, regulation and financing to attract private investor interest, both domestic and foreign, are some of the areas where initiatives are needed. At the same time, full cost recovery allowing for transparent, and explicit subsidisation where needed, would make possible adequate flow of resources to this critical area.*" Even though there have been some regulatory and legal changes in the subsequent period, the import of the above observations still merits consideration.

Infrastructural projects are prone to variety of risks beyond the traditional management and technical risks. The free rider problem and political considerations create appropriability risks. Financial and legal risks arise from non-recourse financing, complex payment mechanisms and imperfect credit enhancement. There are also instrument-specific risks arising from maturity mismatches, exposure to market risk, restrictions on assignability and charge creation. Evolving appropriate mechanisms to manage these risks holds the key to releasing resources for financing infrastructure.

The Reserve Bank has, over the years, liberalised term loan financing by banks for infrastructure with recourse to finance through funds raised by way of subordinated debt, take out financing, direct financing, investment in infrastructure bonds and guarantees. Banks have been allowed to contribute to the equity capital in infrastructure projects and lend to special purpose vehicles (SPVs) in the private sector for directly undertaking infrastructure projects. The Securities and Exchange Board of India (SEBI) has, over the years, extended relaxations for public issues by infrastructure companies regarding size, pricing, mode and minimum subscription of issues.

The experience since the late 1990s suggests that a key prerequisite for the evolution of institutional arrangements for infrastructure financing is the development of the capital market. The central issue is not the adequacy of funds but the convergence of investment horizons of ultimate savers and borrowers in the economy. This, in turn, warrants intensifying reforms in insurance and pension funds which provide a natural hedge for the risks inherent in the financing infrastructure.

Inadequate investment in infrastructure has constrained the growth and development of the States. Several States have, however, proposed in their budgets, projects/schemes to develop the infrastructure, at times with the help of multilateral agencies. The States would need to strengthen their finances through fiscal, structural and institutional reforms which would enable them to release adequate budgetary resources as also enable them to mobilise funds more easily for financing infrastructure.

In the above context, the following observations of the Economic Survey of the Government of India (2003-04), are noteworthy, "*As is well known, enormous financial investments are required to bring India's infrastructure up to world standards. For these investments to come about, a sound policy framework is required, which emphasises sound enforcement of user charges. Conversely, once sound policies fall into place, we may expect a sharp payoff in terms of an improvement in the flow of investment. To the extent that these investments are undertaken by the private sector, this is particularly beneficial given the fiscal constraints that limit the ability of the State to engage in those expenditures.*"

7. Budget Integrity and Transparency

The persistently large deviations between the budget estimates and the accounts data particularly in respect of revenue receipts of the State Governments raise serious concerns since these adversely impact upon the credibility of the budget estimates and preclude a proper assessment of the likely fiscal outcome for the year. It may, therefore, be useful to improve upon the entire budget estimation process and methodology.

It has also been observed that budget documents of all the State Governments do not provide adequate details on their outstanding liabilities, guarantees and off-budget borrowings. Data on wages and salaries, operation and maintenance expenditures, subsidies, and the terms and conditions of negotiated loans from banks and financial institutions are also not usually provided. The recommendations of the Core Group on Voluntary Disclosure Norms for State Governments (2000) assume significance in this regard. The dissemination of such information through the State budgets would not only facilitate policy formulation but also help investors to take informed decisions regarding the health of State finances.

In sum, the sharp deterioration in fiscal imbalances during 2003-04 was mainly a reflection of one-off factors to shore-up the finances of State Electricity Boards. The projected improvement in the fiscal situation in 2004-05 is largely contingent upon the enhanced devolution and transfers from the Centre as well as the containment of the growth in revenue expenditures. The weaknesses in State Government finances have, however, persisted and are manifest mainly in the sluggish non-tax revenues, downwardly rigid non-developmental committed expenditures, and inadequate allocations for education, health and infrastructure. It is increasingly evident that fiscal empowerment holds the key to enduring fiscal correction and to provide adequate resources to finance developmental spending. Self-regulation through the expeditious enactment and implementation of fiscal responsibility legislation and other institutional reforms appear to be a pragmatic approach to improve the fiscal condition of States.

Annex-1 Major Policy Initiatives Proposed in the State Budgets for 2004-05

State	Fiscal	Institutional	Sectoral
1. Andhra Pradesh	• Revitalising State and District level Audit Committees to ensure better audit compliance. • An additional subsidy has been provided for supply of free power to farmers. Outstanding arrears of agricultural farmers have also been waived. • Devolve Rs.200 crore to Panchayati Raj Institutions based on recommendations of Second State Finance Commission. • Special package to rescue families of farmers who committed suicides due to crop failures or debt trap. • Modify expenditures in favour of developmental and infrastructure spending and contain non-plan expenditure. • Address key issues of greater financial accountability.	• Agriculture Technology Mission will be set up immediately to focus on improving efficiency factors. • A new department "Rain-Shadow Development Department" has been established for emphasis on development of rain-shadow areas.	• 26 irrigation projects are planned to be completed within 5 years. • Engaged with World Bank to fund Urban Programme for Advancement of Household Income (UPADHI) Andhra Pradesh Urban Services for Poor (APUSP) programmes in all 118 Urban Local bodies. • A special fund of Rs.300 crore was raised through HUDCO for financing A.P. Urban Infrastructure Development Project and other projects.
2. Arunachal Pradesh	• Adhere to strict financial discipline and ruthlessly curb unnecessary and unproductive expenditure. • Proposes to raise additional revenue by increase in quantum and efficiency of revenue raising departments. • APST students will be exempted from 25 per cent they pay for text books.	• MLA Local Area Development Fund is increased from Rs.20 lakh to Rs. 50 lakh. • A revolving fund to meet the expenditure of salaries of school teachers working on a contractual basis under Sarva Shiksha Abhiyan (SSA). • Assured Career Progression scheme implemented for Government employees stagnating in a particular scale.	• During July-September specified amounts of rice, salt and soap to be distributed free to target group comprising poor, downtrodden and needy people of interior areas not covered under BPL category.
3. Assam	• Exempt the flood affected people from payment of land revenue. • Transfer the salary burden worth Rs.700 crore from plan to non-plan by normalisation of	• Introduce a legislation for protection and insurance cover of the unorganised labour community. • Contemplating introduction of judicious	• Public sector reforms have been keenly addressed by the budget with recommendations of the Public Sector Reform Committee submitted earlier. The various steps suggested are the OTS route, Voluntary Retirement

State	Fiscal	Institutional	Sectoral
	over 75,000 posts during 3 years 2002-03 to 2004-05. • To address the problem of contingent liabilities by guaranteeing Institutional loans, Rs.170 crore budget for the One Time Settlement (OTS) route that is in vogue for 3 years. • Initiated steps for rationalisation of the land revenue system. • Introduce a self assessment scheme and simplify existing assessment system and bring in more transparency and compliance in tax administration. • Extend the scope of the nascent user fee system.	pension reforms and creation of a pension fund. • Negotiating loan of US$ 250 million for Assam Governance and Public Resource Management Programme for financial restructuring and institutional reforms leading to fiscal consolidation and stabilisation of State Government. • Introducing the Assam Rural Health Regulatory Authority Bill 2004. • Tax offices have been computerised and connected. Further, a project to computerise the treasuries and sub-treasuries is on. • The Government intends to enact the Fiscal Responsibility Legislation and has constituted a Task Force for drafting the Bill and 5-member High Powered Committee to finalise it by the end of the year. • Proposal to effect certain administrative changes and enhancement of rates to augment from State Excise.	Scheme and Privatisation in various forms. • Cross settlement of outstanding dues of ASEB to the State Government and vice versa.
4. Bihar	• New Excise Policy is being framed to increase revenue under State excise duties. • Registration process for business establishments/shops has been simplified and Self Tax Assessment Scheme has been introduced.	• Provident Fund Directorate and District Provident Fund Offices have been computerised. • Stamp Regulation 2004 has been put into place to introduce franking machine to prevent use of forged stamp papers. • Bihar Mineral Regulation 2003 has been implemented to shun illegal mining. • State Auditing Services has been instituted for expeditious auditing work.	

State	Fiscal	Institutional	Sectoral
		• All treasuries and sub-treasuries have been computerised for faster transmission of data.	
5. Chhattisgarh	• Establishment cost to be kept within a limit. • Rationalisation in tax rates, taxation system to be made easier and transparent.	• Constitution of Chhattisgarh Housing Construction Board for solving housing problems of weaker and middle income classes. • Separate Tribunal to be set up for sorting out problems relating to commercial taxes.	• Irrigation capacity to be increased substantially by undertaking incomplete and varying sizes of irrigation projects, • Government to give guarantees of Rs.429 crore to State Electricity Board to seek loans from Rural Electrification Corporation for setting up new power projects.
6. Goa	• Comprehensive medical scheme having universal coverage of entire population. • Provides for non-specific grants to zilla parishads for developmental works. • The Goa Gram Samridhi Yojana launched to provide additional financial support to the village panchayats. • Rationalise luxury and sales tax structure.	• Set up a special fund to compensate displaced people of development projects. • Set up a separate Department for tribal welfare. • Formation of ST Corporation. • Introduce legislation to provide a single window clearance to employment oriented schemes. • Set a training institute to train Government employees at various levels for providing good governance. • Goa Employment Board is being set up and made operational. • Set up an Asset management cell for proper management of Government assets – both land and buildings. • Committee of experts would be set up to examine modifications in the excise act and laws.	• Introduce a new scheme to provide differently abled people with gainful employment. • Proposal for a scheme to provide computers to the teaching community. • Several infrastructure works have been considered. • To improve reliability of power supply and ensure consumer satisfaction, a new scheme sanctioned by the Ministry of Power for SCADA/DMS, Consumer care with communication system will be taken up for implementation. • Set up an Aquaculure estate for integrated development of fisheries. • A revitalisation package for the State PSEs is being worked out to turn loss-making units into profit with State Govt. providing interest subsidy.

State	Fiscal	Institutional	Sectoral
		• Proposal under consideration for fishermans' welfare fund to provide relief during lean/ban period and during natural calamity.	
7. Gujarat	• Taxation policy based on reform through rationalisation, simplification and transparency in the tax structure. • Farmers to benefit from full exemption of electricity duty.	• Constituted the Second Finance Commission for strengthening the financial administration of the local governments.	• Provision for an ambitious scheme for providing water to dry land and dry underground and double the income of farmers. • Decided to undertake water supply and sanitation sector reform programme in all the districts. • Start Amritdhara scheme for making available safe drinking water to everyone in municipalities. • Plan to support a major thrust towards the establishment of a gas-based economy in Gujarat. • Implement Matruvandana Scheme to remove deficiency of nutrients in adolescent girls and set up health service organisation/ set up in urban/municipal areas. • Introduce Swayam Pramanikaran Sah Sankalit Varshik Patrak Yojana by adopting the approach to abolish Inspector-Raj to remove hardships of people. • Two Special Economic Zones at Mundra and Dahej with the enactment of Special Economic Zone Act. • Two Garment Parks and Three more Industrial Parks for diamonds and jewellery with collaboration of India. • Identified three zones for development planning. • Implement 'Annapurna Scheme' of Government of India wherein infrm, destitute and old

State	Fiscal	Institutional	Sectoral
			persons above 60 years having no source of income shall be covered.
8. Haryana	• To supplement resources of Power utilities, a one time settlement of outstanding dues of power companies to CPSUs under which tax-free bonds have been issued. • Adopted a composite strategy of revenue augmentation, expenditure curtailment and debt management.	• State Government has decided to transfer the share of local bodies in LADT proceeds from the current year for undertaking urban development works.	• Implement National Agriculture Insurance Risk from kharif 2004. • Setting up a Special Economic Zone in Gurgaon district to boost exports and facilitate FDI. • World Bank assisted Technical Education Quality Improvement Project has been sanctioned for promoting academic excellence.
9. Himachal Pradesh	• State Government has signed MoU with the Govt. of India in order to make the State eligible for release of withheld portion of Revenue Deficit Grant of additional central assistance. • Proposal to rationalise Excise Law and regulations. • To ensure equitable incidence of tax on transported goods, distance based three-tier system to be replaced by more rational two-tier system.	• Proposes to introduce a bill on Fiscal Responsibility and Budget Management Act. • Proposes to bring a legislation to regulate appointments and prohibit irregular appointments in offices and establishments under the control of State Government. • Propose to give more powers, functions and authority to Panchayats and urban local bodies. Collection of revenue would be entrusted with panchayats who would retain the same for development activities.	• Initiate in a phased manner the process of school rationalisation and redeployment of human resources.
10.Jammu & Kashmir	• Fiscal strategy of wiping out non-plan revenue deficit and then try build surpluses on the non-plan revenue account. Specifically, spend more on development works while reducing non-plan expenditure, improve quality of spending and speed of execution of work, put in place a more efficient inter-temporal cash management system. • Proposal to rationalise the stamp duty structure.	• Proposal to the Government of India to privately place Government securities with Jammu & Kashmir Bank and a one time grant from Government of India. Further, there will be a new MoU with J&K Bank such that all terms and conditions are same as the System of Ways and Means facility of the RBI with all other States. • J&K Bank to be made a recognised institution for	• Proposal for the regulation of liquor sales to be restructured.

State	Fiscal	Institutional	Sectoral
	• Proposal suggesting an amnesty scheme for the liquidation of arrears of power dues and water tax. • Augment resources though rationalisation of tax structure by easy tax compliance. • Amnesty schemes for several taxes and duties.	financing its Annual Plan. • Set up an Economic Reconstruction Agency (ERA) to start and speedily execute special projects. • An Assets Management Committee will be set up for implementing the decisions pertaining to restructuring of the corporations and disposal of identified assets of PSUs.	
11. Jharkhand	• Registration fee to be reduced, changes in commercial tax structure, modernisation in tax collection system under transport to be introduced. • Introduction of self-assessment tax scheme for small business man. • Tripartite agreement (Centre, RBI and State Government) has been signed for making payment of old dues by issuing long-term power bonds.	• SBI Capital has been appointed to advise on reconstitution of Jharkhand State Electricity Board. • Treasuries/PF Directorate to be computerised. • Constitution of State Finance Commission to strengthen finances of local bodies and make them self-dependent. • State Health Policy to be introduced.	• Jharkhand State Electricity Regulatory Commission has notified power tariff structure for the first time. • Software technology and Apparel Parks to be set up • E-Governance to have high priority.
12. Karnataka	• The fiscal policy is aimed at rapid economic growth with equity and based on 7 key elements. These are (i) achieving significant increase in tax and non-tax resource mobilisation (ii) ensuring visible and sustained reduction in non-development expenditure; (iii) enhancing allocations on development expenditure in key social sectors; (iv) enforcing efficient subsidy management across sectors; (v) improving the productivity of public expenditure; (vi) ensuring Fiscal Responsibility with strict adherence to Medium Term Fiscal Plan and ensuring compliance of the Karnataka Fiscal responsibility Act; (vii) strengthening institutional measures against corruption to	• Propose to simplify tax administration and encourage better compliance. • Recommendations of the Revenue Reforms Commission on Non-Tax Revenues will be examined for expeditious implementation.	• Providing credit to the farmers through the ooperative banks at 6 per cent of interest. • No compound interest or penal interest on crop loans to be charged by cooperative institutions. • Insurance scheme for small and marginal farmers and agricultural labourers called “Sanjeevani” could be evolved. • Implementation of the recommendations of the High Power Committee on Regional Imbalance and a sharper focus on the development of Northern Karnataka. • Several power sector reforms

State	Fiscal	Institutional	Sectoral
	prevent leakage of revenue on the resource and expenditure side. • State fully prepared to introduce VAT from April 1, 2005 and also computerise all the check posts and also interlink them. • Thrust of tax effort is two-fold; first to reduce the burden of taxes by reducing the incidence of taxation and second to rationalise tax rates by reducing the number of slabs.		contemplated to reduce losses and subsidy.
13. Kerala	• Debt reduction will be a primary focus of fiscal reforms. • Local governments have been exempt from Treasury restrictions. • Follow a policy to encourage and enforce tax compliance without introducing new tax and streamlining Commercial Tax Department for augmenting revenue and curbing tax evasion. • A new Group Personal Accident Scheme for employees. • Introduce a scheme of one-time settlement of tax arrears. • Shoulder the liabilities owed by KSEB to Central PSUs.	• Will be notifying a Guarantee Redemption Fund and its corpus will be built from Guarantee Commissions received by Government. • Set up a Debt management Cell in the Finance Department. • Intends to constitute a High Level Committee that will specially monitor all new schemes. • The Infrastructure Act is expected to be in place during the year. • Excise Department will undertake a massive Modernisation Programme including computerisation of check posts and field offices, formation of information and intelligence wing, *etc*. • Scheme for networking of parliamentary institutions at the State and local levels will be launched. • 11 new Fast Track Courts and 2 more MACTs will be established. • Assurance Implementation Desk will be set up to monitor	• Suraksha Housing Scheme for weaker sections of society and Karunya Housing Society to build houses free of cost for BPL families will be launched. • Chemical Emergency Response Centre to be set up to tackle emergencies arising out of chemical hazards. • State rehabilitation Fund will be set up to provide relief to employees of industrial establishment and plantations in distress. • An innovative programme patterned on the ‘Ashraya’ model of Kudumbashree for the care of destitute and vulnerable sections of society in all village panchayats and urban local bodies. • Mangalaya Scheme for the destitute families of the State providing social security for the poorest of the poor.

State	Fiscal	Institutional	Sectoral
		assurances given in the floor of the House.	
14. Madhya Pradesh	• New transparent Excise policy has been announced to contain tax evasion. • Rationalisation of administrative machinery is under consideration for making taxation system easier and understandable. • Decided to provide higher financial to urban bodies for infrastructural development as per the recommendations of the Second State Finance Commission. • Franking machine is being used to contain revenue losses on account of use of forged stamp paper. • Proposed to seek financial assistance of Rs.1,500 crore from ADB to provide better civic facilities in the areas of six urban local bodies.	• Constituted a committee to prepare a medium-term fiscal policy to contain revenue deficit and to increase public investments. • Decided to constitute Madhya Pradesh Road Development Corporation to encourage private participation in road construction work. • Arrangement for Rural Secretariat in rural areas has been proposed to sort out their problems.	• Special emphasis on enhancing power production through ongoing projects. • Propose to operationalise Madhya Pradesh Water Sector Restructuring Project. • Industrial Growth Policy 2004 and action plan has been chalked out to enhance capital investments and rehabilitate sick and closed industrial units. • New Agriculture Policy is under preparation to boost agro-sector. • Co-operative Dairy Policy, 2004 is being prepared to develop dairy sector.
15. Maharashtra	• Rationalise the tax structure and rates, as well as simplification of procedures. • Loans of beneficiaries of the Employment Guarantee Scheme linked horticultural programme have been waived. • Provided default guarantee to 51 cooperative sugar factories pre-seasonal loan and guarantee for the working capital term loan to 31 cooperative sugar factories. • Announced an Amnesty Scheme providing relief towards disputed tax, interest and penalty. The scheme will cover arrears under various Acts.	• Set up a State Agricultural Commission which will enable a holistic conversion to promote the required growth in the agricultural sector. • Setting up of three Technology Missions. • VAT Bill passed by both Houses of Legislature and is yet to receive the assent of the President.	• Decided to undertake Mumbai Urban Infrastructure Project as a supplementary project to World Bank funded Mumbai Urban Transport Project. • Declared development packages for different parts of the State – Vidharba Development Package, Konkan Development Package and Khandesh Development Package.

State	Fiscal	Institutional	Sectoral
16. Meghalaya	• Continue with economy measures and resort to additional resource mobilisation with fresh taxation. • Continue measures to contain avoidable non-plan expenditure while ensuring unavoidable segments of expenditure are protected and sufficiently provided for.	• MoU on MTFRP with Government of India has been signed.	
17. Mizoram	• Draft VAT Bill is complete and under consideration for legislation.	• Strengthening the cooperative movement in the State by grants-in-aid. • Establishment of family courts is under active consideration during the year. • Computerisation of taxation department is being started.	• Integrated Infrastructure Development Centre is expected to be completed this year. • Proposal for extension of physical transport infrastructure and train officers and staff. • Infrastructure building and training for various department including tourism, trade and commerce, education, animal husbandry, fisheries, among others. • Cadastral survey of non-agricultural land is proposed.
18. Nagaland	• Plan to neutralise negative balance from current revenue by conducting extensive checks on fraudulent pensions, debt restructuring, manpower management, growth in States' own revenue, pruning non-plan expenditure, implementing VRS and privatising loss making units.	• Creating a dedicated Budget Cell and introducing computerisation. • Set up a 'Joint Assembly Committee' along with an Expert Committee' of officers to examine and recommend structural changes to fiscal system.	• Proposal to Ministry of Rural Development, Govt. of India for bringing land under cultivation of plants like citronella, lemongrass, patchouli, *etc.* • Roadmap drawn up to achieve a state of self-reliance in the near future in animal husbandry products. • A Regional Institute of E-learning and Information Technology will soon commence.
19. Orissa	• Priority on augmentation of the revenue of the State through fiscal reforms and to enhance per capita income. • Decided to integrate the settlement and consolidation work with the Tahasil and rationalise the revenue	• A Culture Fund for the first time has been created in the State to promote and propagate the State's past glory and rich cultural heritage. • Committee has been constituted to remove financial	• Government has submitted proposals for two irrigational projects to NABARD for digging of 36,000 shallow and medium tube wells. • A Pilot Project under the National Nutrition Mission has been launched in Koraput and

State	Fiscal	Institutional	Sectoral
	administration at the Directorate, District, Sub-Division and Tahasil levels.	disparity and regional imbalances.	Kalahandi districts to provide @ 6 kg free rice to 1,19,121 under nourished persons. • Department of Information Technology has proposed two innovative self-employment schemes *viz.*, Information Kiosks and Business Process Outsourcing Complex to tackle the problem of unemployment among educated youths. • Emphasis to complete the incomplete projects on priority basis instead of starting new projects.
20. Punjab	• Each Department of Government to undertake an exercise of restructuring of staff and thereafter revival or creation of posts can be considered. • Future employment in the Government would be scheme/ project specific and need based. • Disinvestment on a selective basis for loss making PSUs. • Personal Ledger Accounts have been closed in most cases. • Computerisation of treasuries. • Proposed to leverage funds by raising urban infrastructure bonds shortly for upgradation of existing infrastructure and adding new assets. • Lifted the ban imposed on compassionate employment. • Education cess on liquor sale.	• A new pension scheme based on defined contribution is being introduced. • Constituted Empowered Committee under Chairmanship of Chief Minister to consider special package for mega projects. • Powers and duties relating to several Departments have been transferred to panchayati raj institutions. • Reforms in power sector as per Electricity Act 2003 including unbundling of the present organisational structure at an advanced stage of consideration. • New legislation to be brought out to empower rural and urban local bodies by constituting District Planning Committees. • Draft a new age cooperation legislation "The Punjab Self Supporting Cooperative Societies Act" to remove undue control of Government on cooperatives.	• A new scheme 'Agricultural Production Pattern Adjustment Programme' to shift agricultural area from wheat-paddy to alternative crops with central assistance is awaiting Government of India approval. • Introduced 'Ashirwad Scheme' to provide economic support to families of scheduled caste and backward classes with the benefit limited to two daughters in a family. • To launch a self-financed Health Insurance scheme "Sanjivni" for members of primary cooperative societies.

State	Fiscal	Institutional	Sectoral
21. Rajasthan	• Simplication in taxes with abolition in Surcharge and Turnover taxes. • Rationalisation of entry tax, stamp duties and entertainment tax.	• Rajasthan State Road Fund to be set-up by introducing a Bill in the Assembly. • Local bodies to be given more funds as per the recommendations of the Second Finance Commission. • Rajasthan Urban Infrastructure Finance and Development Corporation to be set-up for the development of infrastructure by urban local bodies. • Fiscal Responsibility and Budget Management Bill is under preparation. • Contributory Pension Scheme has been implemented for new employees joining the services since January 1, 2004.	
22. Sikkim	• Proposal to establish Block Development Offices in each of the administrative blocks and a Regional Secretariat to facilitate the process of democratic decentralisation. • Reorient approach and strategy in overall fiscal administration process by introducing a package of measures tailored to gradually narrow down the fiscal deficit, together with efforts to curtail non-plan expenditure. • Broadening the tax base for additional revenue generation. • Higher studies fellowships to the youth who would take up higher studies.	• Creation of “Technology Induction Fund” to bring in a variety of newer technologies for the farmer. • Setting up of *Jari-Booti Kosh* primarily to list the traditional folk medicine practices in the State. • A separate fund for developing amenities for the physically challenged people in all the public places. • Do a comprehensive ‘Village Mapping’ where natural resources, population features and other information are put together for future development purposes. • Board of Investment will be fully activated as a facilitator for attracting investment proposals. • Bring into force the State Minimum Wages Act	• All Departments to prepare a 100 days action plan highlighting specific projects. • Adoption of Decentralised Participatory and beneficiary Driven Approaches designed to improve delivery of rural services. • Implement recommendations made by Centre for Infrastructure Management, ASCI, Hyderabad in bringing about power sector reforms. Corporatise the power sector and operationalise the Sikkim Power Development Corporation. • Establishment of Food Park and an Export Processing Zone.

State	Fiscal	Institutional	Sectoral
		applicable to all units of production. • Empowerment of Panchayati Raj Institutions and devolutions through Activity Mapping will be based on the Principle of Subsidiarity. • Implement the recommendations made by the Council for Social Development in institutionalising the Monitoring and Evaluation System in the State. Plan to have a Directorate for the management of the entire monitoring and evaluation operation.	
23. Tamil Nadu	• Medium Term Fiscal Plan has been prepared. The salient features are, the plan intends to wipe out the revenue deficit and contain fiscal deficit (3% of GSDP) by 2008-09, ensure a continuous step-up in its capital outlay, operation and maintenance will receive higher priority and the Government's commitment to providing a comprehensive social safety net. • Recommendations of the Tax Reforms and Revenue Augmentation Commission • A 15 point programme forms an integral part of the development agenda for the year. • Land revenue payable by farmers from July 2003 to June 2004 will be completely waived as also Local Cess and Local Cess surcharge. • A Medium Term Fiscal Plan with the Budget has provided the roadmap for the future.	• An Expenditure Review Committee will be constituted to review on an ongoing basis the expenditure in respect of each Department. • Steps to review labour laws, regulations and rules and a detailed roadmap of labour reforms will be drawn up after due consultation.	• Setting up Agri-Export Zones across the State. • Launch a new programme "Namadhu Gramam" with the objective of ensuring all round development of our villages. • A bold initiative with focus on accelerated poverty reduction in the rural areas. • Technology Development Centre for small and medium enterprises will be opened. • Industrial Infrastructure Upgradation Scheme to be launched to cover clusters where industries are concentrated.

State	Fiscal	Institutional	Sectoral
24. Tripura	• Proposed to curtail non-essential expenditure through austerity measures. • Taking steps for securitisation of a portion of outstanding dues. including those for VAT being implemented.	• Initial steps for power sector reforms. Power Corporation is being setup.	• Bring about significant improvements in the power sector with good quality power and no leakages or power theft. • New Education Policy on the anvil based on the recommendations of the Tripura Education Commission.
25. Uttaranchal	• Mid-term Fiscal Reconstruction Policy has been prepared to increase revenue and curtail expenditures. • Rationalisation and simplification in taxation procedures in commercial taxes, excise duties, stamp and registration fee, transport and entertainment taxes.	• Power Development Fund has been constituted on the advice of State Electricity Regulatory Commission. • Separate Power Transmission Corporation under Electricity Regulation Act, 2003 has been set up. • USAID supported Long-term Fiscal Management and Reform programme is to be implemented with technological assistance in the areas of treasury computerisation, fiscal planning and analysis, evaluation and review of plans, debt management, data collection and analysis. • Commercial tax offices to be computerised expeditiously to facilitate implementation of VAT.	
26. Uttar Pradesh	• Administrative cost to be contained by abolishing nine newly constituted districts and four blocks.	• UP Fiscal Responsibility and Budget Management Bill is to be presented in the Assembly. • New power trading company in the area of electricity distribution to be set up. • Uttar Pradesh State Road Transport Authority has been constituted as an Autonomous Institution.	• New Life Insurance Policy for farmers dying due to sudden accident or becoming physically handicap on such account to be instituted. • Gas based power plants under private sector to be set up at the cost of Rs.10,000 crore.

State	Fiscal	Institutional	Sectoral
		• Uttar Pradesh Rural Road Agency has been constituted for construction of rural roads.	
27. West Bengal	• It will be necessary to take steps for appropriate decentralisation in financial powers and also in administration. • Emphasis on States' own resource mobilisation based on improved method of collection in case of tax and non-tax revenues. • Reduction of subsidies by increasing efficiency and keeping the growth in non-Plan expenditure within limits.		• Special priority has been placed on land reforms in the State's programme for alternative economic reforms. • Implementation of alternative policy of economic reforms for increased employment generation through enhancement of production in agriculture and allied sectors and in industry and expansion of services. • Special priority has been accorded to the universalisation of primary education.
28. NCT Delhi	• Committed to the policy of progressive taxation. • Property tax has been introduced by MCD. • Decided to enhance financial assistance to local bodies from tax revenue. • Reinforce pro-people taxation policy while mobilising needed resources for infrastructure development and welfare programmes and simplification and rationalisation of taxation system. • Proposal to have change in the points of taxation.	• Consultants are finalizing the report on restructuring of (Delhi Jal Board) DJB. Restructuring of DTC is being examined.	

Annex 2 : Reserve Bank's Recent Initiatives on State Government Finances

Reserve Bank's Initiatives	Status of Initiatives
Setting up a Consolidated Sinking Fund (CSF).	The Consolidated Sinking Fund was set up in 1999-2000 to meet redemption of market loans of States. So far, 13 States, *viz*, Andhra Pradesh, Arunachal Pradesh, Assam, Chhattisgarh, Goa, Haryana, Maharashtra, Meghalaya, Mizoram, Orissa, 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 the States to raise up to 50 per cent of their gross borrowings through this route.	The States that have gone in for the borrowing through auction/tap issue so far, include – Punjab, Andhra Pradesh, Arunachal Pradesh, 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, on a case by case basis, Maharashtra and Kerala have been permitted to raise up to 50 per cent their allocation through auction in the fiscal year 2002-03.
Constitution of Committee on WMA/ Overdraft Scheme.	An Advisory Committee (Chairman: Shri C. Ramchandran) was constituted to examine the existing scheme of WMA and overdrafts to the States and to consider rationalisation, if warranted, revision of limits. The 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 of India 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 of India constituted a Committee to frame A Model Fiscal Responsibility Legislation at State Level. The Report is being finalised.
Guarantee Redemption Fund	The Reserve Bank has been providing in technical assistance to States in setting up Guarantee Redemption Fund (GRF) and managing these funds on behalf of the States. So far 5 States (Andhra Pradesh, Gujarat, Orissa, Goa and Haryana) have set up Guarantee Redemption Fund (GRF). As on September 30, 2004, the total outstanding amount under the GRF aggregated at Rs.677 crore
Ceiling on Guarantees	As recommended by the Report of the Technical Committee on State Government Guarantees (February 1999), several State Governments have taken initiatives to place ceiling on the guarantees issued by the States. So far, eight States have fixed statutory/administrative ceilings on guarantees. Further, State Governments have also been sensitised to the need for rationalizing user charges on an objective criteria consistent with the risk being guaranteed.
Constitution of a Working Group on Methodology of Compilation of data on State Government Liabilities	This Working Group was constituted following the discussions at the 14th Conference of State Finance Secretaries. The members of the Group include representatives from select State Governments, the Central Government, the office of the Comptroller and Auditor General of India and the Controller General of Accounts. The Report of the Working Group would be submitted by end-December 2004. Please see Footnote 11 at Page 30.

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 regarding 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.

Note :

Appendix Tables and Statements provide data for select years. State-wise data on some major fiscal indicators for the period 1980-81 to 2003-04 (BE) and State-wise detailed data on the transactions in the revenue and capital account for the period 1990-91 to 2003-04 (BE) are presented in "Handbook of Statistics on State Government Finances" published by the Reserve Bank in June 2004. This publication is also freely accessible on the Reserve Bank's website (*www.rbi.org.in*).