

STATE FINANCES: A STUDY OF BUDGETS OF 2006-07¹

Introduction

The State Governments presented their budgets for 2006-07² against the backdrop of the commitments to pursue the process of fiscal correction and consolidation through the progressive enactment of Fiscal Responsibility Legislation (FRL). The efforts of the State Governments towards reducing fiscal imbalances were aided by larger devolution and transfer by the Twelfth Finance Commission (TFC) through shareable central taxes and grants. Furthermore, all States excepting two (Tamil Nadu and Uttar Pradesh) have implemented value added tax (VAT) in lieu of sales tax, which is expected to provide buoyancy to tax mobilisation of the State Governments.

Recognising that the sustained fiscal correction lies in revenue augmentation, the State Governments in their budget for 2006-07 have emphasised broadening and rationalising tax system. Simultaneously, they have laid stress on improvement in tax administration, streamlining and strengthening existing tax and non-tax collection and plugging of revenue leakages. With a view to improving transparency and efficiency in transactions of the Governments, many States have proposed to complete computerisation of their treasuries and also to introduce e-transfer for the transactions of the Governments. For improving

accountability of budget proposals, some States have proposed to introduce 'Outcome Budget', in line with the Central Government. Furthermore, many State Governments have proposed to introduce 'Gender Budgeting'. Some States have proposed comprehensive restructuring of State public sector undertakings including closure of chronically loss making units for reducing budgetary support for them. Progressive number of States announced introduction of new pension scheme based on defined contribution to restrict their rising pension obligations. Some States proposed curtailment of non-developmental expenditure by doing away with vacated posts, adoption of austerity measures and reduction of non-Plan expenditure. In terms of expenditure, many of the States proposed to improve spending on education and health sector and implement the centrally sponsored scheme of rural employment guarantee scheme. The Central Government has also taken several initiatives to support the reform process of the State Governments. Reserve Bank of India (RBI) as the banker and debt manager to the State Governments has been sensitising the State Governments on fiscal issues. RBI has been taking several measures with regard to market borrowings and consolidated sinking funds (CSF) of the State Governments. Furthermore, the Reserve Bank has operationalised a new Ways and Means Advances (WMA)/Overdraft (OD) scheme for the State Governments.

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² An analysis of the consolidated fiscal position of State Governments based on the State budgets of 29 States (4 of which were *Vote-on Accounts*) for 2006-07 has been published in the Annual Report, 2005-06, Reserve Bank of India. 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.

Against the above backdrop, the remainder of the Study is organised as follows. Section II provides Overview of the Study. Section III enumerates the policy initiatives of the State Governments, Government of India and of the Reserve Bank of India. Section IV provides the analysis and assessment of the consolidated budgetary position of the State Governments. Section V provides the State-wise assessment of the fiscal performance of the State Governments. Section VI provides an analysis and assessment of the outstanding liabilities, including contingent liabilities of the State Governments. An analysis of social sector expenditure in India as a special theme is presented in Section VII. The emerging issues on State finances are presented in Section VIII followed by concluding observations in Section IX.

Annex 1 sets out the detailed State-wise major policy initiatives announced in the State budgets. Annex 2 provides the details of the FRL of State Governments. Annex 3 provides the summary of fiscal position of the State Governments (non-special and special) in terms of various indicators for 2002-05 (Average) and revised estimates (RE) of 2005-06. A comparative analysis of fiscal federalism in several countries has been set out in Annex 4. The consolidated data on various parameters and fiscal indicators of the 29 State Governments are set out in the Appendix Tables 1-23 while State-wise data are provided in Statements 1-50. The detailed State-wise budgetary data are provided in the Appendix I-IV (Appendix I-Revenue Receipts, Appendix II- Revenue Expenditure, Appendix III-Capital Receipts, Appendix IV-Capital Expenditure).

II. OVERVIEW

The key indicators in terms of 2004-05 accounts showed substantial improvement while compared to those with the revised estimates. The revised estimates of 2005-06 showed decline in the revenue deficit (RD) by more than 30 per cent compared to the budget estimates (BE). There was,

however, a 3 per cent rise in the gross fiscal deficit (GFD) due to 10.8 per cent step up in the capital outlay. The State Governments have committed in their budgets to carry forward the process of fiscal correction and consolidation further in their budgets for 2006-07.

Improvement in the key deficit indicators of RD, GFD and primary deficit (PD) was evident when revised estimates of 2004-05 were translated into accounts. It is pertinent to note that the correction in the revenue account in 2004-05 (Accounts) was largely due to decline in non-interest revenue expenditure. The capital outlay also registered a decline of Rs.6,672 crore (9.8 per cent) which accounted for 88.0 per cent of fall in capital expenditure.

The revised estimates of 2005-06 indicated improvement in the fiscal performance of the State Governments as compared with the budget estimates, particularly in the revenue account. Reflecting this, the RD registered a reduction in 2005-06 (RE) by 31.0 per cent. Notwithstanding the decline in the RD, the GFD witnessed an increase of Rs.3,338 crore (3.0 per cent) due to a large increase in capital outlay by Rs.8,302 crore (10.8 per cent). As proportion to GDP, however, GFD remained unchanged at 3.2 per cent with the decline in RD of 0.2 per cent being compensated by rise in capital outlay to the same extent.

The consolidated fiscal position of State Governments in 2006-07 indicates that the States have budgeted to achieve a near balance in the revenue account during 2006-07. As a consequence of decline in the RD, the GFD would decline by Rs.4,278 crore (3.8 per cent) to Rs.109,610 crore (2.8 percent of GDP). The PD is also budgeted to decline by Rs.14,709 crore (59.1 per cent) to Rs.10,185 crore (0.3 per cent of GDP) in 2006-07. It may be noted that the primary revenue surplus of Rs.94,914 crore (2.4 per cent of GDP) of the State Governments are budgeted to account for more than 95 per cent of the interest payments during 2006-07 as compared with about 81 per cent

of the interest payments in the previous year. Fiscal correction in the revenue account during 2006-07 has been budgeted to be achieved primarily through revenue enhancement with revenue receipts, as a ratio to GDP, budgeted to rise by 0.3 percentage points over the previous year. States' own tax revenue as a percentage to GDP is expected to show a marginal increase during 2006-07. As ratio to GDP, the States' own non-tax revenue would, however, be maintained at 1.3 per cent. The higher grants coupled with the incentives provided by the TFC towards restructuring of State finances have aided the States in their endeavour for fiscal correction and consolidation. Correction in the revenue deficit during 2006-07 would also be facilitated by deceleration in revenue expenditure to 11.3 per cent in 2006-07 from 15.4 per cent growth in the previous year, though, as proportion to GDP, revenue expenditure is envisaged to remain constant at the level of 13.3 per cent. The budgeted rise in revenue expenditure (11.3 per cent) during 2006-07 would be primarily contributed by non-interest revenue expenditure (80.4 per cent).

Notwithstanding the marked improvement in consolidated fiscal position of the State Governments, there are wide variations across the States. There are few States that have budgeted for an increase in the RD (4 States) and several States for higher GFD (14 States). Only a few States would account for the major part of the overall correction. State-wise analysis of the fiscal correction process indicates that the non-special category States would account for more than 87 per cent of the correction in the revenue account.

It is important to note that the State Budgets read in conjunction with Union Budget 2006-07 indicates that grants-in-aid have been overestimated by 20.6 per cent while shareable central taxes have been underestimated by 3.7 per cent. It may be noted that the consolidated position of RD and GFD of the

State Governments (in terms of their budgets for 2006-07) as percentage of GDP for 2006-07 has been estimated at 0.1 per cent and 2.8 per cent, respectively. Adjusting for data of Union Budget 2006-07, the RD and GFD of the State Governments as a percentage of GDP would be placed higher at 0.4 per cent and 3.1 per cent, respectively. There are also variations with regard to data on loans from the Centre and flows from National Small Savings Fund (NSSF) thereby distorting the financing pattern of GFD.

There has been a steady accumulation in the outstanding debt of State Governments, particularly since the latter half of the 1990s, on account of high RD and GFD of the States. However, the outstanding debt in terms of both growth and GDP witnessed a downward trend in the recent years. The outstanding liabilities of State Governments, as proportion of GDP, are budgeted at 31.8 per cent as at end-March 2007 lower than 33.4 per cent as at end-March 2005. Furthermore, the ratio of interest payments to revenue receipts which was 25.8 per cent in 2003-04 has been budgeted to come down to 19.1 per cent in 2006-07 mainly on account of the debt swap scheme. Securities issued to NSSF remains the biggest component of the outstanding debt followed by loans from the Centre and market borrowings. It may be mentioned that there are only three States³ which have debt-GSDP ratio below 30.8 per cent in 2005-06 while there are fourteen States⁴ which are having interest payments/revenue receipts (IP/RR) ratio below 15 per cent, the targets recommended by TFC for 2009-10. Based on the TFC's recommendation for debt relief, the Government of India has commenced the process of debt consolidation and debt write-off for the States.

One significant development in State finances relates to enactment of Fiscal Responsibility Legislation (FRLs) by a majority of the States. Making the process of fiscal correction a binding

³ Tamil Nadu, Haryana and NCT Delhi.

⁴ Arunachal Pradesh, Assam, Jammu and Kashmir, Jharkhand, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Chattisgarh, Karnataka, Tamil Nadu and Uttaranchal.

force, FRL is expected to augment fiscal discipline and provide a more realistic correction path. A rule based policy would also make the fiscal policy of the State Governments more credible. Recognising this, the RBI Annual Report 2005-06 has observed that *"Adhering to the FRBM targets in respect of fiscal deficit and revenue deficit is, therefore, critical for macroeconomic, financial, external sector and budgetary sustainability. Furthermore, as use of borrowed resources for meeting the current expenditure requirements has resulted in widening of asset-liability mismatches over the years, it is essential to eliminate revenue deficit and generate sufficient revenue surplus which may be utilised for asset creation without creating liabilities. Any slippage in achieving the FRBM targets could erode the gains achieved in the initial year of the FRBM. It could also generate a chain effect at the State levels to relax targets set out in their fiscal responsibility legislations"*. Hence, it would be desirable that the State Governments, which have enacted FRLs, adhere to the rules, while remaining States may make efforts in the direction of adopting a rule based framework. The States should also desist from engaging in accounting arrangements with a view to benefiting from debt relief scheme, as suggested by the TFC in its Report. The State Governments need to adhere to integrity and unanimity in their budgetary accounting and classification.

The level of expenditure on operations and maintenance is vital for the upkeep of the capital assets of the Government. The TFC has emphasised on increasing the level and has also recommended specific grants for this purpose. The proportion of operations and maintenance expenditure in total revenue expenditure of the State Governments, by and large, exhibited a gradual decline over the years. 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 of the State Governments increased over the second half of the 1990s and has declined in recent years. Having a

large share of wages and salaries in total revenue expenditure is one of the primary factors underlying the downward rigidity in revenue expenditures.

An issue that has a bearing on the liquidity management by the State Governments relates to surge in surplus cash balances of the State Governments as reflected in their investments in 14-Day Intermediate Treasury Bills. In view of the build-up of the surplus cash balances, resort to utilisation of WMA/OD by the State Governments has declined significantly. The upsurge in surplus cash balances of the State Governments has emanated mainly from the large automatic inflow of relatively high cost NSSF resources, larger central tax devolution and grants following the recommendations of the TFC, as well as buoyancy of States' own tax revenues, in relation to their budgetary projections. The surge in surplus cash balances of the State Governments, however, has posed challenges to the cash and financial management of the State Governments. The Working Group to Evolve the Framework for Investment of State Government Balances constituted by the Reserve Bank is seized of the matter.

In order to make the process of fiscal consolidation durable and sustainable, adequate investment in economic infrastructure and expenditure on social sectors would be essential. Accordingly, the States would be required to incur higher outlays on the provision on these sectors. Against this backdrop, a desirable path to fiscal correction lies through fiscal empowerment, *i.e.*, by expanding the scope and size of revenue flows into budget. The State Governments' strategy of augmenting tax collection through, *inter alia*, introduction of new taxes and improvement in tax administration needs to be continued with greater vigour. Furthermore, the State Governments may go for a comprehensive review of their tax system to minimise transaction costs and rationalise tax structure, which would help in augmenting tax revenues. In this context, augmenting resource mobilisation as non-tax

revenue through appropriate user charges and restructuring of State public sector undertakings continues to be of critical importance. Raising user charges to appropriate levels will, however, be feasible largely when there is a concomitant improvement in the delivery of the services provided by the States.

Poor financial performance of the State Electricity Boards (SEBs) and Power Utilities has been a matter of concern for the State Governments. Improvement in cost recovery in respect of the power sector, therefore, assumes significance particularly in the context of extending free/subsidised power to certain sections by the State Governments. During 2005-06 (RE), power subsidy to agricultural consumers accounted 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.

The issue of power subsidies also need to be addressed by the State Governments with power sector reform being an integral part of the reform process. In regard to power subsidies, Economic Survey 2005-06 of the Government of India, stated *"in 2005-06, while the direct transfers from State Governments to SEBs was placed at Rs.11,562 crore, an uncovered subsidy of Rs.15,987 crore remained, indicating the large potential that reforms have in improving not only the power sector itself but also the fiscal position of the States"*.

With bulk of the responsibilities pertaining to expenditure on social sectors placed in the domain of State Governments, it is widely recognised that the level of social sector expenditure has important implications for the level of human development and long-term prospects of the economy. One important issue in the arena of social sector expenditure is

that of its adequacy. Given the low level of human development achieved by many of the States in the country, and given the inequalities in income distribution, a minimum adequate level of social sector expenditure by the State Governments may be emphasised, which would lead to subsequent improvement in the human development indicators. Effectiveness of social sector expenditure, *i.e.*, the impact of social sector expenditure on the social indicators is very crucial. Depending on the different conditioning factors, the impact will differ across States. In this context, the distinction has to be made between the outlays and the outcome. In sync with the Union Government, many States have proposed in their budgets for 2006-07 to bring out 'Outcome Budget'. Other States may follow suit. Furthermore, the States need to reprioritise their expenditure so as to ensure adequate investment in the social sector. Within social sector expenditure, expenditure on basic⁵ social services and also the non-salary component assumes importance in order to have greater impact on human development. The State Governments also need to emphasise on the quality of service delivery in respect of social sectors. Improvement in the delivery of services would encourage the public to pay for these services and, therefore, may be considered as a priority by the State Governments.

With the Sixth Pay Commission already constituted by the Central Government, the States may consciously deliberate upon the impact of the award of the Pay Commission upon their financial position, given the State Governments' potential to implement their recommendations for their employees. The States, however, need to be cautious on decisions relating to salary levels and balance it with their fiscal capacity, employee strength, size of population and the required complementary expenditure for productive employment. The economy's moving to a higher growth trajectory has resulted in higher own revenue receipts and greater fiscal capacity for the

⁵ According to an UNDP Study, basic social services refers to basic education, primary health care and family planning services, low cost water and sanitation and nutrition programmes.

States. The buoyancy in revenue mobilisation also needs to be channelised for productive expenditure and investment.

To sum up, it may be mentioned that the State Governments have witnessed marked improvements in the form of major deficits indicators. The States, however, have the challenging task of continuing and sustaining the fiscal correction for eventually translating the same into durable fiscal consolidation. With wide variations in fiscal performance across the States, the fiscally weak States may attempt to undertake reform measures with a view to catching up with the fiscally sound States. As mentioned in RBI Annual Report 2005-06, the State Governments may emphasise fiscal empowerment to augment revenues, which would provide them the necessary flexibility to shift the pattern of expenditure towards greater social sector expenditure and capital outlay. In this context, tax reforms, levying of appropriate user charges, rationalisation of subsidies (including power sector subsidies) and restructuring of State level public sector undertakings assume significance.

III. POLICY INITIATIVES

The various policy measures implemented by the State Governments in the past for addressing their fiscal problems have shown noteworthy results as evident from the improvement in deficit indicators and other fiscal indicators. The State Governments in their budgets for 2006-07 have further pursued with the process of fiscal consolidation. The 2005-06, being the first year of the TFC's award period, the State Governments have started implementing several recommendations of the TFC relating to fiscal restructuring. The Government of India has also been taking several initiatives to provide support besides facilitating and strengthening the endeavours of the States. The Reserve Bank, on its part, has been playing an advisory role in fiscal matters of the State Governments besides the support it provides in the form of WMA/OD and raising of market borrowings.

A brief narration of the various policy initiatives and measures that have been proposed for implementation by the State Governments, the Government of India and the Reserve Bank is attempted in the following paragraphs.

III.1 State Governments

The State Governments have remained resolute in their path of fiscal correction and consolidation as evident from the policies proposed in their budgets for 2006-07. The State Governments have, in general, targeted revenue augmentation along with efforts to contain non-Plan revenue expenditure. Several State Governments, have proposed substantial enhancement of outlays for social schemes, particularly for the weaker sections. During the current year, some States have moved towards the VAT regime aligning themselves with the States which had implemented VAT earlier. Moreover, several States enacted their FRL as recommended by the TFC. Besides, the States have implemented several other policy measures in the realm of taxation, expenditure management and setting up of appropriate institutional mechanisms. The State-wise details of major policy measures are set out in *Annex 1*. A summary account is provided in the following paragraphs.

III.1.1 Revenue Augmentation

During 2006-07, five of the remaining States implemented VAT taking the total number of States implementing VAT to 27 (including NCT Delhi). While Uttar Pradesh is yet to decide on implementing VAT, Tamil Nadu has proposed to implement VAT with effect from January 1, 2007. The States those have already implemented VAT, have taken measures to streamline the procedures, rationalise tax rates and address other issues so as to enable a smooth transition to VAT in their respective States.

State Governments in general have aimed at expanding the tax payer base, better compliance, rationalisation of tax rates, improving the efficiency of tax administration, simplification of tax laws and introducing a modern and improved tax system.

Excepting for a few States which have contemplated to bring in new taxes (tax on lottery tickets in Maharashtra, tax on resale of certified used cars in Goa, 'green tax' on old vehicles in Rajasthan), most State Governments have intended to reduce their tax rates on various types of taxes and even abolish certain taxes. In this context it may be mentioned that two States (Punjab and Maharashtra) have shown inclination to do away with octroi. Kerala, on the other hand, has created a new schedule of goods to be taxed at 20 per cent which is higher than the highest level under VAT i.e., 12.5 per cent. Punjab has budgeted to raise bonds through Punjab State Industrial Development Corporation. State Governments such as Gujarat and West Bengal have brought in amnesty schemes for realising outstanding amounts or arrears in payment. Several State Governments have emphasised streamlining and rationalising of stamp duty while making it applicable on more instruments (e.g., power of attorney, deposits of title deeds).

Maharashtra, Meghalaya and Mizoram have proposed to enhance water charges. However, several States have proposed to reduce power/ electricity rates to various sections of population (Andhra Pradesh, Goa, Gujarat, Haryana, Himachal Pradesh, Karnataka, Punjab and Tamil Nadu).

III.1.2. Expenditure Management

State Governments have proposed measures aimed at better expenditure management and also containment of non-developmental expenditure. Several States including Sikkim and Kerala have proposed ban over recruitments and creation of new posts and put in place a 10 per cent cut in non-Plan expenditure besides bringing in austerity measures. Most State Governments have tightened administrative expenditure. However, developmental expenditure and capital outlay have been emphasised. Several State Governments have proposed insurance schemes for the weaker sections. Some of the States (Assam, Karnataka, Punjab, Sikkim and West Bengal) have proposed setting up of dedicated funds for targeted purposes

and sectors. States are also implementing pension reforms to contain committed expenditure. West Bengal has proposed to reschedule and restructure loans taken from HUDCO. Tamil Nadu has taken over the entire liability of the cooperative banks due to NABARD. While States have been striving to contain expenditure, particularly non-Plan, a plethora of subsidies, waivers and concessions have been announced in the State budgets of 2006-07.

III.1.3. Institutional Measures

The State Governments have adopted institutional measures oriented towards fiscal discipline. Thus, States have gradually put in place legislations in respect of various fiscal parameters such as guarantees, setting up of sinking funds and fiscal responsibility. In this regard, as of now 23 States have enacted FRL which encompasses targets on various fiscal parameters (Annex 2). States have also implemented measures relating to consolidated sinking fund (CSF), guarantee redemption fund (GRF) and ceiling on guarantees (Table 1).

Most of the State Governments have proposed setting up of Committees/Working Groups and policy measures for targeted purposes such as FRBM (Assam), urban infrastructure (Gujarat, Himachal Pradesh, Jammu and Kashmir, Karnataka and Kerala), implementation and monitoring of policies (Jharkhand, Karnataka and Maharashtra), human resource development (Assam, Maharashtra), employment issues (Assam, Goa and Haryana), industrial sector (Bihar, Karnataka, Maharashtra, Punjab and Tamil Nadu), agriculture and irrigation (Himachal Pradesh, Karnataka and Kerala). Tamil Nadu and Uttaranchal have also proposed an Administrative Reform Commission. Assam has proposed a Tax Reform Commission while Nagaland proposed a State Women Commission. Gender budgeting has been proposed by the States of Delhi, Himachal Pradesh and Karnataka. Bihar has proposed an Investment Council. Assam and Himachal Pradesh have proposed for a greater role of the local bodies. Assam has set up a Agriculture Debt Relief

Table 1: Institutional Reforms by State Governments

States	Value Added Tax (VAT) Implemented	Fiscal Responsibility Legislation (FRL) Enacted	New Pension Scheme (NPS) Introduced	Ceilings on Guarantee Imposed	Consolidated Sinking Fund (CSF)	Guarantee Redemption Fund (GRF)
1	2	3	4	5	6	7
1. Andhra Pradesh	April 2005	June 2005	September 2004	S, September 2003	1999-00	January 2002
2. Arunachal Pradesh	April 2005	March 2006	No	No	June 1999	No
3. Assam	May 2005	September 2005	No	S, September 2005	1999-00	No
4. Bihar	April 2005	April 2006	September 2005	No	No	No
5. Chhattisgarh	April 2006	September 2005	November 2004	Yes	2001-02	No
6. Goa	April 2005	2006	August 2005	S, 1993 (Amended, 2005)	June 1999	October 2001
7. Gujarat	April 2006	March 2005	April 2005	A, 1963 (Amended, 2001)	December 2003	February 2002
8. Haryana	April 2003	July 2005	January 2006	Yes	Yes	July 2003
9. Himachal Pradesh	April 2005	2005	Yes	No	No	No
10. Jammu and Kashmir	April 2005	No	No	No	No	2005-06
11. Jharkhand	April 2006	No	Yes	No	No	No
12. Karnataka	April 2005	April 2003	April 06	S, April 1999	No	March 2000
13. Kerala	April 2005	August 2003	No	2003	June 2006	No
14. Madhya Pradesh	April 2006	May 2005	January 2005	A	No	January 2006
15. Maharashtra	April 2005	April 2005	November 2005	No	1999	No
16. Manipur	July 2005	August 2005	December 2004	S, January 2005	No	No
17. Meghalaya	April 2006	March 2006	No	No	November 1999	No
18. Mizoram	April 2005	No	No	No	1999-00	No
19. Nagaland	April 2005	August 2005	No	S, August 2005	No	No
20. Orissa	April 2005	June 2005	January 2005	A, November 2002	January 2003	2002-03
21. Punjab	April 2005	2003	No	A, Yes	Yes	No
22. Rajasthan	April 2006	May 2005	January 2004	May 2005	No	1999-00
23. Sikkim	April 2005	No	April 2006	December 2000	1999-00	2005-06
24. Tamil Nadu	No	2003	April 2003	S, May 2003	March 2006	March 2003
25. Tripura	October 2005	2005	NA	NA	NA	NA
26. Uttaranchal	October 2005	October 2005	October 2005	No	January 2001	No
27. Uttar Pradesh	No	February 2004	April 2005	No	No	No
28. West Bengal	April 2005	No	No	S, August 2001	April 1999	No
29. NCT Delhi	April 2005	No	No	No	No	No
Sum-up	27	23	18	17	17	11

NA : Not Available A : Administrative Ceiling S : Statutory Ceiling
Source : Based on Information received from the State Governments.

Commission and a cell to monitor NABARD loans. Madhya Pradesh, Rajasthan and Tripura have proposed to bring out an Outcome Budget in line with that of Government of India.

III.1.4. Other Initiatives

The State Governments have proposed several schemes particularly directed towards education, health and employment. State Governments have been implementing the National Rural Employment Scheme. Further, several States (Assam, Jharkhand, Sikkim and Tamil Nadu) have proposed setting up of Special Economic Zones (SEZs) and industrial parks for specific industries. State Governments (Uttaranchal, Rajasthan,

Jharkhand and Chhattisgarh) are exploring to set up projects under 'public-private partnership' (PPP) scheme. Several State Governments (Assam, Gujarat, Jammu and Kashmir and Delhi) have budgeted for power projects to take care of their energy requirements while others have taken steps to improve the power situation in their respective States.

III.1.5. Power Sector Reforms

The power sector reforms, crucial for the fiscal reform programme, have assumed critical importance in recent years. The State Electricity Boards (SEBs) account for the bulk of the States' investments in PSUs and poor financial

performance of SEBs thus, adversely impact the State finances. The subsidies provided by the State Governments to partly compensate the SEBs for the subsidised sale of electricity to agriculture and domestic sectors have been on the rise in recent years. In addition to direct loans to SEBs, the State Governments have also provided substantial guarantees to financial institutions for enabling SEBs to raise requisite resources from them.

Based on the recommendation of the Ahluwalia Committee (2001), a scheme for one-time settlement of outstanding dues of the SEBs to Central Public Sector Undertakings (CPSUs) was finalised. In this regard, Tripartite Agreements have been signed amongst the Government of India, the Reserve Bank and 28 State Governments. Under the scheme, the State Governments have issued 15-year bonds during 2003-04 with retrospective effect from October 1, 2001 worth Rs.28,984 crore⁶ to the CPSUs in exchange of the outstanding dues at a nominal tax-free interest rate of 8.5 per cent per annum repayable over 10 years after a moratorium period of five years. Subject to the approval of the Reserve Bank, 10 per cent of the bonds can be off-loaded in the market each year for trading. With securitisation of past dues by the State Governments and creation of the discipline of full payment for current supplies, the raising of the requisite resources from the market for the capacity addition programme of the CPSUs would become easier. This has also facilitated the SEBs to clean their balance sheets to enable them to access markets for funds to finance their future investment programme.

Most of the States have outlined initiatives aimed at restructuring of the power sector through measures relating to private sector entry into power generation, re-organisation of State Electricity Boards into separate corporations for generation, transmission and distribution, measures for

reducing transmission and distribution losses, raising power tariffs and most importantly, initiating statutory steps for establishment of regulatory/tariff authorities.

All States, excepting Arunachal Pradesh and Nagaland, have constituted State Electricity Regulatory Commissions (SERCs) in their States for determining the power tariff structure. However, SERCs of three States (*viz.*, Goa, Jammu and Kashmir and Meghalaya) were non-functional as of end-March 2006. Of 24 functional SERCs, tariff orders have been issued by SERCs in 20 States till end-March 2006. The State-wise details of the initiatives taken by State Governments in the power sector reforms and restructuring are presented in Table 2. Thirteen States have unbundled their SEBs whereas nine States have sought extension for unbundling their SEBs. It may be mentioned that the mandatory date for unbundling of the SEBs into three entities (*i.e.*, generation, transmission and distribution) was June 10, 2004. Seven States have only Electricity Departments. All States have signed Memorandum of Understanding (MoU)/Memorandum of Agreement (MoA) with the Ministry of Power, Government of India to undertake reforms in a time bound manner.

III.2 Government of India

The Government of India has been initiating several measures to facilitate the reform process of the State Governments. In this regard, the Central Government's eight flagship programmes have benefited the State Governments. Based on the recommendations of the TFC, the Centre has devolved larger resources to the States.

The Centre in the Union Budget 2006-07 have outlined several initiatives to assist the State Governments in their developmental and social role. The Centre is assisting the States to the extent of 50 per cent of the actual expenditure incurred for supplementary nutrition. The Centre has taken a

⁶ At present, the total Power Bonds issued by State Governments stands at Rs.31,581 crore

Table 2: Status of Power Sector Reform in States
(position as on March 31, 2006)

States	MoU/MoA signed with Ministry of Power, Gol	State Electricity Board Unbundled	Constitution of State Electricity Regulatory Commission (SERC)	Tariff/ ARR Order Passed	Others
1	2	3	4	5	6
1. Andhra Pradesh	Yes	Yes	Yes	Yes	Anti-theft law passed, strategy for privatising distribution is being finalised
2. Arunachal Pradesh	Yes	No, Only Electricity Department	No	–	–
3. Assam	Yes	Yes	Yes	Yes	–
4. Bihar	Yes	No, Extension sought	Yes	–	Anti-theft law passed
5. Chhattisgarh	Yes	No, Extension sought	Yes	Yes	–
6. Goa	Yes	No, Only Electricity Department	Yes (Non-functional)	–	–
7. Gujarat	Yes	Yes	Yes	Yes	Anti-theft law passed
8. Haryana	Yes	Yes	Yes	Yes	–
9. Himachal Pradesh	Yes	No, Extension sought	Yes	Yes	–
10. Jammu & Kashmir	Yes	No, Only Electricity Department	Yes (Non-functional)	–	–
11. Jharkhand	Yes	No, Extension sought	Yes	Yes	–
12. Karnataka	Yes	Yes	Yes	Yes	Anti-theft law passed
13. Kerala	Yes	No, Extension sought	Yes	Yes	Anti-theft law passed
14. Madhya Pradesh	Yes	Yes	Yes	Yes	Anti-theft law passed
15. Maharashtra	Yes	Yes	Yes	Yes	Anti-theft law passed
16. Manipur	Yes (MoA)	No, Only Electricity Department	Yes	–	–
17. Meghalaya	Yes	No, Extension sought	Yes (Non-functional)	–	–
18. Mizoram	Yes (MoA)	No, Only Electricity Department	Yes	–	–
19. Nagaland	Yes	No, Only Electricity Department	No	–	–
20. Orissa	Yes	Yes	Yes	Yes	Distribution to be privatised
21. Punjab	Yes	No, Extension sought	Yes	Yes	–
22. Rajasthan	Yes	Yes	Yes	Yes	–
23. Sikkim	Yes	No, Only Electricity Department	Yes	–	–
24. Tamil Nadu	Yes	No, Extension sought	Yes	Yes	–
25. Tripura	Yes (MoA)	Yes	Yes	Yes	–
26. Uttaranchal	Yes	Yes	Yes	Yes	–
27. Uttar Pradesh	Yes	Yes	Yes	Yes	Anti-theft law passed
28. West Bengal	Yes	No, Extension sought	Yes	Yes	Anti-theft law passed
29. NCT Delhi	Yes	Yes	Yes	Yes	Distribution privatised
Sum-up	29	13	27	20	11

MoU : Memorandum of Understanding MoA: Memorandum of Agreement ARR : Aggregate Revenue Requirement

Note : For Manipur and Mizoram, joint Electricity Regulatory Commission was notified.

Sources : 1. Annual Report 2005-06, Central Electricity Authority, Ministry of Power, Government of India.

2. Website of Ministry of Power (www.powermin.nic.in), Gol.

major initiative in strengthening the infrastructure of several cities through Jawaharlal Nehru National Urban Renewal Mission (JNNURM) and during 2006-07, projects in Maharashtra, Madhya Pradesh and Gujarat are under active consideration. A special package has been cleared for water drainage system in the city of Mumbai. The Centre will actively promote the establishment of new towns, preferably focused on a specific industry with some projects under consideration in West Bengal and Karnataka. The Centre has a programme for repair, renovation and restoration of water bodies through pilot projects in 23 districts in 13 States. The Centre has proposed to set up a Special Purpose Tea Fund. Further, five ultra mega power projects in five States have been proposed. To provide support to the North Eastern region, a special accelerated road development programme has been laid out while a Central Institute of Horticulture will be established in Nagaland. Besides, the Centre has provided for in the Union Budget 2006-07 for debt consolidation and relief and compensation for VAT losses to the States. In order to meet the rising requirements for creation of rural infrastructure across the States, the Union Budget for 2006-07 proposed to increase the corpus of Rural Infrastructure Development Fund (RIDF) XII to Rs. 10,000 crore. It also proposed to allow specified projects under the PPP model to access RIDF funds. As rural road component of *Bharat Nirman* requires large funds, it has been decided to open a separate window under RIDF XII for rural areas for rural roads with a corpus of Rs.4,000 crore during 2006-07.

III.3 Reserve Bank of India

The Reserve Bank as banker and manager of public debt to the State Governments has been sensitising the States on fiscal issues. In this direction, the Reserve Bank since 1997 has been organising a bi-annual Conference of State Finance Secretaries to establish a consultative approach to issues pertaining to State Governments finances.

This institutional mechanism has helped in providing solutions to many of the financial issues of the State Governments. The Reserve Bank provides the facility of WMA/OD to the State Governments and manages market borrowing programmes for States.

The following measures have been initiated by the Reserve Bank to strengthen debt management operations of the State Governments.

III.3.1 Auctions for Market Borrowings of State Governments

As the auction route promotes price discovery, maintains market discipline and contributes to improved secondary market liquidity, the Reserve Bank has been encouraging the State Governments to progressively increase the share of market borrowings under the auction route. The issue was discussed in the 18th Conference of State Finance Secretaries held on August 7, 2006 and it was decided that during 2006-07, State Governments would utilise auction route as far as possible for raising resources under the market borrowing programme depending upon the overall market condition.

III.3.2 Scheme for Investment Management of State Governments

At present, Consolidated Sinking Funds (CSFs) and the Guarantee Redemption Funds (GRFs) of State Governments are invested in Government securities held in the books of the Reserve Bank. The TFC recommended that all States should set up sinking funds for amortisation of all loans (and not just market borrowings) and continue to maintain the Calamity Relief Fund (CRF) in its present form. The scheme of CSF was revised in May 2006 which incorporated the TFC recommendation relating to amortisation of all loans and also incorporated the recommendation of the Bezbaruah Committee relating to the provision of Special WMA to State Governments against their net incremental annual investment in CSF upto their Normal WMA limit.

III.3.3 Liquidity of State Government Securities

A Working Group on Liquidity of State Government Securities (Chairman: Shri V.K.Sharma) was constituted to review the issue of low liquidity of State Government securities and suggest appropriate measures. Drawing from the recommendations of the Working Group and with a view to widening the investor base in State Development Loans (SDLs), it has been proposed:

- 1 to extend the facility of non-competitive bidding (currently limited to Government of India dated securities) to the primary auction of SDLs.
- 1 to introduce purchase and resale of SDLs by the Reserve Bank under the overnight LAF repo operations.

III.3.4 Constitution of Standing Technical Committee on State Governments Borrowings

As stated in the Annual Policy Statement of April 2005, implementation of the recommendations of the TFC would have major implications for the market borrowing programmes of State Governments. The Reserve Bank would facilitate smooth transition in consultation with the Central and the State Governments. The Government of India constituted a Technical Group (Chairperson: Smt. Shyamala Gopinath) in July 2005 to work out the modalities for a smooth transition to the proposed arrangement. The Report of the Technical Group was submitted to the Government of India in December 2005. On the basis of the recommendations of the Group, it was proposed in the Annual Policy Statement of April 2006:

- 1 to constitute a Standing Technical Committee (STC) under the aegis of the State Finance Secretaries Conference with representation from the Central and State Governments and the Reserve Bank to advise on the wide-ranging issues relating to the borrowing programmes of Central and

State Governments through a consensual and co-operative approach.

The constitution of the STC is under consideration of the Government of India.

III.3.5 WMA/Overdraft Scheme for State Governments

Based on the Report of the Advisory Committee on Ways and Means Advances to State Governments (Chairman: Shri M.P. Bezbaruah), the recommendations of which were discussed in the 17th Conference of State Finance Secretaries held on January 13, 2006, a revised scheme of WMA/Overdraft for the State Governments has been operationalised from April 1, 2006 (Box 1). As per the scheme, the aggregate normal WMA limits for 2006-07 have been enhanced to Rs.9,875 crore as against Rs.8,935 crore in the previous year. Incentives in the form of Special WMA have also been provided to the States to invest in CSF/GRF.

IV. CONSOLIDATED FISCAL POSITION OF STATE GOVERNMENTS

The various fiscal and institutional reforms implemented by the State Governments impacted in improving the consolidated fiscal position of the States, since 2000-01. All the major deficit indicators, as ratios to GDP, witnessed a decline over the period 2000-01 to 2002-03. However, some signs of transitory deterioration was recorded in 2003-04 largely due to issue of power bonds by the State Governments to Central Public Sector Undertakings under the one time settlement scheme for dues of the State Electricity Boards. Since 2004-05, the process of fiscal correction and consolidation has been steadfast as reflected in the consolidated fiscal position of the State Governments. Against this backdrop, the following discussion analyses and assesses the fiscal position of the State Governments in terms of their accounts for 2004-05, 2005-06 and 2006-07⁷.

⁷ The analysis in this section and also in the Study pertains to 2004-05 (Accounts), 2005-06 (Revised Estimates) and 2006-07 (Budget Estimates) provided in the budgets of 2006-07.

Box 1: Report of the Advisory Committee on Ways and Means Advances to State Governments - Summary

The Reserve Bank of India (RBI) has been extending Ways and Means Advances (WMA) to State Governments since 1937, under the provisions of Section 17(5) of the Reserve Bank of India Act, with the objective of covering temporary mismatches in the cash flows of their receipts and payments. According to the Act, such advances are repayable not later than three months from the date of making that advance. The maximum amount of such advance by the RBI and the interest charged thereon are, however, not specified in the RBI Act but are regulated by voluntary agreements with the State Governments. There are two types of WMA viz., (i) Normal or clean advances, which were introduced in 1937; and (ii) Special or secured advances, instituted in 1953, and which are provided against the collateral of Government of India securities. An overdraft (OD) occurs whenever these limits are exceeded. Maximum time-period (days) and/or financial limits for which State Governments can remain in OD are specified. The WMA Scheme has been periodically revised, beginning the early 1950s, in the light of the perceived requirements of the State Governments, keeping in view the evolving fiscal, financial and institutional developments as well as the objectives of monetary and fiscal management. The last revision in the WMA Scheme was made on the basis of the recommendations of the Advisory Committee under the Chairmanship of Shri C. Ramachandran, in 2003.

In accordance with the recommendations of the Ramachandran Committee and in the context of the fiscal developments in the interregnum as well as the outlook for the liquidity position of the State Governments over the medium term, an Advisory Committee to review the WMA Scheme was constituted in April 2005 with Shri M. P. Bezbaruah, Banking Ombudsman, New Delhi, as Chairman.

The terms of reference of the Advisory Committee were as follows:

- To review the existing WMA/Overdraft Scheme of RBI for State Governments, particularly the formula and the limits, and recommend modifications, if necessary, in the light of the recommendations of the Twelfth Finance Commission;
- To examine the existing Overdraft regulations for the State Governments;
- To examine the Scheme of Special WMA of the State Governments in the light of the States' request for building up investments in Central Government securities from their durable surplus for Special WMA; and
- Any other issue germane to the subject.

The major recommendations made by the Committee are as follows:

- The Advisory Committee observed that there was an improvement in the finances of the State Governments in recent years as evident from the reduction in alternative measures of deficit as well as improvement in liquidity management. Viewing the existing Normal WMA limits as more than adequate, the Committee observed that the recommendations of the Twelfth Finance Commission (TFC) (2005-06 to 2009-10) would have an increasingly positive impact on the finances and liquidity position of the State Governments over the medium term. In view of the shift from Central Plan loans to market borrowings by the State Governments, as recommended by the TFC, the year 2006-07 would be a period of transition and accordingly, State Governments require some more time to adjust to the fiscal *milieu* as envisaged by the TFC. The Committee recommended that the base may be defined as total expenditure (revenue plus capital) excluding repayments and adjusted for onetime *ad hoc* expenditures as against revenue receipts applied hitherto. Lottery expenditures should also be excluded from the base. In the case of a State Government which has a revenue surplus, the base may be defined as above, while in the case of a State having a revenue deficit, the base should exclude the revenue deficit.
- The Committee recommends the computation of Normal WMA limits for the period 2006-07 to 2009-10 (*i.e.* coterminous with the remaining period of award of the TFC) on the following lines.
 - The Normal WMA limits for 2006-07 (beginning April 2006) may be computed by taking the average of the base (as defined earlier)

for the years 2001-02, 2002-03 and 2003-04 (all actuals data as presented to the State Legislatures). As part of one-time expenditures, actual amounts mobilised via power bonds during 2003-04 may be excluded from the base. Multiplying ratios of 3.1 per cent and 4.1 per cent may be applied to the average of the base for the three years in respect of Non- Special Category States and Special Category States, respectively. The limits may be rounded off to the nearest multiple of Rs.5 crore.

- It also should be ensured that there is no reduction in the Normal WMA limits for any State Government from the existing (2005-06) levels.
- The Normal WMA limits may be reviewed every year.
- The Committee recognises the need for encouraging the State Governments to build up reserves of Government of India securities as well as the implications of the transition from Central loans to market borrowings for financing the State Plans, over the short to the medium terms. Accordingly, the Committee does not suggest any change in the Special WMA Scheme. In line with extant Scheme, State Governments would be required to avail Special WMA before Normal WMA.
- The Committee suggested that issue of rationalising the limits for Special and Normal WMA within a single integrated limit may be examined at an appropriate time, from the standpoint of monetary stability.
- The Committee recommended that the interest rate on WMA upto 90 days should be the Repo Rate (as against the existing Bank Rate), while WMA beyond 90 days should be charged one percentage point above the Repo Rate. The Committee also recommended that Special WMA may be charged one per cent below the Repo Rate, as an incentive to build up reserves of such securities.
- The Committee felt that recurrent ODs are a manifestation of structural imbalances and/or unsatisfactory cash management. Nevertheless, given the onset of a changed fiscal regime as envisaged by the TFC, the Committee decided not to modify the existing time limits for OD at this stage. Interest rate on OD upto 100 per cent of the Normal WMA limit should be charged 2 percentage points higher than the Repo Rate, while OD in excess of 100 per cent of the Normal WMA limit should be charged 5 percentage points above the Repo Rate.
- The Committee also recommended that State Governments need to be cautioned to take remedial measures to avoid emergence of overdraft, whenever they avail of WMA in excess of 75 per cent of their Normal WMA limit.
- The Committee recommended that all the State Governments should also put in place a monitoring mechanism for their availing of WMA.
- The Committee recommended that States may be permitted to invest their cash surplus in dated GOI securities, provided that they have not availed WMA in the immediately preceding period of 90 consecutive days, and subject to other relevant considerations by the RBI such as availability of such securities with it.
- The Committee recommended that net incremental (*i.e.* new investment less redemption/liquidation) annual investment of States in CSF/GRF may be made eligible for availing Special WMA.
- The Committee recommended that the next review of the WMA/OD scheme may be undertaken after the receipt of the recommendations of the Thirteenth Finance Commission.

Based on the recommendation of the Advisory Committee, a revised WMA Scheme for State Governments has been in place by the Reserve Bank for 2006-07 (refer to Box VI.5 of Reserve Bank's Annual Report 2005-06 for salient features of the revised WMA Scheme).

Source : Report of the Advisory Committee on Ways and Means Advances to State Governments (2005), Reserve Bank of India.

IV.1 Accounts: 2004-05

Improvement in the key deficit indicators of RD, GFD and PD was evident when revised estimates of 2004-05 were translated into accounts (Table 3). RD and GFD witnessed sharp declines

Table 3: Variation in Major Items - 2004-05 (Accounts) over 2004-05 (RE)

(Rs. crore)

Items	Variation		Contribution* (per cent)
	Amount	Per cent	
1	2	3	4
I. Revenue Receipts (i+ii)	-12,364	-3.2	100.0
(i) Tax Revenue (a+b)	-487	-0.2	3.9
(a) Own Tax Revenue	1,718	0.9	-13.9
of which			
Sales Tax	1,424	1.2	-11.5
(b) Share in Central Taxes	-2,205	-2.7	17.8
(ii) Non-Tax Revenue	-11,877	-10.2	96.1
(a) States Own Non-Tax Revenue	-1,646	-3.3	13.3
(b) Grants from Centre	-10,231	-15.3	82.7
II. Revenue Expenditure (i + ii)	-20,244	-4.7	100.0
(i) Non-Interest Revenue Expenditure	-20,334	-6.0	100.4
of which			
Education, Sports, Art and Culture	-4,554	-6.0	22.5
Medical & Public Health and Family Welfare	-1,652	-8.2	8.2
Energy	-2,235	-9.2	11.0
Rural Development	-1,740	-10.2	8.6
Agriculture & Allied Activities	-1,138	-5.4	5.6
Administrative Services	-1,858	-5.7	9.2
Pension	-764	-2.0	3.8
(ii) Interest Payments	91	0.1	-0.4
III. Capital Receipts	316	0.2	100.0
IV. Capital Expenditure	-7,582	-4.6	100.0
of which			
Capital Outlay	-6,672	-9.8	88.0
of which			
Capital outlay on Urban Development	122	7.0	-1.6
Capital outlay on Irrigation & Flood Control	-594	-2.7	7.8
Capital outlay on Energy	-1,954	-20.8	25.8
Capital outlay on Transport	-1,311	-11.5	17.3
Memo Items			
Gross Fiscal Deficit	-14,378	-11.6	
Revenue Deficit	-7,879	-17.8	
Primary Deficit	-14,469	-40.5	

RE: Revised Estimates * : Denotes percentage share in relevant total.

Notes : 1. Capital receipts include public accounts on a net basis while capital expenditure excludes public accounts.

2. Also see Notes to Appendix III & IV.

Source : Budget Documents of State Governments.

of Rs.7,879 crore (17.8 per cent) and Rs.14,378 crore (11.6 per cent), respectively, between 2004-05 revised estimates and 2004-05 (Accounts). Primary deficit also registered a sharp reduction of Rs.14,469 crore (40.5 per cent) between the revised estimates and accounts. This decline in the above deficit parameters was also reflected in terms of their proportion to GDP. In 2004-05 accounts, GFD, RD and PD, as proportion to GDP, were placed at 3.5 per cent (4.0 per cent in RE), 1.2 per cent (1.4 per cent) and 0.7 per cent (1.1 per cent), respectively.

It is pertinent to note that the correction in the revenue account in 2004-05 (Accounts) was largely on account of decline in non-interest revenue expenditure of Rs.20,334 crore (6.0 per cent). The developmental expenditure in revenue account declined substantially by Rs.15,588 crore accounting for 77.0 per cent of the fall in revenue expenditure. Despite a rise in States' own taxes, a decline in current devolution from Centre and States' own non-taxes resulted in revenue receipts declining by Rs.12,364 crore.

Besides the 17.8 per cent decline in RD as mentioned above, there was a decline in capital outlay by Rs.6,672 crore (9.8 per cent) which accounted for 88.0 per cent of fall in capital expenditure. As proportion to GDP, capital outlay declined from 2.2 per cent in revised estimates to 2.0 per cent in accounts. The decline in capital outlay was particularly in respect of sectors such as energy, transport and irrigation and flood control and social services in Assam, Gujarat and Punjab. Thus, GFD showed a decline of Rs.14,378 crore (11.6 per cent) in 2004-05 accounts from that in the revised estimates. The overall correction in GFD was on account of compression of developmental expenditure (including expenditure on loans and advances extended by State Governments) by Rs.22,634 crore.

IV. 2 Revised Estimates: 2005-06

Assessment of revised estimates of 2005-06 vis-à-vis the budget estimates indicates a decline in the RD by Rs.7,735 crore (31.0 per cent) (Table 4 and Appendix Table 1). As proportion to GDP, RD

Table 4: Variation in Major Items - 2005-06 (RE) over 2005-06 (BE)

(Rs. crore)

Items	Variation		Contribution* (per cent)
	Amount	Per cent	
1	2	3	4
I. Revenue Receipts (i+ii)	23,564	5.5	100.0
(i) Tax Revenue (a+b)	12,294	4.0	52.2
(a) Own Tax Revenue	9,573	4.4	40.6
<i>of which</i>			
Sales Tax	4,324	3.2	18.4
(b) Share in Central Taxes	2,721	3.0	11.5
(ii) Non-Tax Revenue	11,270	9.0	47.8
(a) States Own Non-Tax Revenue	150	0.3	0.6
(b) Grants from Centre	11,120	14.1	47.2
II. Revenue Expenditure	15,828	3.5	100.0
(i) Non-Interest Revenue Expenditure	20,132	5.6	127.2
<i>of which</i>			
Education, Sports, Art and Culture	3,273	4.0	20.7
Medical & Public Health and Family Welfare	810	3.6	5.1
Energy	3,046	16.4	19.2
Rural Development	2,163	12.2	13.7
Agriculture & Allied Activities	1,109	5.2	7.0
Relief on account of Natural Calamities	4368	98.0	27.6
Administrative Services	-1,060	-2.8	-6.7
Pension	755	1.8	4.8
(ii) Interest Payments	-4,304	-4.6	-27.2
III. Capital Receipts	9,722	6.5	100.0
<i>of which</i>			
Market Borrowings	569	2.4	5.9
Special Securities Issued to NSSF	23,769	39.3	244.5
Loans from Centre	-20,305	-65.0	-208.8
Recovery of Loans & Advances	1,954	35.5	20.1
Small Savings, Provident Fund, etc. (Net)	934	9.8	9.6
Deposits & Advances (Net)	2,098	-74.9	21.6
IV. Capital Expenditure	13,034	10.6	100.0
<i>of which</i>			
Capital Outlay	8,302	10.8	63.7
<i>of which</i>			
Capital outlay on Urban Development	-722	-20.8	-5.5
Capital outlay on Irrigation & Flood Control	2,385	9.8	18.3
Capital outlay on Energy	3,824	62.1	29.3
Capital outlay on Transport	1,984	13.6	15.2
<i>Memo Items</i>			
Gross Fiscal Deficit	3,338	3.0	
Revenue Deficit	-7,735	-31.0	
Primary Deficit	7,642	44.3	

RE : Revised Estimates BE : Budget Estimates

* : Denotes percentage share in relevant total.

Note : See Notes to Table 3.

Source : Budget Documents of State Governments.

declined from 0.7 per cent in budget estimates to 0.5 per cent in the revised estimates. In the revenue account, there was a substantial increase in revenue receipts of Rs.23,564 crore (5.5 per cent) in 2005-06 (RE) over 2005-06 (BE), which more than compensated for the increase in the revenue expenditure by Rs.15,828 crore (3.5 per cent) (Appendix Table 2).

Notwithstanding the decline in the RD, the GFD recorded a rise of Rs.3,338 crore (3.0 per cent) due to a large increase in capital outlay by Rs.8,302 crore (10.8 per cent). As a proportion of GDP, GFD remained unchanged at 3.2 per cent with capital outlay rising from 2.2 per cent to 2.4 per cent. The rise in capital outlay was mainly in respect of economic services such as energy, irrigation and flood control and transport. It may be mentioned in this context that the TFC in order to contain the fiscal deficit had recommended that the benefit of write-off would be available only if the fiscal deficit of the State is contained to the level of 2004-05. If, in any year, the fiscal deficit exceeds this level, the benefit of write-off, even if eligible otherwise, would not be given.

Increase in revenue receipts was largely accounted for by increase in grants from Centre by Rs.11,120 crore and increase in States' own tax revenue by Rs.9,573 crore. The above two sources accounted for about 47 per cent and 41 per cent of the increase in revenue receipts, respectively. The year 2005-06 being the first year of TFC's award period, States received higher grants from the Centre than budgeted (Appendix Table 3).

Revenue expenditure in 2005-06 (RE) also showed an increase of Rs.15,828 crore over 2005-06 (BE) due to rise in developmental expenditure by Rs.21,845 crore on account of higher expenditure on education, energy and rural development. Non-developmental expenditure, however, declined by Rs.7,313 crore due to fall in respect of miscellaneous general services by Rs.4,432 crore and interest payments by Rs.4,304 crore (Appendix Table 4).

The budgetary figures of the revised estimates of 2005-06 point out that the fiscal performance of the State Governments has improved compared to the budget estimates, particularly in the revenue account. The usual trend of decline in fiscal performance in the revised estimates has been reversed. Incentives provided by the TFC and budgetary rules framed under FRLs have played a composite role in dissuading State Governments to slip on their budgeted fiscal position.

IV.3 Budget Estimates: 2006-07

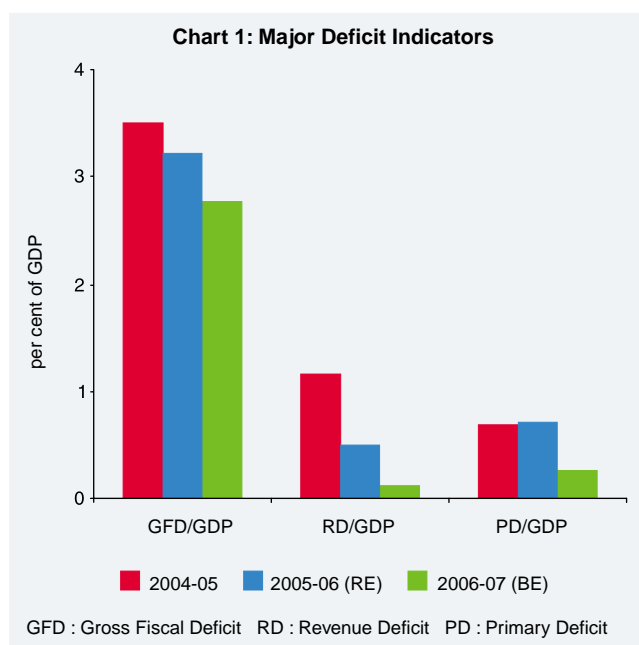
While presenting their budgets for 2006-07 the State Governments have shown further commitment to carry forward the process of fiscal correction and consolidation.

IV.3.1 Budget Estimates 2006-07 - Key Deficit Indicators

The consolidated fiscal position of State Governments indicates that the major deficit indicators are budgeted to show further improvement during 2006-07. The RD is budgeted to decline sharply by Rs.12,667 crore (73.7 per cent) to Rs 4,511 crore during 2006-07 over that of during 2005-06 (RE). At this level, the States are expected to achieve a near balance in the revenue account.

As a consequence in decline in the RD, the GFD would decline by Rs.4,278 crore (3.8 per cent) to Rs.1,09,610 crore (2.8 per cent of GDP). The PD is budgeted to decline by Rs.14,709 crore (59.1 per cent) to Rs.10,185 crore (0.3 per cent of GDP) in 2006-07 (Chart 1). The primary revenue surplus of Rs.94,914 crore (2.4 per cent of GDP) of the State Governments are budgeted to account for more than 95 per cent of the interest payments during 2006-07 as compared with about 81 per cent of the interest payments in the previous year.

Fiscal correction in the revenue account during 2006-07 would be achieved primarily through revenue enhancement with revenue receipts budgeted to grow by 14.5 per cent on top of the 22.1 per cent growth in the previous year.



The budgeted increase in revenue receipts during 2006-07 over that of 2005-06 (RE) would be contributed by own tax revenue (49.1 per cent), share in central taxes (25.3 per cent), grants from the Centre (15.5 per cent) and States' own non-tax (10.1 per cent) (Table 5). Apart from the proposed 14.4 per cent increase budgeted for States' own taxes on commodities and services, stamps and registration fees and taxes on property and capital transactions would rise by 17.5 per cent and 15.9 per cent, respectively (Appendix Table 3).

The reduction in the revenue deficit during 2006-07 would be facilitated by deceleration in revenue expenditure to 11.3 per cent in 2006-07 from 15.4 per cent growth in the previous year. The budgeted rise in revenue expenditure during 2006-07 would be primarily contributed by non-interest revenue expenditure (80.4 per cent). Within revenue expenditure, developmental expenditure (economic and social services) would decelerate to 9.1 per cent (from 21.4 per cent in the previous year) while non-developmental expenditure would accelerate to 13.2 per cent (from 7.9 per cent in the previous year) primarily due to higher provisions in respect of interest payments, administrative services and pensions (Appendix Table 4). Maharashtra accounted for over one-fourth of the increase in interest payments while

Table 5: Variation in Major Items - 2006-07 (BE) over 2005-06 (RE)

(Rs. crore)

Items	Variation		Contribution* (per cent)
	Amount	Per cent	
1	2	3	4
I. Revenue Receipts (i+ii)	65,904	14.5	100.0
(i) Tax Revenue (a+b)	49,083	15.5	74.5
(a) Own Tax Revenue	32,386	14.4	49.1
<i>of which</i>			
Sales Tax	22,403	16.2	34.0
(b) Share in Central Tax Revenue	16,697	18.0	25.3
(ii) Non-Tax Revenue	16,821	12.3	25.5
(a) States Own Non-Tax Revenue	6,635	14.2	10.1
(b) Grants from Centre	10,186	11.3	15.5
II. Revenue Expenditure	53,237	11.3	100.0
(i) Non-Interest Revenue Expenditure	42,806	11.2	80.4
<i>of which</i>			
Education, Sports, Art and Culture	8,990	10.6	16.9
Medical & Public Health and Family Welfare	2,405	10.3	4.5
Energy	-2,156	-10.0	-4.0
Rural Development	661	3.3	1.2
Agriculture & Allied Activities	1,259	5.6	2.4
Administrative Services	6,799	18.6	12.8
Pension	5,409	12.8	10.2
(ii) Interest Payments	10,431	11.7	19.6
III. Capital Receipts	-7,167	-4.5	100.0
<i>of which</i>			
Market Borrowings	4,462	18.7	-62.3
Loans from NABARD	2,534	38.9	-35.4
Special Securities Issued to NSSF	-19,448	-23.1	271.4
Loans from Centre	2,614	24.0	-36.5
Recovery of Loans & Advances	-1,946	-26.1	27.1
Reserve Funds (Net)	1,115	34.3	-15.6
Miscellaneous Capital Receipts	2,449	407.2	-34.2
Remittances (Net)	1,018	106.3	-14.2
IV. Capital Expenditure	7,139	5.2	100.0
<i>of which</i>			
Capital Outlay	11,156	13.1	156.3
<i>of which</i>			
Capital outlay on Urban Development	-629	-22.9	-8.8
Capital outlay on Irrigation & Flood Control	3,743	14.0	52.4
Capital outlay on Energy	-458	-4.6	-6.4
Capital outlay on Transport	3,178	19.2	44.5
Memo Items			
Gross Fiscal Deficit	-4,278	-3.8	
Revenue Deficit	-12,667	-73.7	
Primary Deficit	-14,709	-59.1	

RE : Revised Estimates BE : Budget Estimates

* : Denotes percentage share in relevant total.

Note : See Notes to Table 3.

Source : Budget Documents of State Governments.

Maharashtra and Karnataka each accounted for 17 per cent of the increase in administrative services and Tamil Nadu, Kerala, Rajasthan and Andhra Pradesh accounting for over 55 per cent of the increase in pension expenditure.

With the decline of RD by Rs.12,667 crore, net lending by Rs.1,768 crore, along with a disinvestment of Rs.1,000 crore, GFD is budgeted to decline by Rs.4,278 crore over the year, despite a increase in capital outlay by Rs.11,156 crore. According to budgets 2006-07, as a ratio to GDP, GFD would decline to 2.8 per cent from 3.2 per cent in the previous year and RD from 0.5 per cent to 0.1 per cent while capital outlay would remain constant at the level of 2.4 per cent.

IV.3.2 Revenue Receipts

The revenue receipts are budgeted to increase by 14.5 per cent during 2006-07 as against the growth rate of 22.1 per cent in the preceding year. Revenue receipts, as a ratio to GDP, have been envisaged to increase by 0.3 percentage points to 13.2 per cent in 2006-07. As a ratio to GDP, both States' own revenue as well as transfers from the Centre are estimated to improve marginally over the year (Table 6) (also see Statement 31).

Component-wise details reveal that States' own tax revenue as a percentage to GDP is expected to show a marginal increase during 2006-07. All the components excepting taxes on urban immovable properties and electricity duties would contribute to the rise in States' own taxes. States' own non-tax revenue have been budgeted to rise by 14.2 per cent during 2006-07 against the decline of 1.8 per cent in the preceding year. As ratio to GDP, the States' own non-tax revenue would, however, be maintained at 1.3 per cent.

The low recovery from the various socio-economic services provided by the State Governments partly explains their low level of non-tax revenue collection. The cost recovery during 2005-06 (RE) was low at 1.2 per cent for education, 5.0 per cent for public health, 17.7 per cent for irrigation, 13.1 per cent for power and 11.6 per cent for roads

Table 6 : Aggregate Receipts of State Governments

(Rs. crore)

Items	1990-95 (Avg.)	1995-00 (Avg.)	2000-04 (Avg.)	2004-05 (Accounts)	2005-06 (RE)	2006-07 (BE)	Variations (per cent)	
							Col.6/5	Col.7/6
1	2	3	4	5	6	7	8	9
Aggregate Receipts (1+2)				576,762 (18.5)	613,379 (17.4)	672,116 (17.0)	6.3	9.6
1. Revenue Receipts (a+b)	(16.1)	(15.2)	(17.4)	372,075 (11.9)	454,243 (12.9)	520,148 (13.2)	22.1	14.5
(a) States Own Revenue	(12.1)	(10.9)	(11.4)	236,668 (7.6)	271,518 (7.7)	310,540 (7.9)	14.7	14.4
States Own Tax	(7.3)	(6.9)	(7.1)	189,133 (6.1)	224,817 (6.4)	257,203 (6.5)	18.9	14.4
States Own Non-Tax	(5.4)	(5.3)	(5.7)	47,535 (1.5)	46,702 (1.3)	53,337 (1.3)	-1.8	14.2
(b) Central Transfers	(1.8)	(1.6)	(1.4)	135,406 (4.3)	182,725 (5.2)	209,608 (5.3)	34.9	14.7
Shareable Taxes	(4.9)	(4.0)	(4.2)	78,550 (2.5)	92,723 (2.6)	109,419 (2.8)	18.0	18.0
Central Grants	(2.6)	(2.4)	(2.4)	56,857 (1.8)	90,002 (2.5)	100,188 (2.5)	58.3	11.3
2. Capital Receipts (a+b)	(2.3)	(1.6)	(1.9)	204,687 (6.6)	159,136 (4.5)	151,968 (3.8)	-22.3	-4.5
(a) Loans from Centre@	(4.0)	(4.2)	(6.0)	26,157 (0.8)	10,911 (0.3)	13,525 (0.3)	-58.3	24.0
(b) Others Capital Receipts	(1.2)	(1.0)	(1.0)	178,529 (5.7)	148,224 (4.2)	138,443 (3.5)	-17.0	-6.6
	(2.9)	(3.2)	(5.0)					

Avg. : Average RE : Revised Estimates BE : Budget Estimates

@ With the change in the system of accounting with effect from 1999-2000, States' share in small savings which was included earlier under loans from Centre is included under internal debt and shown as special securities issued to 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 comparability.

Notes : 1. The 4/5-year average of ratios to GDP have been provided for a more meaningful comparison across periods.

2. Capital receipts include public accounts on a net basis.

3. Also see Notes to Appendix III.

4. Figures in bracket are percentages to GDP.

Source : Budget Documents of State Governments.

(Table 7 and Chart 2). The cost recovery for education is budgeted at the previous years level during 2006-07 while it is budgeted to decline for

health, irrigation and roads. The cost recovery for power is, however, budgeted to improve during 2006-07. There is, therefore, a need to enhance cost

Table 7: Cost Recovery of Select Services

(Ratio of Non-Tax Revenue to Non-Plan Revenue Expenditure)

(per cent)

Items	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (RE)	2006-07 (BE)
1	2	3	4	5	6	7	8
Social Services							
(a) Education \$	1.2	1.2	1.6	1.7	2.1	1.2	1.2
(b) Health *	4.6	6.1	5.4	4.7	6.1	5.0	4.8
Economic Services							
(a) Irrigation #	8.2	7.5	8.4	15.2	16.3	17.7	16.9
(b) Power	6.5	6.4	5.8	4.5	11.7	13.1	15.8
(c) Roads @	16.1	19.3	15.5	21.3	14.4	11.6	7.5

BE : Budget Estimates RE : Revised Estimates

\$: Also includes expenditure on sports, art and culture.

* : Includes expenditure on medical and public health and family welfare.

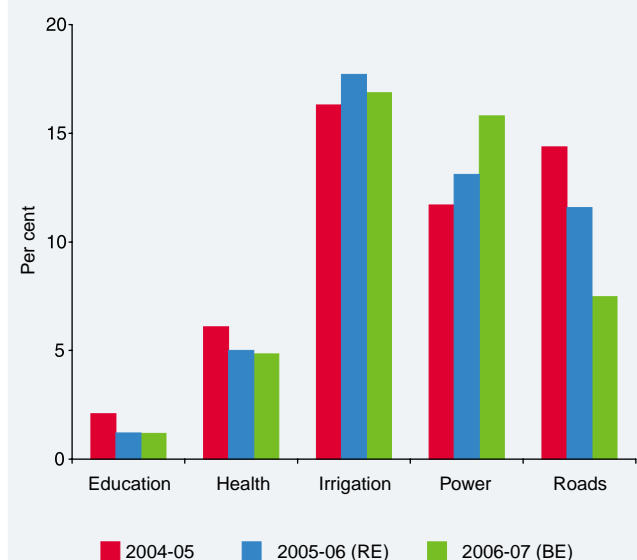
: Relates to irrigation and flood control for non-plan revenue expenditure while it pertains to major, medium and minor irrigation for non-tax revenue.

@ : Relates to roads & bridges for non-plan revenue expenditure while it pertains to road transport for non-tax revenue.

Note : Accounting in respect of power sector has not been uniform across the States which has, at times, resulted in adjustment across years. Hence, the ratios may show fluctuations. Moreover, States have had one-time non-tax receipts under power, such as Rs.2,749 crore grants received by Madhya Pradesh SEB as per the Ahluwalia Committee recommendation during 2003-04 that was returned to the Government of Madhya Pradesh in 2004-05, have been excluded. Further, receipts from Rural Electrification Corporation (REC) that are not in the nature of non-tax such as Rs.240 crore in 2004-05, Rs.160 crore in 2005-06 and Rs.1,350 crore in 2006-07 in case of Government of Uttar Pradesh and Rs.134 crore in 2004-05 for the Government of Uttaranchal, have been excluded.

Source : Compiled from Budget Documents of State Governments.

Chart 2: Cost Recovery of Select Services
(Ratio of Non-Tax Revenue to Non-Plan Revenue Expenditure)

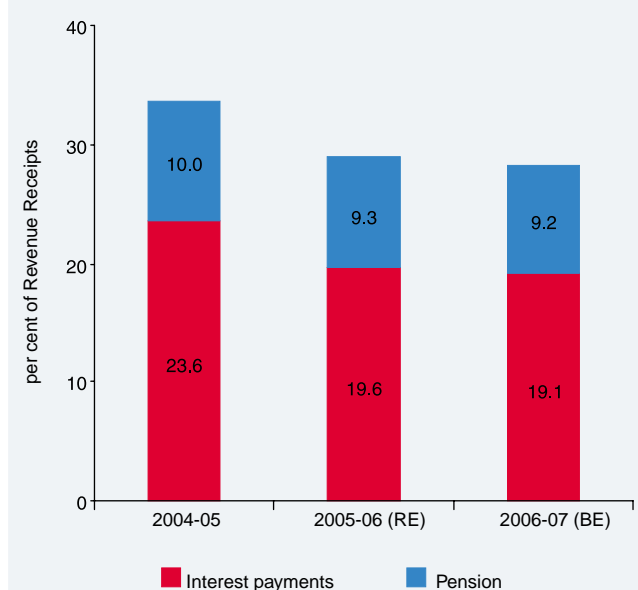


recovery by way of levying appropriate user charges on these services. Furthermore, the rates of return from investments (in terms of dividends and profits) made by the State Governments in State PSUs have been quite low due to their poor performance.

IV.3.3 Revenue Expenditure

Revenue expenditure of the State Governments has been budgeted to increase by 11.3 per cent during 2006-07 compared to 15.4 per cent increase in the preceding year. However, as proportion to GDP, revenue expenditure is envisaged to remain constant at the level of 13.3 per cent. The increase in revenue expenditure would be mainly accounted for by education, sports and culture, urban development, transports and communications, social security and welfare, medical and public health and agriculture and allied activities. Furthermore, provisions in respect of interest payments, administrative services and pensions are also budgeted for substantial increases during 2006-07. Interest payments and pension, however, would pre-empt lower proportion of revenue receipts during 2006-07 compared to the earlier couple of years (Chart 3) (also see Appendix Table 4).

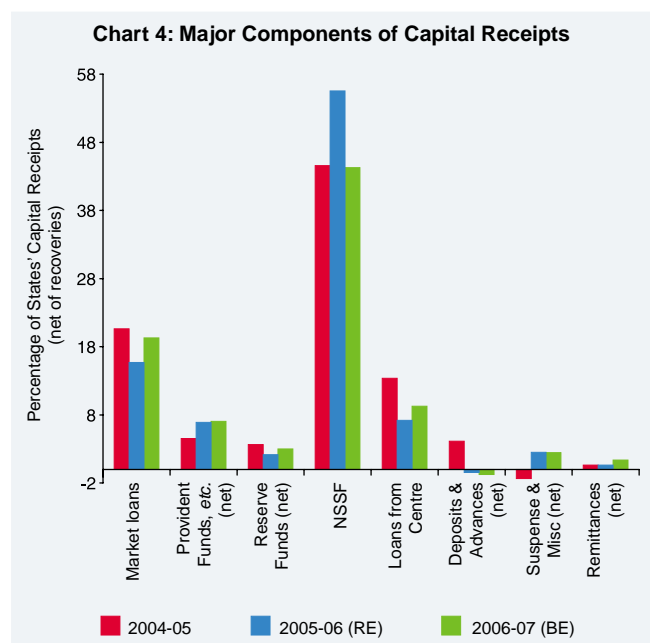
Chart 3: Interest Payments and Pensions



IV.3.4 Capital Receipts

Capital receipts are budgeted to decline by 4.5 per cent during 2006-07 against the decline of 22.3 per cent in the preceding year. Major part of the reduction would be due to substantial decline (23.1 per cent) in Special Securities issued to NSSF and lower recovery of loans and advances (26.1 per cent) (Appendix Table 5) (also see Statement 32). It may be stated that the budgeted amount in respect of Special Securities issued to NSSF by the State Governments is substantially lower compared to those budgeted in the Union Budget 2006-07.

Gross loans from the Centre are budgeted to grow by 24.0 per cent during 2006-07 compared to the sharp decline of 58.3 per cent in the previous year, primarily on account of provisioning in respect of loans for State Plan schemes (Statement 24). Loans from the Centre, however, would be phased out in terms of the recommendations of the TFC. State Governments would have to take recourse to market borrowings for their Plan schemes. The major components of capital receipts as a ratio to total capital receipts (net of recoveries) of the States are depicted in Chart 4.



IV.3.5 Capital Expenditure

The capital expenditure of the State Governments are budgeted to increase by 5.2 per cent during 2006-07 against a decline of 13.6 per cent in the previous year. More than 100 per cent of the increase in capital expenditure would be accounted for by enhancement in capital outlay, primarily representing developmental outlays in economic services. As a ratio to GDP, capital outlay would, however, be maintained at the level of 2.4 per cent, as in the preceding year. Loans and advances by the State Governments are projected to decline by about 19.7 per cent during 2006-07 (Appendix Table 6). The decline is due to the sharp decline in developmental loan for economic services, primarily in power projects and co-operation in Maharashtra.

IV.3.6 Devolution and Transfer of Resources from the Centre

Gross devolution and transfer of resources (*i.e.*, shareable tax revenue, grants and loans and advances) from the Centre are estimated to increase by 15.2 per cent to Rs.223,133 crore during 2006-07 compared to 19.9 per cent growth in the previous year. As a ratio to GDP, gross devolution and transfer from the Centre would marginally improve to 5.6 per cent in 2006-07 from 5.5 per cent in the previous year. It

may be mentioned that gross devolution and transfer from the Centre would finance 33.4 per cent of the aggregate expenditure of the State Governments during 2006-07 as compared with 31.9 per cent in the preceding year. In terms of recommendations of the TFC, the States are receiving a higher share in shareable central taxes and larger grants from the Centre (also see Appendix Table 19).

IV.3.7 Developmental and Non-Developmental Expenditure

There has been a secular decline in share of developmental expenditure in total expenditure from 69.6 per cent in 1990-91 to 51.8 per cent in 2004-05 with almost a compensating increase in the share of non-developmental expenditure. During 2006-07, the share of developmental expenditure would be 58.8 per cent compared to 59.6 per cent in the previous year. As a ratio to GDP, developmental expenditure would be placed at 9.9 per cent during 2006-07, lower than that of 10.3 per cent in the previous year (Table 8). Within developmental expenditure, social sector expenditure (comprising social services, food storage and warehousing and rural development) would be placed lower at 5.9 per cent of GDP during 2006-07 compared to 6.0 per cent in the previous year (Chart 5 and Appendix Tables 11-18) (refer to Section VII for a detailed analysis on social sector expenditure).

Non-developmental expenditure during 2006-07 would be maintained at 5.8 per cent of GDP as in the previous year. Interest payments, administrative services, pension and miscellaneous general services would account for the major increases in non-developmental expenditure during 2006-07 (Appendix Table 14). Non-Plan components would account for 51.7 per cent of developmental expenditure and 97.2 per cent of non-developmental expenditure during 2006-07 (Appendix Table 15). Revenue expenditure would account for 73.0 per cent of developmental expenditure and 97.6 per cent of non-developmental expenditure (Appendix Table 16). Non-Plan non-developmental expenditure, as a ratio to GDP, would be placed marginally higher at

Table 8: Expenditure Pattern of State Governments

(Rs. crore)

Items	1990-95 (Avg.)	1995-00 (Avg.)	2000-04 (Avg.)	2004-05 (Accounts)	2005-06 (RE)	2006-07 (BE)	Variations (per cent)	
							Col. 6/5	Col. 7/6
1	2	3	4	5	6	7	8	9
Aggregate Expenditure (1+2 =3+4+5)	(16.0)	(15.2)	(17.3)	566,303 (18.1)	607,753 (17.2)	668,129 (16.9)	7.3	9.9
1. Revenue Expenditure of which	(12.8)	(12.6)	(13.8)	408,497 (13.1)	471,421 (13.3)	524,658 (13.3)	15.4	11.3
Interest Payments	(1.7)	(2.0)	(2.8)	87,989 (2.8)	88,994 (2.5)	99,425 (2.5)	1.1	11.7
2. Capital Expenditure of which	(3.2)	(2.7)	(3.6)	157,805 (5.1)	136,332 (3.9)	143,471 (3.6)	-13.6	5.2
Capital Outlay	(1.6)	(1.4)	(1.6)	61,559 (2.0)	85,350 (2.4)	96,506 (2.4)	38.6	13.1
3. Developmental Expenditure	(10.8)	(9.6)	(9.7)	293,538 (9.4)	362,300 (10.3)	392,926 (9.9)	23.4	8.5
4. Non-Developmental Expenditure	(4.3)	(4.9)	(6.0)	188,298 (6.0)	203,189 (5.8)	230,225 (5.8)	7.9	13.3
5. Others*	(0.9)	(0.7)	(1.6)	84,467 (2.7)	42,265 (1.2)	44,978 (1.1)	-50.0	6.4

Avg. : Average

RE : Revised Estimates

BE : Budget Estimates

* : Includes repayments of loans to Centre, discharge of internal debt, grants-in-aid and contribution (compensation and assignments to local bodies).

Notes : 1. The 4/5 year average of ratio to GDP have been provided for a more meaningful comparison across periods.

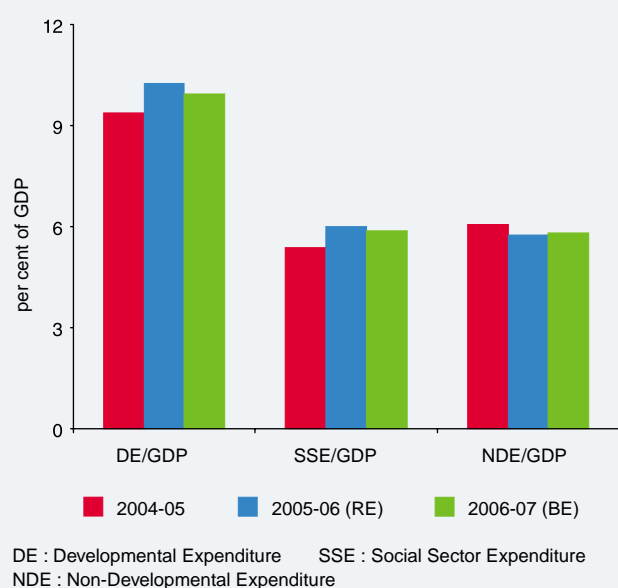
2. Figures in bracket are percent to GDP.

3. Capital expenditure excludes public accounts. Also see Notes to Appendix IV.

Source : Budget Documents of State Governments.

5.7 per cent during 2006-07, compared to 5.6 per cent in the previous year. It may be mentioned that committed expenditure consisting of interest payments, administrative services and pension have been showing some signs of stabilisation in recent years. As a percentage of revenue expenditure, committed expenditure would

marginally increase to 36.3 per cent in 2006-07 compared to 35.6 per cent in the previous year. As a ratio to own revenue, committed expenditure would, however, decline from 61.9 per cent to 61.4 per cent over the year (Statements 37 and 38). Table 8 provides the expenditure pattern of the State Governments over the years.

Chart 5: Developmental and Non-Developmental Expenditure

IV.3.7.1 Expenditure on Wages and Salaries and Operations and Maintenance

The data on wages and salaries and also that of operations and maintenance are not readily available in the budget documents of all the State Governments. An attempt has been made to collate the above data after obtaining the same from the State Governments.

The level of expenditure on operations and maintenance is vital for the upkeep of the capital assets of the Governments. The TFC has emphasised on increasing the level and has also recommended specific grants for this purpose. The proportion of operations and maintenance expenditure in total revenue expenditure, by and large, exhibited a gradual decline over the years (Table 9 and Statement

46). This also 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 28.6 per cent in 2005-06 (RE) from the peak level of 34.6 per cent in 2000-01 (Table 9 and Statement 45). Having a large share (more than one-fourth) of wages and salaries in total revenue expenditure is one of the primary factors underlying the downward rigidity in revenue expenditure. Expenditure on wages and salaries, as proportion to both GDP and revenue expenditure, has stabilised in recent years. State Governments have in recent years initiated measures for expenditure containment including those relating to employment as also pension, enabling their fiscal consolidation.

It is relevant to note in this context that the Government of India has constituted the Sixth Pay Commission in October 2006 to examine the pay and pension structure of the Central Government employees and the Report would be submitted with

18 months of its constitution. As has been experienced with the earlier Pay Commissions, the State Governments have, by and large, followed the Central Pay Commission award to improve the pay structure of their employees. Several State Governments have constituted their own Pay Commissions. The terms of reference, *inter alia*, suggests the need to observe fiscal prudence and the likely impact on State finances if the recommendations are adopted by the States. It would be pertinent to mention (as has been noted by the TFC) that States finances experienced deterioration in the latter part of 1990s subsequent to their adopting the recommendations of the Fifth Pay Commission for their employees. The States, therefore, need to be cautious on decisions relating to salary levels and balance it with their fiscal capacity, employee strength, size of population and the required complementary expenditure for productive employment. The economy's moving to higher growth trajectory has resulted in higher own

Table 9: Administrative Expenditure of State Governments - Wages & Salaries and Operations & Maintenance

(Rs. crore)

Years	Wages & Salaries			Operations & Maintenance		
	Amount	Per cent of Revenue Expenditure	Per cent of GDP	Amount	Per cent of Revenue Expenditure	Per cent of GDP
1	2	3	4	5	6	7
1990-91	18,515	37.3	3.3	6,922	16.5	1.2
1991-92	23,042	35.2	3.5	7,302	12.9	1.1
1992-93	26,234	35.5	3.5	9,281	14.6	1.2
1993-94	29,431	35.6	3.4	9,037	12.7	1.1
1994-95	33,317	34.3	3.3	10,585	12.5	1.0
1995-96	37,673	34.4	3.2	11,368	11.9	1.0
1996-97	45,746	33.3	3.3	12,642	11.1	0.9
1997-98	59,044	35.9	3.9	14,966	10.2	1.0
1998-99	72,196	37.0	4.1	17,814	9.7	1.0
1999-00	87,297	37.9	4.5	17,639	8.2	0.9
2000-01	90,181	35.3	4.3	18,885	7.8	0.9
2001-02	89,340	33.1	3.9	19,889	7.7	0.9
2002-03	91,159	32.0	3.7	21,715	8.0	0.9
2003-04	95,387	29.4	3.5	23,908	7.7	0.9
2004-05	97,552	30.2	3.1	27,339	8.9	0.9
2005-06 RE	114,711	30.5	3.2	34,698	9.9	1.0
2006-07 BE	127,896	30.3	3.2	38,482	9.7	1.0

Notes : 1. Statements 45 and 46 provide State-wise details. The number of States included in each year differs.

2. Proportion of revenue expenditure is based on the number of States included in that year and not that of all States.

Source : Based on information received from some State Governments.

revenue receipts and greater fiscal capacity for the States. The buoyancy in revenue mobilisation also needs to be channelised for productive expenditure and investment.

IV.3.8 Plan Outlay of State Governments

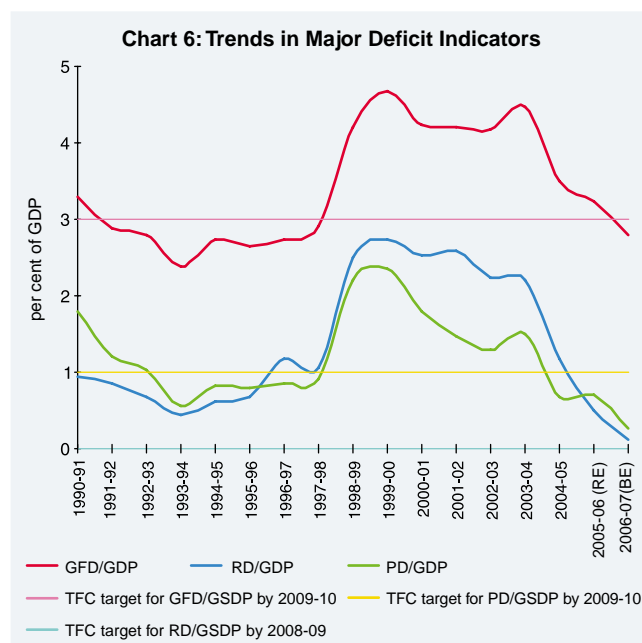
As per information available from the Planning Commission, the aggregate approved outlay of the State Governments during 2006-07 is placed at Rs.1,83,871 crore recording a growth of 27.4 per cent compared to the growth of 29.5 per cent recorded in the previous year. State-wise details of Plan outlays of State Governments are set out in Statement 30.

IV.4 Assessment

IV.4.1 Consolidated Position

Against the backdrop of the above analysis, an assessment of State finances both at consolidated level and State-wise is presented in the following paragraphs. The trend in major deficit indicators as set out in Table 10 and Chart 6 indicates significant improvement witnessed in recent years after recording progressive deterioration during the second half of the 1990s (Appendix Table 1).

Continuing with their fiscal consolidation process, the States Governments have budgeted



for a further reduction in GFD-GDP ratio to 2.8 per cent (0.4 percentage points decline) during 2006-07. Such a substantial correction is based on the improvement envisaged in the RD-GDP ratio that has been budgeted at 0.1 per cent (0.4 percentage points decline). PD-GDP ratio is budgeted to improve to 0.3 per cent from 0.7 per cent in the previous year. Capital outlay-GDP ratio is, however, budgeted to be maintained at the level of 2005-06 revised estimates at 2.4 per cent.

Table 10: Trends in Major Deficit Indicators of State Governments

(Rs. crore)

Years	Gross Fiscal Deficit		Revenue Deficit		Primary Deficit		Primary Revenue Balance (PRB)	
1	2		3		4		5	
1999-00	91,480	4.7	53,797	2.7	46,309	2.4	8,625	0.4
2000-01	89,532	4.2	53,569	2.5	37,830	1.8	1,866	0.1
2001-02	95,993	4.2	59,188	2.6	33,488	1.5	-3,318	-0.1
2002-03	102,123	4.2	55,111	2.2	31,981	1.3	-15,031	-0.6
2003-04	123,070	4.5	61,145	2.2	41,306	1.5	-20,618	-0.7
(Net of Power Bonds)	94,086	3.4						
2004-05	109,257	3.5	36,423	1.2	21,268	0.7	-51,567	-1.7
2005-06 (RE)	113,888	3.2	17,178	0.5	24,894	0.7	-71,816	-2.0
2006-07 (BE)	109,610	2.8	4,511	0.1	10,185	0.3	-94,914	-2.4

RE : Revised Estimates BE : Budget Estimates '-' : sign in PRB indicates surplus

Notes : 1. Figures in italics are percentages to GDP.

2. State Governments had issued power bonds of Rs.28,984 crore during 2003-04 to CPSUs under one-time settlement scheme for dues of SEBs.

Source : Budget Documents of State Governments.

IV.4.2 State-wise Correction of Deficits

Notwithstanding the marked improvement in consolidated fiscal position, there are wide variations across the States. There are a few States which have budgeted for an increase in the RD (4 States) and several States budgeted for higher GFD (14 States). Only a few States would account for the major part of the overall correction. State-wise analysis of the fiscal correction process indicates that the non-special category States would account for more than 87 per cent correction in the revenue account.

Uttar Pradesh and Maharashtra have proposed for revenue surplus in 2006-07 with a correction of Rs.4,255 and Rs.1,725 crore, respectively. From among the special category States, Jammu and Kashmir has proposed revenue surplus of Rs.2,935 crore with a correction of Rs.1,119 crore. Thus, revenue correction of the States would depend to a large extent on performance of the above 3 States (Table 11).

So far as GFD is concerned, Maharashtra has envisaged a sharp correction of Rs.8,053 crore during 2006-07, thus accounting for more than the total GFD correction proposed by all the other States. In the non-special category States such as Tamil Nadu (Rs.1,787 crore), Kerala (Rs.1,557 crore) and Andhra Pradesh (Rs.1,407 crore) have budgeted for higher GFD during 2006-07 over that of 2005-06 (RE). Among the special category States, Jammu and Kashmir (Rs.409 crore), Mizoram (Rs.224 crore), Arunachal Pradesh (Rs.217 crore) and Manipur (Rs. 211 crore) have proposed lower GFD compared to the previous year, while Uttaranchal has proposed an increase of GFD by Rs.402 crore. The overall GFD correction of the States during 2006-07 would to a great extent depend upon the fiscal performance of Maharashtra.

IV.4.3 Decomposition and Financing of State Budgets

The decomposition of GFD based on budget documents of the State Governments reveals that the share of revenue deficit would decline

Table 11: State-wise Correction of RD and GFD - 2006-07 (BE) over 2005-06 (RE)

(Rs. crore)

States	Revenue Deficit		Gross Fiscal Deficit	
	Correction over 2005-06 (RE)	Percentage to Total	Correction over 2005-06 (RE)	Percentage to Total
1	2	3	4	5
A. Non-Special Category				
1. Andhra Pradesh	-122	1.1	1407	-37.1
2. Bihar	-764	6.9	-457	12.1
3. Chhattisgarh	-418	3.8	124	-3.3
4. Goa	-36	0.3	74	-2.0
5. Gujarat	-355	3.2	217	-5.7
6. Haryana	-323	2.9	-65	1.7
7. Jharkhand	-840	7.6	-54	1.4
8. Karnataka	-348	3.1	446	-11.8
9. Kerala	816	-7.4	1557	-41.1
10. Madhya Pradesh	-996	9.0	105	-2.8
11. Maharashtra	-1725	15.6	-8053	212.6
12. Orissa	-41	0.4	262	-6.9
13. Punjab	-307	2.8	-69	1.8
14. Rajasthan	-822	7.4	-928	24.5
15. Tamil Nadu	769	-7.0	1787	-47.2
16. Uttar Pradesh	-4255	38.5	-456	12.0
17. West Bengal	-259	2.3	799	-21.1
18. NCT Delhi	-1015	9.2	-486	12.8
Total (A)	-11040	100.0	-3788	100.0
		(87.2)		(88.5)
B. Special Category				
1. Arunachal Pradesh	32	-2.0	-217	44.3
2. Assam	103	-6.4	267	-54.4
3. Himachal Pradesh	161	-9.9	64	-13.0
4. Jammu and Kashmir	-1119	68.8	-409	83.3
5. Manipur	-316	19.4	-211	43.1
6. Meghalaya	-210	12.9	-130	26.5
7. Mizoram	31	-1.9	-224	45.7
8. Nagaland	-65	4.0	-119	24.3
9. Sikkim	-49	3.0	-9	1.8
10. Tripura	74	-4.5	97	-19.8
11. Uttaranchal	-268	16.5	402	-81.9
Total (B)	-1626	100.0	-491	100.0
		(12.8)		(11.5)
Grand Total (A + B)	- 12,666	100.0	- 4,279	100.0

RE : Revised Estimates BE : Budget Estimates

Note : Figures in brackets indicate percentage correction to grand total.

Source : Budget Documents of State Governments.

substantially to around 4.1 per cent in 2006-07 from 15.1 per cent in the previous year. Correspondingly, the share of capital outlay would move up from 75.0 per cent to 88.0 per cent over the year (Appendix Table 7). Securities issued to NSSF would be the major financing item, *albeit*, the share declining from 65.4 per cent to 53.1 per cent. Market borrowings would finance a larger share of GFD during 2006-07

Table 12: Decomposition and Financing Pattern of Gross Fiscal Deficit - 2004-05 (Accounts) to 2006-07 (BE)

(per cent)			
Items	2004-05 (Accounts)	2005-06 (RE)	2006-07 (BE)
1	2	3	4
Decomposition (1+2+3+4)	100.0	100.0	100.0
1. Revenue Deficit	33.3	15.1	4.1
2. Capital Outlay	56.3	75.0	88.0
3. Net Lending	10.3	10.0	8.8
4. Disinvestment	-	-	-0.9
Financing (1 to 11)			
1. Market Borrowings	31.6	16.4	20.8
2. Loans from Centre	-10.8	1.9	4.4
3. Special Securities issued to NSSF/Small Savings	62.2	65.4	53.1
4. Loans from LIC, NABARD, NCDC, SBI & Other Banks	0.0 ⁸	4.9	6.9
5. State Provident Fund	7.2	7.9	8.0
6. Reserve Funds	6.5	2.9	4.0
7. Deposits & Advances	7.4	-0.6	-1.1
8. Suspense & Miscellaneous	-2.4	3.3	3.3
9. Remittances	1.1	0.8	1.8
10. Overall Surplus (+) / Deficit (-)	9.6	4.9	3.6
11. Others	-12.4 \$	-7.9	-4.7

BE : Budget Estimates RE : Revised Estimates

NSSF: National Small Savings Fund

\$: On account of Land Compensation and other Bonds (Rs.1,962) issued by Government of Tamil Nadu during 2004-05.

Note : See Notes to Appendix Table 8.

Source : Budget Documents of State Governments.

at 20.8 per cent compared to 16.4 per cent during the previous year (Table 12) (Appendix Tables 8 & 9).

IV.4.4 Budgetary Data Variation - State Budgets vis-à-vis Union Budget

A reading of the State Budgets in conjunction with Union Budget for last three years reveals that States have generally overestimated grants-in-aid from the Centre while the amount of shareable Central taxes have been underestimated in the State Budgets. So far as, financing of GFD is concerned, the flows from NSSF have been underestimated in State Budgets while loans from the Centre have been overestimated. The variation of budget estimates data as per the State Budgets and that of the Union Budget for these budgetary heads are set out in Table 13.

In the last three years, on an average, underestimation for the shareable taxes from the Centre has been to the tune of Rs.4,442 crore in the State Budgets while overestimation for the grants has been for about Rs.7,824 crore. In such a scenario, the level of revenue receipts (RR) would differ from those budgeted by the State Governments, resulting in, underestimation of the budgeted RD and in turn GFD. In respect of financing of GFD, loans and advances from the Centre have been overestimated (though Plan loans from the Centre as per the recommendations of the TFC have been dispensed

Table 13: Budgetary Data Variation - State Budgets and Union Budget

(Rs. crore)

Items	2004-05 (BE)		2005-06 (BE)		2006-07 (BE)	
	State Budgets	Union Budget	State Budgets	Union Budget	State Budgets	Union Budget
1	2	3	4	5	6	7
1. Shareable Taxes from Centre	77,887	82,227	90,002	94,959	109,419	113,448
Underestimation(-)/	-4,340		-4,957		-4,029	
Overestimation(+)	(-5.3)		(-5.2)		(-3.6)	
2. Grants-in-Aid	61,176	56,401	78,882	77,275	100,188	83,098
Underestimation(-)/	4,775		1,607		17,090	
Overestimation(+)	(8.5)		(2.1)		(20.6)	
3. Loans from Centre (Net)	-8,235	3,313	17,382	-9,687	4,827	-2,508
Underestimation(-)/	-11,548		27,069		7,334	
Overestimation(+)	(-348.6)		(-279.4)		(-292.6)	
4. NSSF (Net)	63,737	68,650	55,315	86,990	58,162	83,490
Underestimation(-)/	-4,913		-31,675		-25,328	
Overestimation(+)	(-7.2)		(-36.4)		(-30.3)	

Note : Figures in brackets are percentage variation over Union Budget.

Source : Budget Documents of State Governments and Union Government.

⁸ Tamil Nadu have taken into their budget the bonds issued by Tamil Nadu Industrial Development Corporation (TIDCO) and Power Bonds of Tamil Nadu State Electricity Board showing negative figures for Loans from NCDC and Loans from Other Institutions. The consolidated picture has, therefore, undergone substantial change.

with from 2005-06 onwards) while loans against Securities issued to the NSSF have been considerably underestimated, particularly during last two years. Loans and advances from Centre (net) have been overestimated on an average in last three years by about Rs.7,618 crore while that of flow from NSSF (net) has been underestimated by Rs.20,639 crore in the State budgets. Thus, the financing pattern of GFD gets distorted due to such overestimation/underestimation of the budgetary heads of State Governments as compared to that of the Union Budget.

It may be noted that the consolidated position of RD and GFD of the State Governments (in terms of their budgets for 2006-07) as percentage of GDP has been estimated at 0.1 per cent and 2.8 per cent, respectively. Assessing the State Budgets in conjunction with Union Budget 2006-07 indicate that

grants-in-aid have been overestimated by 20.6 per cent while shareable central taxes have been underestimated by 3.6 per cent. Adjusting for the data of Union Budget 2006-07, the RD and GFD of the State Governments as a percentage of GDP would be placed higher at 0.4 per cent and 3.1 per cent, respectively.

Taking into account the data on shareable taxes from the Centre and grants-in-aid from the Union Budget 2006-07, RD and GFD of the State Governments during 2006-07 would be placed at Rs.17,573 crore and Rs.122,672 crore, respectively. Considering the data on loans from Centre and flows from NSSF based on Union Budget 2006-07 and allocation of market borrowings (as per RBI's record), the consolidated financing pattern of the GFD of the State Governments would be as set out in Table 14. There is a significant step up in the share of flows

Table 14: Financing of Gross Fiscal Deficit (GFD) - 2006-07 (Adjusted)

(Rs. crore)

Items	2006-07 (BE)		Variation	
	(State Budgets)	(Adjusted)	Amount	Per cent
1	2	3	4	5
Gross Fiscal Deficit (GFD)	109,610 (100.0)	122,672 (100.0)	13,062	11.9
1. Market Borrowings *	22,762 (20.8)	17,286 (14.1)	-5,476	-24.1
2. Loans from Centre @	4,827 (4.4)	-2,508 (-2.0)	-7,335	-152.0
3. Special Securities issued to NSSF @	58,162 (53.1)	83,490 (68.1)	25,328	43.5
4. Loans from LIC, NABARD, NCDC, SBI and other Banks	7,531 (6.9)	7,531 (6.1)	—	—
5. State Provident Fund	8,739 (8.0)	8,739 (7.1)	—	—
6. Reserve Funds	4,365 (4.0)	4,365 (3.6)	—	—
7. Deposits & Advances	-1,154 (-1.1)	-1,154 (-0.9)	—	—
8. Suspense and Miscellaneous	3,602 (3.3)	3,602 (2.9)	—	—
9. Remittances	1,975 (1.8)	1,975 (1.6)	—	—
10. Overall Surplus (+)/Deficit (-)	3,986 (3.6)	-10,288 (-8.4)	-14,274	-358.1
11. Others	-5,186 (-4.7)	9,634 (7.9)	14,819	-285.8

* : Data are adjusted as per the allocation under market borrowings programme for the State Governments during 2006-07. — : Nil

@ : Data are adjusted as per the Union Budget 2006-07.

Notes : 1. Figures in brackets are percentages to GFD.

2. See Notes to Appendix Table 8.

Source : Budget Documents of State Governments and Union Government and Reserve Bank records.

from NSSF accompanied by decline in share of market borrowings and loans from the Centre. Furthermore, the State Governments are expected to have a cash surplus of Rs.9,677 crore during the fiscal 2006-07 compared to the earlier scenario of drawing down Rs.5,186 crore. Thus, variation in budget estimates data of State Budgets *vis-à-vis* that of Union Budget constrains fiscal analysis in a true perspective.

IV.4.5 Performance of SEBs/State Power Utilities

Most of the SEBs are cash strapped and they are not even able to earn a minimum rate of return of 3 per cent on their net fixed assets in service after providing for depreciation and interest. The SEBs accumulated huge deficit and dues to Central Power Generating Companies could not be paid because of their deteriorating financial performance. The inability of SEBs to pay their dues in full to Central Public Sector Undertakings (CPSUs), in turn, adversely affected the finances and investment plans of CPSUs.

During 2004-05, SEBs/State Power Utilities had incurred losses of Rs.22,126 crore (without subsidies) (Table 15). The average realisation from sale of power was 208 paise/unit as against the average cost of supply of 250 paise/unit. Thus, there was a gap between average realisation from sale

of power and average cost of supply at 42 paise/unit (without subsidies).

As a result of reforms and restructuring of SEBs, various power entities have come into existence as generating, transmission, trading and distributions companies. Participation of private sector in the power industry has added new dimensions to it. The financial performance of the power sector now depends on the performance of the individual power entities. Thus, the profitability of the power sector would depend on the collective performance of the entities.

V. AN ASSESSMENT OF STATE-WISE FISCAL PERFORMANCE

It is evident from the analysis of Section IV that the consolidated position of the State finances has witnessed a significant fiscal correction. Fiscal correction has, however, not been uniform across States, notwithstanding a strong commitment by almost all State Governments to carry forward the process of fiscal correction and consolidation. Against this backdrop, an attempt has been made in this Section on State-wise assessment. The assessment is restricted to 2005-06 (RE) as budget estimates undergo revision.

This section presents the State-wise emerging fiscal situation as evident from the revised estimates for 2005-06 and comparing it with the fiscal position that prevailed, on an average, during the triennium 2002-03 through 2004-05 (Accounts). The analysis is based on 15 fiscal indicators that are classified into four broad groups *viz.*, (a) deficit indicators, (b) revenue performance, (c) expenditure pattern, and (d) debt position. Most of the fiscal indicators are expressed in terms of Gross State Domestic Product (GSDP) at current prices and sourced from the Central Statistical Organisation (CSO) and also budget documents of the State Governments. The GSDP of States for certain years which are not available has been projected based on the previous three year average growth rates. State-wise data for these fiscal

**Table 15: Performance of SEBs/
State Power Utilities**

Years	Gap between average cost of supply of electricity and average realisation from sale of electricity from all sectors (including agriculture) (Paise/unit)	Commercial Losses of SEBs & Other Power Utilities (without subsidies) (Rs. crore)
1	2	3
1991-92	24.91	3,000
1995-96	28.10	8,770
1999-00	70.53	26,353
2000-01	65.38	25,259
2001-02	81.34	27,068
2002-03	48.05	21,192
2003-04	37.00	19,722
2004-05	42.00	22,126

Source : Annual Report 2005-06, Central Electricity Authority, Ministry of Power, Government of India.

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indicators for 2002-05 (Average) and 2005-06 (RE) are presented in Tables 16 and 17, respectively. The median level of each fiscal indicator, in respect of special and non-special categories of States, is also highlighted in the Tables 16 and 17. The States (special and non-special category) have been grouped by their level of performance based on

these indicators such that Q1 indicates the better performed States (Annex 3A-D). The detailed State-wise information on major fiscal parameters are set out in Statements 1 to 50.

Following the overall position, the analysis of fiscal indicators is undertaken separately for special

Table 16: Fiscal Indicators - 2002-03 to 2004-05 (Avg.)

(per cent)

States	Deficit Indicators						Revenue Performance			Expenditure Pattern				Debt Position		R-G
	GFD/ GSDP	RD/ GSDP	PD/ GSDP	PRB/ GSDP	RD/ GFD	RD/ RR	OTR/ GSDP	ONTR/ GSDP	CT/ GSDP	DEV/ GSDP	NON- DEV/ GSDP	SSE/ GSDP	CO/ GSDP	DEBT/ GSDP	IP/ RR	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
Non-Special Category																
1. Andhra Pradesh	4.3	1.6	0.6	-2.1	37.0	11.1	7.7	2.0	4.5	12.3	6.7	7.0	2.4	35.7	25.6	1.7
2. Bihar	6.4	1.6	0.3	-4.5	-3.2	7.5	5.8	0.7	18.5	17.6	13.9	12.1	2.9	79.5	24.8	1.9
3. Chhattisgarh	4.0	0.6	1.2	-2.2	9.6	3.6	7.4	3.0	6.5	14.4	6.0	8.8	2.8	30.6	16.2	-0.8
4. Goa	4.7	1.5	1.5	-1.7	32.7	8.2	7.4	8.6	2.1	15.0	7.7	7.2	3.1	40.6	17.8	-0.6
5. Gujarat	4.9	2.3	1.4	-1.1	48.5	20.1	6.9	2.2	2.6	10.9	5.8	5.6	2.0	39.4	29.8	-3.8
6. Haryana	2.5	0.6	-0.3	-2.3	25.8	4.3	8.6	2.9	1.7	9.9	6.1	4.1	0.8	30.4	21.3	-0.6
7. Jharkhand	6.2	1.0	3.9	-1.3	12.4	5.9	5.8	2.8	10.0	17.3	7.4	12.0	4.2	34.7	12.2	-2.3
8. Karnataka	3.4	0.5	0.7	-2.2	5.4	4.2	9.8	2.1	3.9	12.4	6.7	6.4	2.7	30.8	17.5	-1.0
9. Kerala	5.6	4.3	1.9	0.6	77.1	32.4	9.0	0.9	3.4	10.7	8.2	7.2	0.8	43.6	27.5	-2.0
10. Madhya Pradesh	6.2	1.4	3.0	-1.9	21.2	10.5	7.3	2.6	6.8	15.4	6.9	7.6	3.5	39.3	19.9	2.8
11. Maharashtra	5.1	2.8	2.6	0.3	55.3	26.3	7.8	1.2	1.6	9.7	6.0	5.5	1.9	31.9	23.0	-2.8
12. Orissa	5.1	2.4	-0.7	-3.5	44.7	12.7	6.6	2.2	10.1	13.5	10.6	8.5	1.9	64.9	30.9	-2.7
13. Punjab	5.5	4.4	0.9	-0.1	80.8	29.3	7.7	5.8	1.7	9.0	11.7	4.2	0.7	55.2	30.1	1.6
14. Rajasthan	6.6	3.3	1.8	-1.5	48.6	21.4	7.3	1.9	6.2	13.8	8.4	9.1	2.9	54.9	31.0	1.5
15. Tamil Nadu	3.5	1.5	0.9	-1.2	37.5	10.8	9.7	1.2	3.3	10.6	6.5	6.8	1.9	29.3	18.8	0.6
16. Uttar Pradesh	6.0	4.7	1.6	0.3	73.1	31.9	6.5	1.1	7.4	13.3	9.0	6.6	2.9	55.5	29.6	-0.2
17. West Bengal	6.1	4.7	1.4	0.0	76.7	51.9	4.6	0.5	4.1	7.6	7.7	4.9	0.6	48.8	52.2	0.9
18. NCT Delhi	2.7	-2.9	1.0	-4.6	-121.2	-31.2	7.5	1.1	0.6	8.7	3.3	4.6	1.3	18.5	17.9	0.7
Special Category																
1. Arunachal Pradesh	11.9	-3.6	6.0	-9.5	-35.9	-6.0	1.8	5.1	51.9	51.8	19.0	23.7	15.4	45.7	10.0	5.6
2. Assam	3.6	1.1	0.2	-2.3	32.6	5.5	5.5	2.2	12.3	16.2	8.6	9.6	2.6	35.7	17.0	2.1
3. Himachal Pradesh	12.2	7.9	4.4	0.1	64.9	35.3	5.7	1.9	14.9	21.2	13.6	12.2	4.3	78.6	34.8	1.4
4. Jammu and Kashmir	3.9	-7.1	-2.0	-13.0	3,765.9	-15.9	6.1	2.3	35.3	28.3	19.4	14.0	10.7	58.5	13.8	1.6
5. Manipur	8.7	0.5	2.1	-6.1	10.0	1.5	1.9	1.6	36.5	30.8	18.0	18.1	8.0	58.9	16.5	6.3
6. Meghalaya	4.6	-0.9	1.2	-4.3	-26.2	-3.1	3.6	2.4	23.1	22.8	11.3	13.4	4.6	40.9	11.8	1.1
7. Mizoram	11.5	-0.7	5.2	-7.0	-12.8	-0.8	1.3	2.4	47.1	44.5	18.7	24.6	11.5	89.6	12.4	-6.3
8. Nagaland	3.3	-3.1	-0.8	-7.1	100.2	-8.0	1.2	1.0	29.9	20.1	15.4	10.7	6.4	40.5	13.0	-7.6
9. Sikkim	5.5	-12.9	-1.3	-19.7	-805.7	-10.1	8.0	70.1	51.6	54.9	80.4	29.6	18.4	78.7	5.5	-2.9
10. Tripura	5.4	-1.7	0.8	-6.3	-60.0	-5.3	3.0	2.0	25.6	22.5	12.9	14.2	7.1	51.8	14.9	0.3
11. Uttaranchal	8.2	4.0	4.5	0.3	49.8	19.5	7.0	2.4	11.3	19.4	9.0	11.5	3.6	47.1	17.9	-5.2

Notes : 1. Outstanding debt for the composite State of Bihar as on March 2000, was bifurcated in the population ratio of 74.71 per cent and 25.29 per cent for Bihar and Jharkhand respectively. Similarly, for Madhya Pradesh and Chhattisgarh the proportion of 73.3739 per cent and 26.6203 per cent, respectively has been applied and for Uttar Pradesh and Uttaranchal a proportion of 94.9676 per cent and 5.0324 per cent, respectively were applied.

2. Minus (-) sign indicates surplus in deficit indicators.

3. Figures in bold indicate the median State for the given indicator.

4. Average interest rate (R) of liabilities is worked out by dividing interest payment of the current year by outstanding liabilities of the previous year.

5. The median State is the middle-most State for an indicator after the States have been arranged in the ascending/descending order.

Source : Based on Budget Documents of State Governments.

GSDP : Gross State Domestic Product

RD : Revenue Deficit

CT : Current Transfers

SSE : Social Sector Expenditure

IP : Interest Payment

R-G : Average interest rate (R) on debt *minus* rate of growth of GSDP (G)

GFD : Gross Fiscal Deficit

OTR : Own Tax Revenue

DEV : Developmental Expenditure

CO : Capital Outlay

RR : Revenue Receipts

Avg. : Average

PD : Primary Deficit

ONTR : Own Non-Tax Revenue

NON-DEV : Non-Developmental Expenditure

DEBT : Debt

PRB : Primary Revenue Balance

Table 17: Fiscal Indicators - 2005-06 (RE)

(per cent)

States	Deficit Indicators						Revenue Performance			Expenditure Pattern				Debt Position		R-G
	GFD/ GSDP	RD/ GSDP	PD/ GSDP	PRB/ GSDP	RD/ GFD	RD/ RR	OTR/ GSDP	ONTR/ GSDP	CT/ GSDP	DEV/ GSDP	NON- DEV/ GSDP	SSE/ GSDP	CO/ GSDP	DEBT/ GSDP	IP/ RR	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
Non-Special Category																
1. Andhra Pradesh	3.9	0.5	0.8	-2.6	12.7	3.1	8.8	2.0	5.3	13.9	6.2	7.4	3.2	36.9	19.5	-2.2
2. Bihar	8.3	0.3	2.3	-5.7	3.0	0.8	6.5	0.5	24.6	24.4	15.6	15.7	5.5	84.1	19.0	1.5
3. Chhattisgarh	3.0	-1.8	0.7	-4.1	-59.5	-8.3	9.3	3.0	8.9	17.8	5.7	11.6	4.0	30.8	10.8	-1.9
4. Goa	6.1	0.6	2.7	-2.8	10.1	3.2	8.5	7.4	3.3	18.0	7.4	8.2	5.4	45.2	17.5	-0.4
5. Gujarat	3.2	0.2	0.1	-3.0	5.0	1.3	7.4	1.5	3.3	9.9	5.7	5.5	2.8	38.7	25.8	-5.0
6. Haryana	2.0	0.7	-0.3	-1.7	32.2	4.8	9.2	2.4	2.1	10.3	5.3	5.3	1.3	29.9	17.3	-2.3
7. Jharkhand	10.2	3.2	8.7	1.7	31.6	18.9	6.0	2.9	8.2	20.2	7.1	12.8	4.6	38.5	8.8	-5.7
8. Karnataka	2.9	-0.7	0.6	-3.0	-24.9	-4.0	11.7	2.2	3.9	13.2	6.7	7.2	3.4	30.9	12.9	-4.2
9. Kerala	5.3	4.0	1.8	0.5	76.5	27.1	10.5	0.8	4.9	11.7	8.5	8.6	0.7	45.0	23.6	-2.2
10. Madhya Pradesh	4.4	0.0	1.0	-3.4	0.5	0.1	8.2	2.1	9.3	18.0	7.5	8.8	6.3	44.4	17.3	2.5
11. Maharashtra	3.9	0.3	1.7	-1.9	8.6	2.7	9.0	1.3	2.2	10.9	5.4	6.2	2.7	34.2	17.9	-5.0
12. Orissa	2.2	0.8	-3.4	-4.8	36.5	3.7	7.3	2.1	13.0	13.4	11.3	9.5	1.7	59.3	25.2	3.0
13. Punjab	3.7	1.7	-0.3	-2.3	46.8	9.6	8.8	4.7	4.8	10.5	11.2	4.9	2.0	54.6	22.4	-3.0
14. Rajasthan	5.0	0.7	0.7	-3.6	14.3	4.2	8.0	2.1	6.9	14.6	7.4	9.3	3.8	55.1	25.2	-2.3
15. Tamil Nadu	2.6	0.2	0.4	-2.1	6.6	1.1	10.7	1.2	4.0	11.3	6.6	7.3	2.3	29.7	14.3	-1.2
16. Uttar Pradesh	5.1	1.2	1.2	-2.7	23.8	6.7	7.7	0.9	9.6	13.7	8.8	8.4	3.8	57.2	21.6	-1.6
17. West Bengal	4.9	3.8	0.5	-0.7	76.6	34.9	4.9	0.5	5.4	8.4	7.5	5.5	0.8	49.7	41.0	-0.8
18. NCT Delhi	1.5	-2.6	-0.2	-4.4	-180.7	-26.9	8.0	1.3	0.5	8.3	3.0	5.1	1.6	19.3	17.3	-0.2
Special Category																
1. Arunachal Pradesh	12.4	-8.0	6.6	-13.8	-64.8	-11.5	3.5	8.1	57.8	63.3	18.5	26.3	20.3	65.4	8.4	3.4
2. Assam	6.5	0.7	2.3	-3.5	10.9	2.3	7.1	2.9	20.2	25.6	11.3	14.4	5.4	37.4	13.7	4.2
3. Himachal Pradesh	4.2	0.4	-3.3	-7.0	10.0	1.5	6.3	2.8	19.2	19.2	13.4	11.8	3.7	77.7	26.4	-1.2
4. Jammu and Kashmir	6.9	-7.9	1.3	-13.6	-114.4	-15.7	7.4	3.2	39.7	39.1	18.1	17.5	14.6	60.8	11.3	0.5
5. Manipur	7.4	-11.2	1.7	-16.9	-150.9	-18.9	2.2	2.7	54.3	45.0	21.6	23.2	17.2	77.0	9.6	2.3
6. Meghalaya	3.8	-2.3	0.2	-5.8	-60.6	-6.5	4.0	2.7	28.3	28.0	11.1	16.0	5.5	43.9	10.1	0.4
7. Mizoram	10.0	-5.5	3.7	-11.8	-55.1	-9.6	1.3	3.3	52.7	49.7	18.4	23.6	15.0	88.1	10.9	-6.4
8. Nagaland	3.5	-5.6	0.0	-9.1	-163.1	-17.9	1.4	1.0	29.2	22.0	13.2	10.9	9.1	32.6	11.0	-6.8
9. Sikkim	16.2	-11.6	10.5	-17.4	-71.3	-9.9	6.6	56.9	53.7	64.2	69.3	32.8	27.9	78.4	4.9	-3.9
10. Tripura	5.8	-5.9	1.5	-10.2	-101.3	-16.7	3.2	0.6	31.5	26.3	14.4	15.8	11.7	52.7	12.2	-1.0
11. Uttarakhand	10.4	1.8	6.6	-2.0	17.4	6.6	7.9	2.6	17.0	26.7	10.7	14.8	8.1	55.1	13.9	-6.8

Note : See Notes to Table 16.

and non-special category States. In the case of each category of States, comparisons are made over time (change in the level of a fiscal indicator for a given State Government) and across space (the relative position of a State Government amongst the remaining States, for a given fiscal indicator). The relative fiscal position of both the categories of States, for a broad range of fiscal indicators based on Tables 16 and 17, has also been exhibited through Charts 7 to 12. The discussion of trends is set out below.

V. 1. Overall Position - All States

Both the non-special and special category States witnessed improved fiscal performance

during 2005-06 (RE) compared to the period 2002-05 as reflected in the improvement in the median value of most of the fiscal indicators (Table 18).

The median value of Debt-GSDP ratio, however, showed rises for both categories of States, reflecting skewed pattern of debt burden. The special category States showed significant improvement in terms of RD-GSDP ratio but exhibited deterioration in terms of GFD-GSDP ratio, reflecting the rise in capital outlay over the period.

A comparative analysis indicates that the non-special category States have relatively higher OTR-GSDP ratio and conversely, the special

Table 18: Median Value of Fiscal Indicators

(per cent)

Indicators	Non-Special Category States			Special Category States		
	2002-05 (Avg.)	2005-06 (RE)	Improvement/ Deterioration	2002-05 (Avg.)	2005-06 (RE)	Improvement/ Deterioration
1	2	3	4 (= 3- 2)	5	6	7 (= 6 - 5)
1. GFD/GSDP	5.1	3.9	-1.2	5.5	6.9	1.4
2. RD/GSDP	1.6	0.6	-1.0	-0.9	-5.6	-4.7
3. PD/GSDP	1.4	0.7	-0.7	1.2	1.7	0.5
4. PRB/GSDP	-1.5	-2.7	-1.2	-6.3	-10.2	-3.9
5. RD/GFD	37.5	12.7	-24.8	10.0	-64.8	-74.8
6. RD/RR	11.1	3.2	-7.9	-3.1	-9.9	-6.8
7. OTR/GSDP	7.4	8.2	0.8	3.6	4.0	0.4
8. ONTR/GSDP	2.0	2.0	0.0	2.3	2.8	0.5
9. CT/GSDP	3.9	4.9	1.0	29.9	31.5	1.6
10. DEV/GSDP	12.3	13.2	0.9	22.8	28.0	5.2
11. NON-DEV/GSDP	7.4	7.4	0.0	15.4	14.4	-1.0
12. SSE/GSDP	6.8	7.4	0.6	14.0	16.0	2.0
13. CO/GSDP	2.0	2.8	0.8	7.1	11.7	4.6
14. DEBT/GSDP	39.4	44.4	5.0	51.8	60.8	9.0
15. IP/RR	24.8	19.0	-5.8	13.8	11.0	-2.8
16. R-G	-0.2	-1.9	-1.7	1.1	-1.0	-2.1

Note : Based on Tables 16 and 17.

category States have higher dependency on the Centre, as reflected in comparatively higher CT-GSDP ratio. Furthermore, the special category States have substantially higher DEV-GSDP, SSE-GSDP and CO-GSDP ratios compared to the non-special category States. Debt-GSDP ratios are comparatively higher for the special category States in view of higher GFD-GSDP ratios. The IP-RR ratio for the special category States is, however, much lower compared to the non-special category States.

V.2. Non-Special Category States

V.2.1 Overall Position - Non-Special Category States

There exists wide variation in fiscal performance across the non-special category States. Few States such as Haryana, Tamil Nadu, Karnataka and NCT Delhi have remained as better fiscal performers with revenue surplus (or low RD) and comparatively low GFD-GSDP ratio. These States have relatively higher own tax revenue and, therefore, receive lower central transfers. Bihar and Jharkhand, which have remained fiscally weak, however, make relatively higher developmental

expenditure, social sector expenditure and capital outlay (as a ratio to GSDP). Few States such as Kerala and West Bengal have been poor performers in terms of almost all the fiscal indicators. Kerala, however, is relatively placed better in terms of social sector expenditure.

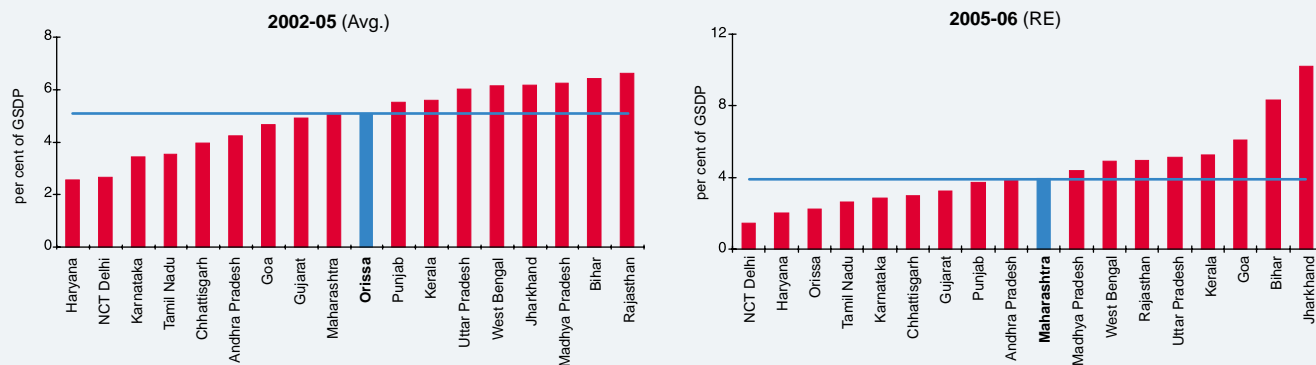
V.2.2 Deficit Indicators

Improvement in fiscal performance, in terms of deficit indicators, was clearly discernible across the States in 2005-06 (RE) as compared with the period 2002-05 (Average) (Charts 7-A, B & C) (also see Statements 1-11).

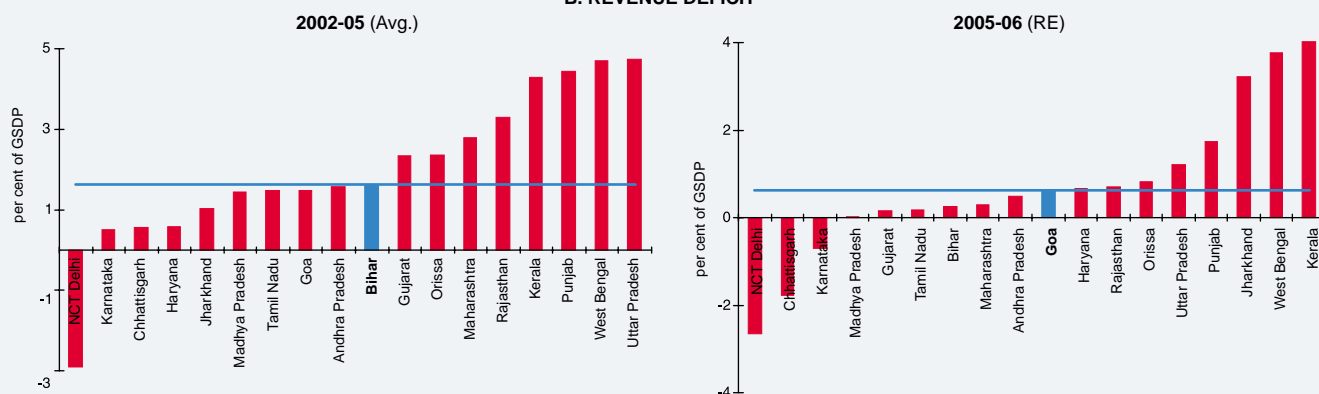
Improvement was evident in RD-GSDP ratio for the State Governments with the ratio for the median State declining from 1.6 per cent during 2002-05 to 0.6 per cent in 2005-06 (RE). Three States (NCT Delhi, Chattisgarh and Karnataka) were in revenue surplus in 2005-06 as compared with only one State (NCT Delhi) in 2002-05 (Table 19 & Chart 7-B). These three States could achieve the target of zero level of revenue deficit, as recommended by the TFC, ahead of schedule of end-2008-09. The RD-GSDP ratio for 10 States

Chart 7: Deficit Indicators - Non-Special Category States

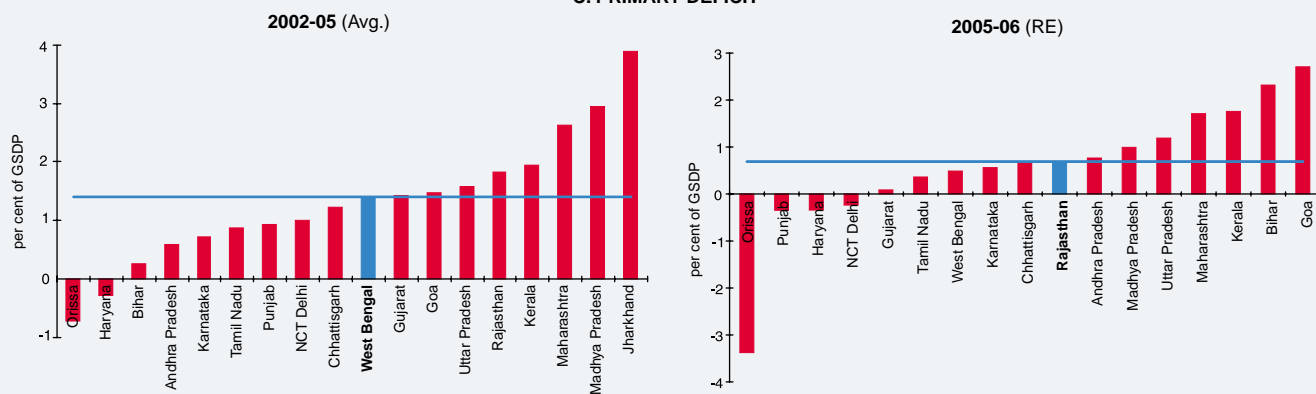
A. GROSS FISCAL DEFICIT



B. REVENUE DEFICIT



C. PRIMARY DEFICIT



Note : Jharkhand has not been depicted for 2005-06 (RE) on account of its high value.

were less than 1 per cent in 2005-06 as against only three States in 2002-05.

Reflecting the decline in the RD-GSDP ratio, there was improvement in GFD-GSDP ratio, with the ratio for the median State declining from 5.1 per cent during 2002-05 to 3.9 per cent in 2005-06

(RE). The median value of PD-GSDP ratio also improved from 1.4 per cent to 0.7 per cent during the above period (Chart 7-C). The ratio of GFD to GSDP was below 3 per cent for five out of 18 States in 2005-06 (Delhi, Haryana, Orissa, Karnataka and Tamil Nadu) as against two States (Haryana and

Table 19: Frequency Distribution of Non-Special Category States - Revenue Deficit/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Revenue Surplus	NCT Delhi	NCT Delhi, Chhattisgarh, Karnataka
Below 0.5	—	Madhya Pradesh, Tamil Nadu, Bihar, Maharashtra, Gujarat
0.5 to 1.0	Chhattisgarh, Haryana, Karnataka	Goa , Haryana, Rajasthan, Orissa, Andhra Pradesh
1.0 to 1.5	Madhya Pradesh, Jharkhand	Uttar Pradesh
1.5 to 2.0	Andhra Pradesh, Bihar , Tamil Nadu, Goa	Punjab
Above 2.0	Gujarat, Orissa, Maharashtra, Rajasthan, Kerala, Punjab, West Bengal, Uttar Pradesh	Jharkhand, West Bengal, Kerala

Avg. : Average RE : Revised Estimates
Notes : 1. Based on Tables 16 and 17.
2. Bold indicates the median State.

Delhi) in 2002-05 (Table 20 & Chart 7-A). It may be mentioned that these five States could achieve the target of 3 per cent of GFD, as recommended by the TFC, ahead of the schedule of end-2009-10.

The ratio of RD to GFD, which indicates the extent of pre-emption of borrowings for current expenditure, also showed a decline in the case of

Table 20: Frequency Distribution of Non Special Category States - Gross Fiscal Deficit/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 2	—	NCT Delhi
2 to 3	Haryana, NCT Delhi	Haryana, Orissa, Tamil Nadu, Karnataka
3 to 4	Karnataka, Tamil Nadu	Gujarat, Maharashtra , Chhattisgarh, Punjab, Andhra Pradesh
4 to 5	Andhra Pradesh, Goa, Chhattisgarh, Gujarat	Madhya Pradesh, West Bengal
Above 5	Maharashtra, Orissa , Punjab, Kerala, Uttar Pradesh, West Bengal, Jharkhand, Madhya Pradesh, Bihar, Rajasthan	Uttar Pradesh, Kerala, Rajasthan, Goa, Bihar, Jharkhand

Note : See Notes to Table 19.

all State Governments (except Bihar, Jharkhand and Haryana) in 2005-06 *vis-à-vis* 2002-05. The RD-GFD median value improved substantially from 37.5 per cent during 2002-05 to 12.7 per cent in 2005-06 (RE). However, the RD-GFD ratio of two States (Kerala and West Bengal) remained high during 2005-06 with the extent of pre-emption placed above three-fourth.

The median value of the RD-RR ratio in 2005-06 at 3.2 per cent showed marked improvement over that of 11.1 per cent in 2002-05. RD-RR ratio was high for Jharkhand, Kerala and West Bengal ranging from 18.9 to 34.9 per cent in 2005-06 compared with the States of Madhya Pradesh, Bihar and Tamil Nadu (with the ratio below 1.1 per cent).

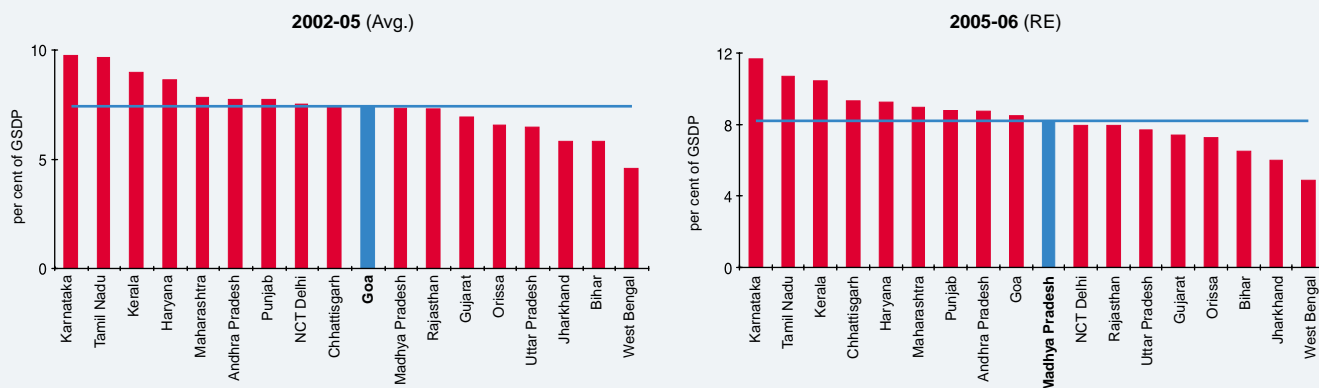
The median level for primary revenue balance as ratio to GSDP witnessed an improvement from 1.5 per cent in 2002-05 to 2.7 per cent in 2005-06. The primary revenue balance (*i.e.*, revenue deficit minus interest payments) turned out to be inadequate to meet interest payment obligations for two States (Kerala and Jharkhand) in 2005-06 as compared with three States (Uttar Pradesh, Maharashtra and Kerala) in 2002-05. Primary revenue deficit, which implies recourse by the State Governments to high cost borrowed funds to meet the interest payment obligations, is a matter of concern.

V.2.3 Revenue Performance

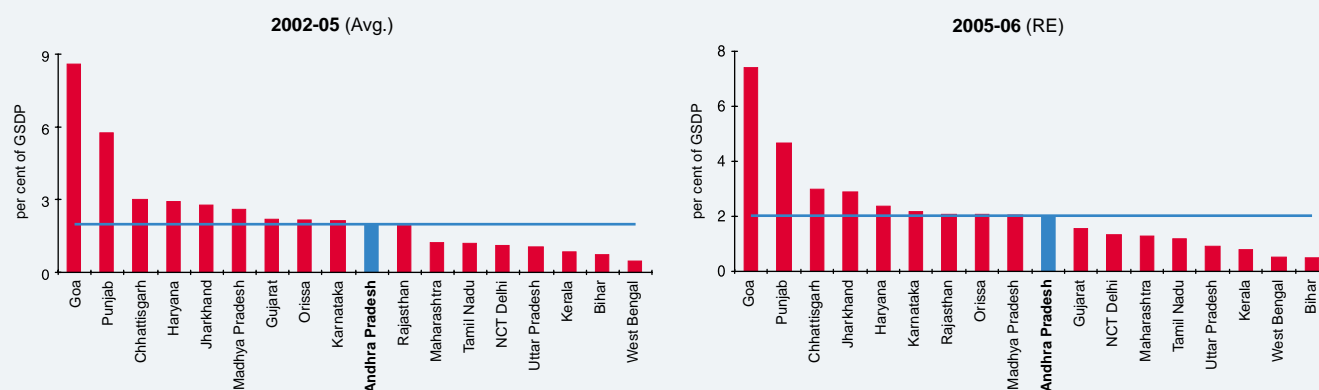
All the State Governments witnessed improvement in their own tax revenue performance (as percentage of GSDP) during 2005-06 over 2002-05 with the median value of OTR-GSDP improving from 7.4 per cent to 8.2 per cent (Chart 8-A) (also see Statements 18-23 and 25). Tamil Nadu, Karnataka and Kerala accounted for the highest OTR-GSDP ratios (more than 9.0 per cent) during both 2002-05 and 2005-06, while West Bengal, Jharkhand and Bihar occupied the lowest rungs (Table 21).

Chart 8: Revenue Performance - Non-Special Category States

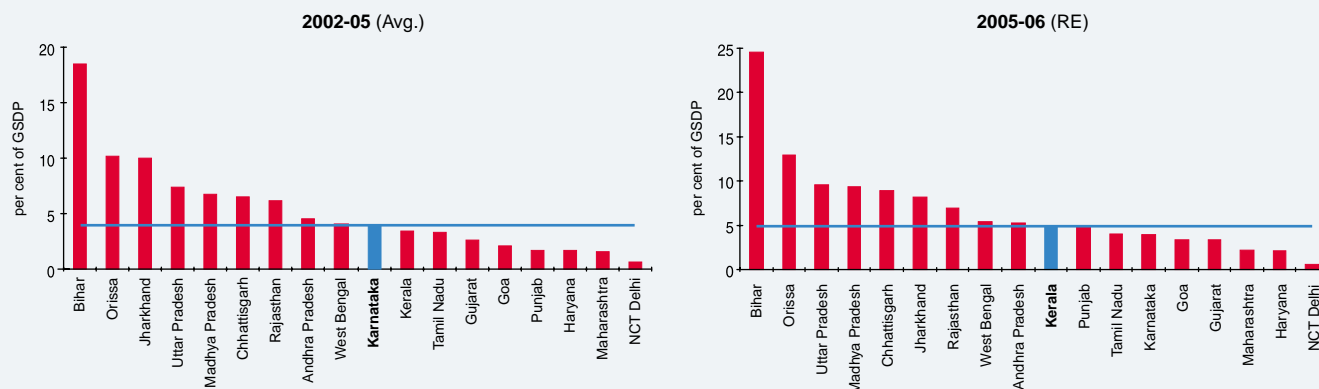
A. OWN TAX REVENUE



B. OWN NON-TAX REVENUE



C. CURRENT TRANSFERS FROM CENTRE



— Indicates the value of that indicator for the median State, which is shown in bold.

In contrast to the trends in own tax revenues, about half of the State Governments showed deterioration in own non-tax-GSDP ratio during 2005-06 over 2002-05 with the median value of non-tax-GSDP ratio remaining constant at 2.0 per cent (Chart

8-B). While Goa, Punjab and Chhattisgarh continued to occupy the highest ranks in terms of own non-tax-GSDP ratio, States like Bihar, West Bengal, Kerala and Uttar Pradesh occupied the lowest ranks. The low level of non-tax revenue has been partly due to

Table 21 : Frequency Distribution of Non-Special Category States - Own Tax Revenue/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 5	West Bengal	West Bengal
5 to 7	Bihar, Jharkhand, Uttar Pradesh, Gujarat, Orissa	Jharkhand, Bihar
7 to 9	Rajasthan, Madhya Pradesh, Goa , Chhattisgarh, NCT Delhi, Punjab, Andhra Pradesh, Maharashtra, Haryana, Kerala	Orissa, Gujarat, Rajasthan, Uttar Pradesh, NCT Delhi, Madhya Pradesh , Andhra Pradesh, Goa, Punjab, Maharashtra
Above 9	Tamil Nadu, Karnataka	Haryana, Chhattisgarh, Kerala, Tamil Nadu, Karnataka

Note : See Notes to Table 19.

low cost recovery (*i.e.*, ratio of non-tax receipts to non-Plan revenue expenditure) from sectors such as education, medical and public health and family welfare, irrigation, power and roads.

Current transfers (*i.e.*, shareable central taxes and grants-in-aid) as a ratio to GSDP were typically higher for States like Bihar, Orissa, Jharkhand and Uttar Pradesh, which had low OTR-GSDP ratios, reflecting the principle of horizontal equity in fiscal transfer (Chart 8-C).

V.2.4 Pattern of Expenditure

All States excepting Gujarat, Orissa and Delhi witnessed increase in developmental expenditure-GSDP ratio in 2005-06 over 2002-05 with the median value of DEV-GSDP rising from 12.3 to 13.2 per cent over the period (Charts 9-A). It may be mentioned that the relatively weak States such as Jharkhand, Bihar and Madhya Pradesh had the highest ranking in terms of developmental expenditure-GSDP ratio (over 15 per cent) in both the periods, whereas West Bengal and Delhi had the lowest ranking (less than 9 per cent) (Table 22).

The median value of non-developmental expenditure as ratio to GSDP remained stagnant

Table 22: Frequency Distribution of Non-Special Category States - Developmental Expenditure/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 8	West Bengal	—
8 to 12	NCT Delhi, Punjab, Maharashtra, Haryana, Tamil Nadu, Kerala, Gujarat	NCT Delhi, West Bengal, Gujarat, Maharashtra, Haryana, Punjab, Tamil Nadu, Kerala
12 to 16	Andhra Pradesh , Karnataka, Orissa, Uttar Pradesh, Rajasthan, Goa, Chhattisgarh, Madhya Pradesh	Karnataka , Orissa, Uttar Pradesh, Andhra Pradesh, Rajasthan
Above 16	Bihar, Jharkhand	Chhattisgarh, Madhya Pradesh, Goa, Jharkhand, Bihar

Note : See Notes to Table 19.

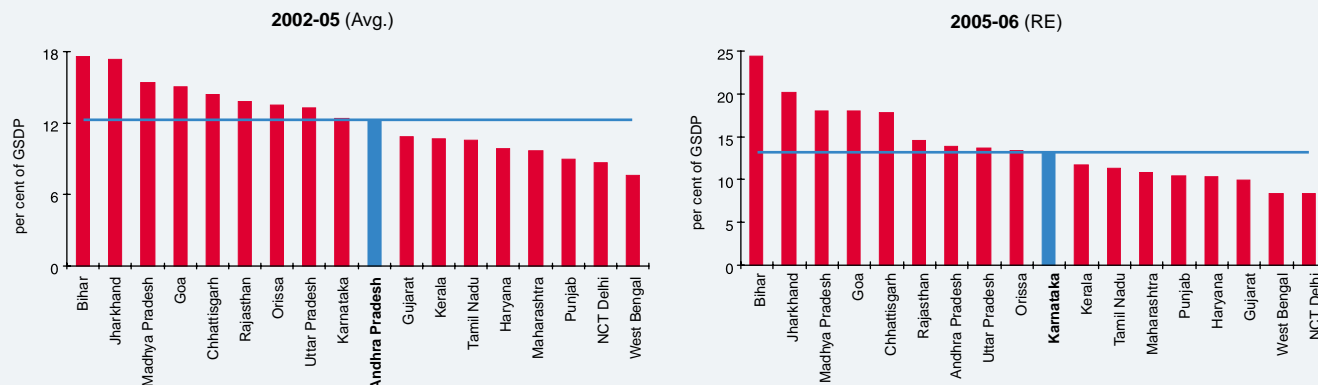
at 7.4 notwithstanding the mixed behaviour of the State Governments (Chart 9-B). The ratio of non-developmental expenditure to GSDP was highest for Orissa, Bihar and Punjab (above 10 per cent) while the ratio was lowest for Delhi (below 3.5 per cent) (also see Statements 12-16).

All States excepting Gujarat have shown improvement in respect of social sector expenditures (*i.e.*, social services, rural development, food storage and warehousing under both revenue and capital accounts) as a ratio to GSDP during 2005-06 over that of 2002-05 with the median value improving from 6.8 per cent to 7.4 per cent. Amongst all the States, Bihar, Jharkhand and Chhattisgarh continued to provide for a higher level (more than 8.8 per cent) of social sector expenditure (in terms of GSDP). On the other hand, Haryana, Delhi and Punjab continued to have lower level of social sector expenditure-GSDP ratio during both the periods (less than 5.3 per cent) (refer to section VII for a detailed discussion).

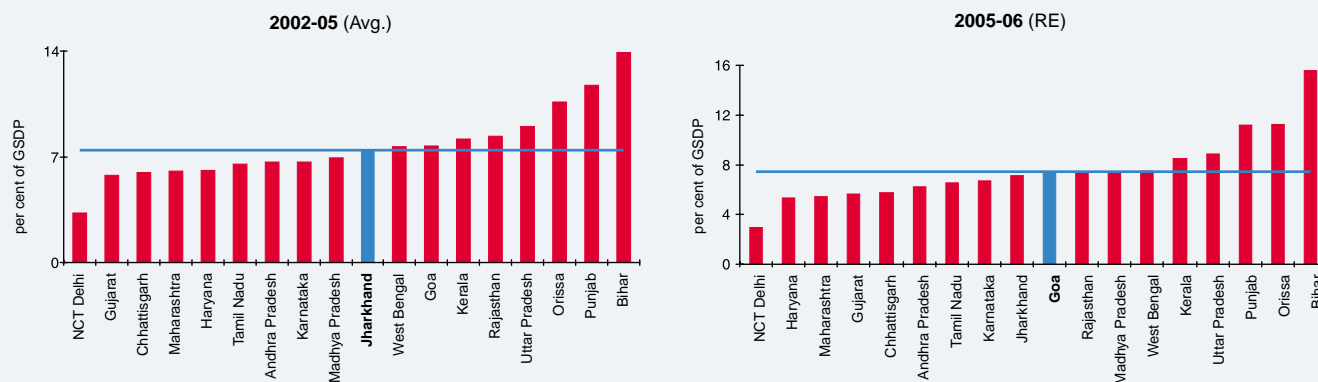
All State Governments (barring Orissa) showed an increase in the ratio of capital outlay to GSDP during 2005-06 over 2002-05 with the median value witnessing a rise from 2.0 per cent

Chart 9 : Expenditure Pattern - Non-Special Category States

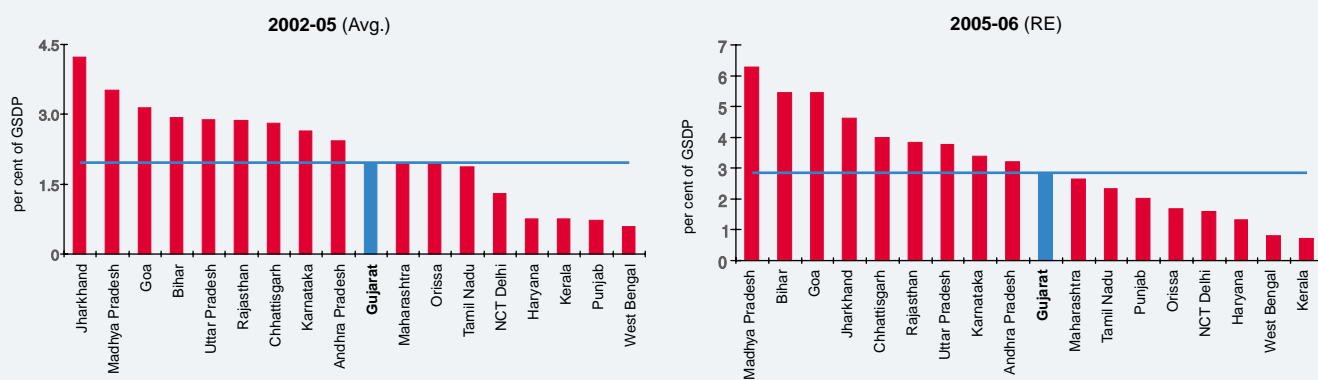
A. DEVELOPMENTAL EXPENDITURE



B. NON-DEVELOPMENTAL EXPENDITURE



C. CAPITAL OUTLAY



— Indicates the value of that indicator for the median State, which is shown in bold.

to 2.8 per cent (Chart 9-C). Madhya Pradesh, Goa, Bihar and Jharkhand continued to maintain higher proportion of capital outlay (above 2.9 per cent), while Haryana, Kerala and West Bengal continued to have lower proportion (below 1.3 per cent) (Table 23).

The proportions of expenditure (revenue and capital outlay) under education (including sports, art and culture) (Statement 42) and health (medical and public health and family welfare) (Statement 43) as percentage to aggregate expenditure have increased between 2003-04 and 2005-06, notwithstanding wide

Table 23: Frequency Distribution of Non-Special Category States - Capital Outlay/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 1	West Bengal, Punjab, Kerala, Haryana	Kerala, West Bengal
1 to 2	Gujarat , NCT Delhi, Tamil Nadu, Orissa, Maharashtra	Haryana, Orissa, NCT Delhi, Punjab
2 to 3	Andhra Pradesh, Karnataka, Bihar, Chhattisgarh, Rajasthan, Uttar Pradesh	Tamil Nadu, Maharashtra, Gujarat
3 to 4	Goa, Madhya Pradesh	Andhra Pradesh, Karnataka, Rajasthan, Uttar Pradesh, Chhattisgarh
Above 4	Jharkhand	Jharkhand, Bihar, Madhya Pradesh, Goa

Note : See Notes to Table 19.

variations across the States. In 2005-06 (RE), expenditure under education was less than 14.1 per cent (*i.e.*, average of non-special category States) of aggregate expenditure for more than half of the States (Andhra Pradesh, Chhattisgarh, Goa, Gujarat, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, West Bengal and Delhi). Similarly, expenditure under health services as ratio to aggregate expenditure was less than 4.4 per cent (*i.e.*, average of non-special category States) for more than half of the States (Andhra Pradesh, Chhattisgarh, Gujarat, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab, Tamil Nadu and West Bengal). There is an imperative need to improve the share of expenditure on education and health in aggregate expenditure for making available these social services to larger section of populace across the States (refer to section VII for a detailed discussion on social sector expenditure).

V.3. Special Category States⁹

V.3.1 Overall Position - Special Category States

Almost all the States under special category show similar performance, notwithstanding the

differences in a broad range across the fiscal indicators. Most of the States (eight out of eleven) experienced revenue surplus during 2005-06 accompanied by high GFD-GSDP ratio on account of higher capital outlays as well as developmental and social sector expenditure. Arunachal Pradesh exhibited improved fiscal performance but for its high GFD-GSDP ratio and high dependence on central transfer. Uttaranchal, the newly created State, however, showed poor performance in terms of the fiscal indicators of GFD, PD, non-developmental expenditure and debt, as ratio to GSDP.

V.3.2 Deficit Indicators

It may be noted that eight out of the eleven States in special category recorded a revenue surplus during 2005-06 as compared with seven States in 2002-05 with the median value of revenue surplus to GSDP rising from 0.9 per cent to 5.6 per cent (Table 24 & Chart 10-B). Uttaranchal had the highest RD-GSDP ratio of 1.8 per cent in 2005-06.

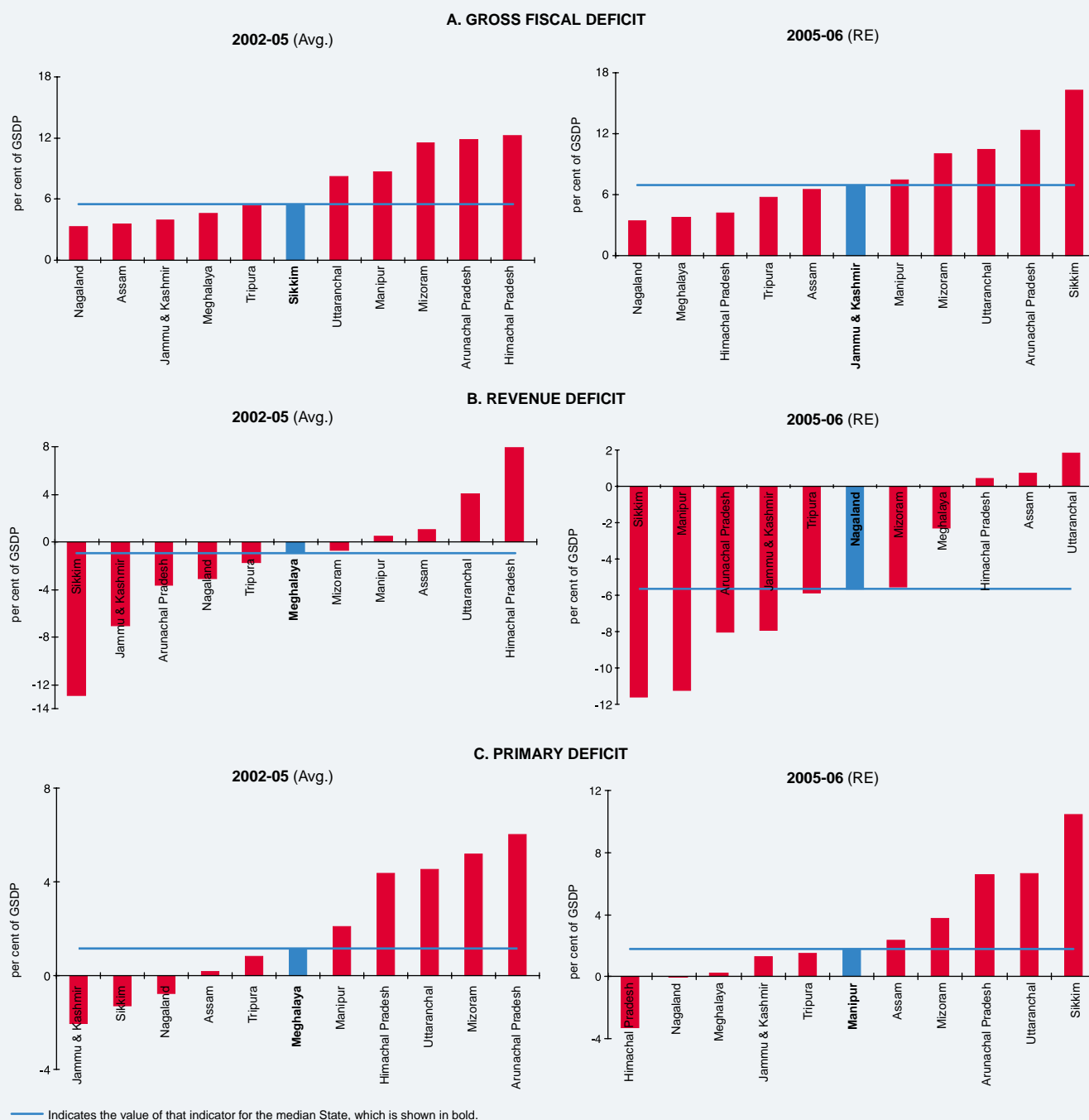
Table 24: Frequency Distribution of Special Category States - Revenue Deficit/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Revenue Surplus	Sikkim, Jammu and Kashmir, Arunachal Pradesh, Nagaland, Tripura, Meghalaya , Mizoram	Sikkim, Manipur, Arunachal Pradesh, Jammu and Kashmir, Tripura, Mizoram, Nagaland , Meghalaya
Below 0.5	—	Himachal Pradesh
0.5 to 1.0	Manipur	Assam
1.0 to 1.5	Assam	—
1.5 to 2.0	—	Uttaranchal
Above 2.0	Uttaranchal, Himachal Pradesh	—

Note : See Notes to Table 19.

⁹ 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.

Chart 10: Deficit Indicators - Special Category States



There was a general deterioration with regard to GFD-GSDP ratio with seven States recording a rise in 2005-06 compared with 2002-05 and the median value rising from 5.5 per cent to 6.9 per cent during the above period (Table 25 & Chart 10-A). The median value of PD-GSDP

ratio also deteriorated from 1.2 per cent to 1.7 per cent (Chart 10-C). In terms of GFD-GSDP ratio, Nagaland continued to be better placed in both the periods (less than 4.0 per cent) while Arunachal Pradesh continued to have high ratio (above 11.9 per cent).

Table 25: Frequency Distribution of Special Category States - Gross Fiscal Deficit/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
3 to 6	Nagaland, Assam, Jammu and Kashmir, Meghalaya, Tripura, Sikkim	Nagaland, Meghalaya, Tripura, Himachal Pradesh
6 to 9	Uttaranchal, Manipur	Assam, Jammu and Kashmir , Manipur
Above 9	Mizoram, Arunachal Pradesh, Himachal Pradesh	Uttaranchal, Arunachal Pradesh, Sikkim, Mizoram

Note : See Notes to Table 19.

The primary revenue balance (*i.e.*, revenue deficit minus interest payments), which was inadequate for two States (Himachal Pradesh and Uttaranchal) to meet interest payment obligations in 2002-05, however, improved during 2005-06.

V.3.3 Revenue Performance

The own tax revenue as ratio to GSDP, which is typically low for the special category States, showed some improvement with median value improving to 4.0 per cent in 2005-06 from 3.6 per cent during 2002-05. The ratio continued to be low in the case of Mizoram and Nagaland (less than 2 per cent) and was high for Uttaranchal and Jammu and Kashmir (above 6 per cent) in both the periods (Table 26 & Chart 11-A).

The own non-tax revenue to GSDP ratio of the special category States showed some rise in 2005-06 over 2002-05 with the median value of the ratio improving from 2.3 per cent to 2.8 per cent over the period (Chart 11-B). The ratio was exceptionally high in the case of Sikkim in both the periods, essentially reflecting the impact of State lotteries.

The current transfer and devolution from the Centre (shareable Central taxes and grants-in-aid) continued to be a dominant source of revenues for all the special category States with the median

Table 26: Frequency Distribution of Special Category States - Own Tax Revenue/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 2	Nagaland, Mizoram, Arunachal Pradesh, Manipur	Mizoram, Nagaland
2 to 4	Tripura, Meghalaya	Manipur, Tripura, Meghalaya Arunachal Pradesh
4 to 6	Assam, Himachal Pradesh	—
Above 6	Jammu and Kashmir, Sikkim, Uttaranchal	Himachal Pradesh, Assam, Sikkim, Jammu and Kashmir , Uttaranchal

Note : See Notes to Table 19.

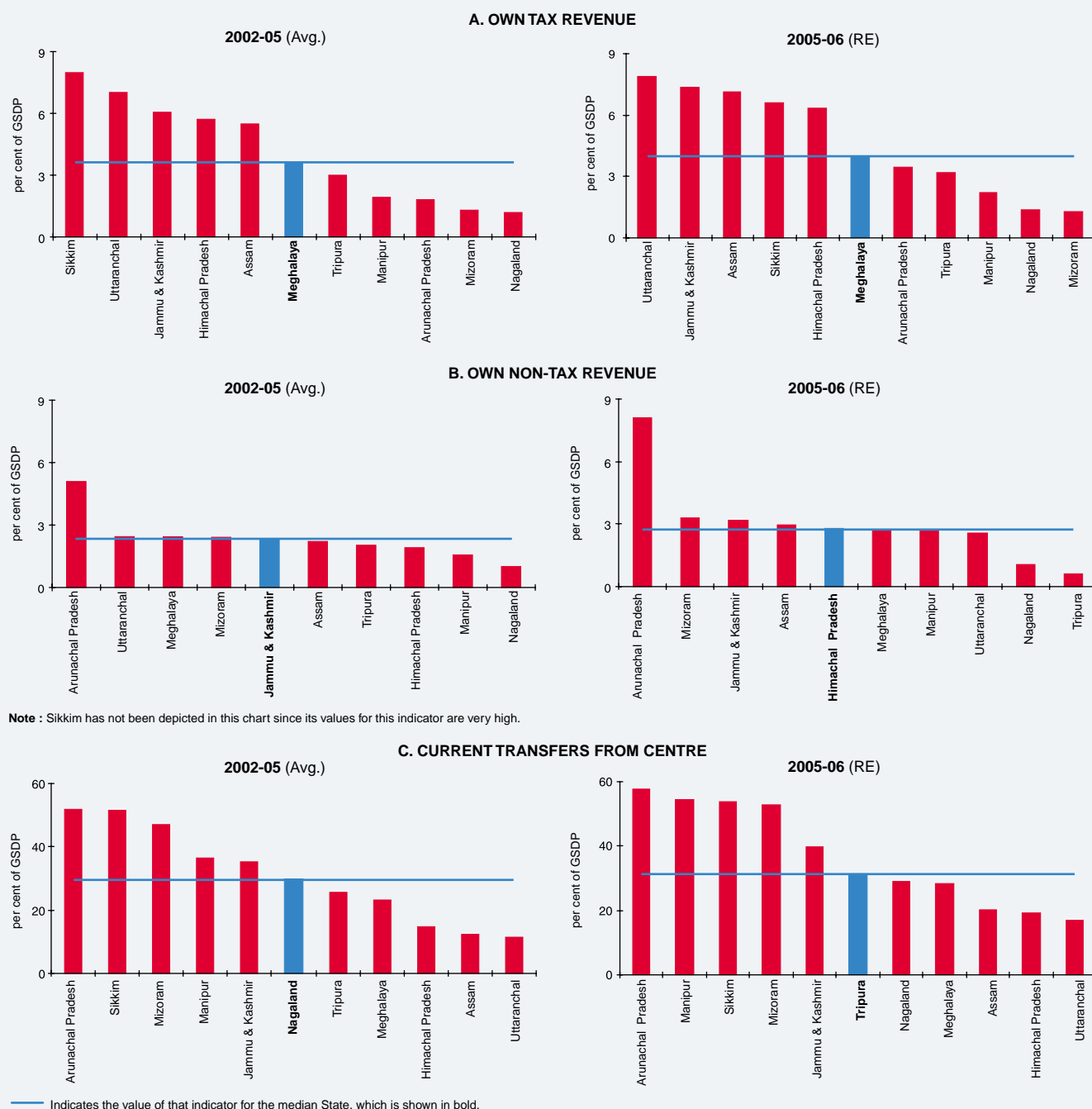
value of CT-GSDP ratio improving from 29.9 per cent during 2002-05 to 31.5 per cent in 2005-06 (Chart 11-C). The ratio of central transfer continued to be more than 50 per cent of GSDP in case of Arunachal Pradesh and Sikkim in both the periods while the ratio continued to be placed at less than 21 per cent for Assam, Himachal Pradesh and Uttaranchal.

V.3.4 Pattern of Expenditure

Ratio of developmental expenditure in GSDP in special category States was significantly higher as compared to non-special category States with the median value in respect of special category States improving significantly from 22.8 per cent during 2002-05 to 28.0 per cent in 2005-06 (Chart 12-A). Sikkim and Arunachal Pradesh continued to have this ratio above 50 per cent in 2005-06 over 2002-05 while Assam, Nagaland and Himachal Pradesh continued to have this ratio less than 26 per cent in both the period (Table 27).

The median level for non-developmental expenditure as ratio to GSDP declined from 15.4 per cent in 2002-05 to 14.4 per cent during 2005-06, indicating improvement in deployment of expenditure (Chart 12-B). Uttaranchal, Meghalaya and Assam continued to have low (below 12 per cent) non-developmental expenditure as ratio to

Chart 11: Revenue Performance - Special Category States



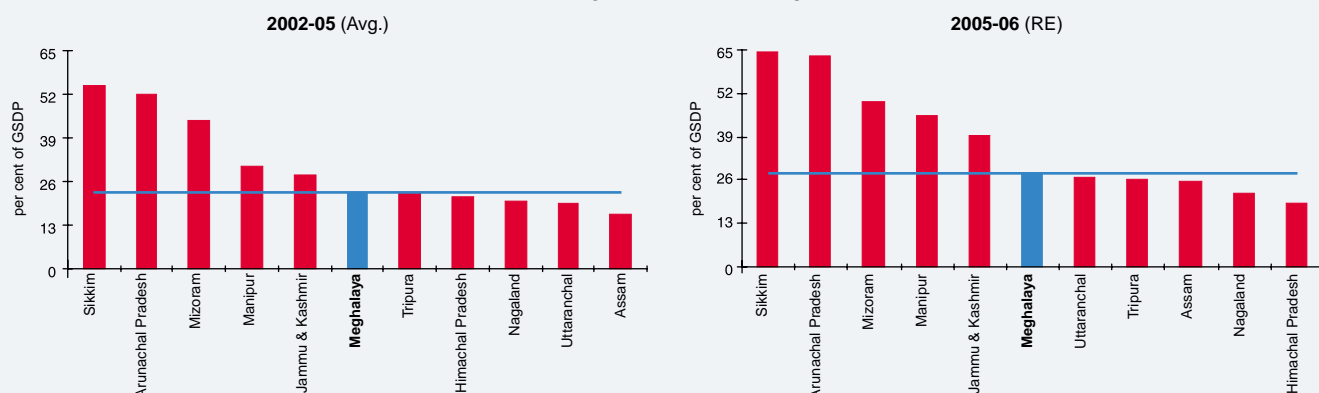
GSDP while Arunachal Pradesh and Sikkim continued to have higher ratio, during both the periods. Though, declining between 2002-05 and 2005-06, non-developmental expenditure as ratio to GSDP continues to be substantially high for Sikkim (69.3 per cent).

There was general improvement with regard to social sector expenditure in the special category States with the median value of SSE-GSDP ratio improving from 14.0 per cent during 2002-05 to 16.0 per cent in 2005-06. Arunachal Pradesh and Sikkim continued to maintain high proportion of SSE (as ratio to GSDP),

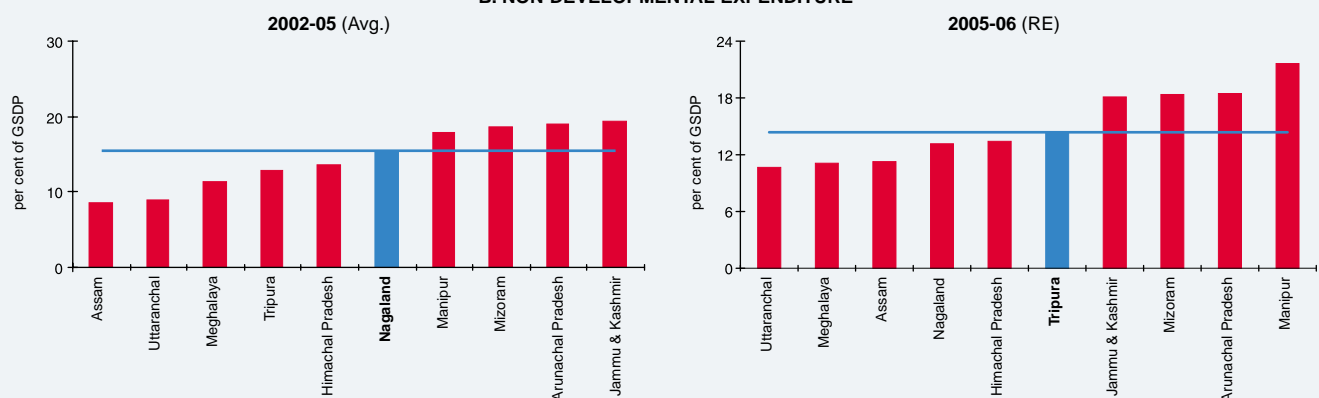
State Finances : A Study of Budgets of 2006-07

Chart 12: Expenditure Pattern - Special Category States

A. DEVELOPMENTAL EXPENDITURE

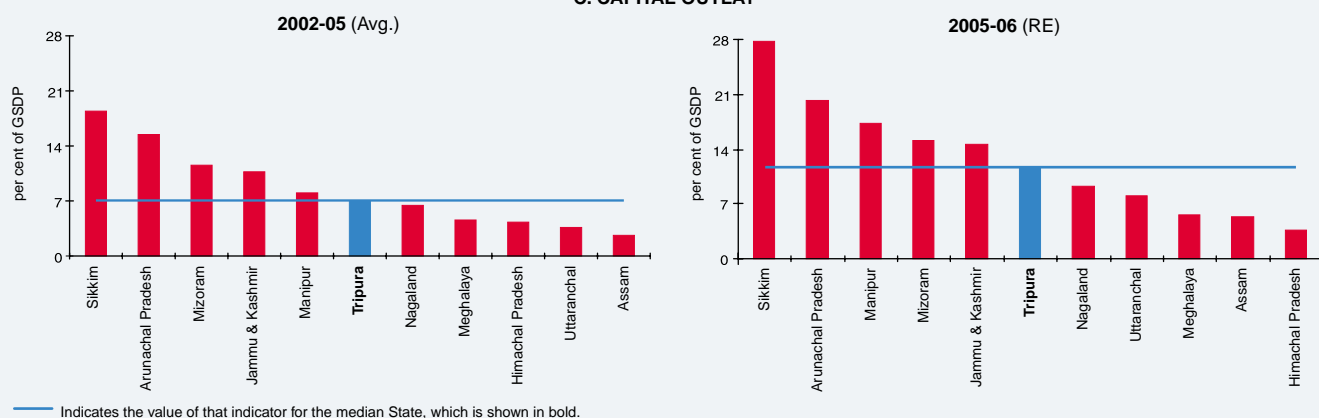


B. NON-DEVELOPMENTAL EXPENDITURE



Note : Sikkim has not been depicted in this Chart since its values for this indicator are very high.

C. CAPITAL OUTLAY



— Indicates the value of that indicator for the median State, which is shown in bold.

while Assam and Nagaland had lower proportion of SSE during both the periods (refer to section VII for a detailed discussion on social sector expenditure).

The high level of capital outlay (as a ratio to GSDP) of the special category States showed further improvement with the median level

improving significantly from 7.1 per cent during 2002-05 to 11.7 per cent in 2005-06 (Chart 12-C). While the capital outlay-GSDP ratio continued to be high in the States like Arunachal Pradesh and Sikkim, it was low in Assam and Himachal Pradesh in both the periods (Table 28).

Table 27: Frequency Distribution of Special Category States - Developmental Expenditure/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 20	Assam, Uttaranchal	Himachal Pradesh
20 to 40	Himachal Pradesh, Tripura, Meghalaya , Jammu and Kashmir, Manipur, Nagaland	Assam, Tripura, Uttaranchal, Meghalaya , Jammu and Kashmir, Nagaland
40 to 60	Mizoram, Sikkim, Arunachal Pradesh	Manipur, Mizoram
Above 60	—	Arunachal Pradesh, Sikkim

Note : See Notes to Table 19.

About half of the special category States (Arunachal Pradesh, Assam, Himachal Pradesh, Meghalaya and Sikkim) witnessed an improvement in expenditure on education (as ratio to aggregate expenditure) in 2005-06 over 2004-05 (Statement 42). This ratio was as high as 20.8 per cent for Assam in 2005-06 whereas it was as low as 9.3 per cent for Jammu and Kashmir. The ratio of expenditure on health services to aggregate expenditure improved for about half of the special category States (Assam, Manipur, Meghalaya, Tripura and Uttaranchal) in 2005-06 over 2004-05 (Statement 43). However, the ratio was maximum at 5 per cent for Meghalaya in 2005-06 and minimum at 2.6 per cent for Sikkim.

To sum up, the marked improvement in the consolidated fiscal position of the State Governments in the recent years do not reveal the wide variation in fiscal position across the States. This section has attempted to portray the State-wise position through analysis of 15 major fiscal indicators. The fiscally weak States may make efforts to catch up with the fiscally sound States. It may be mentioned that TFC has recommended a uniform fiscal restructuring plan based on targets

Table 28: Frequency Distribution of Special Category States - Capital Outlay/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 5	Assam, Himachal Pradesh, Meghalaya, Uttaranchal	Himachal Pradesh
5 to 8	Manipur , Nagaland, Tripura	Meghalaya, Assam
8 to 11	Jammu and Kashmir	Uttaranchal, Nagaland
11 to 14	Mizoram	Tripura
Above 14	Arunachal Pradesh, Sikkim	Mizoram, Jammu and Kashmir, Manipur, Arunachal Pradesh, Sikkim

Note : See Notes to Table 19.

for 15 fiscal parameters (not necessarily the same 15 indicators provided in Table 16 & 17) to be attained by all States by 2009-10.

VI. OUTSTANDING LIABILITIES, MARKET BORROWINGS AND CONTINGENT LIABILITIES OF STATE GOVERNMENTS

VI.1 Outstanding Liabilities (Debt) of State Governments¹⁰

VI.1.1 Debt Definition

With a purpose of having unanimity on the definition and composition of State Government liabilities, a Working Group on the Methodology and Compilation of State Government Liabilities was constituted as per the decision taken in the 14th Conference of State Finance Secretaries (August 2004). The members comprised of select State Finance Secretaries, representatives of Government of India, Comptroller and Auditor General of India, Controller General of Accounts, Gol, Reserve Bank of India and an academician. The Group submitted its Report in December 2005, which subsequently was placed on the Reserve Bank's website (Box 2).

¹⁰ A detailed exercise was taken up for compiling a revised and consistent data series on outstanding liabilities of State Governments starting with 1990-91, which was published in the Study of State Finances for 2005-06. The data series, further fine tuned, have been reported in this Study.

Box 2 : Report of the Working Group on Compilation of State Government Liabilities - Summary

Availability of consistent time series data on the liabilities of the Government is of particular importance as it would throw light on their debt servicing capacity. At present, there appears to be no unanimity about the exact level, composition and the methodology for compiling the liabilities of State Governments in India. Recognising the various problems associated with the database of the State Government liabilities, the Conference of State Finance Secretaries held at the Reserve Bank, in August 2004, considered and approved the proposal of constituting a Working Group on Compilation of Liabilities of the State Governments. Accordingly, a Working Group was constituted with the following terms of reference:

- Examine the extant methodologies of compilation of State Government liabilities by various agencies viz., the office of the Comptroller and Auditor General of India (CAG) / Accountant Generals (AGs) of State Governments, the Finance Commission, State Governments and the Reserve Bank of India;
- Define and delineate the composition of State Government liabilities on the basis of analytically sound principles (including coverage), international best practices and country-specific pragmatic considerations;
- Evolve a Model Compilation Methodology for State Government Liabilities in a phased manner; and
- Make recommendations on the mechanism and institutional arrangements for data collection and dissemination of State Government liabilities on a regular and timely basis.

The Working Group submitted its Report in December 2005 and was placed on the Reserve Bank's website in October 2006.

The major recommendations of the Committee are as follows:

- It has been proposed that debt and liabilities be considered synonymous. Accordingly, all borrowings which are repayable and on which interest accrues are recommended to be considered as debt.
- The Group recommended that withdrawal of cash balances may continue to be taken as a financing item of GFD. Cash balances, in any case, do not form part of liabilities. 'Remittances', 'Suspense and Miscellaneous', 'Appropriation to Contingency Fund' and 'Decrease in Cash Balance' would be excluded from liabilities but shown as 'Memo Items' with a view to maintaining consistency between the definitions of GFD and liabilities. Inter-State Settlement would also be excluded from liabilities, but may not be shown as a memo item, since the amounts reported under this head are usually not very significant.
- Contingent liabilities may be excluded from the formal definition of liabilities. In order to incorporate this dimension, however, the Group recommends the reporting of these liabilities on an annual basis under a separate head.
- For ensuring the consistency in the data, it is desirable that a single agency compiles and disseminates the information on outstanding liabilities of all the States.
- Although the State Governments are the most reliable sources of such information, the task cannot be fully entrusted to them unless it becomes an obligatory part of the State Budget documents. The Government of India, RBI and other institutions could help the States in creating necessary capacity, systems and processes and acquiring technology to compile data on liabilities. RBI can then act as a single agency putting estimates of liabilities of all States together in a single publication, as it does for the State Budgets.

The State Governments would publish in their budget documents the information on the State Government liabilities under the following Statements:

- (1) Budgetary Liabilities of State Government (outstanding at end-March) and their break-up. This Statement would have four Annexes providing details of:
 - a) Open Market Borrowings
 - b) Loans from the Centre
 - c) Details of borrowings from banks/financial institutions
 - d) Special Securities issued to NSSF
- (2) Details of Guarantees given by the State Governments (GASAB Format)
- (3) Assessed Fiscal Risk of State Government Guarantees
- (4) Off-Budget Borrowings of State Governments
- (5) Liabilities of State Government Public Sector Undertakings
- (6) Other Implicit Liabilities of State Governments (including pension liabilities).

It has been proposed that all the data relating to the liabilities of State Governments may be published in the budget documents of the respective State Governments. The State Governments should also bring out quarterly, if not monthly reports on their accounts and liabilities. The CAG may also compile and publish the audited data on liabilities in addition to the Finance Accounts of the States. The Group, however, suggests that the non-availability of audited data should not delay the reporting of data on liabilities as per the 'accounts' (un-audited), revised estimates and budget estimates of the latest years. In order to facilitate the process of data compilation, the Group recommended the following:

- RBI will provide the data on outstanding market borrowings to the State Governments.
- The Central Government may provide the details regarding the loans from Centre to the State Governments as also Special Securities issued by the States to NSSF.
- The data on borrowings from banks and financial institutions and any other such transactions may be provided by the State Governments.
- Till such time that the State Governments are not in a position to publish the requisite data on their outstanding liabilities in their budget documents, all the above data may be furnished by the concerned institutions to the RBI, as a transitional measure, to enable consolidation and publication.

The liabilities details would be provided in the budget documents by the State Governments in the Statement suggested by the Group. The outstanding data is to be provided as of end- March for two years with Accounts figures, one year with Revised Estimates and one year with Budget Estimates for the following items.

I. CONSOLIDATED FUND

1. Public Debt
 - a. Open Market Borrowings (Net SLR based market borrowings)
 - b. Borrowings from Banks and FIs/Negotiated Loans
 - c. Special Securities issued to NSSF
 - d. Bonds/Debentures which are issued by the State Government
 - e. Loans from the Centre (net)
 - i) Plan
 - ii) Non-Plan
 - f. Others (Specify)*
2. WMA & Overdrafts from RBI or any other bank
 - a. WMA
 - b. OD

II. PUBLIC ACCOUNT

1. State Provident Funds
2. Small Savings, Insurance and Pension Funds, Trust and Endowments, etc.
3. Other Items in Public Accounts

of which:

 - a. Deposits
 - i) Bearing Interest
 - ii) Not bearing interest
 - b. Reserve Funds/Sinking Fund
 - i) Bearing Interest
 - ii) Not bearing interest

III. CONTINGENCY FUND

IV. TOTAL LIABILITIES (I+II+III)

V. Memo Items

1. Remittances
2. Suspense and Miscellaneous
3. Appropriation to Contingency Fund
4. Decrease in Cash Balance

@ : It may be noted that 'Accounts' data are un-audited.

* : This should include liabilities of SPVs in respect of which it is *a priori* indicated that the repayment and/or interest payment would be met by the State Government from the provisions in its budget. This could also include the risk-weighted component of guaranteed liabilities of the State Government.

Source : Report of the Working Group on Compilation of State Government Liabilities (2005), RBI (Convenor: Dr. Narendra Jadhav).

VI.1.2 Magnitude of Debt

The large and increasing GFD of States, particularly since the latter half of the 1990s, has led to steady accumulation in the outstanding debt of State Governments. Nevertheless, the level of debt in terms of both growth and GDP witnessed a downward trend in the recent years (Table 29).

The outstanding liability as at end-March 1991 was placed at Rs.1,28,155 crore (or 22.5 per cent of GDP). The debt-GDP ratio, which was at a low of 21.1 per cent as at end 1997, rose sharply to 33.5 per cent as at end-March 2004 but declined thereafter. The outstanding liabilities of State Governments are budgeted at Rs.12,58,672 crore as at end-March 2007 with the debt-GDP ratio placed at 31.8 per cent (also see Appendix Tables 20 & 21).

Table 29: Outstanding Liabilities of State Governments
(as at end-March)

(Rs.crore)

Years	Outstanding Liabilities		
	Amount	Annual Growth (per cent)	Debt /GDP (per cent)
1	2	3	4
1991	128,155		22.5
1992	147,030	14.7	22.5
1993	168,365	14.5	22.5
1994	187,992	11.7	21.9
1995	217,100	15.5	21.4
1996	250,889	15.6	21.1
1997	288,103	14.8	21.1
1998	333,897	15.9	21.9
1999	403,364	20.8	23.2
2000	515,877	27.9	26.3
2001	602,072	16.7	28.6
2002	700,524	16.4	30.7
2003	798,921	14.0	32.6
2004	923,500	15.6	33.5
2005	1,042,305	12.9	33.4
2006 (RE)	1,152,652	10.6	32.6
2007 (BE)	1,258,672	9.2	31.8

Sources : 1. Budget Documents of State Governments.
2. Combined Finance & Revenue Accounts of the Union and State Governments in India, CAG, Government of India.
3. Reserve Bank records.

The servicing of debt at about one-third of GDP has been pre-empting significant proportion of the States' revenue receipts. With the concern for the sustainability of this high level of debt, State Governments in their FRLs have placed limits to the level of debt to be achieved within a stipulated timeframe. The TFC has also recommended for 30.8 per cent of debt as ratio to GDP to be achieved by the States by end-March 2010 from the viewpoint of ensuring debt sustainability in the medium-term. Furthermore, the TFC has recommended an overall cap to borrowings (3 per cent of GSDP) to be achieved by the State Governments by end of 2009-10. The TFC has also recommended that ratio of interest payments to revenue receipts at 15 per cent to be achieved by 2009-10.

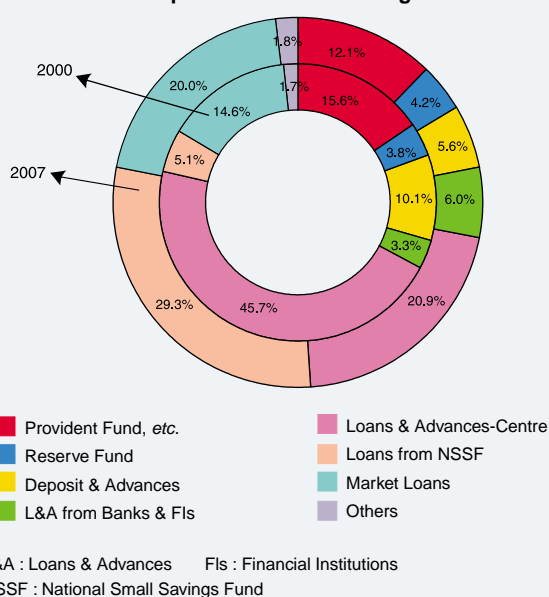
VI.1.3 Composition of Debt

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 loans from banks and other institutions. Significantly, reserve funds and deposits and advances have constituted over 10 per cent in the last few years. Loans from NSSF would remain the dominant component (29.3 per cent) during 2006-07 (BE), followed by loans from the Centre (20.9 per cent) and market borrowings (20.0 per cent). Other important sources for debt have been small savings, State provident funds, etc. (12.1 per cent) and loans from Banks and Financial Institutions (6.0 per cent) (Chart 13).

The broad composition of outstanding debt is indicated in Table 30. The detailed composition of consolidated outstanding liabilities of the State Governments from 1990-91 to 2006-07 (BE) are set out in Appendix Tables 20 and 21 while the State-wise composition of outstanding liabilities are provided in Statements 26-28.

It may be mentioned that the budget documents of the State Governments do not

Chart 13: Composition of Outstanding Liabilities



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). This is particularly evident in the case of negotiated loans from banks and financial institutions. Consequently, in-depth analysis of the debt position of the State Governments remains circumscribed.

VI.2. Market Borrowings

VI.2.1 Consolidated Position

The State Governments issue dated securities of varying tenures that are mostly subscribed by the banks and financial institutions. The share of market borrowings in the aggregate outstanding liabilities of State Governments gradually moved up from 14.6 per cent at end-March 2000 to 20.5 per cent at end-March 2005 (Table 30). Following the implementation of the recommendations of the TFC, no provision is now being made in the Union Budget in respect of Central loans for State Plans from 2005-06 and States are required to access the market to raise resources for their Plan programmes. The share of market borrowings of the State Governments in their total debt declined to around 20 per cent in 2005-06 and budgeted to remain at that level during 2006-07.

The share of high cost market loans of State Governments declined further during 2005-06. As at end-March 2006, the share of outstanding stock with interest rate of 10 per cent and above declined to 32.2 per cent from 37.3 per cent as at end-March 2005 (Table 31).

Table 30: Composition of Outstanding Liabilities of State Governments
(as at end-March)

(per cent to total)

Items	1991	2000	2004	2005	2006	2007
1	2	3	4	5	6	7
1. Internal Debt	15.0	24.5	46.5	51.4	54.7	57.1
of which						
(i) Market Loans	12.2	14.6	19.4	20.5	19.9	20.0
(ii) Special Securities issued to NSSF	—	5.1	18.2	22.6	26.9	29.3
(iii) Loans from Banks & FIs	2.0	3.3	6.6	6.0	5.9	6.0
2. Loans and Advances from the Centre	57.4	45.7	29.0	24.6	22.4	20.9
3. Public Accounts (i to iii)	26.9	29.5	24.5	24.1	22.7	21.9
(i) Small Savings, State PF, etc.	13.2	15.6	13.3	12.7	12.3	12.1
(ii) Reserve Funds	3.7	3.8	4.2	4.4	4.2	4.2
(iii) Deposits & Advances	10.0	10.1	7.0	7.0	6.2	5.6
4. Contingency Fund	0.8	0.3	—	—	—	—

‘—’ : Nil/Negligible/Not applicable.

Source : Same as Table 29.

Table 31: Interest Rate Profile of the Outstanding Stock of State Government Securities
(as at end-March)

(Rs. crore)

Range of Interest Rate	Outstanding Amount		Percentage to Total	
	2005	2006	2005	2006
1	2	3	4	5
5.00-5.99	33,825	33,825	15.8	14.8
6.00-6.99	58,563	58,563	27.4	25.6
7.00-7.99	27,872	49,601	13.1	21.7
8.00-8.99	8,004	8,004	3.7	3.5
9.00-9.99	5,412	5,412	2.5	2.4
10.00-10.99	14,563	14,563	6.8	6.4
11.00-11.99	17,062	17,062	8.0	7.5
12.00-12.99	26,146	26,146	12.2	11.4
13.00-13.99	15,722	15,722	7.4	6.9
14.00	6,274	0	2.9	0.0
Total	213,443	228,898	100.0	100.0

Source : As per Reserve Bank records.

VI.2.2 Allocation of Market Borrowings during 2006-07

The net allocations of market borrowings to the State Governments, as per Reserve Bank

records, have increased since 2002-03 (Table 32 and Statement 29). Additional allocations have, however, witnessed a sharp decline over this period. The net allocation under market borrowing

Table 32: Market Borrowings of State Governments

(Rs. crore)

Items	2002-03	2003-04	2004-05	2005-06	2006-07*
1	2	3	4	5	6
1. Net Allocation	12,722	12,767	13,969	16,112	17,242
2. Additional Allocation	6,422	4,893	3,236	3,522	44
3. Allocation under DSS	10,000	29,000	19,766	-	-
4. Total (1+2+3)	29,144	46,660	36,970	19,634	17,286
5. Repayments	1,789	4,145	5,123	6,274	6,551
6. Gross Allocation (4+5)	30,933	50,805	42,093	25,909	23,837
7. Amount raised under DSS	10,000	26,623	16,943	-	-
8. Amount raised to prepay RIDF loans	-	-	1,386	-	-
9. Total Amount Raised	30,853	50,521	39,101	21,729	11,026
Tap Issues	27,880	47,626	38,216	11,186	-
Auctions	2,973	2,895	885	10,543	11,026
	(13)	(8)	(3)	(24)	(20)
10. Net Amount Raised (9-5)	29,064	46,376	33,978	15,455	4,475
11. Net Amount Raised (other than DSS) (10-7)	19,064	19,753	17,035	15,455	4,475
12. Net Amount Raised (other than DSS & RIDF) (11-8)	19,064	19,753	15,649	15,455	4,475
Memo Items					
i. Coupon/Cut-off Yield Range (%)	6.60-8.00	5.78-6.40	5.60-7.36	7.32-7.85	7.65-8.66
ii. Weighted Average Interest Rate (%)	7.49	6.13	6.45	7.63	8.00
iii. Average Maturity (in years)	10.00	10.05	10.01	10.00	10.00

DSS : Debt Swap Scheme. '-' : Nil/Not Applicable * : Amount raised up to November 17, 2006.

Notes : 1. Figures in brackets represent number of States opted 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.

programme for State Governments is placed at Rs.17,286 crore during 2006-07. Taking into account repayments of Rs.6,551 crore, the gross allocation amounts to Rs.23,837 crore, showing a decline of 8 per cent over the previous year. During 2006-07 (up to November 17, 2006), the States have raised market loans amounting to Rs.11,026 crore (or 46.2 per cent of gross allocation) through auctions with a cut-off rate in the range 7.65-8.66 per cent (Appendix Table 10). The weighted average interest rate on market loans which had declined since the mid-1990s up to 2003-04, firmed up to 8.0 per cent during 2006-07 (up to November 17, 2006) (Table 33). The rise in yields was in line with that of Central Government securities and reflected general upward movement in interest rates.

The preference for auction route by the States to raise market loans increased during 2005-06 (24 States) and 2006-07 (20 States up to November 17, 2006). Furthermore, the

proportion of market loans raised through auction was nearly half in 2005-06 while in 2006-07 State Governments resorted to auction only. The increased recourse to auctions during 2005-06 and 2006-07 (up to November 17, 2006) indicated improved market perception of States' fiscal situation (Box 3).

VI.2.3 State-wise Debt Position

The detailed State-wise component-wise break-up of outstanding liabilities from 1990-91 to 2006-07 (BE) are provided in Statements 26-28. It may be mentioned that the outstanding liabilities as on end-March 2000 of the 3 bifurcated States (Bihar, Madhya Pradesh and Uttar Pradesh) have been apportioned to the 3 newly formed States (Jharkhand, Chhattisgarh and Uttaranchal), respectively on the basis of their respective population proportions. The States (non-special and special) have been grouped by their debt-GSDP and IP-RR ratios to give their relative positions and provided in Annex 3A-D.

Non-Special Category States

The median value of debt-GSDP ratio rose from 39.4 per cent during 2002-05 to 44.4 per cent at end-March 2006 reflecting the rise in indebtedness of several States (Chart 14A). While State like Haryana, Karnataka and Tamil Nadu and NCT Delhi continued to have relative lower debt-GSDP ratios (below 30.5 per cent) during 2002-05 and 2005-06, States like Bihar, Orissa and Uttar Pradesh had the ratio at higher than 55 per cent during both periods (Table 34).

The extent of pre-emption of revenue receipts by interest payments (IP/RR), one of the indicators of debt sustainability, showed improvement with its median value declining sharply from 24.8 per cent during 2002-05 to 19.0 per cent in 2005-06 (Chart 14B). The ratio was relatively low for Jharkhand, Karnataka and Chhattisgarh in both the periods, while it was high

Table 33: Weighted Average Yield of State Government Securities

(per cent)

Years	Range	Weighted Average	Gross Amount (Rs. crore)
1	2	3	4
1990-91	11.50	11.50	2,569
1991-92	11.50-12.00	11.82	3,364
1992-93	13.00	13.00	3,805
1993-94	13.50	13.50	4,145
1994-95	12.50	12.50	5,123
1995-96	14.00	14.00	6,274
1996-97	13.75-13.85	13.83	6,536
1997-98	12.30-13.05	12.82	7,749
1998-99	12.15-12.50	12.35	12,114
1999-00	11.00-12.25	11.89	13,706
2000-01	10.50-12.00	10.99	13,300
2001-02	7.80-10.53	9.20	18,707
2002-03	6.60-8.00	7.49	30,853
2003-04	5.78-6.40	6.13	50,521
2004-05	5.60-7.36	6.45	39,101
2005-06	7.32-7.85	7.63	21,729
2006-07*	7.65-8.66	8.00	11,026

*: Up to November 17, 2006.

Source : As per Reserve Bank records.

Box 3 : Market Borrowings of State Governments: Recent Developments and Future Challenges

There are certain major developments in recent years with regard to market borrowings (referred to as State Development Loans) of the State Governments as follows:

Following the recommendations of the TFC, Central loans for State Plan Schemes were eliminated during 2005-06, requiring the State Governments to enter the markets for their borrowing requirements thereby exposing them to greater market discipline. The Reserve Bank's Annual Policy Statement had drawn attention to the likely impact of the recommendations of the TFC on the borrowing arrangements for the State Governments. In the 16th Conference of State Finance Secretaries convened on April 8, 2005 to specifically discuss the recommendations of the TFC, the necessity to strengthen the joint approach among the Centre, State and the Reserve Bank to ensure a smooth transition to the proposed arrangement was noted. Subsequently, in July 2005, the Government of India constituted a Technical Group (Chairperson: Smt. Shyamala Gopinath) comprising members from the Centre, select State Governments and the Reserve Bank to work out the modalities for a smooth transition to the proposed arrangement for States' borrowings. The Group submitted its Report to the Government of India on December 22, 2005. On the basis of the recommendations of the Group, the Annual Policy Statement for 2006-07 proposed to constitute a Standing Technical Committee (STC) under the aegis of the State Finance Secretaries Conference with representation from the Central and State Governments and the Reserve Bank to advise on the wide-ranging issues relating to the borrowing programmes of Central and State Governments through a consensual and cooperative approach.

The Annual Policy Statement issued in April 2006 had proposed to (i) encourage States to progressively increase the share of market borrowings under the auction route with a view to covering the entire borrowings through auctions as early as possible; and (ii) encourage the States at their discretion and initiative to develop an advance indicative borrowing calendar. These issues are being discussed with the States and steps are being taken to evolve a concrete action plan.

There is negligible level of secondary market liquidity in State Government securities, which could be attributed to certain interrelated factors such as (i) low level of outstanding stock resulting in an even lower level of floating stock, (ii) predominance of buy-and-hold investors, (iii) disconnect between the uniform coupon fixed in respect of States participating in a tap issue with their corresponding secondary market yields, and (iv) fragmentation across issuers (28 States) and securities (each State issuing up to eight new securities in a year). To address these issues, one Working Group on Liquidity of State Government Securities (Chairman: Shri V.K.Sharma), which submitted its Report in September 2006. The Working Group explored the following options to build up volumes to ensure a critical minimum mass for secondary market liquidity: (i) increase in issue size; (ii) consolidation of securities; (iii) higher share of open market borrowings in financing of fiscal deficit; and (iv) securitisation of outstanding State Government securities. While considering these options, the Group felt that the issue size could be raised by limiting the number of issues. Second, passive consolidation of securities through reissuances of existing securities would involve bunching of repayments and reduction in the maturity profile. Third, an increase in the share of open market borrowings would depend, *inter alia*, on fiscal reform measures to boost investor

confidence. Fourth, the outstanding stock of State Government securities could be consolidated through the securitisation route whereby the assets would be assigned to a special purpose vehicle (SPV) against which securities would be issued to the new investors. Drawing from the recommendations of the Group and with a view to widening the investor base in State Development Loans (SDLs), the Annual Policy Statement for 2006-07 (April 2006) proposed the following action points:

- to extend the facility of non-competitive bidding (currently limited to Central Government securities) to the primary auction of SDLs.
- to introduce purchase and resale of SDLs by the Reserve Bank under the overnight LAF repo operations.

Reflecting the ongoing fiscal correction and consolidation process, GFD of the State Governments have been moderating in recent years thereby containing the pressure for funds. Furthermore, the financing pattern of the GFD of the State Governments continued to reflect the predominance and buoyancy of small savings (Securities issued to National Small Savings Fund), an 'autonomous' source of funds, which helped to reduce the need for accessing alternative market resources. It may be mentioned that nine States (*viz.*, Bihar, Goa, Gujarat, Karnataka, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and West Bengal) did not raise the entire allocated amount of gross market borrowings during 2005-06 while Chattisgarh did not participate in the market borrowing programme during the year, mainly reflecting the build up their cash surplus balances.

The States are increasingly showing preference to borrow through the auction route, raising as much as 48.4 per cent of their total borrowings through auctions during 2005-06 (only 2.3 per cent in 2004-05). Twenty-four States opted for the auction route under market borrowing programme during 2005-06 as compared with only three States in the previous year. This trend also continued during 2006-07. The increased recourse to auctions indicates to improved market perceptions of States' fiscal situation as reflected in the lower spread of cut off yields of auctions *vis-a-vis* the tap issues (20-50 basis points in auctions as against 50 basis points in tap issues) over Central Government securities of comparable maturities.

Future Issues and Options

Certain improvements in market borrowing programmes of the State Governments which may be considered are as follows:

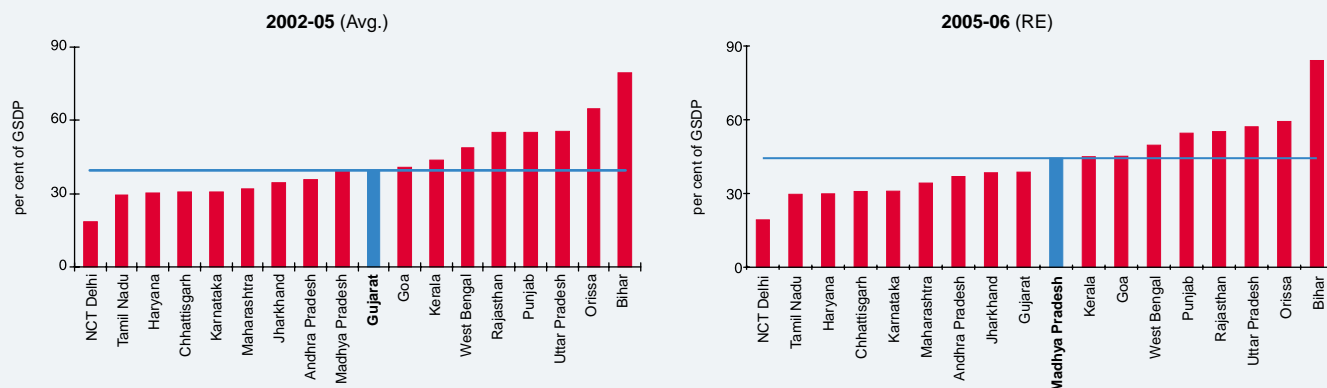
- With a view to providing assured subscription to the State Governments concerned, underwriting for primary issues of SDLs may be considered.
- To encourage auction for market borrowings of State Governments, 'Indicative Calendar' for market borrowings of the States may be introduced.
- With a view to reducing high interest cost, a buy-back scheme of high coupon SDLs (say 10 per cent and above) may be considered. The presently available cash surplus of the State Governments may be utilised for the buy-back scheme.
- With a view to providing liquidity, the secondary market for SDLs needs to be developed.

Source : Annual Report, 2005-06, Reserve Bank of India.

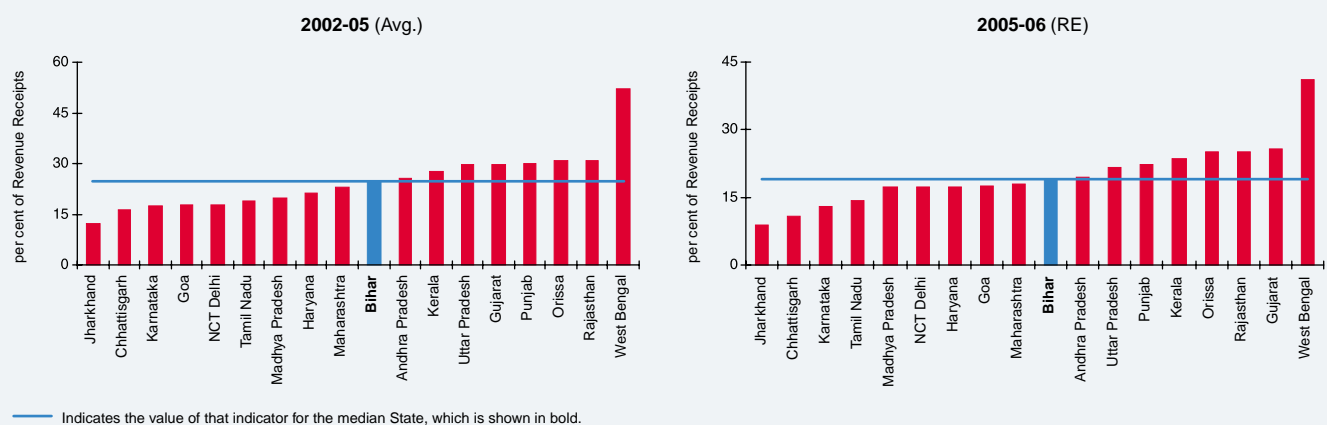
State Finances : A Study of Budgets of 2006-07

Chart 14: Outstanding Liabilities - Non-Special Category States

A. OUTSTANDING LIABILITIES (DEBT)



B. INTEREST PAYMENTS



— Indicates the value of that indicator for the median State, which is shown in bold.

Table 34: Frequency Distribution of Non-Special Category States - Debt/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 30	NCT Delhi, Tamil Nadu	NCT Delhi, Tamil Nadu, Haryana
30 to 50	Karnataka, Haryana, Chhattisgarh, Maharashtra, Jharkhand, Andhra Pradesh, Gujarat , Goa, Madhya Pradesh, Kerala, West Bengal	Maharashtra, Chhattisgarh, Karnataka, Andhra Pradesh, Jharkhand, Gujarat, Madhya Pradesh , Kerala, Goa, West Bengal
50 to 70	Rajasthan, Punjab, Uttar Pradesh, Orissa	Punjab, Rajasthan, Uttar Pradesh, Orissa
Above 70	Bihar	Bihar

Note : See Notes to Table 19.

for Rajasthan, Orissa and West Bengal (Table 35) (also see Statement 17). The decline in the IP/

RR ratio reflects to a large extent the decline in interest payments owing to the debt swap scheme (DSS).

In the context of debt sustainability, TFC has emphasised the need for fiscal discipline on the part of the States and suggested that the overall borrowing programme of a State should be within a prescribed limit, determined annually, taking into account borrowing from all sources. The State Governments are gradually putting in place institutional mechanisms to contain the level of debt and also bring it to the sustainable level by way of enactment of FRLs, introduction of guarantee ceilings, setting up of Sinking Funds and Guarantee Redemption Funds. The State with high levels of debt may consider adopting appropriate reform measures as there may be a vicious circle of deficit,

Table 35: Frequency Distribution of Non-Special Category States - Interest Payments/ Revenue Receipts

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 15	Jharkhand	Jharkhand Chhattisgarh, Tamil Nadu, Karnataka
15 to 30	Chhattisgarh, Karnataka, Goa, NCT Delhi, Tamil Nadu, Haryana, Madhya Pradesh, Maharashtra, Bihar , Andhra Pradesh, Uttar Pradesh, Kerala, Gujarat	Madhya Pradesh, NCT Delhi, Goa, Haryana, Maharashtra, Bihar , Andhra Pradesh, Uttar Pradesh, Punjab, Kerala, Orissa, Gujarat, Rajasthan
30 to 45	Punjab, Orissa, Rajasthan	West Bengal
Above 45	West Bengal	-

Note : See Notes to Table 19.

debt and interest payments arising from high cost of debt servicing.

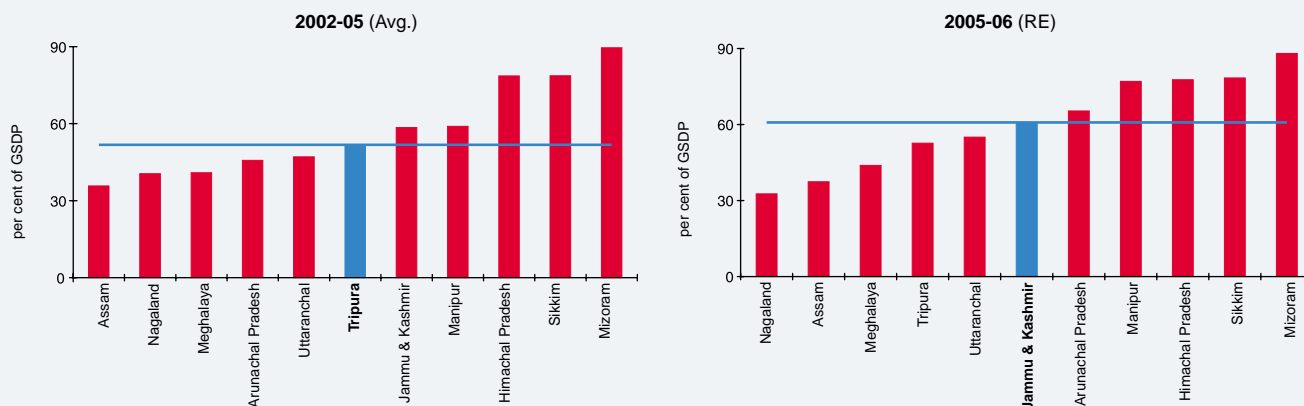
Special Category States

Wide variation across the special category States has been noticed in debt-GSDP ratio with a rise in the median value of the debt-GSDP ratio from 51.8 per cent during 2002-05 to 60.8 per cent during 2005-06 (Charts 15A). Sikkim, Mizoram and Himachal Pradesh continued to have high level of debt-GSDP ratio in 2005-06 and 2002-05 while Assam, Nagaland and Meghalaya continued to have this ratio at relatively low level during the above period (Table 36).

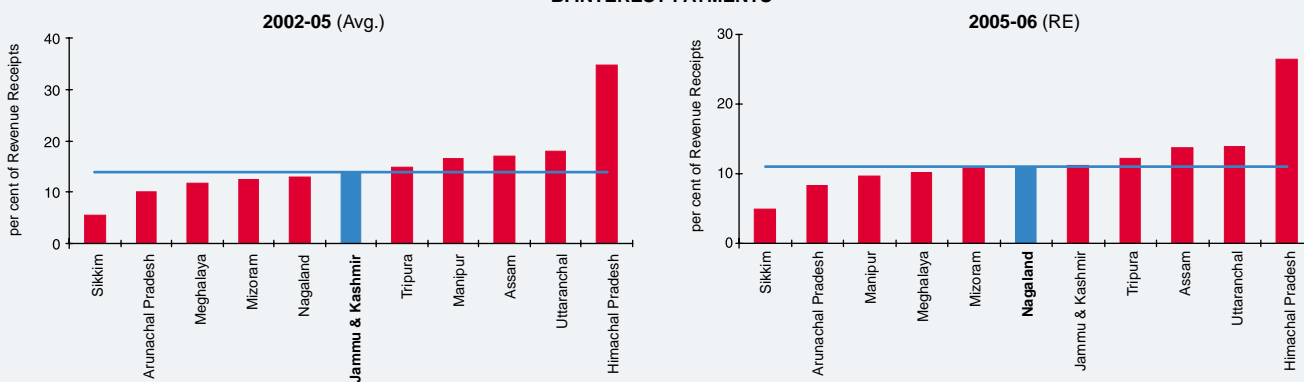
The median level for IP/RR declined from 13.8 per cent during 2005-06 to 11.0 per cent in 2005-06 (Chart 15B). The debt burden (IP/RR) for all special category States [except for Himachal Pradesh (26.4 per cent)] was below 15 per cent, the target set by the TFC to be achieved by end-2009-10. During 2005-06, Sikkim, Arunachal

Chart 15: Outstanding Liabilities - Special Category States

A. OUTSTANDING LIABILITIES (DEBT)



B. INTEREST PAYMENTS



— Indicates the value of that indicator for the median State, which is shown in bold.

Table 36: Frequency Distribution of Special Category States - Debt/GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 40	Assam	Assam, Nagaland
40 to 50	Meghalaya, Uttaranchal, Nagaland, Arunachal Pradesh	Meghalaya
50 to 60	Tripura, Jammu and Kashmir, Manipur	Tripura, Uttaranchal
Above 60	Sikkim, Himachal Pradesh, Mizoram	Jammu and Kashmir, Arunachal Pradesh, Manipur, Sikkim, Himachal Pradesh, Mizoram

Note : See Notes to Table 19.

Pradesh and Manipur had IP-RR ratio at below 10 per cent level (Table 37).

VI.3 Liquidity Position and Cash Management

Based on the recommendations of the Bezbaruah Committee, a revised WMA Scheme for State Governments was put in place for 2006-07 with effect from April 1, 2006. Accordingly, the aggregate Normal WMA limit was increased by 10.5 per cent to Rs.9,875 crore for the year 2006-07 (Table 38). The interest rate on WMA for 2006-07 has been linked to the LAF repo rate as against the Bank Rate earlier.

Table 37: Frequency Distribution of Special Category States - Interest Payments/ Revenue Receipts

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 10	Sikkim	Sikkim, Arunachal Pradesh, Manipur
10 to 15	Arunachal Pradesh, Meghalaya, Mizoram, Nagaland, Jammu and Kashmir, Tripura	Meghalaya, Mizoram, Nagaland, Jammu and Kashmir, Tripura, Assam, Uttaranchal
15 to 20	Manipur, Assam, Uttaranchal	-
Above 20	Himachal Pradesh	Himachal Pradesh

Note : See Notes to Table 19.

Table 38: Normal WMA Limits - 1996 to 2006

(Rs. crore)

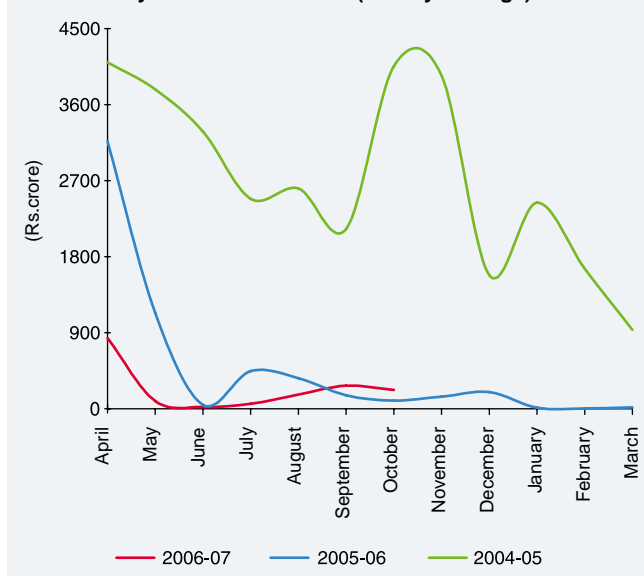
Period	Amount	Increase over earlier limits (per cent)
1	2	3
(i) August 1996 to February 1999	2,234	100.0
(ii) March 1999 to January 2001	3,941	76.4
(iii) February 2001 to March 2002	5,283	34.1
(iv) April 2002 to March 2, 2003	6,035	14.2
(v) March 3, 2003 to March 31, 2004	7,170	18.8
(vi) April 1, 2004 to March 31, 2005	8,140	13.5
(vii) April 1, 2005 to March 31, 2006	8,935	9.8
(viii) April 1, 2006 to till date	9,875	10.5

Source : As per Reserve Bank records.

During 2005-06, the average utilisation of normal WMA, special WMA and overdrafts by the States remained substantially lower reflecting an improvement in their overall cash position. There was a reduction in the number of States that availed normal WMA during 2005-06 (12 States as compared with 21 States in 2004-05). This reflected a change mainly on account of the provision under the revised Scheme that special WMA should be availed before taking recourse to normal WMA. The special WMA facility is linked to the investment in Government of India securities by the State Governments. The rate of interest charged on special WMA was one percentage point less than that on normal WMA. Higher mobilisation of Small Savings and enhanced market borrowings also facilitated the reduction in recourse to normal WMA. Similarly, there was a reduction in the number of the State Governments (8 States as compared with 13 States in 2004-05) availing overdraft during 2005-06 (Statement 39).

The liquidity position of the States has remained comfortable during 2006-07 (up to October 31, 2006). The weekly average utilisation of WMA and overdraft by the States at Rs.239 crore during 2006-07 (up to October 31, 2006) was substantially lower than that of Rs.772 crore in the corresponding period of the previous year

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



(Chart 16). During 2006-07 (up to November 16, 2006), six States availed of WMA for a period of 2-141 days, of which two States resorted to overdraft for a period of 15 and 29 days (Statement 39). The lower utilisation of WMA reflects persistent cash surplus with State Governments.

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. Data on Centre's (gross) WMA to the State Governments, as reported in the budget documents of the State Governments, during 2000-01 to 2006-07 (BE) are set out in Statement 40. The total amount of such advances has consistently declined from Rs.3,329 crore in 2002-03 (12 States) to Rs.500 crore in 2005-06 (RE) (3 States) and further budgeted to decline to Rs.450 crore in 2006-07 (2 States). Among the special category States, these advances are budgeted for Nagaland while Kerala has budgeted for such advances among the non-special category States during 2006-07. This probably reflects their anticipation of continued short-term (liquidity) pressures on their budgets.

VI.4 Contingent Liabilities

State Governments have been issuing guarantees and letters of comfort on behalf of PSUs and other institutions to facilitate them to raise resources to meet the requirements of the public investment. This is primarily because the States are budget constrained to provide the required resources for such investments.

The outstanding guarantees of State Governments increased from Rs.1,32,029 crore (6.7 per cent of GDP) as at end-March 2000 to Rs.2,14,149 crore (or 7.8 per cent of GDP) as at end-March 2004 (Table 39 & Statement 44). 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. In view of the fiscal implication of rising level of guarantees, many States have taken initiatives to place ceilings (statutory or administrative) on guarantees either through FRLs or otherwise and are also in the process of setting up Guarantee Redemption Funds through earmarked guarantee fees as recommended by the TFC.

Table 39: Outstanding Guarantees of State Governments

(Rs. crore)

Years	Amount	Percentage of GDP
1	2	3
1991-92	40,158	6.1
1992-93	42,515	5.7
1993-94	48,865	5.7
1994-95	48,479	4.8
1995-96	52,631	4.4
1996-97	65,339	4.8
1997-98	73,751	4.8
1998-99	79,457	4.6
1999-00	132,029	6.7
2000-01	168,719	8.0
2001-02	165,386	7.2
2002-03 (P)	184,294	7.5
2003-04 (P)	219,658	8.0
2004-05 (P)	204,426	6.5

P : Provisional

Source : Information received from 17 major State Governments and Budget Documents of State Governments.

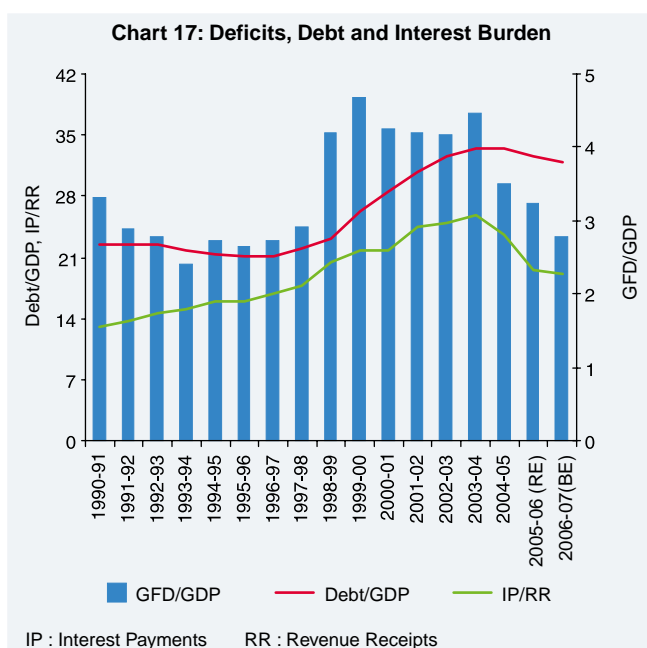
VI.5 Assessment of Debt Position of State Governments

An assessment of the debt position of State Governments depends not only on the absolute level of its outstanding liability but also the various indicators which determine the sustainability of the debt.

VI.5.1 Interest Payments

The ratio of interest payments to revenue receipts of the State Governments, which is an important indicator of debt sustainability, deteriorated sharply from 13.0 per cent in 1990-91 to a high level of 25.8 per cent in 2003-04, but declined thereafter largely due to the DSS (2002-03 to 2004-05). It is budgeted at 19.1 per cent during 2006-07. This ratio is required to be gradually brought down to 15 per cent by all the States by end of the terminal year (2009-10) of the award period of the TFC as per its suggested restructuring path for State finances. The high burden of interest payments tends to widen the revenue deficit and in turn, the GFD. Consequently, a vicious circle of deficit, debt and interest payments gets created in the State finances (Chart 17).

The deceleration in the growth of debt in recent years is the manifestation of the efforts of



the State Governments towards containing RD and consequently, GFD. The debt relief provided by the Centre to the States has facilitated in reining in the debt level in recent years. Furthermore, the recommendations of TFC for debt relief has reinforced this process. The impact of the array of initiatives taken by the State and Central Governments including recent debt swap scheme (*i.e.*, to prepay high cost debt to the Centre) is evident from the reduction in the average interest rate of the outstanding debt of the State Governments from the peak level of 11.2 per cent in 1999-2000 to 10.2 per cent in 2003-04 and is budgeted at 8.6 per cent for 2006-07 (Table 40).

The international experience on debt management by sub-national Governments in Australia is briefly discussed in Box 4.

VI.5.2 Maturity Profile of State Government Securities

In terms of maturity profile of the outstanding stock of State Governments securities, about 44 per cent of the outstanding stock of State

Table 40: Average Interest Rate on Outstanding Liabilities of State Governments

(per cent)	
Years	Average Interest Rate*
1	2
1991-92	8.5
1992-93	9.0
1993-94	9.4
1994-95	10.3
1995-96	10.1
1996-97	10.2
1997-98	10.5
1998-99	10.7
1999-00	11.2
2000-01	10.0
2001-02	10.4
2002-03	10.0
2003-04	10.2
2004-05	9.5
2005-06 (RE)	8.5
2006-07 (BE)	8.6

* : Worked out by dividing interest payments of the current year by outstanding liabilities of the previous year.

Source : Same as Table 29.

Box 4 : Debt Management by Sub-National Governments in Australia

Australia has a federal structure of Government and follow a unique system for management of debt of the provincial Governments. The Australian Loan Council was created in 1923, and was provided with legislative and the constitutional backing through the Financial Agreement Validation Act in 1929. It consists of one member from the Commonwealth Government and one member from each of the State Governments. Up to 1984, the States borrowed through the Commonwealth Government, but thereafter, States were allowed to raise their own finance under global limits established by the Loans Council. The Council discusses the global debt limits of each States and monitor compliance with such limits. Monitoring is done through a before and after analysis of outstanding debts. These limits were abandoned in the early 90s in the face of successful attempt by the States to subvert them through new financing techniques. State Borrowings was characterised by attempts to elude debt limit by resorting to off-budget operations, innovative financing techniques, and through borrowings from the State-owned enterprises. Therefore, the loan council, in 1993, decided to shift its focus to prior analysis and subsequent monitoring of the net financing requirements of each State. It requires the States to present detailed projections of their yearly budgetary operations to show developments in their finances. To strengthen market discipline on State borrowings, the Council facilitates the collection and timely dissemination of this information. Presently the Loan Council arrangement emphasises transparency of public sector financing rather than the adherence to strict borrowing limits.

With loosening of the central controls over State borrowings, individual States have strengthened their fiscal management. A new body created in the late 1980s, the Council of Australian Governments, has taken a number of important initiatives as follows:

- Agreement on a standard format for presenting income, expenditure, deficits, financial assets, debt and unfunded liabilities in State budget papers.
- Adoption of a National Competition Policy whereby State Governments agreed to review all legislations covering their

commercial activities so as to eliminate anti-competitive practices.

- Cooperation of publishing performance indicators on all public enterprises and major Government agencies in two sets of national publications.

In Australia, the Australian Debt Council determines the total public debt and the distribution between the different Government levels, but in practice market mechanisms operate. The seven provincial Treasury Corporation of Australia are vested with the responsibility of providing funding, cash management and financial risk management to the State Governments. Their primary responsibilities include:

- Sourcing the States' long term debt funding requirements in the most cost effective manner,
- Providing financial risk management services and advice to the State and its public sector organisations, and
- Investing the States' short to medium-term cash surplus with the aim of maximising returns within a conservative risk management framework.

In addition to the above, the Treasury Corporations extend the following services:

- Providing access to professional skills and resources, on a cost recovery basis, for identifying and managing financial risks on a consistent basis.
- Acting as a central store of knowledge and expertise on financial structures and transactions, and the risks and benefits they encompass.
- Providing independent advice on matters of financial and commercial policy and financial and commercial risks relating to the States and its entities.
- Working as a conduit between the Government and private sector.

Source : Treasury Corporations of Australia's Provinces.

Government securities as at end-March 2006, belonged to the maturity bracket of 4-8 years, while 21 per cent are under 0-4 per cent bracket and 35 per cent are above 8 per cent bracket (Table 41).

The maturity profile of market borrowings shows a hump in repayments during 2012-13 to 2015-16 due to high amount of borrowings during 2002-03 to 2004-05 under the debt swap scheme (Table 42) (also see Statements 35-36). The State-wise and scrip-wise details of outstanding market loans are presented in Statements 33 and 34.

An issue that has a bearing on the liquidity management by the State Governments relates to their surplus cash balance. The large build up of

surplus cash balances by the State Governments was reflected in the spurt in their investments in 14-day Intermediate Treasury Bills during the recent years. During 2005-06, the monthly investments in 14-day Intermediate Treasury Bills averaged more than thrice (Rs.35,028 crore) their levels in the previous year (Rs.10,561 crore). The outstanding investments increased from Rs.14,314 crore (by 16 States) as at end-March 2005 to Rs.38,983 crore (by 24 States) as at end-March 2006 (Statement 41) and further to Rs.39,610 crore (25 States as on November 16, 2006). The weekly average investment by the States in the 14-day Treasury Bills during 2006-07 (up to October 31, 2006) amounted to Rs.41,219 crore, considerably higher

Table 41: Maturity Profile of Outstanding State Government Securities

(as at end-March 2006)

States	Per cent to Total Amount Outstanding		
	0 - 4 years	4 – 8 years	above 8 years
1	2	3	4
1. Andhra Pradesh	25.4	47.6	27.0
2. Arunachal Pradesh	10.8	35.6	53.5
3. Assam	22.8	40.9	36.2
4. Bihar	22.5	44.3	33.3
5. Chattisgarh	24.3	43.2	32.5
6. Goa	22.2	43.9	33.8
7. Gujarat	18.2	53.6	28.2
8. Haryana	19.6	43.5	36.9
9. Himachal Pradesh	12.7	47.8	39.5
10. Jammu&Kashmir	15.3	53.6	31.1
11. Jharkhand	23.2	46.3	30.6
12. Karnataka	21.6	45.7	32.7
13. Kerala	22.8	41.2	36.0
14. Madhya Pradesh	21.8	39.4	38.7
15. Maharashtra	15.7	42.0	42.3
16. Manipur	17.2	27.6	55.2
17. Meghalaya	24.1	32.6	43.2
18. Mizoram	16.6	37.8	45.6
19. Nagaland	23.2	40.3	36.4
20. Orissa	27.4	42.4	30.2
21. Punjab	18.5	43.1	38.4
22. Rajasthan	24.9	45.0	30.1
23. Sikkim	33.1	20.1	46.8
24. Tamil Nadu	19.6	47.1	33.3
25. Tripura	20.9	31.9	47.1
26. Uttar Pradesh	27.4	39.0	33.6
27. Uttaranchal	10.5	52.1	37.5
28. West Bengal	15.8	43.2	41.0
All States (1 to 28)	21.4	44.0	34.6

Source : Same as Table 31.

than that of Rs.30,081 crore in the corresponding period of the previous year (Chart 18).

Yet another issue that has a bearing on the liquidity management by the State Governments relates to their negative opening cash balance. A large number of State Governments (9 special category and 11 non-special category) have recorded a negative opening cash balance in the budget estimates for 2006-07, varying between (-) Rs 4 crore (West Bengal) and (-) Rs.1,659 crore (Jammu and Kashmir). Many of these State Governments had recorded negative opening cash

Table 42: Maturity Profile of Outstanding State Loans and Power Bonds

(as at end-March 2006)

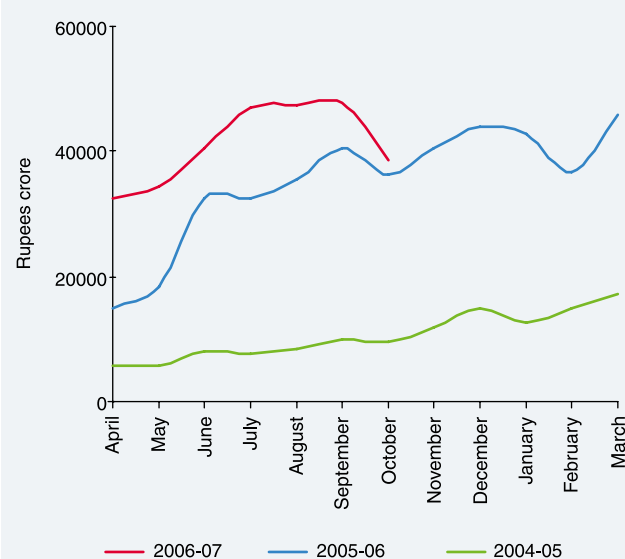
(Rs. crore)

Years	State Loans	Power Bonds	Total
1	2	3	4
2006-07	6,551	1,579	8,130
2007-08	11,555	3,158	14,713
2008-09	14,400	3,158	17,558
2009-10	16,511	3,158	19,669
2010-11	15,870	3,158	19,028
2011-12	22,032	3,158	25,190
2012-13	30,628	3,158	33,786
2013-14	32,078	3,158	35,236
2014-15	33,384	3,158	36,542
2015-16	35,191	3,158	38,349
2016-17	10,698	1,579	12,277
Total	228,898	31,581	260,479

Source : As per Reserve Bank records.

balance in the past as well. An opening cash deficit signifies *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.

Chart 18: Investments in 14-day Intermediate Treasury Bills by State Governments (Weekly Average)



VI.5.3 State Governments' Debt and TFC - Consolidation and Waiver

The Second Finance Commission was the first to address the issue of State debt while from the Sixth Commission onwards State debt has been a terms of reference. With an estimate of the States' debt position, the TFC has recommended targets on two of such indicators viz.; the ratios of IP-RR and debt-GDP. The targets to be achieved by 2009-10 for IP-RR is 15.0 per cent and debt-GDP being 30.8 per cent. The TFC has also put forward a debt relief package for the State Governments consisting of two components viz., (i) a general scheme of debt relief applicable to all States and (ii) a write-off scheme linked to fiscal performance with a view

to providing an incentive for achievement of revenue balance by 2008-09. Loans given to States from NSSF have been excluded from the scope of debt relief since the Fund is maintained in the Public Account. Under the general scheme of debt relief, all Central loans to the States contracted till March 31, 2004 and outstanding on March 31, 2005 (amounting to Rs.1,28,795 crore) would be consolidated and the interest rate thereon would be fixed at 7.5 per cent along with a uniform tenor of 20 years. This will be subject to the States enacting FRL. The debt relief during the award period for all States works out to Rs.21,276 crore in interest payments and Rs.11,929 crore in repayments (Table 43).

Table 43: Outstanding, Repayment and Debt Relief of Loans from Centre

(Rs.crore)

States	Outstanding Balance on 31.03.2004	Total Repayment Due From 2005 to 2010	Debt Relief (2005-2010)	
			Repayment	Interest
1	2	3	4	5
1. Andhra Pradesh	18,545.00	4,573.93	739.64	2,683.74
2. Arunachal Pradesh	409.40	117.37	19.98	71.73
3. Assam	2,939.83	1,032.57	507.62	153.87
4. Bihar	10,181.29	2,546.47	620.45	1,268.27
5. Chhattisgarh	2,748.11	716.35	146.03	393.77
6. Goa	585.56	171.19	39.06	94.66
7. Gujarat	14,037.04	3,465.13	849.15	1,840.02
8. Haryana	3,627.74	839.73	258.30	387.67
9. Himachal Pradesh	1,777.37	275.94	69.88	134.79
10. Jammu & Kashmir	2,697.73	635.22	161.38	264.02
11. Jharkhand	3,052.48	864.43	204.94	454.49
12. Karnataka	10,555.40	2,510.86	431.32	1,529.43
13. Kerala	5,517.28	1,442.19	379.14	715.03
14. Madhya Pradesh	8,977.66	2,491.76	616.66	1,310.98
15. Maharashtra	16,166.55	3,086.34	1,133.12	1,217.39
16. Manipur	777.11	480.68	292.14	27.26
17. Meghalaya	356.65	95.08	14.82	56.49
18. Mizoram	290.56	75.16	7.31	50.54
19. Nagaland	341.33	101.50	21.35	56.06
20. Orissa	8,965.24	2,624.14	872.85	1,008.43
21. Punjab	5,396.83	1,114.90	351.48	523.18
22. Rajasthan	9,605.40	2,446.16	737.77	962.25
23. Sikkim	208.45	58.76	10.69	33.96
24. Tamil Nadu	9,180.55	2,406.84	688.67	1,195.47
25. Tripura	555.96	142.29	24.77	123.97
26. Uttar Pradesh	27,407.35	6,138.16	1,553.04	3,132.68
27. Uttaranchal	308.17	61.89	-10.13	37.70
28. West Bengal	19,056.02	3,612.55	1,187.48	1,547.81
Total (1 to 28)	184,268.06	44,127.60	11,928.91	21,275.65

Source : Report of the Twelfth Finance Commission.

Under the debt write-off scheme, repayments due from 2005-06 to 2009-10 on loans from the Centre contracted upto March 31, 2004 and recommended to be consolidated and rescheduled as above, will be eligible for write-off subject to the quantum of write-off of repayment being linked to the absolute amount by which the revenue deficit is reduced in each successive year during the award period and fiscal deficit of the State being contained at the level of 2004-05. The enactment of FRL would be a necessary pre-condition for availing the debt relief under this scheme also, with the benefit accruing prospectively.

The relief that would be available to the 19 State Governments during 2005-06 based on the

recommendation of TFC is Rs.5,787 crore, of which the interest component would be Rs.4,459 crore and the remaining would be the relief for principal¹¹. It may be added that debt waiver till end-July 2006 has been Rs.3,245 crore which was given to 9 State Governments (Statements 47-48).

VII. SOCIAL SECTOR EXPENDITURE¹²

VII.1 Significance of Social Sector Expenditure

The important role played by Government social sector expenditure (SSE) in channeling the economic growth to human development is well documented in the literature (Box 5).

Box 5 : Government Social Sector Expenditure, Economic Growth and Human Development - Theory and Evidence

The theoretical underpinnings of the relationship between economic growth and human development are well documented in the literature (United Nations Development Programme (UNDP), 1990, Anand & Ravallion, 1993, Ghosh, 2006). Economic growth can have a positive impact on human development through three different channels: (i) through an increase in the general level of per capita income; (ii) through poverty reduction; and (iii) through higher public expenditure on education, health and related sectors. It is expected that an increase in the general level of per capita income is likely to increase the demand for education and health care, and may improve the human development of a country. Secondly, economic growth associated with poverty reduction may enable the poorer sections of the population to enjoy the fruits of growth and thus, may have a better impact on the human development indicators. In any economy it is the poorer sections of population who are more deprived of human development elements. The third channel through which the growth can improve human development is through the increased public expenditure on social sectors. Economic growth by increasing the revenue base of the economy may enable the State to spend more on the social sectors. Obviously, this is dependent both on the buoyancy of revenue collection resulting in a softening of the State budget constraint and on the political willingness to allocate proportionately for the social sectors. Thus, if the economic growth is to have a positive impact on human development, it would be required to have appropriate policies aimed at reducing income inequalities and higher public social sector expenditure and conversely, if the economic growth is to be sustainable in the long run it has to be supported by better human capital (UNDP, 1990).

In an economy, economic growth may be affecting the human development through all the three channels. However, there are

studies which have reiterated the importance of public expenditure channel over and above the trickling down channel of economic growth in improving human development. A cross-country study by looking into the relative importance of growth channel and public expenditure channel in improving life expectancy finds that public expenditure on health care contributed two-third of the improvement in life expectancy and economic growth through poverty reduction contributed only one-third (Anand & Ravallion, 1993). However, in the case of literacy, the study did not get any concrete evidence in favour of public expenditure on education. Moreover, there are countries like Sri Lanka, which achieved relatively higher human development despite being a developing country. The supported policies followed in Sri Lanka through higher public expenditure on social sectors are widely acknowledged in the literature (Dreze & Sen, 1989). An inter-State study on India also reveals that while the disparities in per capita income among the States are increasing, the disparities in social development are coming down, pointing to the importance of public social sector expenditure in achieving human development (Ghosh, 2006).

References:

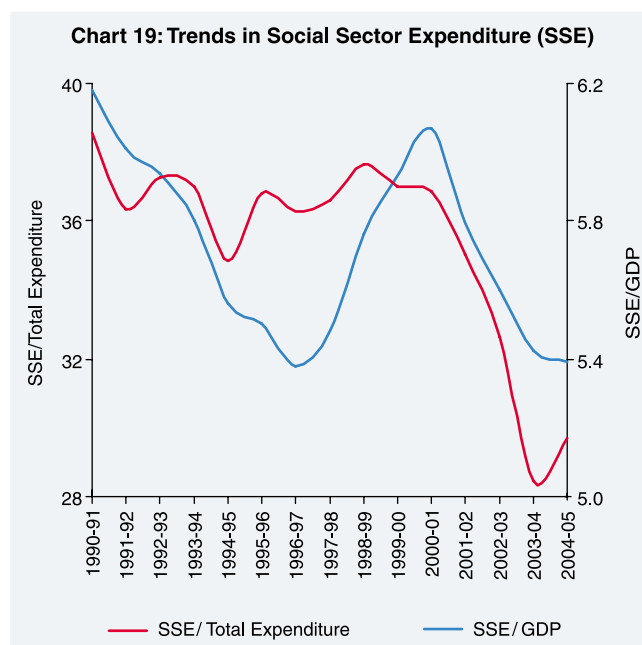
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2. Dreze, J. & Sen, A. K. (1989), "Hunger and Public Action" Oxford University Press, New York.
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4. UNDP (1990), Human Development Report.

¹¹ As per information received from Ministry of Finance, Government of India.

¹² The Social Sector Expenditure (SSE) includes expenditure on social services, rural development and food storage and warehousing under revenue expenditure, capital outlay and loans and advances by the State Governments.

VII.2 Social Sector Expenditure - Aggregate Position

In India, the primary responsibility of social sector expenditure lies with the State Governments. The States' social sector expenditure averaged 5.8 per cent of GDP during the 1990s but with a marginal decline in the current decade. The States' total expenditure, as ratio to GDP, averaged 15.6 per cent during the 1990s and increased thereafter. Fiscal priority to social sectors defined as the ratio of SSE to total expenditure, on an average, has been nearly 37 per cent during the 1990s. This ratio has shown a declining trend since 1998-99 to reach 29.7 per cent in 2004-05 (Table 44 and Chart 19). The per capita expenditure on the social sector, however, has shown almost a three fold increase during the period 1990-91 to 2000-01, from Rs.420 to Rs.1,244. There is little consensus in the literature regarding the optimum size of SSE in an economy. It depends, *inter alia*, on the level of human development, population and the stage in the development of social infrastructure. Nevertheless, UNDP in its Human Development Report (1991) provides minimum target expenditure ratios (minimum target for total expenditure to GDP is 0.25, SSE to total expenditure is 0.4, expenditure on basic social services¹³ to SSE is 0.5 and expenditure on basic social services to GDP is 0.05) related to social sector which is expected to benefit the human development aspect in an economy. Notwithstanding, the robustness of such targets, a



comparison of these targets shows that the level of SSE is comparatively low in India.

VII.3 Social Sector Expenditure - Composition

In terms of composition of SSE, during 1990-2005, revenue expenditure, capital outlay and loans and advances constituted 92 per cent, 5.5 per cent and 2.5 per cent, respectively (Table 45 and Appendix Table 22-23). It indicates that only 8 per cent of the aggregate SSE is available for investment (*i.e.*, capital expenditure comprising of capital outlay and loans and advances) in social infrastructure in the country. During the above period, within capital expenditure, loans and

Table 44: Trends in Aggregate Social Sector Expenditure of State Governments

(per cent)					
Items	1990-95 (Avg.)	1996-00 (Avg.)	2001-05 (Avg.)	2005-06 (RE)	2006-07 (BE)
1	2	3	4	5	6
TE/GDP	16.0	15.2	17.5	17.2	16.9
SSE/GDP	5.9	5.6	5.7	6.0	5.9
SSE/TE	36.8	36.9	32.5	34.9	34.9
PCSSE (Rupees)	420	-	1,244	-	-

Avg. : Average SSE : Social Sector Expenditure TE : Total Expenditure PCSSE : Per Capita Social Sector Expenditure '-': Not available.

Note : PCSSE relates to two time points *i.e.*, 1990-91 and 2000-01.

Sources : Budget Documents of State Governments and Census Reports, Government of India.

¹³ According to an UNDP Study, basic social services refers to basic education, primary health care and family planning services, low cost water and sanitation and nutrition programmes.

advances to SSE (an indirect SSE by the State Governments) and capital outlay constituted 30 per cent and 70 per cent, respectively. The States' direct expenditure (*i.e.*, capital outlay) for social infrastructure, thus, constituted a small proportion of SSE of the State Governments, over 4 per cent during the 1990s but improved to around 8 per cent during 2000-01 to 2004-05. The low proportion of capital outlay and also inadequate availability of social infrastructure within the vicinity of habitations being a major concern in many States of India, there is need for greater allocation of resources for social sectors, particularly in capital outlay.

VII.4 Social Sector Expenditure – Social Services

Based on the budgetary heads, the components of SSE are expenditure on social services, rural development and food storage and warehousing while social services, *per se*, have 12 sub-heads. Among these three components of SSE, expenditure on social services constitutes the major

component followed by rural development and food storage and warehousing (Table 45).

An analysis of the components of social services, reveals that expenditure on education has been the major component followed by health. Expenditure on education under social services comprised nearly 52 per cent during the period 1990-2005 (Table 46 and Chart 20), of which 98 per cent constituted revenue expenditure. During this period, expenditure on health, with a declining trend, comprised, on an average, 13.5 per cent of expenditure on social services, of which 94 per cent constituted revenue expenditure. The other significant expenditure on social services during this period pertains to water supply and sanitation (7.4 per cent) and welfare of SCs, STs and OBCs (6.4 per cent). It may be mentioned that a high proportion of revenue expenditure limits available resources for building social infrastructure. It may also be noted that revenue expenditure includes, *inter alia*, expenditure for operations and maintenance of capital assets.

Table 45: Trends in Composition of Social Sector Expenditure

(Percentage to SSE)

Items	Revenue Expenditure	Capital Outlay	Loans & Advances	Total (2+3+4)
1	2	3	4	5
1990-91 to 1994-95 (Avg.)				
Social Services	78.9	3.9	2.5	85.2
Rural Development	13.5	0.4	0.0	13.9
Food Storage & Warehousing	0.7	0.2	0.0	0.9
Total	93.2	4.4	2.5	100.0
1995-96 to 1999-00 (Avg.)				
Social Services	82.1	4.0	2.3	88.4
Rural Development	10.0	0.4	0.0	10.4
Food Storage & Warehousing	1.0	0.1	0.1	1.3
Total	93.1	4.5	2.4	100.0
2000-01 to 2004-05 (Avg.)				
Social Services	80.6	5.6	2.4	88.6
Rural Development	8.5	1.5	0.0	10.0
Food Storage & Warehousing	0.8	0.5	0.1	1.4
Total	89.8	7.7	2.5	100.0
2005-06 (RE)				
Social Services	77.3	7.8	2.2	87.4
Rural Development	9.4	2.2	0.0	11.6
Food Storage & Warehousing	0.8	0.1	0.2	1.0
Total	87.5	10.1	2.4	100.0

Source : Budget Documents of State Governments.

Table 46: Expenditure on Social Services (Revenue & Capital Accounts) - Composition

(percentage to expenditure on social services)

Items	1990-95 (Avg.)	1996-00 (Avg.)	2001-05 (Avg.)	2005-06 (RE)	2006-07 (BE)
1	2	3	4	5	6
Expenditure on Social Services (a to l)	100.0	100.0	100.0	100.0	100.0
(a) Education, Sports, Art and Culture	52.2	52.1	51.1	46.9	46.7
(b) Medical and Public health	16.0	12.7	11.9	11.9	12.4
(c) Family welfare	0.0	2.4	2.0	1.8	1.8
(d) Water Supply and Sanitation	7.2	7.4	7.6	7.8	7.4
(e) Housing	2.9	2.9	2.8	2.5	3.0
(f) Urban Development	2.3	2.9	4.0	4.9	6.4
(g) Welfare of SCs, STs and OBCs	6.5	6.3	6.3	7.3	6.8
(h) Labour and Labour Welfare	1.4	1.3	1.0	1.0	1.0
(i) Social Security and Welfare	4.5	4.2	5.0	5.9	6.6
(j) Nutrition	1.7	2.8	2.1	2.3	2.5
(k) Relief on account of Natural Calamities	2.6	2.8	3.7	4.8	2.2
(l) Others	2.6	2.2	2.5	2.9	3.1

Avg. : Average RE : Revised Estimates BE : Budget Estimates

Source : Budget Documents of State Governments.

VII.5 State-wise Position

VII.5.1 Non-Special Category States

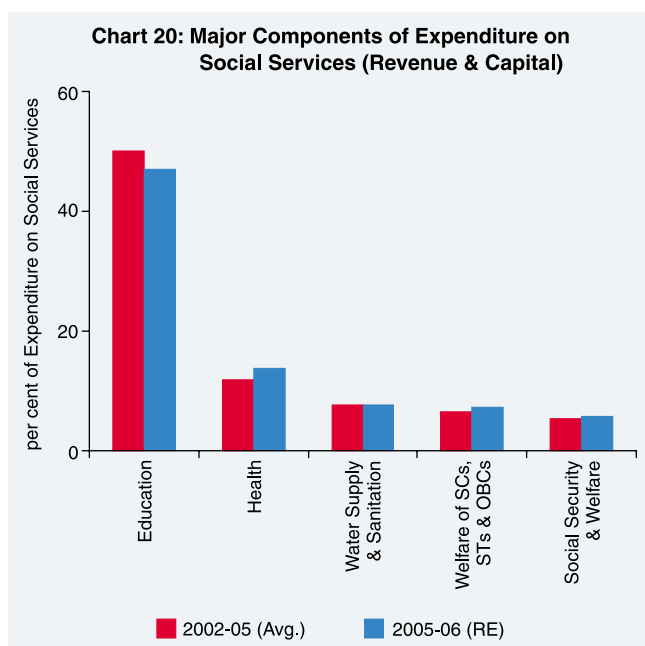
The proportion of States' income (GSDP) earmarked for the social sectors varies across the non-special category States (Table 47 and Chart 21). Bihar tops the list with an average expenditure of nearly 12 per cent of its GSDP on social sectors during 2002-05. The States like NCT Delhi, Punjab and Haryana are spending only 4.6 per cent, 4.8 per cent

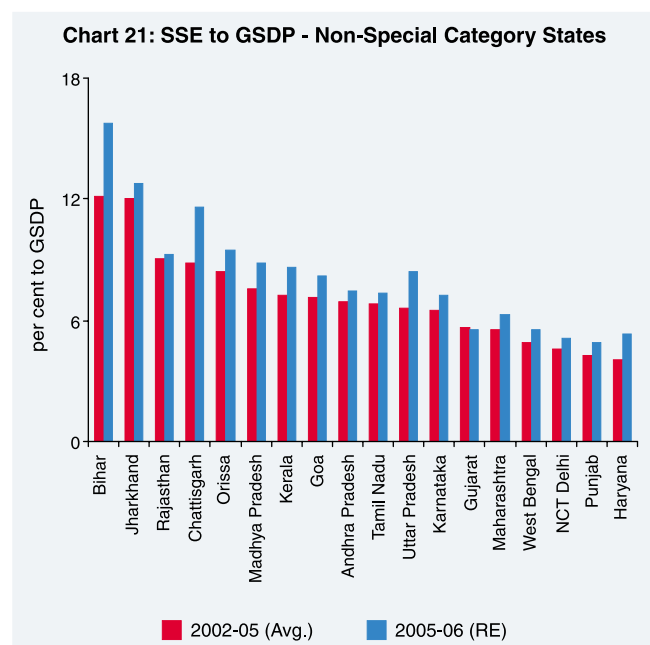
and 4.9 per cent, respectively on social sectors during the same period. States like Bihar, Gujarat, Madhya Pradesh, Punjab, Maharashtra, Uttar Pradesh and Rajasthan have witnessed a rising trend in the allocation of income for the social sectors during the

Table 47: Frequency Distribution of Non-Special Category States - Social Sector Expenditure / GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 5	Haryana, Punjab, NCT Delhi West Bengal	Punjab
5 – 6	Maharashtra, Gujarat	Gujarat, Haryana, West Bengal, NCT Delhi
6 – 7	Karnataka, Tamil Nadu , Uttar Pradesh, Andhra Pradesh	Maharashtra
7 – 8	Goa, Kerala, Madhya Pradesh	Andhra Pradesh , Karnataka, Tamil Nadu
Above 8	Bihar, Jharkhand, Orissa, Rajasthan, Chhattisgarh	Bihar, Chhattisgarh, Goa, Jharkhand, Kerala, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh

Note : See Notes to Table 19.





period 2000-01 to 2004-05 compared to the late 1990s. Other States either experienced a declining or a stagnating trend in the SSE to GSDP ratio during this period. Among non-special category States Bihar, Jharkhand, Orissa and Rajasthan have allocated a higher proportion of GSDP for the social sectors during this period (also see Statement 49).

The fiscal priority to social sectors (*i.e.*, SSE to total expenditure ratio) for non-special category States which averaged at around 37 per cent during the period 1990-95 declined to 33 per cent during the period 2000-05. Among the non-special category States, except Haryana with a marginal rise, all other States showed a declining fiscal priority to the social sectors during the period 2000-05 compared to the late 1990s (Statement 49 and 50).

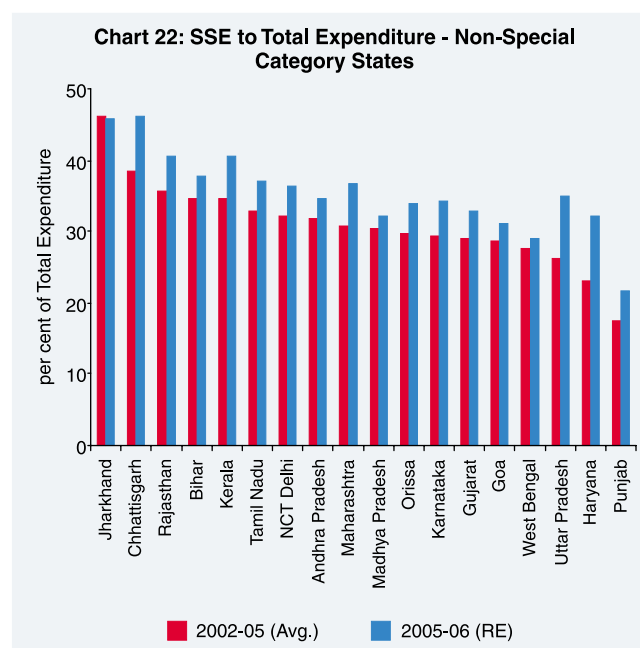
The fiscal priority for the social sectors varies widely across the States, with an overall declining trend. During the period 2000-01 to 2004-05, while Punjab spent only 21 per cent of its total expenditure for the social sectors, Jharkhand spent 46 per cent for these sectors. States, such as, Kerala, Madhya Pradesh, Tamil Nadu, NCT Delhi, West Bengal and Bihar have historically attached high fiscal priority to the social sectors while States like Punjab and Haryana have shown low fiscal priority (Table 48 and

Table 48: Frequency Distribution of Non-Special Category States - Social Sector Expenditure / Total Expenditure

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 30	Goa, Haryana, Punjab, Uttar Pradesh, West Bengal, Gujarat, Karnataka, Orissa	Punjab, West Bengal
30 – 35	Andhra Pradesh, Madhya Pradesh, NCT Delhi, Tamil Nadu, Kerala, Bihar, Maharashtra	Andhra Pradesh , Goa, Gujarat, Haryana, Karnataka, Madhya Pradesh, Orissa, Uttar Pradesh
35 – 40	Rajasthan, Chhattisgarh	Bihar, Maharashtra, Tamil Nadu, NCT Delhi
Above 40	Jharkhand	Chhattisgarh, Jharkhand, Kerala, Rajasthan

Note : Bold indicates the median State.

Chart 22). Furthermore, some States like Madhya Pradesh, West Bengal and NCT Delhi have experienced a higher decline in their fiscal priority to social sectors, while States like Gujarat, Kerala, Maharashtra, Orissa and Rajasthan experienced a lower decline in their fiscal priority for social sectors during the period 1990-2005.



The per capita social sector expenditure (PCSSE) has also shown variations among the non-special category States. In 2000-01, the year for which the latest population data is available, the PCSSE for Goa was at Rs.3,846 whereas for Uttar Pradesh it was at Rs.730 (Chhattisgarh was lower at Rs.464 but 2000-01 being its first year of budget after its formation, the figure may not be truly reflective). The PCSSE of non-special category States have had an annual growth of 20.3 per cent during the period 1990-91 to 2000-01. For Uttar Pradesh, West Bengal, Tamil Nadu and Goa the amount more than doubled during the period 1990-91 to 2000-01. Whereas the per capita social sector expenditure of Bihar, Orissa, Madhya Pradesh, Rajasthan, Andhra Pradesh, Karnataka, Maharashtra, Punjab, Haryana, Kerala and Gujarat experienced more than three fold increase in the per capita social sector expenditure, while Gujarat registered four fold increase in the same during the same period.

In most (17 out of 18) of the non-special category States, expenditure on education and health together constituted more than 50 per cent of the total expenditure for social services during the period 1990-91 to 2004-05. During the period 2000-01 to 2004-05, however, the proportion of expenditure on education and health under social services varied from as high as 77 per cent in Bihar to 52 per cent in Gujarat (for Chhattisgarh it was lower at 47 per cent). In Bihar, expenditure for education alone constitutes over 65 per cent of the total expenditure for social services, whereas this ratio is low at 38 per cent for NCT Delhi during the period 2000-01 to 2004-05. Karnataka, Maharashtra and Bihar have shown a rising trend during the period 1990-91 to 2004-05 for their expenditure on education as a per cent of total expenditure for social services, while Gujarat, Madhya Pradesh, Orissa and West Bengal exhibited a declining trend.

With regard to proportion of expenditure on health to total expenditure for social services, as many as 11 States¹⁴ have shown a declining trend during

the period 1990-91 to 2004-05. This ratio varied from 19 per cent in NCT Delhi to 9 per cent in Gujarat during the period 2000-01 to 2004-05. In general, the States with low level of human development such as Bihar, Rajasthan and Uttar Pradesh have also shown a declining trend in terms of expenditure on health to total expenditure for social services.

VII.5.2 Special Category States

Compared to the non-special category States, most of the special category States spent higher proportion of their State's GSDP for the social sectors. Sikkim spent almost 29 per cent of GSDP on social sectors, while Assam spent almost 10 per cent during the period 2000-05 (Table 49, Statement 49-50 and Chart 23). Notwithstanding the high proportion, some States such as Jammu and Kashmir, Meghalaya, Mizoram, Nagaland and Tripura have exhibited a declining trend in terms of expenditure-GSDP ratios for the social sectors during the period 1990-05.

The special category States, except Jammu and Kashmir, did not experience a declining fiscal priority for the social sectors during the period 1990-05. In most of the States, fiscal priority for social sectors registered an increase during the late 1990s, even though, it declined thereafter. During the period 2000-01 to 2004-

Table 49: Frequency Distribution of Special Category States - Social Sector Expenditure / GSDP

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 10	Assam	-
10 - 15	Himachal Pradesh, Jammu and Kashmir , Meghalaya, Nagaland, Uttaranchal, Tripura	Assam, Himachal Pradesh, Uttaranchal, Nagaland
15 - 20	Manipur	Jammu & Kashmir, Meghalaya , Tripura
Above 20	Arunachal Pradesh, Mizoram, Sikkim	Arunachal Pradesh, Manipur, Mizoram, Sikkim

Note : See Notes to Table 19.

¹⁴ Bihar, Goa, Gujarat, Haryana, Karnataka, Punjab, Rajasthan, Maharashtra, West Bengal, Tamil Nadu and Uttar Pradesh.

State Finances : A Study of Budgets of 2006-07

Chart 23: SSE to GSDP - Special Category States

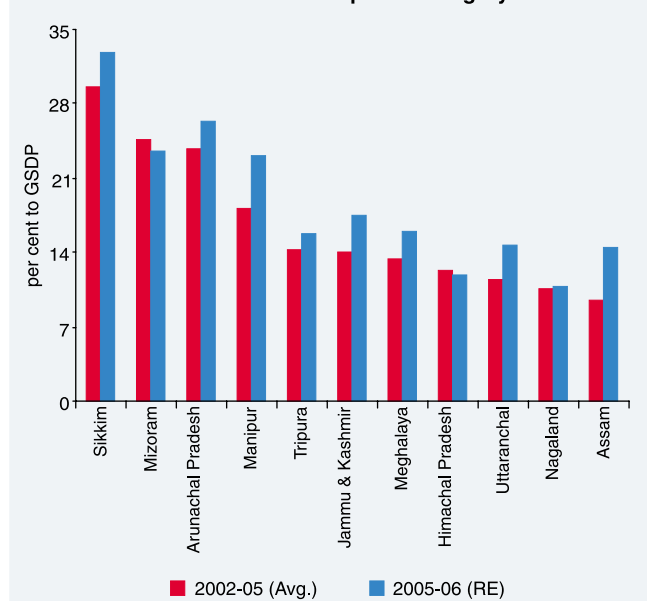
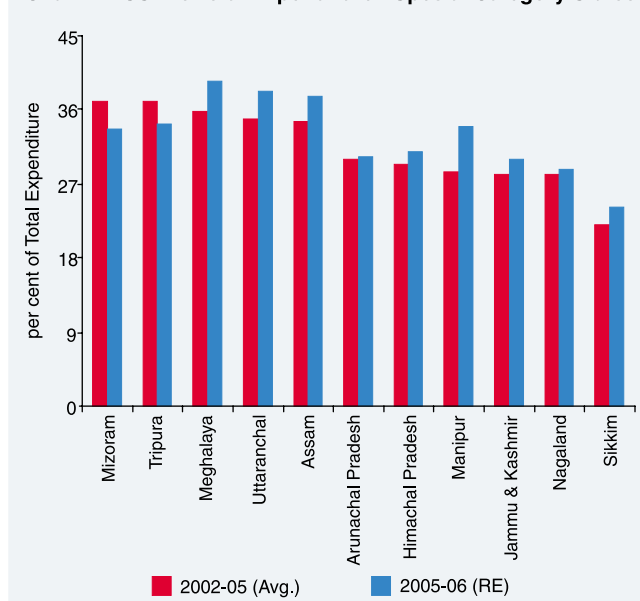


Chart 24: SSE to Total Expenditure - Special Category States



05, the fiscal priority of special category States has ranged from 39 per cent for Mizoram to 22 per cent for Sikkim (Table 50, Statement 49-50 and Chart 24).

Among the special category States, PCSSE varied from Rs.5,688 for Mizoram to Rs.1,154 for Assam (Uttaranchal has a lower value of Rs.418 but 2000-01 being its first budget may not be truly reflective). The PCSSE of special category States have had an annual growth of 11.0 per cent during the period 1990-91 to 2000-01. In all the special category

States, except Nagaland, the PCSSE more than doubled during the period 1991 to 2001.

Analogous to the trend observed among the non-special category States, expenditure on education and health together constituted more than half of the total expenditure under social services for the special category States. During the period 2000-01 to 2004-05, expenditure on education for Assam constituted 65 per cent of the total expenditure for social services as against 40 per cent in Mizoram. During the period 1990-91 to 2004-05, Arunachal Pradesh and Manipur have shown a declining trend in their proportion of expenditure on education to total expenditure for social services. On the other hand, Himachal Pradesh, Meghalaya, Tripura, Jammu and Kashmir and Nagaland exhibited a rising trend in the expenditure on education to total expenditure for social services during the same period.

Expenditure on health as proportion of total expenditure for social services varied from 20 per cent for Jammu and Kashmir to 9 per cent for Tripura during 2000-01 to 2004-05. Eight¹⁵ out of 11 special category States exhibited a declining proportion of expenditure on health in terms of total expenditure for social services.

Table 50: Frequency Distribution of Special Category States - Social Sector Expenditure / Total Expenditure

Range (per cent)	2002-05 (Avg.)	2005-06 (RE)
1	2	3
Below 25	Sikkim	Sikkim
25 – 30	Jammu & Kashmir, Manipur, Nagaland, Himachal Pradesh	Jammu & Kashmir, Nagaland
30 – 35	Arunachal Pradesh, Assam	Arunachal Pradesh, Himachal Pradesh, Manipur, Mizoram , Tripura
Above 35	Meghalaya, Mizoram, Tripura, Uttaranchal	Assam, Meghalaya, Uttaranchal

Note : Bold indicates the median State.

¹⁵ Arunachal Pradesh, Assam, Himachal Pradesh, Manipur, Meghalaya, Mizoram, Sikkim and Tripura.

VII.6 Social Sector Expenditure and Human Development

VII.6.1 All-India Position

As per the human development index¹⁶ (HDI) published by UNDP since 1975, India has made a continuous progress in human development. In 1975, the human development index for India was 0.412, which gradually improved to 0.611 in 2004. As per the latest Human Development Report, 2006 India's rank in human development is 126 out of 177 countries. Table 51 provides human development index for India *vis-à-vis* select countries of the world.

Norway has been the leading country in human development with a HDI of 0.965 in 2004 as per the latest Human Development Report (2006). It is pertinent to note that India's distance from Norway (*i.e.*, the difference between the HDI of India and Norway) has been decreasing over the last three decades from 0.456 in 1975 to 0.354 in 2004 (Table 51).

VII.6.2 State-wise Position

Though India is making progress in human development, discernible disparities exist across the

States. As per the National Human Development Report 2001, Kerala was the leading State with a HDI at 0.638, while the HDI for Bihar was at 0.367 (Table 52). Though some studies have shown that there has been a convergence in social indicators over time among the major Indian States, there still exist wide disparities for these indicators. To illustrate such disparity, literacy rate in India varied between 47.53 per cent for Bihar to 90.92 per cent for Kerala in 2001, life expectancy varied from 55.2 in Madhya Pradesh to 73.1 in Kerala during 1992-96. The sex ratio varied from 861 in Haryana to 1058 in Kerala in 2001 (National Human Development Report, 2001).

The State Governments have a greater role in social sector development. The UNDP has incentivised the State Governments to prepare State Human Development Reports. So far, 17 State Governments have prepared State Human Development Reports and the highlights of these Reports have been provided in Box 6.

A simple exercise to examine the relationship between SSE and HDI for 15 of the Indian States shows that the correlation coefficient between the

Table 51: Human Development Index of India *vis-a-vis* other Countries

Countries	HDI Rank	Human Development Index (HDI)							
	2004	1975	1980	1985	1990	1995	2000	2003	2004
1	2	3	4	5	6	7	8	9	10
India	126	0.412 (0.456)	0.438 (0.450)	0.476 (0.422)	0.513 (0.399)	0.546 (0.390)	0.577 (0.379)	0.602 (0.361)	0.611 (0.354)
Medium Human Development Countries									
China	81	0.525	0.558	0.594	0.627	0.683	-	0.755	0.768
Sri Lanka	93	0.607	0.649	0.681	0.705	0.727	-	0.751	0.755
Pakistan	134	0.363	0.386	0.419	0.462	0.492	-	0.527	0.539
Nepal	138	0.296	0.333	0.376	0.423	0.466	0.499	0.526	0.527
Bangladesh	137	0.345	0.364	0.389	0.419	0.452	0.506	0.52	0.53
Malaysia	61	0.615	0.659	0.695	0.721	0.76	0.79	0.796	0.805
High Human Development Countries									
Norway	1	0.868	0.888	0.898	0.912	0.936	0.956	0.963	0.965
Japan	7	0.857	0.882	0.895	0.911	0.925	0.936	0.943	0.949
Singapore	25	0.725	0.761	0.784	0.822	0.861	-	0.907	0.916
Korea Rep of	26	0.707	0.741	0.78	0.818	0.855	0.884	0.901	0.912
Kuwait	33	0.763	0.777	0.78	-	0.813	0.837	0.844	0.871

Note : Figures in brackets indicate the distance of India from Norway (best performer) in terms of HDI *i.e.*, the difference between the HDI of the two countries.

Source : UNDP (2005 & 2006), Human Development Reports.

¹⁶ The Human Development Report (2005) provides a country-wise consistent series of HDI from 1975 to 2003.

Table 52: Human Development Index for States

States	1981	Rank	1991	Rank	2001	Rank
1	2	3	4	5	6	7
1. Andhra Pradesh	0.298	9	0.377	9	0.416	10
2. Assam	0.272	10	0.348	10	0.386	14
3. Bihar	0.237	15	0.308	15	0.367	15
4. Gujarat	0.360	4	0.431	6	0.479	6
5. Haryana	0.360	5	0.443	5	0.509	5
6. Karnataka	0.346	6	0.412	7	0.478	7
7. Kerala	0.500	1	0.591	1	0.638	1
8. Madhya Pradesh	0.245	14	0.328	13	0.394	12
9. Maharashtra	0.363	3	0.452	4	0.523	4
10. Orissa	0.267	11	0.345	12	0.404	11
11. Punjab	0.411	2	0.475	2	0.537	2
12. Rajasthan	0.256	12	0.347	11	0.424	9
13. Tamil Nadu	0.343	7	0.466	3	0.531	3
14. Uttar Pradesh	0.255	13	0.314	14	0.388	13
15. West Bengal	0.305	8	0.404	8	0.472	8
All-India	0.302		0.381		0.472	

Source : National Human Development Report, Planning Commission, 2001.

average ratio of social sector expenditure to GSDP (i.e., SSE/GSDP) for the period 1990-91 to 1999-

00 and human development index of 2001 (HDI) as well as that between the average ratio of social

Box 6 : State Human Development Reports – Highlights

With the initiative of UNDP, 17 State Governments have published State Human Development Reports so far. These Reports discuss the levels of human development achieved by the respective States and highlight the State-specific issues in improving human development.

It is clear from the different State Human Development Reports that the level of human development achieved by many of the States is very poor in terms of their distance from the best performer Kerala. It may be noted that some pockets of the well-off States, such as Punjab, are also having very low human development. In almost all the States there is a gender as well as rural-urban gap in the achievement of human development, placing urban man in the top of the map and rural woman at the bottom. Inequalities among the social groups are also very high in most of the States with Scheduled Tribes situated in the lowest end of the ladder preceded by Scheduled Castes. An important finding of these Reports is that of accessibility to the institutions is still an issue in many of the States. In other words, these institutions are physically inaccessible besides being economically difficult for the people. The lack of development of adequate transport facilities aggravates the problem.

States with higher initial achievement in human development at the time of independence, such as Kerala, are still leading other States in human development. In fact, in many of the States having remained isolated from the mainstream India till independence, human development is a post-independence experience. Thus, the history of human development is also short in such States. All State Governments make efforts to improve the social infrastructure in their respective States despite constraining factors. Fiscal capacity of the States remains as the one of the major constraints. Besides, factors such as natural calamities and mountainous terrain result in increasing the cost of building social infrastructure. Moreover, a low density of population entails greater expenditure towards making social infrastructure available to greater numbers.

Several of State Human Development Reports have highlighted poverty as the major problem in improving human development forming a vicious circle. The issue starts from hunger leading to poor nutrition, and illness. Poverty is a compelling reason for sending children to work. Hence, many States have low retention levels at schools despite having a high enrolment ratio. In most of the States majority of the population, especially in the rural areas, is employed in agriculture and therefore, improving productivity in the agricultural sector as well as diversifying rural employment would serve in eliminating poverty and thereby improving human development. Furthermore, on the need to strengthen the causality between human development and economic growth, with both reinforcing each other, has been emphasised. The States need to allocate a higher proportion of their expenditure for social sectors, especially in the capital account to improve social infrastructure. Also, investing in economic infrastructure is equally important to strengthen the relationship between economic growth and human development.

Some of the Reports have opined that maintaining the quality of social services provided by the Government is critical in deciding the outcome in terms of human development. The lack of popular pressure to improve the quality of services is one of the major problems hindering the improvement in quality. It is reported that since the public is paying taxes to the Government, they have the right to receive better quality services from the Government. Secondly, the lack of incentives for the Government employees is also preventing them to provide quality services to the public. The general feeling of the employees is that even if they work hard, they are not going to receive any reward. Further, in some of the remote areas of the country, finding out qualified people willing to work is also posing a challenge to provide quality services. In addition, corruption in the Government machinery, high density of population and lack of maintenance of the existing infrastructure are also leading to poor quality of Government services.

Reference : State Human Development Reports of 17 State Governments.

sector expenditure to total expenditure (*i.e.*, SSE/TE) and HDI, is negative¹⁷. The correlation coefficient between PCSSE and HDI is, however, observed to be positive. These correlations, however, do not necessarily imply causality.

It may be noted that Bihar is spending, on an average, 42 per cent of its total expenditure or 9 per cent of GSDP on social sectors during the period 1990-91 to 1999-00. However, Bihar's HDI is one of the lowest (0.367) in India. The low PCSSE (Rs.893) in Bihar, *inter alia*, may account for low HDI (Chart 25). It may then be noted that PCSSE has a greater impact in the outcome of HDI than the proportion of funds allocated for the social sectors. Thus, it is clear that despite the high fiscal priority to social sectors in Bihar coupled with a high proportion of SSE to GSDP, Bihar is constrained by its low fiscal capacity to increase PCSSE. According to the TFC, besides Bihar, there are 7 other States (*viz.*; Assam, Jharkhand, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh and West Bengal) that are of low fiscal capacity on account of being fiscally weak and hence, the TFC

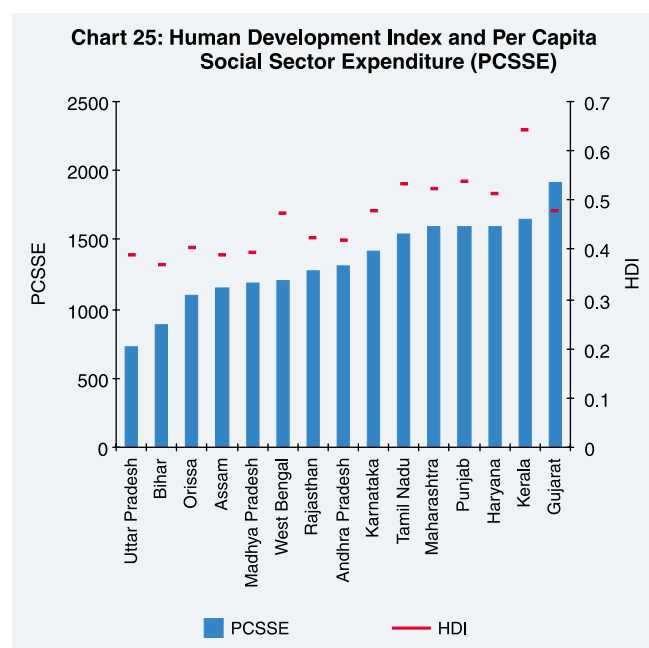
has provided for specific grants for social sectors to these States (Box 7).

VIII. ISSUES AND PERSPECTIVES

VIII.1 Fiscal Correction and Consolidation

The fiscal correction and consolidation measures undertaken by the State Governments have impacted the State finances favourably in recent years, as is evident from the reduction in fiscal imbalances. The key fiscal indicators in terms of 2004-05 accounts showed substantial improvement while compared to those with the revised estimates. The revised estimates of 2005-06 showed a decline in the RD by more than 30 per cent compared to the budget estimates. There was, however, 3 per cent rise in the GFD due to 10.8 per cent step up in the capital outlay. The State Governments have committed to carry forward the process of fiscal correction and consolidation further in their budgets for 2006-07. Thus, the fiscal reform process has been enduring. In this context, it is important to recognise that the fiscal position of the States in the medium term would, to a large extent, be shaped by the recommendations of the TFC (refer to the Box I.4 on 'Twelfth Finance Commission and State Finances' in Reserve Bank's Annual Report, 2005-06). TFC prescribed for progressive correction in terms of 15 fiscal indicators, which included targets for different items of receipt, expenditure, debt in addition to targets for deficit indicators. Following a holistic approach, the path for fiscal correction and consolidation of the State Governments in their scheme of restructuring, should emphasise revenue augmentation, compression and rationalisation of expenditure and containment of debt within sustainable limits.

Another significant development relates to enactment of FRLs by a majority of the States. Making the process of fiscal correction a binding



¹⁷ The correlation co-efficient between SSE/GSDP and HDI is -0.44 and between SSE/TE and HDI is -0.22 while that between PCSSE and HDI is 0.80.

Box 7 : Twelfth Finance Commission and Social Sector

The TFC has allowed a greater role for grants in overall Finance Commission transfers and based on the assessment of needs and development concerns of the States, grants-in-aid of the revenues of States have been indicated. The formula used for horizontal distribution of sharable taxes among the States, by its nature, cannot take care of all dimensions of the fiscal needs of a State. TFC considered certain common as well as specific needs of the States and has accordingly recommended grants for education, health, maintenance of roads, maintenance of buildings, maintenance of forests, heritage conservation, local bodies, calamity relief and State specific needs.

Even though considerable funds are made available by the Central Government to the States on the Plan side, the availability of funds still falls short of the requirements in the view of the magnitude of the problem. In many Plan schemes in these two sectors, the inability to meet the requirement of counterpart funding by the State Governments also becomes a handicap in fully utilising the funds. Many States have been unable to meet this requirement. The TFC has, therefore, provided specific grants-in-aid for these two sectors to those States which are unable to spend adequately in these sectors because of deficiencies in fiscal capacity.

Per capita expenditure of many States are much below the average per capita expenditure of the relevant group of States (special and non-special). While the amount of transfer required for a full application of the equalisation approach would be too

large, TFC decided to focus on two critical areas of deficiencies, namely, education and health. But, only a partial correction could be made, because of large disparity between the relevant group average and the actual per capita expenditure of some of the constituent States, particularly those having low fiscal capacity and large population. In the estimation of grants, care is taken of those States, who have not been able to allocate on education and health an amount equal to the group average, as measured in relation to the aggregate revenue expenditure, including both Plan and non-Plan. Aggregate expenditure for this purpose is taken net of interest payments, pensions, and some other adjustments.

In estimating the extent of grants for these two sectors, a two-step normative approach has been adopted. In the first instance, low expenditure preferences of the States in these sectors have been corrected. In other words, it is expected that all States should spend normatively a certain minimum percentage of their total revenue expenditure (both Plan and non-Plan) on education and health. The second step involves identification of those States which, even after spending the required percentage, fall short of a normative level of per capita expenditure in these two sectors.

These grants are being provided for the education and health sectors as additionality, over and above the normal expenditure by the States in these sectors. No further conditionalities should be imposed by the Central Government for the release of these grants. Monitoring of the expenditure relating to these grants will rest with the State Government concerned.

Table : Grants-in-aid for Education and Health Sectors as recommended by TFC

(Rs. crore)

States	2005-06	2006-07	2007-08	2008-09	2009-10	Total (2005-10) (2 to 6)
1	2	3	4	5	6	7
A. Education Sector						
1. Assam	183.20	200.60	219.66	240.53	263.38	1107.37
2. Bihar	443.99	486.17	532.36	582.93	638.31	2683.76
3. Jharkhand	107.82	118.06	129.28	141.56	155.01	651.73
4. Madhya Pradesh	76.03	83.25	91.16	99.82	109.3	459.56
5. Orissa	53.49	58.57	64.13	70.22	76.89	323.30
6. Rajasthan	20.00	20.00	20.00	20.00	20.00	100.00
7. Uttar Pradesh	736.87	806.87	883.52	967.45	1059.36	4454.07
8. West Bengal	64.83	70.99	77.73	85.11	93.20	391.86
Total A (1 to 8)	1686.23	1844.51	2017.84	2207.62	2415.45	10171.65
B. Health Sector						
1. Assam	153.58	171.24	190.93	212.89	237.38	966.02
2. Bihar	289.30	322.57	359.66	401.02	447.14	1819.69
3. Jharkhand	57.39	63.99	71.35	79.55	88.70	360.98
4. Madhya Pradesh	28.88	32.20	35.90	40.03	44.63	181.64
5. Orissa	31.22	34.81	38.81	43.28	48.25	196.37
6. Uttar Pradesh	367.63	409.90	457.04	509.6	568.21	2312.38
7. West Bengal	10.00	10.00	10.00	10.00	10.00	50.00
Total B (1 to 7)	938.00	1044.71	1163.69	1296.37	1444.31	5887.08

Reference : Report of the Twelfth Finance Commission (2004), Government of India.

force, FRL is expected to augment fiscal discipline and provide a more realistic correction path. A rule

based policy would also make the fiscal policy of the State Governments more credible (Box 8).

Box 8 : Adoption of Rule-Based Fiscal Policy by State Governments

Enactment of Fiscal Responsibility Legislation (FRL) in India at both the Centre as well as State level (23 States so far) has provided impetus to the process of attaining fiscal sustainability in the Central and State Government finances. The realisation of underlying benefits of this institutional development would, however, depend on strict adherence to the targets set in FRLs of the respective Governments. Reduction in the key deficit indicators is critical for fiscal sustainability, particularly in view of the mounting level of debt which at its present level (more than 62 per cent of GDP for the Centre and 32 per cent of GDP for States) is higher than many countries.

Apart from fiscal sustainability, meeting the targets set in FRLs is crucial for maintaining credibility for potential investors at home as well as from abroad. As noted by Kopits (2001), 'all these rules share at least one feature in common: they seek to confer credibility on the conduct of macroeconomic policies by removing discretionary intervention'. It is established in the literature that rules are necessary to restrain politically rational policymakers who conduct discretionary policies with a deficit bias when facing electorate that fails to understand, or is indifferent to, the inter-temporal budget constraints. In a federal system, fiscal rules can be usefully applied at the sub-national level of Government. Application of such rules at sub-national level is the key to economic performance particularly in those economies where the revenue/expenditure of sub-national Governments constitutes a major portion of overall Government revenue/expenditure. Smaller the share of central Government, greater is the need for applying sub-national rules to counter the moral hazard that may arise among sub-national Governments to incur fiscal imbalances with repercussions on the borrowing costs of the rest of federal system.

There can be two basic approaches to design fiscal rules at sub-national level: first, bottom-up approach where sub-national Governments voluntarily make rules for themselves and secondly, top-bottom approach where rules are imposed by the central Government. The second approach is mainly relevant in the countries where the central Government frequently undertakes bail out of sub-national Governments. This approach also reflects the need to bring about a lasting fiscal adjustment encompassing the entire general Government or consolidated public sector, in the face of a possible sustainability problem with likely repercussions on the countrywide premium. The examples of the first approach are U.S., Switzerland and Canada where sub-national Governments chose to adopt fiscal rules largely because of the need to build good reputation in financial markets in the absence of a potential bailout. In contrast, in Brazil (or in EU member countries under EMU), sub-national Governments are subject to centrally imposed rules to prevent moral hazard, particularly given a relatively small portion of fiscal activity under central (supranational) control. In this case, adherence to rules generally helps lower the individual Government's default risk premium, as well as the country risk premium faced by the entire federal (or supranational) Government. The degree of fiscal decentralisation in India is comparable to countries having high degree of decentralisation such as Sweden and Denmark (Kannan *et al.*, 2004). The State Governments collect about 40 per cent of combined revenue receipts and incur around 50 per cent of combined expenditure. In view of the relatively greater role played by the State Governments in Indian public finances, it is crucial for overall macroeconomic management that the State Governments follow rule based fiscal policy.

Twelfth Finance Commission (TFC) recommended that each State should enact FRL. This has been stipulated as a pre-condition for availing the debt relief recommended by the TFC. According to TFC, this legislation should, at a minimum, provide for:

- (a) eliminating revenue deficit by 2008-09;
- (b) reducing fiscal deficit to 3 per cent of GSDP or its equivalent defined as ratio of interest payment to revenue receipts;
- (c) bringing out annual reduction targets of revenue and fiscal deficits;
- (d) bringing out annual statement giving prospects for the State economy and related fiscal strategy;
- (e) bringing out special statements along with the budget giving in detail number of employees in government, public sector, and aided institutions and related salaries.

Karnataka was the first among the States to enact the FRL in September 2002 followed by Kerala (2003), Tamil Nadu (2003), and Punjab (2004). Following the recommendations of the TFC, 19 more States have enacted the FRL so far. The FRLs of the States have almost similar characteristics (Annex 2). The targets set in the FRLs of State Governments are similar to those set by the Central Government for itself, *i.e.*, elimination of revenue deficit by 2008-09 and reducing GFD-GDP ratio to 3 per cent by 2009-10 (GFD-GSDP for State Governments). It may be mentioned that the enactment of FRL by State Governments in India reflects a mix of the two approaches discussed above. While some State Governments have voluntarily enacted FRLs others were encouraged to adopt such legislations to avail benefits under incentive scheme recommended by the TFC.

The persistence of large fiscal deficits has resulted in accumulation of outstanding debts of the State Governments. Furthermore, use of borrowed resources for meeting the current expenditure requirements by the States resulted in widening of asset-liability mismatches over the period. This underscores the imperatives of eliminating the revenue deficit and generating sufficient revenue surplus which may be utilised for creation of assets without creating liabilities. Any deviation from the targets set under their FRLs by the State Governments may generate a chain effect among other State Governments to follow the suit thereby having deleterious effects in terms of undermining credibility of policy stance and adverse impact on macroeconomic, financial, external sector and budgetary sustainability. Moreover, the States deviating from their FRL targets would have difficulties in raising the required resources due to market perceptions. It may be noted that fiscal discipline remains the major factor in determining the investment grade rating of the Indian economy by various international rating agencies. Hence, it would be desirable that the State Governments, which have enacted FRLs, adhere to the rules, while remaining States make efforts in the direction of adopting the rule based framework.

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VIII.2 Fiscal Rules and Accounting Arrangements

The TFC has observed that the States need to be guarded against any attempt to defeat the objectives of the debt relief scheme through accounting arrangements. Hence, the TFC suggests standardisation with a uniform classification and definition of deficits. The TFC further points out that unauthorised changes in accounting policies and arbitrary reclassification of expenditure should be viewed seriously for monitoring debt relief. In this context, it may be mentioned that most of the FRLs of State Governments include as a provision that the definitions of fiscal items need to be clearly stated and changes in them need to be notified. The concept and practice of accounting arrangements in international context is discussed in Box 9.

VIII.3 Surplus Cash Balances, Liquidity and Investment Management by States

Currently the majority of the State Governments are carrying large amount of cash surpluses as evident from their investment in 14-Day Intermediate Treasury Bills of Government of India, a phenomenon which became prominent starting with financial year 2005-06. The outstanding investment of the States in 14-Day Intermediate Treasury Bill as of November 16, 2006 stands at Rs.39,610 crore. Further many State Governments have also invested their surplus in 91-Day, 182-Day and 364-Day Treasury Bills of the Central Government and the total such investments as of November 17, 2006 stands at Rs.21,118 crore (Box 10).

The upsurge in the cash balances of the State Governments has posed challenges to the cash and financial management of State Governments. Presently, the State Governments apart from investing in 14-Day Intermediate Treasury Bills, have the option of investing, as non-competitive bidders, in auctioned regular Treasury Bills. The State Governments are, however, not permitted to investment in dated securities of Government of

India. The issues relating to the investment of cash surplus balances of the States were discussed in the 18th Conference of State Finance Secretaries held on August 7, 2006 at the Reserve Bank. Taking cognizance of the views of the State Governments for alternative investment options, a Working Group to Evolve a Framework for Investment of State Governments Balances has been constituted with representatives from select State Governments and the Reserve Bank. In the interim, the States saddled with high and durable cash surplus have the options to refrain from open market borrowings and other loans where States have an active role in mobilisation.

Investment portfolio of the State Governments is related to their maintenance of their cash surplus balance. Presently, the Reserve Bank has been in charge of managing the statutory funds of the State Governments such as CSF and GRF (Box 11). The State Governments, however, are required to set up debt units and develop necessary expertise for cash and investment management.

VIII.4 Fiscal Empowerment

In order to make the process of fiscal consolidation durable and sustainable, adequate investment in economic infrastructure and spending on social services would be essential. Accordingly, the States would be required to incur higher outlays on the provision of these services. Against this backdrop, a desirable path to fiscal correction lies through fiscal empowerment, *i.e.*, by expanding the scope and size of revenue flows into budget. The State Governments' strategy of augmenting tax collection through, *inter alia*, introduction of new taxes and improvement in tax administration needs to be continued with greater vigour. Adoption of the VAT regime by the majority of the States indicates a rise in revenue buoyancy in the initial period compared to erstwhile sales tax regime and VAT is likely to yield higher revenue in the future. The State Governments may go for a comprehensive review of their tax system to

Box 9 : Fiscal Rules and Accounting Arrangements - A Comparative View

Fiscal rules have drawn public attention and have been a subject of policy debate in several countries. The imposition of numerical rules on budget deficits is one possible way to reduce or eliminate this bias, though such rules may have important shortcomings. Rules that are not contingent on the macroeconomic cycle can force Governments to tighten fiscal policy during cyclical downturns, thus exacerbating macroeconomic fluctuations - a concern often expressed in European Union Countries. Fiscal rules are introduced to restrict profligate fiscal behaviour of Governments and they necessarily refer to specific budgetary items and data. Governments can engage in creative accounting in order to circumvent fiscal rules by shifting budget items from these specific, restricted to non-restricted positions. Creative accounting is more likely the higher the economic cost of sticking to the rule. When setting an optimal fiscal rule, creative accounting should be taken into account such that the rule is stricter than an optimal rule in the absence of creative accounting.

According to Koen and Noord (2005), a measure implying an improvement in the fiscal balance is considered to be creative accounting if it does not imply an improvement in the intertemporal budgetary position of the Government sector at large (an increase in the Government's net worth). In practice, accounting conventions usually leave some scope for judgment. Hence, when fiscal rules threaten to bite, or are biting, Governments may be tempted to take advantage of the implied degrees of freedom. In fact, irrespective of any formal fiscal rules, Governments may wish to put the best possible gloss on the accounts presented to the outside world. Governments have incentives to present flattering fiscal accounts and to report improving fiscal performance, and new Governments have reasons to "audit" the accounts inherited from their predecessors. For instance, the new French Governments that took office in spring 1997 and in spring 2002 undertook such audits. So did the new Portuguese Government in spring 2002 and the new Greek and Spanish Governments in spring 2004. Each time, the diagnosis pointed to a distinctly weaker fiscal condition than previously acknowledged, most spectacularly so in the case of Greece, where deficit and debt data for all years going back to 1997 have recently been substantially corrected. This is especially true when fiscal rules set limits for fiscal flows and/or stocks.

The literature provides several examples. Easterly (1999) argues that fiscal adjustment in a number of developing countries with World Bank and IMF programmes relied heavily on a decumulation of Government assets (mainly through reductions in public investment and in expenditure on operations and maintenance), implying that the reduction in Government liabilities did not necessarily correspond to an increase in the Government's net worth. Bunch (1991) presents evidence that States in US with constitutional debt limits use public authorities to circumvent borrowing restrictions, and Kiewiet and Szakaly (1996) find that constitutional limitations pertaining only to guaranteed state debt do not meaningfully affect the total amount of debt issued by State and local public authorities. Some examples would be as follows.

- (i) In France, the budget deficit in 1997 was reduced by around 0.5 percent of GDP thanks to a one-time payment from France Telecom, a public enterprise, to compensate the State for taking on its pension liabilities. The payment was structured as a capital receipt, therefore counting for deficit reduction, rather than an asset transaction, which would have reduced the debt, but not the deficit. This was possible because public

enterprises are not part of 'general Government' in the sense of the Maastricht treaty.

- (ii) In Greece, capital transfers to public enterprises were recorded as 'equity increases,' and thus excluded from the calculation of the budget deficit (with approval from Eurostat). This measure, together with a reduction in interest payments due to the issuance of zero-coupon bonds, accounted for a reduction in the 1997 budget deficit of over 1 per cent of GDP.
- (iii) In Italy, two sentences of the Constitutional Court forced the Government to pay back pension outlays for an approximate amount of 0.2 per cent of GDP. These payments, financed through bond issuance, took place between 1997 and 2000, but were retroactively imputed to the budgets of the years the liabilities were incurred in (1993-95), leaving the budget deficits for the year 1997-2000 unaffected. Also the accounting of capitalised interest on postal savings certificates was shifted from an accrual to a cash basis. As a result, interest payments are now recorded only when they fall due, analogously to zero-coupon bonds, thus reducing the deficit by 0.3 per cent of GDP. Finally, debts of the railway company were recognised as Government debt. This implies that the amortisation of capital on this debt, which was previously recorded as a transfer to a State enterprise, is now treated as the repayment of a Government liability and as such it does not affect the budget deficit.
- (iv) According to the US General Accounting Office Report (1993) "many States are meeting the letter, not the spirit, of their requirements, focusing their efforts on only a portion of their operations, and often relying upon gimmickry to create the appearance that their budgets are balanced." The State experience suggests that a wide range of accounting changes and related techniques could be used to adhere to balanced budget rules. The General Accounting Office (GAO) provides examples such as California transferred revenues from an oil extraction royalty tax from a trust fund to the general fund. New York enacted a new payroll system to shift its last payroll payment from fiscal year 1983 to next fiscal year. Minnesota accelerated tax collection to move receipts across fiscal years.

Ceteris paribus, a fiscal rule imposed when the budget is not transparent may lead to creative accounting rather than fiscal adjustment.

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minimise transaction costs and rationalise tax structure, which would help in augmenting tax revenues. In this context, augmenting resource mobilisation from non-tax revenue through appropriate user charges and restructuring of State public sector undertakings continues to be of critical importance. Higher user charges will, however, be feasible only when there is a concomitant improvement in the delivery of the services provided by the States. Improving the delivery of public services should, therefore, be a priority for the State Governments. The issues of power subsidies also need to be addressed by the State Governments

with power sector reform being an integral part of the reform process.

VIII.5 Power Subsidies

The improvement in cost recovery in respect of the power sector assumes significance particularly in the context of extending free power to certain sections by the State Governments and the long-standing problem of power subsidies. According to Economic Survey 2005-06, Government of India, the rate of return of SEBs improved to -26 per cent in 2005-06 (RE) from -32 per cent in 2004-05. The resources forgone through

Box 10 : Management of Surplus Cash Balances

It needs to be recognised that surplus cash balances provide a cushion to tide over any unforeseen developments such as a deterioration in the liquidity environment. The State Governments with high level of cash surplus would have the options of utilising their cash surplus to swap high cost debts with new low coupon issues or prepay their outstanding high coupon market borrowings. As regards debt swap, the gains to the respective State Governments on account of lower coupon on new issues would be exactly offset by the premia they will have to pay to the high coupon bond holders and the net present value of the cash flows under both streams will be exactly equal. As in the case of debt swap, outright prepayment also involves upfront payment of premia in the year of prepayment as long as the coupon on the stock being bought back is higher than the rate at which it is bought back. Debt prepayment would enable the State Government to improve their fiscal and revenue balances, the extent of which would depend on the difference between the (higher) average yields arrived at the debt buy-back auctions and the (lower) rate of returns on investments of surplus cash balances in Treasury Bills. Second, the reduction in the outstanding liabilities due to prepayment of debt is expected to improve the market perception of States' fiscal position with positive implications for the cost of future market borrowings. Thus, buy-back of outstanding high coupon debt could in certain situations may be preferred alternative to swapping of high coupon debt with low coupon debt contracted. States that are considering prepayment of debt, however, need to satisfy themselves that the surplus cash balances are of an enduring nature. Second, given that the State Government securities are rarely traded, the appropriate pricing of securities contemplated to be bought back could be an issue. Third, since the investor profile is dominated by the 'buy-and-hold' investors, the likely response from the market participants could be lukewarm. An alternative option to debt buy-back and debt swap could be refraining from open market borrowings and other loans where States have an active role in mobilisation.

It may be mentioned that the build-up and volatility in Central Government's cash surplus with the Reserve Bank during 2005-06 had a significant impact on liquidity conditions in India. Government's cash balances, when maintained with the Central

Bank, do not form part of the liquidity in the banking system. Therefore, sharp increase in surplus balances in Government's account reduces liquidity in the banking system and this could drive up the short term interest rates. Arrangements which facilitate transfer of surplus funds from Government's account to deficit participants in the system could help in better management of liquidity in the system. Such arrangements not only enable the Government to earn better returns on the cash balances, but also mitigate volatility in short-term interest rates and keep overnight money market rates stable.

Arrangements aimed at achieving such transfer of liquidity vary widely across countries. For instance, in Canada, the cash balances of the Central Government are auctioned in a competitive auction twice a day to a select set of participants. The participants' auction limits (collateralised and uncollateralised) are decided on the basis of their credit rating. All Government receipts and disbursements flow through the Government's accounts at the Bank of Canada and the accounts are managed such that the balances at the Central Bank are essentially nominal. As a result, the Central Government invests effectively all of its cash balances in the market almost on a daily basis.

In contrast, in other G-7 countries, substantial cash balances are generally maintained with their respective Central Banks. Japan and Italy, for example, maintain all Government balances at their respective Central Banks. France and the United States maintain a significant working balance at their Central Banks while amounts beyond the targeted working balances are invested in the market. Germany invests cash surpluses in the market only on rare occasions.

Countries that keep balances at the Central Bank, of course, rely on the Central Bank to invest the funds. The United States allocates its balances to market participants on a pro rata basis at a fixed reference rate of interest (currently 25 basis points below the Fed funds rate), while France and the United Kingdom deal directly with market participants. The United States requires full collateral for its cash balances while France and the United Kingdom invest mainly through the repo market.

Source : Annual Report, 2005-06, Reserve Bank of India.

Box 11 : Investment Portfolio of State Governments

The Reserve Bank has been managing, since the late 1990s, the investments of Consolidated Sinking Funds (CSFs) of 14 State Governments and the Guarantee Redemption Funds (GRFs) of five State Governments from its portfolio of holdings of Government securities. The investments under Calamity Relief Fund (CRF) set up by the State Governments are being managed by select public sector banks. The Twelfth Finance Commission (TFC) had recommended in favour of an expanded coverage of CSF to include amortisation of all loans (and not just open market borrowings as at present), while GRF and CRF would be continued in its present form. The expanded ambit of CSF is likely to increase States' investments in CSF and could constrain Reserve Bank's open market operations for monetary policy purposes in view of the finite stock of securities with the Reserve Bank. In this regard, the Technical Group on Borrowings by States (Chairperson: Smt. Shyamala Gopinath), in its Report submitted in December 2005, recommended that whereas the Reserve Bank should continue to manage the expanded CSF, the Reserve Bank should also acquire Central Government securities from the PDs/banks and immediately pass them on to the State Government concerned at the same price *i.e.*, without loading any charge and with proper dissemination of such transactions so as to obviate any confusion among market participants about the intent of such transactions.

In the context of these developments, the Annual Policy Statement for 2006-07 proposed to revisit the scheme of CSF to cover the entire liabilities of State Governments. Furthermore, the Advisory

Committee on Ways and Means Advances to State Governments (Chairman: Shri M.P. Bezbaruah) had recommended that the net incremental (*i.e.* new investment less redemption/liquidation) annual investment of States in CSF/GRF may be made eligible for availing Special WMA in case the CSF/GRF schemes of the State Governments incorporate the above provision. Accepting this recommendation, the Reserve Bank circulated the revised model schemes of CSF/GRF among the States in May 2006. As regards CRF, following the recommendations of the TFC, the Government of India had circulated the details of the scheme among all the State Governments. In this context, and in consultation with the Government of India, the Reserve Bank had drafted a revised scheme as applicable to the Reserve Bank as the manager of investments in the Fund and had forwarded the same to the Government of India for concurrence. The Central Government, in turn, has forwarded the revised scheme to all the State Governments. The changes incorporated by the Reserve Bank in the CRF scheme are essentially to bring about uniformity in the modalities of investment and payment of commission, similar to the CSF and GRF schemes. States would, however, have the discretion to choose the Reserve Bank as the fund manager. The investments of the CRF would be dictated by consideration of maximisation of market-related return to the State Governments while ensuring safety and liquidity of the investments.

Source : Annual Report, 2005-06, Reserve Bank of India.

such poor return continue to be very large. The gross power subsidy increased by about five-folds from Rs.7,449 crore in 1991-92 to Rs.35,632 crore in 2005-06 (RE) (Table 53). It may be mentioned that power subsidy as ratio to GDP remained stagnant at the level of 1.2 per cent during 2002-03 to 2004-05 and declined to 1.0 per cent in 2005-06 (RE).

During 2005-06 (RE), 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 so far has been by way of cross-subsidisation mainly to the industrial and commercial consumers, as also *via* subventions

Table 53: Subsidies provided by State Electricity Boards

(Rs. crore)

Years	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	5,938	1,310	201	7,449 (1.14)	2,045	5,404	2,173	3,231
2000-01 (P)	24,074	9,968	386	34,428 (1.63)	8,820	25,607	3,435	22,172
2001-02 (P)	24,013	10,347	227	34,587 (1.52)	8,680	25,907	3,698	22,209
2002-03 (P)	21,845	8,534	189	30,568 (1.25)	12,996	17,572	4,797	12,775
2003-04 (P)	23,346	8,885	923	33,154 (1.20)	11,081	22,073	6,133	15,941
2004-05 (P)	25,240	10,432	516	36,187 (1.16)	10,478	25,709	6,391	19,319
2005-06 (RE)	25,043	10,179	410	35,632 (1.01)	11,562	24,070	8,083	15,987

P: Provisional RE: Revised Estimates

Note : Figures in brackets are proportion of GDP.

Source : Economic Survey, Government of India, various issues.

(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 lower at around 46 per cent in 2005-06 (RE) as compared with about 60 per cent in 2002-03. The ratio of cross-subsidies to power subsidy to agricultural consumers was placed lower at 32 per cent in 2005-06 (RE) 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.15,987 crore in 2005-06 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. According to Economic Survey 2005-06 of the Government of India, *"in 2005-06, while the direct transfers from State Governments to SEBs was placed at Rs.11,562 crore, an uncovered subsidy of Rs.15,987 crore remained, indicating the large potential that reforms have in improving not only the power sector itself but also the fiscal position of the States."*

VIII.6 Social Sector Expenditure

With bulk of the responsibilities pertaining to public expenditure on social services placed in the domain of State Governments, it is widely recognised that the level of social sector expenditure has important implications for the level of human development and long-term prospects of the economy (as discussed in Section VII). In this context, certain issues are worth discussing.

One important issue in the arena of social sector expenditure is the question of adequacy. Given the low level of human development achieved by many of the States in the country, and given the inequalities in income distribution, a minimum adequate level of social sector expenditure by the State Governments may be emphasised in order

to improve the human development indicators. Particularly, in the process of ongoing fiscal correction and consolidation, the States may ensure the level of social sector expenditure is not curtailed. The improvement in finances of the States during the recent years, however, would enable them to step up expenditure on education and health in the future, which would aid in promoting human development and improving the quality of overall social infrastructure in the country. Furthermore, the States need to reprioritise their expenditure so as to ensure adequate investment in the social sector. The reprioritisation of the social sector expenditure basket is also equally important as is the absolute level. Accordingly, expenditure on basic social services within social sector expenditure and the non-salary component of the social sector expenditure presumes importance in order to have greater impact on human development.

Another important issue relates to the effectiveness of social sector expenditure, *i.e.*, the impact of social sector expenditure on the social indicators. This impact could be different in different contexts depending on how effectively the funds have been utilised, level of corruption, awareness of the people, state of development of different institutions relevant for the delivery of social services, *etc.* Thus, depending on the different conditioning factors, the impact would differ across States. In this context, the distinction has to be made between the outlay and the outcome. In sync with the Union Government, many States have proposed in their budgets for 2006-07 to bring out 'Outcome Budget'. The other States may follow suit. This could improve transparency and in the process may yield better delivery of services from the investments made in the social sector projects.

In fact, providing quality services to the citizens may also have a positive impact on the poorer sections of the population. In the context of health care, there are studies showing that poor people are more sensitive to price than to quality.

Thus, even if the quality is poor they stick to public health care systems since they cannot afford to pay for private health care facilities. Thus, if the quality of public health services is poor, it is going to have an adverse impact on the poorer sections of the population, since those who can afford have the option to choose private health care facilities. Further, improvement in the delivery of services would encourage the public to pay for these services. In fact, the logic behind subsidising the social services is to enable the poorer sections of the society to access the merit goods like education and health, so as to improve the overall level of human development.

IX. CONCLUDING OBSERVATIONS

The analysis of fiscal position of the State Governments indicates marked improvement in the key deficit indicators in the recent years. In 2005-06, GFD and RD, as ratios to GDP, declined to 3.2 per cent and 0.5 per cent, respectively. Such a correction has been primarily through revenue enhancement with revenue receipts, as ratio to GDP, rising by 1.0 per cent over the previous year and States' own tax receipts rising by 0.3 per cent. Furthermore, the revised estimates of 2005-06 point out that the fiscal performance of the State Governments improved compared to the budget estimates, particularly in the revenue account reversing the usual trend of decline in fiscal performance in the revised estimates. Incentives provided by the TFC and budgetary rules framed under FRLs have played a composite role in dissuading State Governments to slip on their budgeted fiscal position.

The State Governments have committed in their budgets to carry forward the process of fiscal correction and consolidation further in their budgets for 2006-07. Accordingly, GFD and RD, as ratios to GDP, have been budgeted lower at 2.8 per cent and 0.1 per cent, respectively, than the previous year level. These corrections are budgeted to be achieved mainly through revenue enhancement. Recognising that the sustained fiscal correction lies

in revenue augmentation, the State Governments have emphasised broadening and rationalising tax system. Simultaneously, the State Governments have laid stress on improvement in tax administration, streamlining and strengthening existing tax and non-tax collection and plugging of revenue leakages. With a view to improving accountability of budget proposals, some States have proposed to introduce 'Outcome Budget', in line with the Central Government. Progressive number of States announced introduction of new pension scheme based on defined contribution to restrict their rising pension obligations. Some States proposed curtailment of non-developmental expenditure by doing away with vacated posts, adoption of austerity measures and reduction of non-Plan expenditure. The States, however, have the challenging task of continuing and sustaining the fiscal correction, which would eventually translate into durable fiscal consolidation.

Notwithstanding the improvement in the consolidated fiscal position of the State Governments in the recent years, there exists a wide variation in fiscal performance across the States as evident from the assessment of several fiscal indicators. The fiscally weak States may consider initiating measures to catch up with the fiscally sound States. In this connection, it may be mentioned that the TFC has provided a target oriented fiscal restructuring path, which needs to be attained by all the States by end of 2009-10.

Enactment of FRLs by majority of States has ushered in a rule based fiscal policy framework at the State level. However, fiscal correction path under the FRLs needs to be realistic. The process of correction should not adversely impact capital outlay and expenditure on social sectors. Any deviation from the targets set by the States under the FRLs enacted by them would, however, raise the issue of credibility. Hence, it would be desirable that the State Governments, which have enacted FRLs, adhere to the rules, while remaining States make efforts in the direction of adopting the rule based framework.

With bulk of the responsibilities pertaining to public expenditure on social services placed in the domain of State Governments, it is widely recognised that the level of social sector expenditure has important implications for the level of human development and long-term prospects of the economy. With regard to social sector expenditure, the States may consider the aspects such as adequacy, equity and efficiency. Furthermore, improvement in quality and delivery of social services may help in raising cost recovery in respect of these services.

There has been a sharp build-up of surplus cash balances of the State Governments in recent period as reflected in their investment in 14-Day Intermediate Treasury Bills. The upsurge in surplus cash balances of the State Governments has emanated mainly from the large automatic inflow of relatively high-cost NSSF resources, larger central tax devolution and grants following the recommendations of the TFC, as well as buoyancy of States' own tax revenues, in relation to their budgetary projections. The build-up of cash surplus also reflects the improvement in the financial health of the States, facilitated largely by the enactment of FRLs and the commitment of the States to the process of fiscal consolidation. Possible factors that could impinge upon the volume and durability of the cash balances of the State Governments include changes in the buoyancy and extant arrangements in respect of Small Savings (NSSF) and increases in expected expenditures (including repayment obligations, deferred expenditures and

higher wage bill following the recommendations of the Sixth Pay Commission) and/or unanticipated expenditures. The upsurge in the cash balances of the State Governments has, however, posed challenges to the cash and financial management of the State Governments.

With the Sixth Pay Commission already constituted by the Central Government, the States may consciously deliberate upon the impact of the award of the Pay Commission upon their financial position, given the State Governments' potential to implement their recommendations for their employees. The States, however, need to be cautious on decisions relating to salary levels and balance it with their fiscal capacity, employee strength, size of population and the required complementary expenditure for productive employment.

The State Governments may emphasise fiscal empowerment to augment revenues *i.e.*, by expanding the scope and size of revenue flows into budget. This would provide them the necessary flexibility to shift the pattern of expenditure to redirect it for social sector and capital expenditure. In this context, apart from tax reforms, levying of appropriate user charges, rationalisation of subsidies (including power sector subsidies) and restructuring of State level public sector undertakings assume significance. Furthermore, the State Governments' strategy of augmenting tax mobilisation through improvement in tax administration and recovery of tax arrears needs to be continued with greater vigour.