STATE FINANCES: A STUDY OF BUDGETS OF 2007-08[1]

Introduction

The State Governments presented their budgets for 2007-08[2] in an environment of growing recognition to pursue fiscal correction and consolidation. The progressive enactment of Fiscal Responsibility Legislation (FRL) ushered in a rule-based fiscal regime for the State Governments. The efforts of the State Governments towards reducing fiscal imbalances were aided by larger devolution and transfers from the Centre based on the recommendations of the Twelfth Finance Commission (TFC) along with the improvement in tax buoyancy on the strength of macroeconomic fundamentals. Furthermore, all States excepting Uttar Pradesh have implemented Value Added Tax (VAT) in *lieu* of sales tax, which has been an unqualified success in raising the tax revenue for the States.

The State Governments while presenting their budgets for 2007-08 have taken into account the priorities as laid out in the Eleventh Five Year Plan (2007-12). In order to ensure quality of human resource development, social sector expenditure is proposed to be raised by higher allocations in 2007-08. In view of the priority given to infrastructure development in the Eleventh Five Year Plan, the State Governments have envisaged implementation of various projects, especially power and roads. Many State Governments have proposed to implement the infrastructure projects through the framework of public-private partnership (PPP). The State Governments have also undertaken development of urban infrastructure under the Jawaharlal Nehru National Urban Renewal Mission (JNNURM).

The State Governments in their budgets for 2007-08 proposed various policy initiatives to carry forward the process of fiscal correction and consolidation through measures aimed at augmenting revenue and improving expenditure management. To augment their revenues, the State Governments announced measures for enhancing resource mobilisation through simplification/ rationalisation of tax structure, better enforcement and tax compliance. Some States proposed to review the user charges on power, water and transport. By adopting an outcome-oriented budgetary framework, some States have emphasised on translation of outlays into defined outcomes through monitorable performance indicators. Several States made commitments to contain revenue expenditure through restrictions on fresh recruitment and creation of new posts. State Governments have also focused on administrative reforms at various levels for simplifying administrative processes and procedures. A few more States announced the introduction of a contributory pension scheme for their newly recruited staff to contain rising pension obligations. A few States also proposed a comprehensive review of the functioning of the State PSUs and their restructuring. In order to restore financial viability of electricity boards, some States have signed Memorandum of Understanding (MoU) with

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[2] An analysis of the consolidated fiscal position of State Governments based on the State budgets of twenty-nine States including NCT Delhi for 2007-08 has been published in the Reserve Bank of India Annual Report, 2006-07. This Study covers budgets of twenty-eight State Governments. Information in respect of NCT Delhi and Puducherry are provided additionally as memo item. The Study provides detailed consolidated fiscal position as also State-wise analysis covering budgetary data as well as additional information obtained from the State Governments and the Government of India.

the Central Government for bringing reforms in the power sector. Some States have proposed to introduce “Gender Budget” to ensure empowerment and active participation of women in various development schemes.

The Government of India has taken initiatives to provide support to the State Governments in their developmental role by announcing measures in the area of education, health, social security, agricultural insurance, *etc*. The Reserve Bank, on its part, has been advising the State Governments on several issues, besides providing support in the form of ways and means advances (WMA)/overdraft (OD) and raising of market borrowings. The Reserve Bank aided the State Governments in organising prepayment of high cost debt, introduction of non-competitive bidding in the auctions of State Government securities and investment of cash balances.

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. Analysis and assessment of the consolidated budgetary position of the State Governments are made in Section IV. Section V brings out the State-wise assessment of the fiscal performance of the State Governments. Section VI provides an analysis and assessment of the outstanding liabilities, including market borrowings and contingent liabilities of the State Governments. An analysis of fiscal transfers from the Centre to the States as a special theme is presented in Section VII. The emerging issues on State finances are presented in Section VIII followed by concluding observations.

Annex 1 sets out the State-wise major policy initiatives announced in the State budgets. Annex 2 provides the details of the FRL of three States, *viz*., Jammu and Kashmir, Mizoram and Jharkhand, which were presented in August 2006, October 2006 and May 2007, respectively. Annex 3 provides the summary position of the State Governments (non-Special and Special) according to various fiscal indicators for 2003-06 (average) and revised estimates for 2006-07. Annex 4 provides the constitutional framework for allocation of functions and finance between the Union and the States. Annex 5 gives the shares in divisible taxes recommended by the successive Finance Commissions and Annex 6 gives the criteria and weights used for tax devolution by the Finance Commissions. The consolidated data on various parameters and fiscal indicators of the twenty-eight State Governments are set out in the Appendix Tables 1-31, while State-wise data are provided in Statements 1-56. 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 major fiscal indicators of the State Governments have witnessed significant improvement in the recent years. Continuing the fiscal correction and consolidation process, the State Governments in their budgets for 2007-08 have budgeted a consolidated surplus in the revenue account after a gap of two decades. The ratio of gross fiscal deficit (GFD) of the States to gross domestic product (GDP) has been estimated lower at 2.3 per cent in the budget estimates (BE) for 2007-08 (a decline of 0.5 percentage points) after witnessing an increase of 0.3 per cent of GDP in the revised estimates (RE) for 2006-07 over 2005-06 (Accounts) on account of increase in capital expenditure despite a decline in revenue deficit (RD). The proposed correction in GFD during 2007-08 is based on the turnaround envisaged in the revenue account, which has been budgeted to generate a surplus of 0.3 per cent of GDP as compared with a deficit of 0.1 per cent of GDP in 2006-07 (RE). The primary deficit (PD)-GDP ratio is budgeted to decline to 0.1 per cent during 2007-08 from 0.4 per cent in the previous year. Capital outlay-GDP ratio would increase to 2.6 per cent from 2.5 per cent in the preceding year.

The key deficit indicators of the State Governments, *viz*., RD, GFD and PD recorded significant reduction when revised estimates of 2005-06 translated into accounts (Table 1). The

Table 1: Key Deficit Indicators

(Per cent of GDP)

Item	2005-06 (RE)	2005-06 (Accounts)	2006-07 (BE)	2006-07 (RE)	2007-08 (BE)
1	2	3	4	5	6
Revenue Deficit	0.6	0.2	0.2	0.1	-0.3
Gross Fiscal Deficit	3.2	2.5	2.6	2.8	2.3
Primary Deficit	0.7	0.2	0.2	0.4	0.1

Note : Negative (-) sign indicates surplus.
Source : Budget Documents of the State Governments.

correction in the revenue account in 2005-06 (Accounts) was largely on account of a reduction in the revenue expenditure, mainly non-interest revenue expenditure. There was also a decline in capital outlay, which as a ratio to GDP declined from 2.4 per cent in 2005-06 (RE) to 2.2 per cent in accounts.

The trends in the revised estimates of 2006-07 *vis-à-vis* the budget estimates indicate an improvement in the revenue account of the State Governments compared with the budget estimates. The increase in revenue receipts mainly on account of increase in States' own tax revenue and share in Central taxes more than compensated for the increase in the revenue expenditure. The GFD, however, increased notwithstanding the decline in RD, due to higher provision for capital outlay.

The consolidated fiscal position of State Governments in 2007-08 indicates further improvement in terms of the major deficit indicators. The correction in the revenue account during 2007-08 has been envisaged to be achieved primarily through enhancement in revenue receipts, which have been estimated to increase to 13.1 per cent of GDP in 2007-08 from 12.9 per cent in the previous year. The improvement in revenue account would also be facilitated by deceleration in revenue expenditure, which would decline to 12.8 per cent of GDP during 2007-08 from 13.0 per cent in the previous year. The revenue surplus would facilitate a lower level of GFD than in the previous year.

The marked improvement in consolidated fiscal position does not reveal the wide variation that exists across the States. During 2007-08, twenty States have presented revenue surplus budgets. However, fifteen States have budgeted for higher GFD in 2007-08 over the previous year. Only a few States account for a major part of the envisaged overall correction. State-wise analysis of the fiscal correction process indicates that the non-special category States would account for 85 per cent of the correction in the revenue account and 73 per cent of the correction in GFD.

Assessing the State Budgets in conjunction with Union Budget 2007-08 indicates that grants-in-aid have been overestimated by 17.8 per cent while shareable central taxes have been underestimated by 4.4 per cent. So far as financing of GFD is concerned, the flows from NSSF, which have been generally underestimated in State Budgets, have been overestimated in 2007-08. It may be noted that in their budgets for 2007-08, the consolidated position of revenue surplus of the State Governments has been estimated at Rs.11,973 crore (0.3 per cent of GDP), while GFD has been estimated at Rs.1,08,323 crore (2.3 per cent of GDP). Adjusting for the data of Union Budget 2007-08, the revenue surplus of the State Governments would be placed lower at Rs.503 crore (0.01 per cent of GDP) and the GFD would be placed higher at Rs.1,19,793 crore (2.6 per cent of GDP).

The large and growing GFD of States, particularly since the latter half of the 1990s, led to accumulation in the outstanding debt of State Governments. The outstanding liabilities as ratio to GDP, however, have witnessed a decline in the recent years. The outstanding liabilities of State Governments, as proportion to GDP, are budgeted at 29.9 per cent as at end-March 2008, lower than 30.9 per cent as at end-March 2007. Furthermore, the ratio of interest payments to revenue receipts, which was 26.0 per cent in 2003-04 has been budgeted to come down to 16.9 per cent in 2007-08 mainly on account of the debt swap scheme (DSS). This ratio is required to be gradually brought down to 15 per cent by all States by the end of the terminal year (2009-10) of the award period of the TFC as per its suggested restructuring path for State finances. Loans from National Small Savings Fund (NSSF) remain the dominant component of outstanding debt followed by market borrowings and loans from the Centre.

A significant development in respect of State finances in the recent period has been progressive enactment of Fiscal Responsibility Legislation (FRL) by the State Governments (twenty-six States so far). The enactment of FRL has provided impetus to the process of attaining fiscal sustainability as reduction in key deficit indicators, *viz*., RD and GFD, is critical for reducing the mounting level of debt of the States. Apart from fiscal sustainability, meeting the targets set in FRLs is crucial not only for maintaining credibility in budgetary operations but also ensuring prudent debt management and greater transparency. Although enactment of FRL by most of the States has ushered in a rule-based fiscal policy framework at the State level, it is important to ensure that the process of fiscal correction does not adversely impact capital outlay and expenditure on social sectors. In particular, the quality of fiscal correction assumes significance. Assessment of fiscal performance indicates that most of the States are reaching their RD and GFD targets well ahead of the stipulated time schedule under their FRL.

Prudent fiscal management requires that durable fiscal consolidation is attempted through fiscal empowerment, *i.e.,* by expanding the scope and size of revenue flows. A fiscal strategy based on revenue maximisation would also provide the necessary flexibility to shift the pattern of expenditure towards developmental purposes. On the other hand, fiscal adjustment predominantly based on expenditure reduction may result in welfare losses and risks the danger of triggering a downturn in overall economic activity. There has been some progress in reforming the tax framework in terms of improvement in tax administration and reduction in tax distortion. The introduction of VAT by the State Governments has been an unqualified success. States' own tax revenue has witnessed buoyancy in recent years. However, the non-tax revenue of States has remained low. Thus, augmenting resource mobilisation from non-tax revenues through appropriate user charges, cost recovery from social and economic services and restructuring of State public sector undertakings (PSUs) assumes 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.

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. It may be mentioned that most of the millennium development goals prescribed by the United Nations to be achieved by 2015 relate to social sector. A reorientation of expenditure towards productive purposes may necessitate the adherence to the principles of public expenditure management. In this context, the international experience indicates a wide variety of methods including placing limits on certain expenditures, prioritisation of expenditure, greater decentralisation of executive functions, improved cash management and greater accountability in the delivery of services against specified targets. The adoption of some of these principles could facilitate a qualitatively superior process of fiscal consolidation. Closely related to expenditure management is the issue of monitoring and evaluation of Government programmes. Traditionally, plan monitoring has been done by the States by tracking expenditure levels achieved in relation to outlays. While expenditure is an important measure of the pace of implementation, it is not a measure of effectiveness. Therefore, it is necessary to move from outlays and expenditures to final outcomes.

An issue that has a bearing on the liquidity and cash management by the State Governments relates to their surplus cash balance. The buoyancy in small saving collections over the last few years and the automatic channelisation of these funds to the States has meant that State Governments' borrowings are more than the amount required for financing their GFD. This gets reflected in large surplus cash balances maintained by most of the State Governments in the form of investments in 14-Day Intermediate and Auction Treasury Bills, which at the consolidated level stand at Rs.62,996 crore (as on November 23, 2007). The States get a lower rate of return on these investments than the cost of borrowings for these resources, thus having an adverse impact on the revenue account.

Fiscal transparency, which is considered to be one of the cornerstones of good governance, has been gaining critical importance in the recent period in the context of prudent fiscal management and attainment of macroeconomic balance. Fiscal transparency requires providing comprehensive and reliable information about past, present, and future activities of economic policy decisions. Transparency in Government fiscal operations would need to be strengthened in tandem with the process of fiscal consolidation and the financial sector reforms so as to enhance credibility of the fiscal stance of the Government. The need for adequate availability of information through State budgets is not only to aid policy makers or to enhance transparency at the State level, but also for investors to make 'informed' decisions. Further, fiscal transparency benefits citizens by giving them the information they need to hold their Government accountable for its policy choices. An issue which deserves special mention in the context of fiscal transparency is the lack of availability of data on the outstanding liabilities and contingent liabilities. Furthermore, persistently large deviations between the budget estimates and the accounts data particularly in respect of revenue receipts of the State Governments adversely impact upon the credibility of the budget estimates and preclude a proper assessment of the likely fiscal outcome.

The State Governments are responsible for most infrastructure services except for telecommunications, civil aviation, railways and major ports. Inadequate investment in infrastructure has constrained the growth and development of the States. The States would need to strengthen their finances through fiscal, structural and institutional reforms which would enable them to release adequate budgetary resources as also enable them to mobilise funds more easily for financing infrastructure. In view of the budget constraints under rule-based fiscal regime, the State Governments also need to promote PPP projects in the area of economic infrastructure.

To sum up, it may be mentioned that the State Governments have witnessed visible reduction in the deficits indicators. The States, however, have to strive to sustain the ongoing process of fiscal correction to achieve durable fiscal consolidation. It is important to note that only a few States account for the major part of the overall correction in the consolidated fiscal position. At the same time, the fiscal position of some States continues to remain weak. In particular, there are concerns regarding the sustainability of high level of debt of a number of States. The State Governments may emphasise on creating fiscal space, which would provide them the necessary flexibility to shift the pattern of expenditure towards development expenditure. In this context, tax reforms aimed at plugging loopholes, levying of appropriate user charges to shore up non-tax revenue and restructuring of State-level public sector undertakings assume significance. A reorientation of expenditure towards productive purposes may necessitate adherence to the principles of public expenditure management by the States. With a view to improving monitoring and evaluation of programmes, the State Governments may aim at a system which is responsive to the needs of improving the efficiency and effectiveness of spending measured in terms of improvement in delivery of services, ensuring intended benefit to the targeted groups, completion of projects as per the time schedule and plugging the leakages in the spending processes.

III. POLICY INITIATIVES

The State Governments, while presenting their budgets for 2007-08, continued to pursue further the fiscal correction and consolidation in terms of the path of fiscal restructuring prescribed by the TFC. FRL has been enacted by twenty-six State Governments (as at end-October 2007). All States, excepting Uttar Pradesh, have implemented the VAT in *lieu* of sales tax. The Medium Term Fiscal Plan (MTFP) of various States formulated in terms of their FRLs attempt to address the structural infirmities with a view to improving tax administration, removing tax distortion and prioritising expenditure (Box 1). The State Governments have taken into account the priorities

Box 1: Adoption of Medium Term Fiscal Policy by State Governments with Special Reference to Karnataka

The Twelfth Finance Commission (TFC) mandates the States to enact the Fiscal Responsibility Act (FRA) and formulate the Medium Term Fiscal Policy (MTFP) to receive the benefits of debt relief. All State Governments excepting two, *viz*., Sikkim and West Bengal have enacted the Fiscal Responsibility Legislation (FRL). The section 3 of the FRLs of the State Governments, in general, requires the MTFP Statement to include the following: (i) a statement of recent economic trends and prospects for growth and development, (ii) an evaluation of the performance of the prescribed fiscal indicators in the previous years, (iii) the medium-term fiscal objectives of the Government, (iv) three-four year rolling targets of fiscal indicators with specification of underlying assumptions, (v) an assessment of sustainability relating to the revenue deficit and the use of capital receipts for generating productive assets, (vi) policies of Government for the ensuing financial year relating to taxation, expenditure, borrowings and other liabilities, *etc.,* and (vii) the strategic priorities and key policies of the Government.

Karnataka was the first among the States to enact FRL in September 2002 followed by Tamil Nadu (May 2003), Kerala (September 2003) and Punjab (May 2004). Taking Karnataka as an example, the salient features of the MTFP statement prepared by the Karnataka Government covering the period from 2007-08 to 2009-10 are set out here.

The MTFP of Karnataka assumes real growth of GSDP at 8 per cent and inflation at 5 per cent. The financial performance of the State for last four years with regard to various indicators shows an improvement. Despite an increase in revenue expenditure, revenue surplus has grown and the fiscal deficit has been kept within 3 per cent of GSDP. Devolution of taxes and grants from the Centre has increased on account of improved buoyancy of Central taxes and the TFC award. The emphasis of the Karnataka Government has been to increase outlays in social sector expenditure so as to ensure better service delivery and provide impetus to equitable growth. Committed expenditure has been kept under control. Development expenditure as a per cent of GSDP has grown, reflecting effort towards increasing outlay for promoting economic growth. The State Government has raised concerns regarding issues pertaining to certain major subsidies, which need to be reviewed in terms of both quantum and targeting.

Revenue reforms initiated with the constitution of the Tax Reforms Commission has given a new impetus to the revenue collection of the State Government. For the purpose of MTFP, based on trend growth rates and recent growth rates in value added tax (VAT), buoyancy of 1.075 has been assumed for the purposes of projection. The State Government has enjoyed buoyant revenue collection under excise in last few financial years. Buoyancy of 1.075 has been assumed for the medium-term plan. Because of unexpected growth in housing sector in last few years, the revenue under stamps and registration has grown beyond budget estimates. Taking this into account, a buoyancy of 1.1-1.5 has been taken for medium-term plan. For motor vehicle tax, a buoyancy of 1.025 has been assumed for making the projections. Collection under non-tax revenue has, however, not kept pace with the growth of economy. Lack of revision of user fees and user charges has been one of the important reasons for that.

In order to meet the expenditure requirements of the State, surplus in revenue account is to be used for capital formation. It is proposed to continue to make higher allocations for high priority development expenditure in areas of health, education, agriculture, irrigation and infrastructure. To improve effectiveness and efficiency of service delivery of basic necessities as well as creation of local assets, the State would increase devolution to both Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) and provisions for adequate maintenance expenditure. To supplement State's investment in infrastructure, private partnership route for viable projects through transparent bidding procedure would be emphasised. Programme budgeting would be introduced to monitor outcomes against outlays. Revenue expenditure on pre-committed items like interest payments would be brought down further through debt swapping and pre-payment of high cost debt. Through fiscal discipline, the State would avail of benefit of debt waiver scheme also.

As a part of budgetary reforms, the State has made efforts to bring down its off-budget borrowings as well as debt stock. It is proposed to phase out off-budget borrowings from 2008-09 by bringing them on-budget. The State Government has proposed to introduce Commonwealth Secretariat's Debt Reporting and Management Software. This software would not only enable monitoring and supervision of State's debt but would also assist in generating management information reports. Government will classify the guarantees in terms of their level of risks and review them selectively and take corrective action if required. It has been envisaged to create a central data base of all Government guarantees extended by State Government till now and get them rated through a professional rating agency to assess associated risk.

With the prescriptive buoyancy of revenues coupled with higher Central transfers and expenditure restructuring measures suggested, the State is expected to generate revenue surplus of 1.6 per cent of GSDP in 2010-11 as compared with 0.7 per cent of GSDP in 2007-08. Fiscal deficit would be brought down to 2.8 per cent of GSDP in 2010-11 as compared with 2.9 per cent of GSDP in 2007-08 mainly on account of increase in revenue surplus. The emerging fiscal profile shows a decline in the debt stock to GSDP ratio from 30.8 per cent as at end-March 2008 to 27.3 per cent by end-March 2011. Although public finances have improved over the last few years, major challenge for the Karnataka Government would be the adverse impact of the Sixth Pay Commission award. The fiscal space available to Government is limited, since essential items of expenditure like salaries, pensions and interest payment absorb a major share in total expenditure. Apart from effective and credible expenditure rationalisation and additional resource mobilisation, revenue reforms including *inter alia* automation of the tax administration and greater devolution of service tax are crucial for placing State finances on a sustainable fiscal consolidation path.

Reference:

1. Medium Term Fiscal Policy Statements of various State Governments.

laid down in the Eleventh Five Year Plan (2007-12) in the State Budgets for 2007-08 as it is the first year of the Plan. Accordingly, allocations for the social sector and rural infrastructure are proposed to be raised by the States. The Government of India has taken initiatives to provide support to the State Governments in their developmental role by announcing measures in the area of education, health, social security, agricultural insurance, *etc*. The Reserve Bank, on its part, has been advising the State Governments on several issues, besides providing support in the form of WMA/OD and raising of market borrowings. The Reserve Bank aided the State Governments in organising prepayment of high cost debt, introduction of non-competitive bidding in the auctions of State Government securities and investment of cash balances. The various policy initiatives and measures that have been proposed for implementation by the State Governments, the Government of India and the Reserve Bank of India are briefly narrated in this section.

III.1 State Governments

The State Governments, in their budgets for 2007-08, have remained committed to carry forward the process of fiscal correction and consolidation and have announced several policy measures aimed at revenue augmentation, expenditure management and institutional development. On the revenue side, the State Governments have announced measures for mobilisation of additional resources through simplification/rationalisation of tax structure, better enforcement and tax compliance. The States have made commitments to contain non-plan revenue expenditure and reduce pension obligations, while enhancing capital disbursement for the social and rural sectors. The States have also undertaken the development of urban infrastructure under JNNURM. The States have also proposed to implement infrastructure projects through the PPP framework. The State-wise details of major policy measures are set out in Annex 1. The major policy initiatives announced by the State Governments in their budgets for 2007-08 are summarised in the following paragraphs.

III.1.1 Revenue Measures

In their budgets, the State Governments in general have placed emphasis on improving tax administration by simplification of rules and procedures, rationalisation of tax rates and making the system of tax collection easy and transparent to ensure better tax compliance. For example, Gujarat has proposed reform and rationalisation of motor vehicle tax, while Bihar has proposed reduction in motor vehicle tax. As a revenue generating measure, Haryana and Rajasthan have proposed cess on banquet halls and lawns. The Kerala Government has proposed to impose stamp duty on demat transactions.

All the State Governments, except Uttar Pradesh, and both the Union Territories (UTs) with legislature, *i.e.,* NCT Delhi and Puducherry, have implemented VAT. The States that have already implemented VAT have announced measures like simplification of VAT return form (West Bengal), audit assessment of VAT to judge the efficiency of collection of VAT (Mizoram) and evaluation of VAT implementation (Himachal Pradesh). Some State Governments (Kerala, Maharashtra and West Bengal) have decided to impose VAT on tobacco and tobacco products in view of the reduction in the rate of Central Sales Tax (CST) from 4 per cent to 3 per cent.

A few States have proposed a reduction in certain taxes aimed at providing incentives to specific sectors/industries. In order to provide a boost to the tourism industry, Gujarat and West Bengal have announced reduction in the rates of luxury tax. Haryana has announced tax relief on energy saving devices to encourage conservation of power in the State. Some States have proposed to reduce power/electricity rates to various sections of population (Andhra Pradesh, Goa and Gujarat). However, in order to conserve energy, States like Goa have imposed energy cess on consumers whose consumption exceeds a certain limit during the month. Rajasthan has also granted tax exemption to hand-made goods of self-help groups (SHGs). The State Governments have also placed emphasis on the need to enhance their non-tax revenues. For example, Jammu and Kashmir has proposed to review the progress of collection of non-tax revenues apart from devising strategies to augment the revenue flows.

III.1.2 Expenditure Measures

State Governments have continued their efforts to place emphasis on expenditure management and containment of non-plan revenue expenditure. While several States had already imposed ban over recruitments and creation of new posts, Nagaland has proposed a voluntary retirement scheme and ban on creation of new posts. The State Governments have highlighted the need to reduce salary expenditure and proposed measures to reduce administrative expenditure. While aiming at expenditure prioritisation, the State Governments have proposed several developmental schemes for the weaker sections of the society. A number of concessions have been announced in the State Budgets for 2007-08, especially towards reduction in the interest burden of loans extended to the farmers and persons belonging to the scheduled caste/tribe for education purposes. Few State Governments have also proposed to provide loans at lower than market interest rates to women organisations. Several State Governments, including Andhra Pradesh, have proposed insurance schemes for the poorer sections of population and tribal groups. Chhattisgarh has proposed an insurance scheme for farmers to provide protection against losses due to natural calamities, while Goa has proposed to provide insurance cover against accidental fire hazards to small and marginal farmers. Some of the States have proposed setting up of dedicated funds for targeted purposes/sectors, such as corpus fund to rejuvenate sick industries (Bihar), road development fund (Bihar and Jharkhand), garbage management fund (Goa), pension fund (Himachal Pradesh), social sector viability gap fund (Rajasthan). Several State Governments have announced expansion in coverage under pension schemes and increase in rates of pension rates for senior citizens, widows and disabled persons (Himachal Pradesh, Karnataka, Sikkim, Tamil Nadu and West Bengal).

In order to assist the rural and urban local bodies to improve infrastructure and civic services, few State Governments (Punjab, Tamil Nadu and West Bengal) have provided higher devolution to the Panchayati Raj Institutions and Urban Local Bodies.

III.1.3 Institutional Measures

During past few years, the State Governments have adopted various institutional measures, which were oriented towards further strengthening of fiscal discipline, such as legislation in respect of guarantees and fiscal responsibility. Three State Governments, *viz*., Jammu and Kashmir (August 2006), Mizoram (October 2006) and Jharkhand (May 2007) enacted FRL encompassing targets on various fiscal parameters, thus taking the total number of States that have enacted FRL to twenty-six. The main features of the FRL of Jammu and Kashmir, Mizoram and Jharkhand in terms of various parameters are presented in Annex 2. The States have also implemented measures like introduction of new pension scheme (NPS), setting up of consolidated sinking fund (CSF) and guarantee redemption fund (GRF) and ceiling on guarantees (Table 2).

Most of the State Governments have proposed setting up of committees/institutions/ schemes for targeted purposes, such as agricultural technological management authority (Bihar), knowledge incentive scheme (Chhattisgarh), women employment exchange (Gujarat), rural development (Haryana and Uttar Pradesh), streamlining of exemptions given to industries (Jammu and Kashmir), development of roads (Bihar and Jharkhand), public distribution grievance redressal (Jharkhand), regional imbalances (Karnataka), micro-credit (Karnataka), welfare of unorganised workers (Karnataka), bio-fuel mission (Karnataka), dairy development (Karnataka), urban development (Kerala and Mizoram), farmers' welfare (Madhya Pradesh), bamboo promotion (Meghalaya and Mizoram), mineral exploration (Orissa), welfare of weaker sections (Rajasthan, Tamil Nadu and Uttar Pradesh), capacity building (Sikkim), monitoring of welfare schemes (Tamil Nadu) and professional education (Uttar Pradesh). Karnataka Government

Table 2: Institutional Reforms by State Governments*

	State	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.	Andhra Pradesh	April 2005	June 2005	September 2004	Yes	Yes	Yes
2.	Arunachal Pradesh	April 2005	March 2006	No	No	Yes	No
3.	Assam	May 2005	September 2005	February 2005	Yes	Yes	No
4.	Bihar	April 2005	April 2006	September 2005	No	No	No
5.	Chhattisgarh	April 2006	September 2005	November 2004	Yes	Yes	No
6.	Goa	April 2005	May 2006	August 2005	Yes	Yes	Yes
7.	Gujarat	April 2006	March 2005	April 2005	Yes	Yes	Yes
8.	Haryana	April 2003	July 2005	January 2006	Yes	Yes	Yes
9.	Himachal Pradesh	April 2005	April 2005	May 2003	No	No	No
10.	Jammu and Kashmir	April 2005	August 2006	No	No	No	Yes
11.	Jharkhand	April 2006	May 2007	December 2004	No	No	No
12.	Karnataka	April 2005	September 2002	April 2006	Yes	No	No
13.	Kerala	April 2005	August 2003	No	Yes	Yes	No
14.	Madhya Pradesh	April 2006	May 2005	January 2005	Yes	No	Yes
15.	Maharashtra	April 2005	April 2005	November 2005	No	Yes	No
16.	Manipur	July 2005	August 2005	January 2005	Yes	No	No
17.	Meghalaya	April 2006	March 2006	No	No	Yes	No
18.	Mizoram	April 2005	October 2006	No	No	Yes	No
19.	Nagaland	April 2005	August 2005	No	Yes	Yes	Yes
20.	Orissa	April 2005	June 2005	January 2005	Yes	Yes	Yes
21.	Punjab	April 2005	October 2003	No	Yes	Yes	No
22.	Rajasthan	April 2006	May 2005	January 2004	Yes	No	No
23.	Sikkim	April 2005	No	April 2006	Yes	Yes	Yes
24.	Tamil Nadu	January 2007	May 2003	April 2003	Yes	Yes	No
25.	Tripura	October 2005	June 2005	No	No	Yes	No
26.	Uttarakhand	October 2005	October 2005	October 2005	No	Yes	Yes
27.	Uttar Pradesh	No	February 2004	April 2005	No	No	No
28.	West Bengal	April 2005	No	No	Yes	Yes	No
Sum-up		**27**	**26**	**19**	**17**	**19**	**10**

* : Position as at end-October, 2007.
Source : Based on Information received from respective State Governments and Reserve Bank records.

has proposed to establish a new Directorate of Social Security and Pensions to implement all the pension schemes. Kerala has proposed to integrate various social security schemes after undertaking a comprehensive evaluation. Gender budgeting has been proposed by Madhya Pradesh and Uttarakhand, while Kerala would be forming a Gender Advisory Committee. Some States have also proposed to introduce insurance schemes in pursuance of a new scheme called Aam Admi Bima Yojana (AABY) announced in the Union Budget 2007-08. Few States would explore the possibility of linking their existing schemes with the AABY. Assam has set up a Rural Housing Board to address the problems of rural housing and a Terrorist Victims Welfare Board to help the relatives of terrorist victims on a sustainable basis. A number of State Governments (Assam and Chhattisgarh) have decided to implement the recommendations of the Vaidyanathan Committee to strengthen the co-operative banks. Several State Governments have proposed for a greater role of the local bodies.

III.1.4 Other Initiatives

The State Governments have proposed several schemes particularly directed towards education, health and employment. Almost all the State Governments have proposed to set up (upgrade) new (existing) schools/colleges/ universities towards providing basic as well advanced education facilities to wider sections of populations in their respective States. State Governments have announced extension of the employment guarantee schemes to cover more districts. Jammu and Kashmir has proposed to constitute a high-powered employment mission to look into employment related issues and monitor programmes at various levels. Furthermore, several States (Assam and Sikkim) have proposed setting up of Special Economic Zones (SEZs) and industrial parks for specific industries like information technology. The State Governments are also setting up projects on PPP basis for various purposes, including management of Industrial Training Institutions (ITIs), development of health services, provision of transport services, infrastructure projects, and power projects. Some of the State Governments (Goa, Madhya Pradesh, Maharashtra and Uttar Pradesh) have suggested measures to augment power supply, ensure energy conservation and reduce transmission losses to meet their energy requirements. The State Governments have also announced initiatives to improve irrigation facilities and supply of drinking water in rural as well as urban areas. The West Bengal and Tamil Nadu Government have announced measures to revise and revitalise the tea gardens of their States. Some States (Punjab, Sikkim, Tripura) have also placed emphasis on horticulture and floriculture projects.

Some State Governments have placed emphasis on setting up of environment friendly industrial units. Karnataka has proposed to establish an environment impact assessment authority. Kerala has proposed a scheme to sustain the ecological balance of wet land areas. Sikkim has commissioned an environment and green mission and proposed to constitute an Expert Group to study the state of glaciers and its impact on water system. Some States have also proposed measures to increase tree and forest cover in their States and encourage eco-tourism.

III.2 Government of India

The Government of India aids the reform process of the State Governments through various measures. The progress of eight flagship programmes under Bharat Nirman would continue to aid the development process in the State Governments.

In the Union Budget 2007-08, the Government of India outlined several initiatives to assist the State Governments in their developmental and social role. The Centre has integrated the polio eradication programme into the National Rural Health Mission (NRHM). There will be intensive coverage in the twenty high risk districts of Uttar Pradesh and ten districts of Bihar. To make a beginning towards introducing a social security scheme for unorganised workers, the Union Government has proposed to extend death and disability insurance cover through Life Insurance Corporation of India (LIC) to rural landless households under a new scheme called “Aam Admi Bima Yojana”. This scheme, which proposes to provide insurance cover to the head of the family or one earning member in the family among rural landless households, will be finalised in consultation with the State Governments. The Central Government would bear 50 per cent of the premium of Rs.200 per year per person and the State Governments would be urged to bear the other 50 per cent on behalf of the beneficiaries. A pilot project was launched in thirteen States in March 2005 to repair, renovate and restore water bodies. Such projects are being prepared for Karnataka, Orissa and West Bengal. In order to revive and replicate a programme called ‘Training and Visit’, in which the agricultural extension workers worked side by side with the farmers during the Green Revolution of the 1960s, the Ministry of Agriculture will draw up a new programme in consultation with the State Governments. The Agricultural Insurance Corporation (AIC), which has been running a pilot weather insurance scheme since Kharif 2004, will be asked to start a weather based crop insurance scheme on a pilot basis in two or three States in consultation with the State Government concerned, as an alternative to National Agriculture Insurance Scheme (NAIS). The scheme will be operated on an actuarial basis with an element of subsidy. The Centre has announced a scheme for the modernisation and technological upgradation of the coir industry with special emphasis to major coir producing States such as Kerala, Karnataka, Tamil Nadu, Andhra Pradesh and Orissa.

The Union Budget based on the mutual agreement between the Centre and the States proposed to phase out the CST, commencing with a reduction of the CST rate from 4 per cent to 3 per cent from April 1, 2007. The Union Budget provided an amount of Rs.5,495 crore for compensation of losses to the States, if any, on account of the VAT as well as the CST. In the spirit of ongoing co-operative fiscal federalism between the Centre and the States, the Union Budget announced that the Empowered Committee of State Finance Ministers would prepare a roadmap for introducing a national-level Goods and Services Tax (GST) with effect from April 1, 2010 (Box 2). The Central Government is also lending support to the e-governance action plans at the level of State Governments with the aim of improving efficiency, accessibility and transparency in Government functions.

III.3 Reserve Bank of India

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

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

III.3.1 Pre-payment of Debt by State Governments

Faced with the accumulation of surplus cash balances and a negative spread earned on the investment of such balances, some State Governments had approached the Reserve Bank to arrange for the buy-back of their outstanding State Development Loans (SDLs). Accordingly, the Reserve Bank formulated a general scheme for the buy-back of SDLs with the concurrence of the Government of India. Buy-back auctions were conducted for two State Governments, *viz*., Orissa and Rajasthan, on February 22, 2007 and March 23, 2007 and a total amount of Rs.479.07 crore of SDLs was bought back. Prepayment of outstanding debt reduces future coupon payment liabilities, generates market interest in the otherwise dormant securities and imparts liquidity in those securities.

III.3.2 Indicative Calendar for Market Borrowings of State Governments

The Annual Policy Statement of April 2006 had indicated that States, at their discretion and initiative, would be encouraged to develop an advance indicative open market borrowing calendar, with a view to helping investors to plan their investments in advance and, in turn, to avoid undue liquidity pressure in the system. In a move towards greater transparency in market borrowings of State Governments, based on the discussions held during the Conferences of State Finance Secretaries, a Press Release was issued on September 12, 2007 by the Reserve Bank disseminating information on gross allocation (inclusive of net allocation, additional allocation and repayments) during 2007-08 and the amount that could be raised during the remaining period of 2007-08.

III.3.3 Introduction of Non-Competitive Bidding Scheme in the Auctions of State Development Loans

With a view to widening the investor base in SDLs, the Annual Policy Statement of April 2006

Box 2: A Roadmap to Goods and Services Tax in India

Goods and Services Tax (GST) is a comprehensive value added tax (VAT) on goods and services levied and collected on the value added at each stage of sale and purchase wherein the manufacturers and dealers claim credit for 'input tax' while the final consumer bears the incidence of the full tax. GST is founded on the premise that in a modern economy where value addition in the production and sale of many products requires inputs of both goods and services which may be bundled indistinguishably there should be a unified rate of tax on goods and services. GST thus removes the infirmities of a tax system and allows the industries and the economy to function efficiently and smoothly.

In India, considerable progress has been made on the front of indirect taxation reforms such as significant convergence in tax rates and extending input tax credit to convert excise duties into a CENVAT, and VAT replacing sales taxes in all the States, excepting Uttar Pradesh since April 2005. A final destination of this indirect tax reforms would be to have a comprehensive VAT in the form of a harmonised GST. The Finance Minister, in the Union Budget for the year 2006-2007, had proposed that India should move towards a national level GST by April 1, 2010 which would be shared between the Centre and the States. A number of critical steps, however, need to be taken before the introduction of GST. Each of the parallel systems of indirect taxation at the Centre and State levels requires to be reformed to eventually harmonise them since GST requires evolving an efficient and harmonised consumption tax system. A first step in this direction would be progressive convergence of the service tax and the CENVAT rate. The central excise duty may have to be converted into a full-fledged manufacturing stage VAT on goods and services while transforming the States sales tax systems into a retail stage destination based VAT before the two systems are integrated and harmonised. Other steps required to bring about a comprehensive and unified system of taxation of goods and services would include: abolishment of the Central Sales Tax (CST); determining a suitable GST rate on goods, which is much lower than the sum of core rates of CENVAT at 16 per cent and State VAT at 12.5 per cent; enabling the States to tax goods and services at an equal rate; and enabling the Centre to tax value added in goods up to the retail stage.

On the issue of abolition of CST, the Empowered Committee of the State Finance Ministers and the Ministry of Finance, Government of India reached a broad consensus. Accordingly, it was announced in the Union Budget 2007-08 to phase it out. A package has been envisaged to compensate the losses arising out of the abolition of CST. With regard to a suitable GST rate, the Kelkar Committee has suggested a 20 per cent combined GST rate as it compares well with some of the international GST rates. The highest GST rates of 25 per cent are in Sweden and Denmark followed by Iceland (24.5 percent) and Finland (22 per cent).

The experiences in federal countries reveal three models of GST *viz.*, a) collection at the federal level; b) collection at the sub-national level; and c) dual level of GST. The third model in turn has three variants: 1) collected by the federal government though the constitutional authority is vested with both tiers of Governments; 2) independent GST collected by the two tiers of Governments; and 3) a single harmonised rate on a common base administered by the States. Each variant of GST has its own merits and demerits. A Centralised GST provides harmonisation of tax rates and exemptions by definition. On the other hand, an exclusive State level GST takes state autonomy to the extreme and calls for external harmonisation efforts apart from reducing Centre's capacity of equalising transfers in a country characterised by extreme disparities.

A decision on the GST model to be adopted in India is yet to be taken. However, many views have been expressed by the fiscal experts in the contemporary literature. According to one view, a dual-VAT, a variant of the QST-GST model of Canada, with elbow room to the States in the matter of rates and to a limited extent in the base seems to be the most promising alternative in India (Bagchi, A., 2006). It is viewed that centralisation of sales taxation is not essential and similar to the experiences of Canada with VAT and of the US with income taxes, Central and State taxes can exist side by side. It has been suggested that a system of concurrent taxation consisting of a State GST (SGST) and a Central GST (CGST) would be a viable medium-term option. However, one critical question that remains from the vertical imbalances point of view is determining the component tax rates of CGST and SGST given the benchmark for the overall tax rate. The Kelkar Committee in this regard had suggested a division of the 20 per cent GST rate, where 12 per cent is for the Central GST and 8 per cent for the State GST. The Twelfth Finance Commission (TFC), however, had observed that the 12:8 ratio is in favour of the Centre and can increase the vertical imbalance in the system.

From the administrative angle also, there are supports for a two tier structure of GST involving Central and State Governments. The Centre's administrative capacity vests with the Central excise department whereas the States have a larger capacity in the form of States sales tax establishments. It is thus viewed that use of both the Centre and States machinery in the implementation of GST would be ideal. Further, the limitations of resources of the Central tax department and the experience of States in implementing sales tax suggest that every effort should be made to get the best out of the two.

The Finance Minister in the Union Budget 2007-08 had stated that the VAT in India has proved to be an unqualified success. In pursuance, the Empowered Committee of State Finance Ministers and the Central Government are preparing a roadmap for introducing a national level GST with effect from April 1, 2010. In designing the roadmap for GST, efforts should be made to build on the success in the implementation of VAT at the State level.

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5. Purohit, Mahesh C., (2007), 'GST and the 13th Finance Panel', The Economic Times, September 8.
6. Srivastava, D.K. (2007), 'A Roadmap to Goods and Services Tax', The Hindu Business Line, August 13.
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had proposed to extend the facility of non-competitive bidding (currently limited to Central Government dated securities) to the primary auction of SDLs. Necessary provisions of the Scheme on "Non-Competitive Bidding Facility" have been incorporated in the Revised General Notification issued by all the State Governments in July 2007. The scheme will be operationalised shortly.

III.3.4 Working Group to Evolve a Framework for Investment of States' Balances

The upsurge in the surplus cash balances of State Governments in recent years and the negative spread on these balances has posed newer challenges to the financial and cash management of State Governments. The issues relating to the investment of surplus cash balances of the States were discussed in the 18th Conference of State Finance Secretaries that was held on August 7, 2006 at the Reserve Bank, Mumbai. Taking cognizance of the different views expressed during the Conference, it was decided to constitute a small group of State Finance Secretaries and RBI officials to suggest a framework for alternative investment options of the surplus cash balances of the State Governments. The Working Group included the Finance Secretaries of the State Governments of Rajasthan, Karnataka, Maharashtra and Assam. The Working Group submitted its Report to the Reserve Bank in December 2006. The Report of the Working Group was discussed in the 20th Conference of State Finance Secretaries held in August 2007.

III.3.5 Constitution of Standing Technical Committee

The Reserve Bank in its Annual Policy Statement for 2006-07, had 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 co-operative approach*". The STC was constituted after consultation with the State Governments and with the concurrence of the Government of India in December 2006. The STC is chaired by the Deputy Governor of the Reserve Bank and its members include the Principal Finance Secretaries of all the State Governments, senior officials of the Government of India and the Reserve Bank. The secretariat to the STC is provided by the Reserve Bank.

The Terms of Reference of the STC include:

- To make annual projections of the borrowing requirements of the State Governments, taking into account evolving macroeconomic and financial conditions with due regard to the sustainability of debt and the provisions of fiscal responsibility legislation, wherever applicable. The STC's projections may be conveyed to the RBI by December every year for consideration as an input for internal monetary projections.
- To build alternative scenarios and suggest alternative strategies and instruments for raising resources for States.
- To develop a transparent mechanism for annual allocation of market borrowings among the States.
- To take note of actual borrowings of the State Governments during the year *vis-à-vis* the budgeted GFD. This would help in advising the States to take appropriate action in case of large deviation of actual borrowings through various instruments from their respective budget estimates.
- To develop an appropriate database that would facilitate the above monitoring exercise.
- To assess the fiscal risks from issuances of State Government guarantees.
- To advise the State Governments on various issues relating to their borrowings including the formulation of a market borrowing calendar; the progressive adoption of the auction route for market borrowings; liquidity of State Government securities; and measures for building capacity relating to debt management at the State Government level.

III.3.6 Management of Foreign Exchange Risk

The external assistance by multilateral agencies to the States has traditionally been routed through the Central Government as part of the Central assistance, with the Centre bearing the foreign exchange risk. However, as part of the policy of disintermediation of the Centre in the borrowings by the State Governments, it was decided by the Central Government that there should be a back-to-back transfer of external assistance to the States. At the 16th Conference of the State Finance Secretaries, some of the State Finance Secretaries suggested that the RBI could play an advisory role in assisting the States in hedging their exchange rate risks arising from the policy of back-to-back transfer of external assistance. In the context of the TFC recommendations and following the discussions at the 19th Conference of State Finance Secretaries, held in January 2007, the first workshop on the management of foreign exchange risk was organised by the Reserve Bank in May 2007 for the benefit of State Government officials. The States have also proposed alternative mechanisms for providing for foreign exchange risk by setting aside funds in their budgets, where the Reserve Bank is expected to play a role in managing these funds on the lines of CSF. These proposals were discussed at the 20th Conference of the State Finance Secretaries, held in August 2007.

III.3.7 Re-issuance of State Government Securities

In the Annual Policy Statement of April 2007, it was proposed that, with a view to building up a critical mass and thereby improving the secondary liquidity of such securities, reissuance of SDLs may be introduced in consultation with the State Governments. The feasibility of introducing the system of re-issue of SDLs is being examined taking into account the responses received from State Governments.

III.3.8 Review of Payment of Brokerage Commission on State Development Loans

In the 19th Conference of State Finance Secretaries held on January 24, 2007, the provision for payment of brokerage and commission by the State Governments to the banks/other eligible entities for issuance of SDLs through auction method was reviewed. It was decided to discontinue the payment of brokerage/commission to the banks/ other eligible entities by the State Governments in the issuance of SDLs by the auction method. Accordingly, in terms of General Notification issued by all the State Governments in July 2007, payment of brokerage/commission to banks/other eligible entities stands discontinued in case SDLs are issued through auction method.

IV. CONSOLIDATED FISCAL POSITION OF STATE GOVERNMENTS

The fiscal and institutional reforms aimed towards fiscal correction and consolidation coupled with the implementation of recommendations of TFC and improvement in tax buoyancy on the strength of macroeconomic fundamentals have contributed in bringing about substantial improvement in the consolidated fiscal position of the State Governments since 2005-06. The major deficit indicators, as ratios to GDP, were substantially lower than the averages during 2000-01 to 2004-05. It may be recalled that the consolidated fiscal position of the State Governments had worsened transitorily in 2003-04 after recording an improvement over the period 2000-01 to 2002-03. This section analyses and assesses the consolidated fiscal position of the State Governments in terms of their accounts for 2005-06, 2006-07 and 2007-08[3].

IV.1 Accounts: 2005-06

The key deficit indicators of the State Governments, *viz.*, RD, GFD and PD recorded significant reduction when 2005-06 (RE) translated into accounts (Table 3). RD and GFD witnessed sharp declines of Rs.12,813 crore (64.6 per cent) and Rs.22,338 crore (19.9 per cent) respectively, between 2005-06 (RE) and 2005-06 (Accounts). Primary deficit also registered a sharp reduction of Rs.19,070 crore (75.9 per cent). In 2005-06

[3] The analysis pertains to 2005-06 (Accounts), 2006-07 (Revised Estimates) and 2007-08 (Budget Estimates) provided in the budgets of 2007-08 of twenty-eight State Governments.

Table 3: Variation in Major Items – 2005-06 (Accounts) over 2005-06 (RE)

Item	Variation		Contribution*
	Amount (Rs. crore)	Per cent	(Per cent)
1	2	3	4
I. Revenue Receipts (i+ii)	**-13,384**	**-3.0**	**100.0**
(i) Tax Revenue (a+b)	-3,262	-1.1	24.4
(a) Own Tax Revenue	-4,563	-2.1	34.1
of which: Sales Tax	-3,961	-3.0	29.6
(b) Share in Central Taxes	1,302	1.4	-9.7
(ii) Non-Tax Revenue	-10,122	-7.5	75.6
(a) States Own Non-Tax Revenue	2,580	5.7	-19.3
(b) Grants from Centre	-12,702	-14.2	94.9
II. Revenue Expenditure (i + ii)	**-26,197**	**-5.6**	**100.0**
(i) Non-Interest Revenue Expenditure	-22,928	-6.1	87.5
of which:			
Education, Sports, Art and Culture	-4,930	-5.9	18.8
Medical and Public Health and Family Welfare	-2,217	-9.8	8.5
Energy	-276	-1.3	1.1
Rural Development	-2,316	-11.6	8.8
Agriculture and Allied Activities	-1,341	-6.0	5.1
Administrative Services	-1,944	-5.4	7.4
Pension	-1,768	-4.2	6.7
(ii) Interest Payments	-3,269	-3.7	12.5
III. Capital Receipts	**10,242**	**6.6**	**100.0**
IV. Capital Expenditure	**-5,875**	**-4.5**	**100.0**
of which: Capital Outlay	-6,207	-7.4	105.6
of which:			
Rural Development	-723	-15.4	12.3
Irrigation and Flood Control	-615	-2.3	10.5
Special Area Programmes	-900	-41.3	15.3
Transport	-1,244	-7.9	21.2
Memo Item:			
Revenue Deficit	-12,813	-64.6	
Gross Fiscal Deficit	-22,338	-19.9	
Primary Deficit	-19,070	-75.9	

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

Note : 1. Capital receipts include public accounts on a net basis while capital expenditure excludes public accounts.
2. Also see Notes to Appendix III and IV.

Source : Budget Documents of the State Governments.

(Accounts), RD, GFD, and PD, relative to GDP, were placed at 0.2 per cent, 2.5 per cent and 0.2 per cent as against 0.6 per cent, 3.2 per cent and 0.7 per cent, respectively in the revised estimates (refer to Table 1).

The correction in the revenue account in 2005-06 (Accounts) was largely due to a sharp reduction in the revenue expenditure, mainly non-interest revenue expenditure which fell by Rs.22,928 crore (6.1 per cent). The developmental expenditure in revenue account declined substantially by Rs.17,160 crore accounting for 65.5 per cent of the fall in revenue expenditure. The non-developmental revenue expenditure also registered a decline by Rs.9,296 crore in 2005-06 over 2005-06 (RE). The revenue receipts declined by Rs.13,384 crore on account of a decline in States' own tax revenue and grants from the Centre, which was partly compensated by increase in States' share in Central taxes and their own non-tax revenue.

There was a decline in capital outlay by Rs.6,207 crore (7.4 per cent), which was higher in magnitude than the fall in capital expenditure. The decline in capital outlay was particularly in respect of sectors such as rural development (15.4 per cent), special area programmes (41.3 per cent), transport (7.9 per cent) and irrigation and flood control (2.3 per cent). Thus, despite a decline in revenue receipts by 0.4 per cent of GDP, the overall correction in the key deficit indicators was on account of compression of developmental expenditure (both revenue and capital) by 0.6 per cent of GDP.

IV. 2 Revised Estimates: 2006-07

The trends in the revised estimates of 2006-07 *vis-à-vis* the budget estimates revealed that there was a decline in RD from 0.2 per cent of GDP in budget estimates to 0.1 per cent of GDP in the revised estimates (Appendix Table 1). On the revenue account, there was a substantial increase in revenue receipts of Rs.22,654 crore (4.5 per cent) in 2006-07 (RE) over 2006-07 (BE), which more than compensated for the increase in the revenue expenditure by Rs.19,872 crore (3.8 per cent) (Table 4 and Appendix Table 2).

The marked rise in revenue receipts by 0.6 per cent of GDP was mainly on account of increase in States' own tax revenue and share in Central taxes, accounting for 39.7 per cent and 27.9 per

Table 4: Variation in Major Items – 2006-07 (RE) over 2006-07 (BE)

Item	Variation		Contribution* (Per cent)
	Amount (Rs. crore)	Per cent	
1	2	3	4
I. Revenue Receipts (i+ii)	**22,654**	**4.5**	**100.0**
(i) Tax Revenue (a+b)	15,318	4.3	67.6
(a) Own Tax Revenue	9,001	3.6	39.7
of which: Sales Tax	3,771	2.4	16.6
(b) Share in Central Taxes	6,317	5.8	27.9
(ii) Non-Tax Revenue	7,336	4.8	32.4
(a) States Own Non-Tax Revenue	3,672	7.1	16.2
(b) Grants from Centre	3,664	3.7	16.2
II. Revenue Expenditure (i + ii)	**19,872**	**3.8**	**100.0**
(i) Non-Interest Revenue Expenditure	21,463	5.1	108.0
of which:			
Education, Sports, Art and Culture	2,900	3.2	14.6
Transport and Communication	1,135	8.3	5.7
Energy	5,412	27.9	27.2
Rural Development	1,592	7.7	8.0
Agriculture and Allied Activities	1,887	8.0	9.5
Relief on account of Natural Calamities	3,489	77.3	17.6
Administrative Services	-475	-1.1	-2.4
Pension	-86	-0.2	-0.4
(ii) Interest Payments	-1,591	-1.6	-8.0
III. Capital Receipts	**-8,475**	**-5.6**	**100.0**
of which:			
Market Borrowings	-3,290	-11.6	38.8
Special Securities Issued to NSSF	-2,516	-3.9	29.7
Loans from Centre	-3,328	-24.6	39.3
Recovery of Loans and Advances	3,156	59.3	-37.2
Small Savings, Provident Fund, *etc.* (Net)	551	5.3	-6.5
Deposit and Advances (Net)	2,928	-253.8	-34.6
IV. Capital Expenditure	**13,290**	**9.7**	**100.0**
of which:			
Capital Outlay	10,399	11.0	78.2
of which:			
Urban Development	109	5.4	0.8
Irrigation and Flood Control	2,242	7.4	16.9
Energy	1,270	13.4	9.6
Transport	1,524	8.1	11.5
Memo Item:			
Revenue Deficit	-2,782	-33.3	
Gross Fiscal Deficit	7,160	6.7	
Primary Deficit	8,752	92.5	

RE : Revised Estimates. BE : Budget Estimates.
* : Denotes percentage share in relevant total.
Note : See Notes to Table 3.
Source : Budget Documents of the State Governments.

cent of the increase in revenue receipts, respectively. States' non-tax revenue and grants from the Centre to the States, accounted for 16.2 per cent each of the increase in revenue receipts, respectively (Appendix Table 3).

The developmental component of revenue expenditure increased by 0.5 per cent of GDP on account of higher expenditure on energy, natural calamities, education, rural development and transport and communication (Appendix Table 4).

The GFD increased by Rs.7,160 crore (6.7 per cent), notwithstanding the decline in RD, due to higher provision for capital outlay by Rs.10,399 crore (11.0 per cent). The rise in capital outlay was mainly in respect of economic services such as irrigation and flood control, transport, energy and urban development. As a result, capital outlay, relative to GDP, increased from 2.3 per cent in 2006-07 (BE) to 2.5 per cent in 2006-07 (RE). Reflecting this, GFD as a ratio to GDP increased to 2.8 per cent in the revised estimates from 2.6 per cent in the budget estimates.

An assessment of the revised estimates of 2006-07 indicates an improvement in the fiscal performance of the State Governments compared with the budget estimates, particularly in the revenue account, both in terms of enhancement in revenue receipts and higher provisions for developmental expenditure. It is of interest to note that the incentives provided by the TFC and fiscal rules framed under FRL played important role in containing slippages in budgeted fiscal position.

IV.3 Budget Estimates: 2007-08

Against the backdrop of an improved fiscal position in the revised estimates for 2006-07 particularly in the revenue account, the State Governments, while presenting their budgets for 2007-08, have shown further commitment to continue the process of fiscal correction and consolidation in line with their FRLs. At the same time, the State Budgets have provided higher allocations for the social and rural sectors in line with the priorities set out in the Eleventh Five Year Plan (Box 3).

Box 3: Eleventh Five Year Plan: Issues and Challenges for the State Governments

Recognising the enormous improvement in the economic fundamentals, the Eleventh Five Year Plan has the objective of making a decisive impact on improving the quality of life of the people, especially the poor and the marginalised. It emphasises not only faster growth, but one which is more broad-based and inclusive. It has, thus, envisaged an overall average growth of 9.0 per cent, while doubling the agricultural growth to 4.0 per cent and generating 70 million new jobs in the non-agricultural sector for making a dent on poverty. Another key objective is to provide access to basic facilities such as health, education, clean drinking water, sanitation, *etc*. to those deprived. As social services are primarily State subjects, the role of State Governments will be crucial in implementing the schemes under the Eleventh Plan.

Issues

Besides the creation of productive employment and reduction in poverty, disparities across regions and communities need to be addressed in the Eleventh Plan, with special attention to the needs of marginalised and unorganised groups. Provision of education and health and other basic facilities to the deprived and agriculture and infrastructure sectors would require huge public investment. Delivery of services needs to improve significantly not only to improve the quality of life of the people but also to enable the Government to levy user charges commensurate with improvement in the quality of services provided. While there is the demographic dividend of falling dependency rate (ratio of dependents to working age population), to reap the benefit, quality education will have to be provided and enough gainful employment created.

Challenges

The State Governments need to address the challenges with regard to the following sectors/segments during the Eleventh Plan.

i) Agriculture

Doubling agriculture growth to 4.0 per cent would necessitate corrective policies to address the problem of stagnation in agricultural productivity. State Governments need to provide substantial amount of resources for major and medium irrigation, particularly in rain-fed and drought-prone areas. State Governments would also need to act on a number of critical areas which include: providing information to farmers on the type of crops to be sown in case of inadequate rainfall and precautionary measures in case of pest attacks; establish link between agriculture universities and farmers; reduce the indebtedness of farmers; insurance against contingencies; reclamation of degraded land and improvement of soil quality. Enabling environment will also have to be created for diversification into high value items such as fruit, vegetables, flowers, *etc*., and animal husbandry and fishery. Equal emphasis is needed on provision of credit at affordable rates, functioning of markets and refocus on land reforms.

ii) Employment

Services and manufacturing sectors would be the main source of additional employment in future and the emphasis may be placed on promoting labour-intensive areas of these sectors such as food processing, leather products, footwear and textiles, and tourism and construction, with a focus on village and small scale enterprises. Skills need to be imparted, as otherwise employers might opt for capital-intensive technologies due to lack of skilled labour. State Governments also have important role in ensuring that National Rural Employment Guarantee Programme (NREGP) is adequately funded and effectively implemented.

iii) Education

Raising the level of literacy and imparting education to the level envisaged in the Eleventh Plan will be a major challenge. The Plan envisages the following: universalisation of Integrated Child Development Programme; providing free and compulsory elementary education to all children up to the age of 14 through programmes such as Sarva Shiksha Abhiyan; expansion of secondary schools; according top priority to vocational training; improvement in the quality of higher education; increase in adult literacy to 85 per cent; evolving an integrated Science and Technology Plan and enlarging the pool of scientific manpower.

iv) Health

The Eleventh Plan emphasises: integrated district and block specific health plans for the primary healthcare in partnership with NGOs; address all infirmities and problems across rural primary healthcare; address health needs of the urban poor under Sarv Swasthya Abhiyan; address the problem of shortage of trained personnel in healthcare system by making use of trained paramedical personnel; and increasing availability of sanitation and clean water. To achieve the targets, the present level of public expenditure on health in India will need to multiply by 2-3 times to 2-3 per cent of GDP.

v) Improving Manufacturing Competitiveness

For improving competitiveness of the manufacturing sector, State Governments need to act on several fronts. These include: streamlining of tax rates and eliminating Octroi, entry taxes, *etc*.; infrastructure development in local areas such as Special Economic Zones and Special Economic Regions; creation of investor friendly environment; minimising delay in land registration, water and utility connections, environmental and other clearances through a single window supplemented by initiatives by the Centre towards amendment of labour laws, de-reservation for small scale production, elimination of residual restrictions and control and recognition of the special needs of the micro, small and medium enterprises.

vi) Disparities and Divides

Reducing the disparities between poor and rich, rural and urban areas, the employed and the under/unemployed, among States, districts and communities, and between genders remain one of the greatest challenge. This can be achieved by ensuring inclusive growth of all these categories through creation of employment, promotion of small scale industries balanced regional development and solving gender specific problems.

vii) Required Resources

Investment will have to rise significantly, and the budgetary resources for Plan expenditure of the combined Government is estimated to increase by 2.5 percentage points of GDP to about 9.65 per cent. Yet, the Government will be required to remain fiscally prudent since the Centre and most of the States (26 out of 28) have passed FRL. For the States, substantial flow of resources from the Centre would be required either in the form of normal central assistance or centrally sponsored scheme. The States should also be able to contribute an appropriate percentage of the required expenditure. Reprioritising of expenditure and lowering of non-plan expenditure (including explicit and hidden subsidies) is essential while raising the tax and non-tax revenues.

Reference:

Government of India (2006), 'Towards Faster and More Inclusive Growth: An Approach to the 11th Five Year Plan', Planning Commission, December.

IV.3.1 Budget Estimates 2007-08 – Key Deficit Indicators

During 2007-08, the consolidated fiscal position of State Governments is slated to show further improvement in terms of the major deficit indicators. A noteworthy aspect in this regard is that the consolidated revenue balance is envisaged to turn into a surplus of Rs.11,973 crore (0.3 per cent of GDP) during 2007-08 (BE) from a deficit of Rs.5,566 crore (0.1 per cent of GDP) in 2006-07 (RE). It is pertinent to note that the revenue surplus has been budgeted one year in advance of the FRL stipulations and TFC recommendations (Box 4).

Box 4: Fiscal Responsibility Legislation and State Finances

A significant development in respect of State finances in the recent period has been the enactment of Fiscal Responsibility Legislation (FRL) by the State Governments. To facilitate adoption of a rule-based fiscal programme at the State level, the Reserve Bank, based on a decision taken in the Twelfth Conference of State Finance Secretaries held in August 2003, constituted a Group with representatives from several State Governments and Government of India to frame a Model Fiscal Responsibility Bill. The Group submitted its report in January 2005. The enactment of FRL has provided impetus to the process of attaining fiscal sustainability as reduction in key deficit indicators, *viz.*, revenue deficit (RD) and gross fiscal deficit (GFD), is critical for reducing the mounting level of debts of the States. Apart from fiscal sustainability, meeting the targets set in FRLs is crucial not only for maintaining credibility in budgetary operations but also ensuring prudent debt management and greater transparency. Recognising this, the Twelfth Finance Commission (TFC) recommended that each State should enact FRL, which would be a pre-condition for availing debt relief.

All State Governments, except Sikkim and West Bengal, have enacted FRLs so far. Karnataka was the first to enact the FRL in September 2002 followed by Tamil Nadu (May 2003), Kerala (August 2003) and Punjab (October 2003). Following the recommendations of the TFC, twenty-two more States have enacted the FRLs. Although there are variations across States in the choice of target and the time frame for achieving the target, most of the FRLs have stipulated elimination of RD by March 31, 2009 and reduction in GFD as per cent of gross state domestic product (GSDP) to 3 per cent by March 31, 2010, in line with the targets prescribed by the TFC. In addition, several States have imposed limits on guarantees and targeted to reduce their liabilities.

Measures for fiscal correction and consolidation undertaken by the States have had a favourable impact on the State finances. Reflecting this, all non-special category States, except Jharkhand, Punjab, West Bengal and Kerala, are estimated to achieve a revenue balance/surplus in 2007-08 (BE). The remaining four non-special category States would require annual adjustments of 0.8 per cent, 1.4 per cent, 2.7 per cent and 3.4 per cent of GSDP, respectively, to achieve the TFC target in respect of the revenue balance by 2008-09 (Table). While West Bengal has not enacted FRL so far, the Finance Minister of Government of Kerala in his budget speech for 2007-08 stated that Kerala would be achieving a revenue deficit of less than one per cent of GSDP by 2010-11. All special category States, except Himachal Pradesh, have budgeted a revenue surplus in 2007-08.

As regards GFD, eight non-special category States have budgeted GFD at less than 3 per cent of GSDP in 2007-08, *i.e.*, two years ahead of the target prescribed by the TFC. Of the remaining nine States, eight States would require an annual adjustment of 0.2-0.9 per cent of GSDP in the fiscal years 2008-09 and 2009-10, while one State (Jharkhand) would require an annual adjustment of 2.2 per cent of GSDP in the next two fiscal years. Among special category States, four out of eleven States have budgeted GFD at less than 3 per cent of GSDP in 2007-08. Out of the remaining seven States, six States would require an annual adjustment of 0.4-2.2 per cent of GSDP. However, Sikkim, which has not enacted FRL, would require an annual adjustment of 4.3 per cent of GSDP to achieve the TFC target.

Enactment of FRL by most of the States has ushered in a rule-based fiscal policy framework at the State level. However, the process of fiscal correction should not adversely impact capital outlay and expenditure on social sectors. Any deviation from the targets set by the States under the FRL enacted by them would, however, raise the issue of credibility. Hence, it would be desirable that the States adhere to the rules framed under their respective FRL.

Table: State Finances and Twelfth Finance Commission Targets for RD and GFD

(Per cent of GSDP)

State	2007-08 (BE)	Annual Adjustment*
1	2	3
REVENUE DEFICIT		
Non-Special Category		
1. Kerala	3.4	3.4
2. West Bangal	2.7	2.7
3. Punjab	1.4	1.4
4. Jharkhand	0.8	0.8
Special Category		
1. Himachal Pradesh	0.7	0.7
GROSS FISCAL DEFICIT		
Non-Special Category		
1. Jharkhand	7.4	2.2
2. Kerala	4.8	0.9
3. Punjab	4.6	0.8
4. West Bengal	4.4	0.7
5. Goa	4.3	0.7
6. Bihar	4.2	0.6
7. Uttar Pradesh	3.6	0.3
8. Rajasthan	3.5	0.3
9. Madhya Pradesh	3.3	0.2
Special Category		
1. Sikkim	11.6	4.3
2. Jammu and Kashmir	7.3	2.2
3. Tripura	5.9	1.5
4. Arunachal Pradesh	4.2	0.6
5. Uttarakhand	4.2	0.6
6. Himachal Pradesh	4.1	0.6
7. Assam	3.7	0.4

* : Annual Adjustment required to eliminate RD by 2008-09 and bring down GFD as a ratio to GSDP to 3 per cent by 2009-10.

References:

1. Government of India (2004), Report of the Twelfth Finance Commission (2005-10), November.
2. Reserve Bank of India (2007), 'Annual Report 2006-07', August.

Consequent upon the budgeted revenue surplus, the GFD would decline by Rs.5,590 crore (4.9 per cent) to Rs.1,08,323 crore (2.3 per cent of GDP). Similarly, the PD is budgeted to decline by Rs.12,561 crore (69.0 per cent) to Rs.5,648 crore (0.1 per cent of GDP) in 2007-08 (Chart 1). Reflecting this, the primary revenue surplus of the State Governments at 2.5 per cent of GDP is budgeted to be higher than the interest payments during 2007-08, *i.e.*, 112 per cent of the interest payments as compared with about 94 per cent of the interest payments in the previous year.

The correction in the revenue account during 2007-08 has been envisaged to be achieved primarily through enhancement in revenue receipts by 14.2 per cent on top of the 23.3 per cent growth recorded in the previous year. The increase in revenue receipts during 2007-08 is budgeted to be contributed by own tax revenue (49.1 per cent), share in Central taxes (27.2 per cent), grants from the Centre (19.1 per cent) and States' own non-tax revenue (4.7 per cent) (Table 5). The revenue from VAT/sales tax, which accounts for nearly half of States' own tax revenue, are budgeted to increase by 15.7 per cent, while taxes on property and capital transactions would rise by 18.3 per cent, respectively (Appendix Table 3).

Chart 1: Major Deficit Indicators

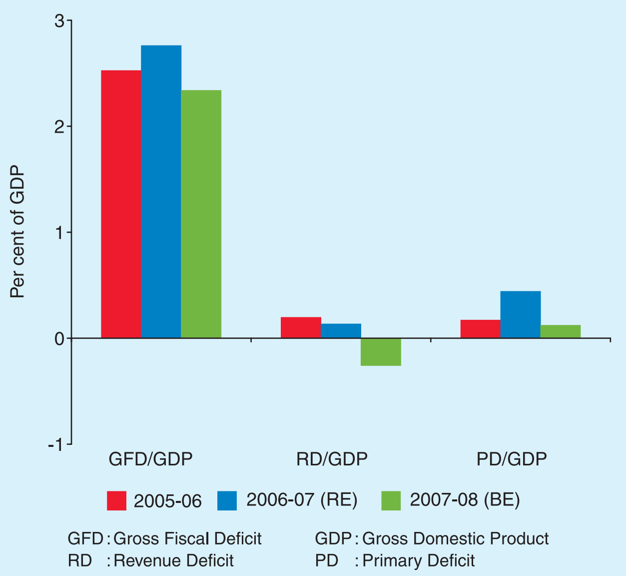


Table 5: Variation in Major Items – 2007-08 (BE) over 2006-07 (RE)

Item	Variation: Amount (Rs. crore)	Variation: Per cent	Contribution* (Per cent)
1	2	3	4
I. Revenue Receipts (i+ii)	**75,304**	**14.2**	**100.0**
(i) Tax Revenue (a+b)	57,405	15.4	76.2
(a) Own Tax Revenue	36,958	14.4	49.1
of which: Sales Tax	24,860	15.7	33.0
(b) Share in Central Taxes	20,447	17.7	27.2
(ii) Non-Tax Revenue	17,899	11.3	23.8
(a) States Own Non-Tax Revenue	3,534	6.3	4.7
(b) Grants from Centre	14,366	14.0	19.1
II. Revenue Expenditure	**57,765**	**10.8**	**100.0**
(i) Non-Interest Revenue Expenditure	50,795	11.5	87.9
of which:			
Education, Sports, Art and Culture	9,054	9.5	15.7
Medical and Public Health and Family Welfare	2,672	10.7	4.6
Energy	-817	-3.3	-1.4
Rural Development	2,481	11.2	4.3
Agriculture and Allied Activities	3,143	12.3	5.4
Administrative Services	6,556	15.4	11.3
Pension	6,524	13.7	11.3
(ii) Interest Payments	6,971	7.3	12.1
III. Capital Receipts	**17,805**	**12.4**	**100.0**
of which:			
Market Borrowings	11,840	47.4	66.5
Loans from NABARD	1,657	20.4	9.3
Special Securities Issued to NSSF	-2,553	-4.1	-14.3
Loans from Centre	4,721	46.3	26.5
Recovery of Loans and Advances	-3,890	-45.9	-21.8
Reserve Funds (Net)	-543	-11.4	-3.0
Miscellaneous Capital Receipts	7,048	230.8	39.6
Remittances (Net)	-364	-113.9	-2.0
IV. Capital Expenditure	**20,908**	**13.9**	**100.0**
of which:			
Capital Outlay	13,854	13.2	66.3
of which:			
Urban Development	390	18.5	1.9
Irrigation & Flood Control	3,655	11.2	17.5
Energy	4,221	39.2	20.2
Transport	3,227	15.9	15.4
Memo Item:			
Revenue Deficit	-17,539	-315.1	
Gross Fiscal Deficit	-5,590	-4.9	
Primary Deficit	-12,561	-69.0	

BE : Budget Estimates. RE : Revised Estimates.
* : Denotes percentage share in relevant total.
Note : See Notes to Table 3.
Source : Budget Documents of the State Governments.

The improvement in revenue account would also be facilitated by deceleration in revenue expenditure to 10.8 per cent during 2007-08 from 22.6 per cent growth in the previous year. The budgeted increase in revenue expenditure during 2007-08 would be primarily contributed by non-interest revenue expenditure (87.9 per cent). Within revenue expenditure, developmental expenditure (economic and social services) would decelerate to 11.3 per cent after recording a sharp increase of 26.0 per cent in the previous year. Non-developmental expenditure would also decelerate to 9.5 per cent (from 17.6 per cent in previous year) on account of deceleration in expenditure on administrative services, pensions and interest payments (Appendix Table 4). Capital outlay is budgeted to increase by 13.2 per cent on account of higher investment in energy, irrigation and flood control, transport, *etc.*

The revenue surplus at 0.3 per cent of GDP would facilitate a lower level of GFD of 2.3 per cent of GDP in 2007-08 than the previous year's level of 2.8 per cent, despite increase in capital expenditure.

IV.3.2 Revenue Receipts

Revenue receipts are budgeted to increase by 14.2 per cent during 2007-08 on top of the 23.3 per cent growth rate registered in the preceding year. Revenue receipts as a ratio to GDP have been estimated to increase by 0.2 percentage points to 13.1 per cent in 2007-08, contributed mainly by own tax revenue and devolution and transfers from the Centre (Table 6) (also see Statements 19 and 25).

Table 6: Aggregate Receipts of State Governments

(Amount in Rs. crore)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-05 (Avg.)	2005-06 (Accounts)	2006-07 (RE)	2007-08 (BE)	Variation (Per cent)	
							Col.6/5	Col.7/6
1	2	3	4	5	6	7	8	9
Aggregate Receipts (1+2)	1,23,415 (16.1)	2,31,618 (14.8)	4,40,075 (17.2)	5,95,628 (16.7)	6,74,736 (16.4)	7,67,845 (16.6)	13.3	13.8
1. Revenue Receipts (a+b)	92,679 (12.1)	1,65,416 (10.7)	2,85,661 (11.2)	4,31,021 (12.1)	5,31,429 (12.9)	6,06,733 (13.1)	23.3	14.2
(a) States Own Revenue	55,546 (7.2)	1,03,542 (6.7)	1,78,171 (7.0)	2,60,247 (7.3)	3,12,738 (7.6)	3,53,229 (7.6)	20.2	12.9
States Own Tax	41,158 (5.4)	78,733 (5.1)	1,41,933 (5.6)	2,12,307 (6.0)	2,57,080 (6.2)	2,94,038 (6.3)	21.1	14.4
States Own Non Tax	14,388 (1.8)	24,809 (1.6)	36,238 (1.4)	47,939 (1.3)	55,657 (1.3)	59,191 (1.3)	16.1	6.3
(b) Central Transfers	37,133 (4.9)	61,874 (4.0)	1,07,490 (4.2)	1,70,774 (4.8)	2,18,691 (5.3)	2,53,504 (5.5)	28.1	15.9
Shareable Taxes	19,790 (2.6)	37,608 (2.4)	61,047 (2.4)	94,024 (2.6)	1,15,737 (2.8)	1,36,184 (2.9)	23.1	17.7
Central Grants	17,343 (2.3)	24,267 (1.6)	46,444 (1.8)	76,750 (2.2)	1,02,955 (2.5)	1,17,320 (2.5)	34.1	14.0
2. Capital Receipts (a+b)	30,737 (4.0)	66,202 (4.1)	1,54,415 (6.0)	1,64,607 (4.6)	1,43,307 (3.5)	1,61,112 (3.5)	-12.9	12.4
(a) Loans from Centre @	14,632 (1.9)	26,440 (1.7)	24,337 (1.0)	8,097 (0.2)	10,197 (0.2)	14,918 (0.3)	25.9	46.3
(b) Other Capital Receipts	16,104 (2.1)	39,762 (2.4)	1,30,078 (5.0)	1,56,510 (4.4)	1,33,109 (3.2)	1,46,193 (3.2)	-15.0	9.8

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 Savings 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.

Note : 1. The 5-year averages have been provided for a more meaningful comparison across periods.
2. Figures in bracket are percentages to GDP. Totals may not add up due to rounding off.
3. Capital receipts include public accounts on a net basis. Also see Notes to Appendix III.

Source : Budget Documents of the State Governments.

States' own tax revenue as a percentage of GDP is estimated to rise marginally during 2007-08, maintaining the upward trend witnessed since the mid-1990s. All the components would contribute to the rise in States' own taxes (Appendix Table 3). The growth in States' own non-tax revenue is budgeted to decelerate to 6.3 per cent during 2007-08 from 16.1 per cent in the preceding year. As a ratio to GDP, the States' own non-tax revenue would, however, be maintained at 1.3 per cent. The low recovery from the various services provided by the State Governments, especially social services, partly explains their low level of non-tax revenue collection. The cost recovery in 2007-08 is budgeted at 1.3 per cent for education, 4.5 per cent for public health, 15.6 per cent for irrigation, 23.6 per cent for power and 7.6 per cent for roads (Table 7 and Chart 2). In addition, the return in terms of dividend and profits from investments made by the State Governments in State public sector undertakings (PSUs) has been quite low due to their lackluster performance. For raising the level of non-tax revenue of the State Governments, there is a need for enhancing the cost recovery by way of levying of appropriate user charges and restructuring of the State PSUs.

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

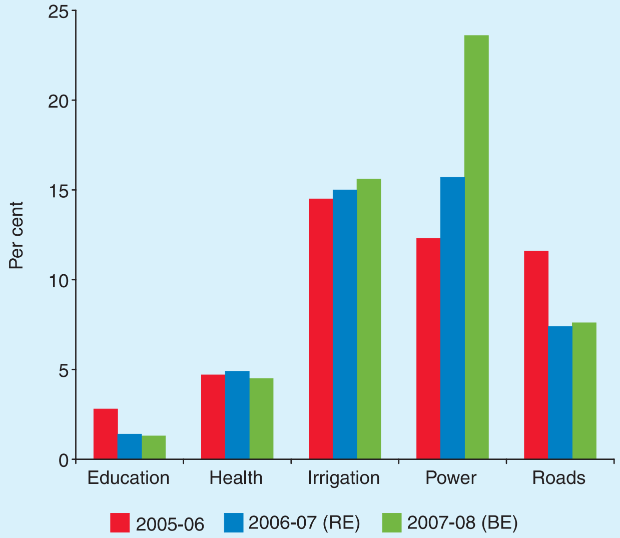


Table 7: Cost Recovery of Select Services
(Ratio of Non-Tax Revenue to Non-Plan Revenue Expenditure)

(Per cent)

Item	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)
1	2	3	4	5	6	7	8	9
Social Services								
(a) Education $	1.2	1.3	1.6	1.8	2.1	2.8	1.4	1.3
(b) Health *	4.6	6.2	5.4	4.7	6.2	4.7	4.9	4.5
Economic Services								
(a) Irrigation #	8.1	7.5	8.4	15.3	16.4	14.5	15.0	15.6
(b) Power	6.5	6.5	9.7	2.8	11.7	12.3	15.7	23.6
(c) Roads @	16.3	19.6	15.6	21.5	14.6	11.6	7.4	7.6

RE : Revised Estimates. BE : Budget 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 and 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 in case of Government of Uttar Pradesh and Rs.134 crore in 2004-05 for the Government of Uttarakhand, have been excluded.

Source : Compiled from the Budget Documents of the State Governments.

IV.3.3 Revenue Expenditure

Revenue expenditure of the State Governments has been budgeted to increase by 10.8 per cent during 2007-08 as compared with 22.6 per cent in the preceding year. As proportion to GDP, revenue expenditure would decline to 12.8 per cent during 2007-08 from 13.0 per cent in the previous year. The increase in revenue expenditure would mainly be accounted for by education, sports, art and culture, rural development, medical and public health, irrigation and flood control and transport and communications. Furthermore, provisions in respect of interest payments, administrative services and pensions are also budgeted for substantial increase during 2007-08. However, interest payments, administrative services and pensions taken together would pre-empt lower proportion of revenue receipts during 2007-08 than in the previous two years (Chart 3) (also see Appendix Table 4).

IV.3.4 Capital Receipts

Capital receipts are budgeted to increase by 12.4 per cent during 2007-08 against the decline of 12.9 per cent in the preceding year mainly on account of sharp increase in budgeted amount of market borrowings. It is pertinent to note that the State Governments have budgeted both special securities issued to NSSF and recovery of loans and advances at lower levels by 4.1 per cent and 45.9 per cent, respectively (Appendix Table 5).

Gross loans from the Centre are budgeted to grow by 46.3 per cent during 2007-08 as compared to a rise of 25.9 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, are being 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 presented in Chart 4.

IV.3.5 Capital Expenditure

The total capital expenditure of the State Governments is budgeted to increase by 13.9 per cent during 2007-08 as compared with an increase of 22.1 per cent in the previous year. Enhancement in capital outlay would account for 66.3 per cent of the increase in capital disbursements in 2007-08, primarily representing developmental outlays in economic services. As a ratio to GDP, capital outlay

Chart 3: Expenditure on Interest Payment, Pension and Administrative Services

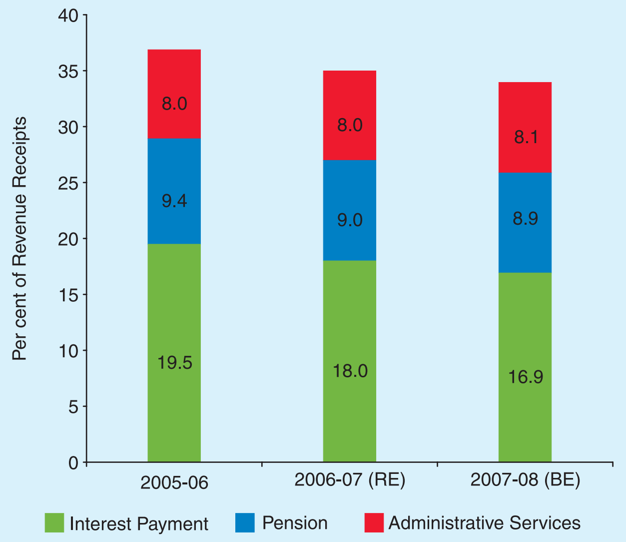
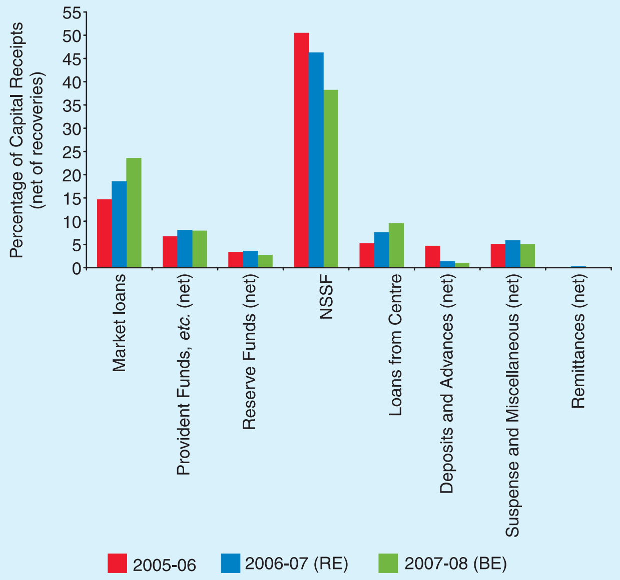


Chart 4: Major Components of Capital Receipts



would increase to 2.6 per cent from 2.5 per cent in the preceding year. One fourth of the increase in capital disbursements (26.6 per cent) would be on account of discharge of internal debt. Loans and advances by the State Governments are projected to increase by 8.4 per cent during 2007-08 (Appendix Table 6).

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 to the State Governments are estimated to increase by 17.3 per cent to Rs.2,68,422 crore during 2007-08 as compared with 28.0 per cent growth recorded in the previous year. As a ratio to GDP, gross devolution and transfer from the Centre would improve to 5.8 per cent in 2007-08 from 5.5 per cent in the previous year. It may be stated that gross devolution and transfer from the Centre would finance 35.0 per cent of the aggregate disbursements of the State Governments during 2007-08 as compared with 33.3 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 (Appendix Table 7) (refer to Section VII for detailed analysis on devolution and transfer of resources from the Centre to the States).

IV.3.7 Developmental and Non-Developmental Expenditure

There has been a secular decline in share of developmental expenditure in total disbursements from 69.6 per cent in 1990-91 to 58.8 per cent in 2005-06 with almost a compensating increase in the share of non-developmental expenditure. The share of developmental expenditure in aggregate expenditure, however, rose to 60.9 per cent in 2006-07 (RE) and is budgeted to rise further to 61.0 per cent in 2007-08. As a ratio to GDP, developmental expenditure would be placed at 10.1 per cent during 2007-08, marginally lower than that of 10.2 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 maintained at 5.9 per cent of GDP during 2007-08 as in the previous year (Chart 5) (Appendix Tables 8-13).

Non-developmental expenditure as a ratio to GDP would be marginally lower at 5.3 per cent during 2007-08 as compared with 5.4 per cent in the previous year. Interest payments, administrative services, pension and miscellaneous general services would account for the major increases in non-developmental expenditure during 2007-08 (Appendix Table 11). Non-Plan component would account for 49.3 per cent of developmental expenditure and 96.8 per cent of non-developmental expenditure during 2007-08 (Appendix Table 12). Revenue expenditure would account for 72.3 per cent of developmental expenditure and 97.7 per cent of non-developmental expenditure (Appendix Table 13). Non-Plan non-developmental expenditure, as a ratio to GDP, would be placed marginally lower at 5.1 per cent during 2007-08 than 5.3 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 be maintained at 34.6 per cent in 2007-08 as in the previous year. As a ratio to own revenue, committed expenditure would decline from 59.5 per cent to 58.3 per cent over the year (Statements 36 and 37).

IV.3.7.1 Social Sector Expenditure

The share of social sector expenditure (SSE), including expenditure on social services, rural development and food storage and warehousing, in total expenditure (TE) by the State Governments, which showed a declining trend in the first half of this decade, witnessed an improvement during the recent years (Chart 6). From an average of 32.5 per cent during 2000-05,

Table 8: Expenditure Pattern of State Governments

(Amount in Rs. crore)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-05 (Avg.)	2005-06 (Accounts)	2006-07 (RE)	2007-08 (BE)	Variation (Per cent)	
							Col.6/5	Col.7/6
1	2	3	4	5	6	7	8	9
Aggregate Expenditure (1+2 = 3+4+5)	1,22,270 (16.0)	2,33,441 (15.0)	4,37,299 (17.1)	5,61,682 (15.7)	6,87,946 (16.7)	7,66,620 (16.5)	22.5	11.4
1. Revenue Expenditure *of which:*	98,009 (12.8)	1,93,816 (12.4)	3,40,752 (13.4)	4,38,034 (12.3)	5,36,995 (13.0)	5,94,760 (12.8)	22.6	10.8
Interest Payments	13,605 (1.7)	31,421 (2.0)	69,685 (2.7)	84,024 (2.4)	95,704 (2.3)	1,02,675 (2.2)	13.9	7.3
2. Capital Expenditure *of which:*	24,261 (3.2)	39,625 (2.5)	96,547 (3.6)	1,23,648 (3.5)	1,50,951 (3.7)	1,71,859 (3.7)	22.1	13.9
Capital Outlay	11,893 (1.5)	21,044 (1.4)	41,856 (1.6)	77,559 (2.2)	1,04,942 (2.5)	1,18,796 (2.6)	35.3	13.2
3. Developmental Expenditure	81,989 (10.8)	1,45,852 (9.4)	2,39,576 (9.4)	3,30,044 (9.3)	4,19,050 (10.2)	4,67,696 (10.1)	27.0	11.6
4. Non-Developmental Expenditure	33,734 (4.3)	76,035 (4.8)	1,50,715 (5.9)	1,90,021 (5.3)	2,24,475 (5.4)	2,46,130 (5.3)	18.1	9.6
5. Others*	6,547 (0.9)	11,554 (0.7)	47,009 (1.7)	41,617 (1.2)	44,421 (1.1)	52,794 (1.1)	6.7	18.8

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

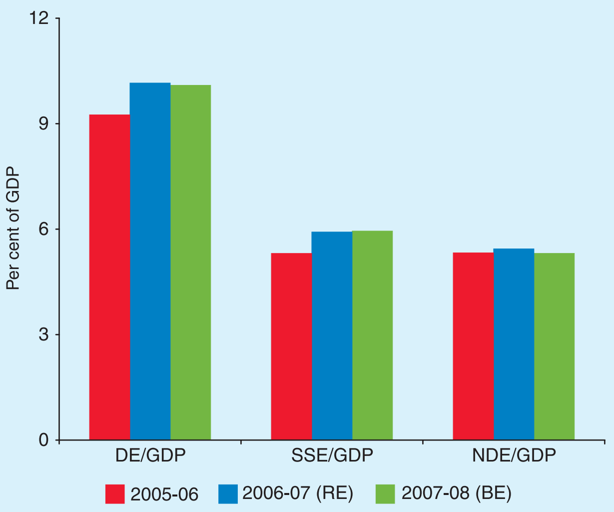
* : Includes repayments of loans to Centre, discharge of internal debt, grants-in-aid and contribution (compensation and assignments to local bodies).

Note : 1. The 5-year averages have been provided for a more meaningful comparison across periods.
2. Figures in bracket are percent to GDP. Totals may not add up due to rounding off.
3. Capital expenditure are exclusive of public accounts. Also see Notes to Appendix IV.

Source : Budget Documents of the State Governments.

the ratio of SSE-TE increased to 33.7 per cent in 2005-06 and further to 35.5 per cent 2006-07 (RE). SSE-TE ratio is budgeted at 35.9 per cent in 2007-08 (Table 9). SSE as a ratio to GDP would be maintained at 5.9 per cent in 2007-08 as in the previous year.

Chart 5: Developmental and Non-Developmental Expenditure



DE : Developmental Expenditure NDE : Non-Developmental Expenditure
SSE : Social Sector Expenditure

Chart 6: Trend in Social Sector Expenditure

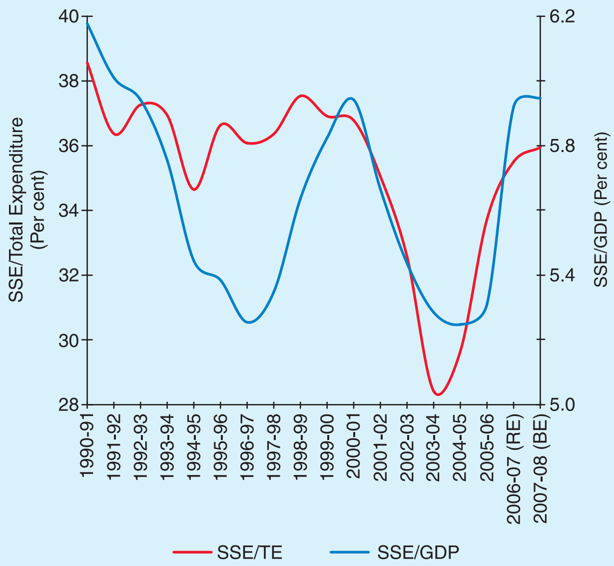


Table 9: Trend in Aggregate Social Sector Expenditure of State Governments

(Per cent)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-05 (Avg.)	2005-06 (Accounts)	2006-07 (RE)	2007-08 (BE)
1	2	3	4	5	6	7
TE/GDP	16.0	15.0	17.1	15.7	16.7	16.5
SSE/GDP	5.9	5.5	5.5	5.3	5.9	5.9
SSE/TE	36.8	36.7	32.5	33.7	35.5	35.9

RE: Revised Estimates. BE: Budget Estimates.
Avg. : Average. TE : Total Expenditure.
SSE : Social Sector Expenditure.
Source : Budget Documents of State Governments.

In terms of composition of SSE, during 1990-91 to 2004-05, revenue expenditure, capital outlay and loans and advances constituted 93.3 per cent, 4.3 per cent and 2.4 per cent, respectively. In the recent years, there has been some improvement in the share of capital expenditure comprising of capital outlay and loans and advances in aggregate SSE (Table 10). Nonetheless, the States' direct expenditure (*i.e.*, capital outlay) for social infrastructure constitutes a small portion of the aggregate SSE of State Governments. Expenditure on social services (encompassing twelve sub-heads) constitutes the

Table 10: Trend in Composition of Social Sector Expenditure

(Per cent to SSE)

Item	Revenue Expenditure	Capital Outlay	Loans and Advances	Total (2+3+4)
1	2	3	4	5
1990-91 to 1994-95 (Average)				
Social Services	78.9	3.8	2.4	85.1
Rural Development	13.6	0.4	0.0	14.0
Food Storage and Warehousing	0.7	0.1	0.0	0.9
Total	**93.3**	**4.3**	**2.4**	**100.0**
1995-96 to 1999-00 (Average)				
Social Services	82.2	4.0	2.0	88.2
Rural Development	10.2	0.4	0.0	10.6
Food Storage and Warehousing	1.1	0.1	0.1	1.2
Total	**93.4**	**4.5**	**2.1**	**100.0**
2000-01 to 2004-05 (Average)				
Social Services	80.8	5.5	2.0	88.3
Rural Development	8.7	1.6	0.0	10.2
Food Storage and Warehousing	0.8	0.5	0.1	1.4
Total	**90.3**	**7.6**	**2.1**	**100.0**
2005-06				
Social Services	78.7	7.5	1.1	87.2
Rural Development	9.3	2.1	0.0	11.4
Food Storage and Warehousing	0.9	0.1	0.4	1.1
Total	**88.9**	**9.7**	**1.5**	**100.0**
2006-07 (RE)				
Social Services	77.4	8.4	1.4	87.2
Rural Development	9.1	2.4	0.0	11.5
Food Storage and Warehousing	0.7	0.3	0.3	1.3
Total	**87.2**	**11.1**	**1.8**	**100.0**
2007-08 (BE)				
Social Services	76.6	8.5	2.6	87.7
Rural Development	9.0	2.3	0.0	11.3
Food Storage and Warehousing	0.5	0.1	0.4	1.0
Total	**86.1**	**10.9**	**3.0**	**100.0**

SSE : Social Sector Expenditure. RE: Revised Estimates. BE: Budget Estimates.
Note : Totals may not add up due to rounding off of figures.
Source : Budget Documents of the State Governments.

Table 11: Expenditure on Social Services (Revenue and Capital Accounts) – Composition

(Per cent to expenditure on social services)

Item	1990-95 (Avg.)	1996-00 (Avg.)	2000-05 (Avg.)	2005-06 (Accounts)	2006-07 (RE)	2007-08 (BE)
1	2	3	4	5	6	7
Expenditure on Social Services (a to l)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
(a) Education, Sports, Art and Culture	52.2	52.4	51.4	48.2	45.8	44.1
(b) Medical and Public Health	16.0	12.6	11.7	11.6	11.7	11.3
(c) Family Welfare	0.0	2.5	2.0	1.7	1.7	1.6
(d) Water Supply and Sanitation	7.3	7.5	7.7	8.2	7.7	7.6
(e) Housing	2.9	2.9	2.9	2.3	3.0	4.6
(f) Urban Development	2.3	2.6	3.7	4.2	6.4	8.1
(g) Welfare of SCs, ST and OBCs	6.6	6.5	6.5	7.1	7.3	7.4
(h) Labour and Labour Welfare	1.4	1.3	1.0	1.0	1.1	1.1
(i) Social Security and Welfare	4.5	4.2	5.1	5.7	6.6	7.1
(j) Nutrition	1.7	2.8	2.1	2.4	2.5	2.4
(k) Expenditure on Natural Calamities	2.6	2.9	3.8	5.2	3.8	2.1
(l) Others	2.5	2.0	2.1	2.3	2.7	2.6

Avg. : Average. RE : Revised Estimates. BE : Budget Estimates.
Source : Budget Documents of the State Governments.

major component of SSE, followed by rural development and food storage and warehousing. The share of expenditure on education and health, which constituted 52.2 per cent and 16.0 per cent, respectively of States' expenditure on social services during 1990-91 to 2004-05, has shown a declining trend. On the other hand, there has been an increase in the share of expenditure on services like housing, urban development and social security and welfare (Table 11 and Appendix Table 16 and 17). The State-wise picture of SSE is presented on Statement 47 and 48.

IV.3.7.2 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 (Table 12).

The level of expenditure on operations and maintenance is vital for the upkeep of the capital assets of the Governments. The TFC had 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 (Statement 45). On the other hand, share of wages and salaries in revenue expenditure increased over the second half of the 1990s, but declined to 27.8 per cent in 2006-07 (RE) from the peak level of 39.1 per cent in 2000-01 (Statement 44). 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 containing expenditure on wages and salaries as also pension obligations.

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 within 18 months of its constitution. As has been

Table 12: Administrative Expenditure of State Governments – Wages and Salaries and Operations and Maintenance

Year	Wages and Salaries			Operations and Maintenance		
	Amount (Rs. crore)	Per cent of Revenue Expenditure	Per cent of GDP	Amount (Rs. crore)	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	58,282	34.4	3.8	14,872	9.5	1.0
1998-99	71,234	35.6	4.1	17,710	9.6	1.0
1999-00	86,285	36.4	4.4	17,522	8.2	0.9
2000-01	94,507	39.1	4.5	19,529	8.1	0.9
2001-02	93,008	36.3	4.1	19,591	7.6	0.9
2002-03	94,717	35.1	3.9	22,438	8.3	0.9
2003-04	98,741	32.0	3.6	25,464	8.3	0.9
2004-05	1,03,924	31.1	3.3	29,163	8.8	0.9
2005-06	1,04,158	29.1	2.9	33,976	9.5	1.0
2006-07 (RE)	1,23,270	27.8	3.0	42,081	9.5	1.0
2007-08 (BE)	1,30,483	29.4	2.8	44,418	10.0	1.0

RE : Revised Estimates. BE : Budget Estimates.

Note : 1. Statements 44 and 45 provide State-wise details. The number of States included in each year differ.
2. Data as per cent of revenue expenditure (Col. 3 and 6) are based on the number of States included in that year.

Source: Based on information received from State Governments.

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,* suggest 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 base their decisions relating to salary levels after due consideration to their fiscal capacity, employee strength, size of population and the required complementary expenditure for productive employment.

IV.3.8 Plan Outlay of State Governments

In the context of the formulation of Eleventh Five Year Plan, the Planning Commission set up a working group on the resources of the States. The aggregate plan resources of the States and Union Territories for the Eleventh plan are estimated at 2.4 times the corresponding figure for the Tenth Plan (Box 5). During 2007-08, the aggregate approved outlay of the State Governments is placed at Rs.2,25,642 crore recording a lower growth of 26.0 per cent than the growth of 31.3 per cent recorded in the previous year. State-wise details of plan outlays of State Governments are set out in Statement 30.

Box 5: Report of the Working Group on States' Resources for the Eleventh Five Year Plan (2007-2012)

The Steering Committee on Financial Resources (Planning Commission) for the Eleventh Five Year Plan (2007-12) set up a Working Group to examine the trends and the projections of the Resources of the States for the Eleventh Plan under the Chairmanship of Dr.E.A.S. Sarma in January 2006. The Working Group had constituted three Sub-Groups for analysing tax resources, non-tax resources and expenditure in detail. The Working Group on States' Resources submitted its report in July 2007.

The Working Group has projected Aggregate Plan Resources (APR) required to finance the Plan expenditure during the Eleventh Five Year Plan, which is defined as aggregate receipts (comprising current revenues excluding plan grants, non-debt capital receipts and net borrowings) net of non-plan expenditure (comprising non-plan revenue expenditure and non-plan capital expenditure). The difference between the current revenues excluding plan grants and non-plan revenue expenditure gives the Balance from Current Revenues (BCR).

Based on the assumptions made by the Working Group regarding GSDP and the various components of APR on both the revenue and expenditure side, the aggregate resources of the States and the UTs have been projected at Rs.14,09,160 crore during the Eleventh plan. The APR for the Eleventh plan are thus estimated at 2.4 times the corresponding figure for the Tenth plan. The main factor contributing to this increase is the overall improvement in the States' own resources, contributed mainly by the significant improvement expected in the BCR of the States. The details of the projections of the aggregate resources for the Eleventh plan are set out in Table.

The Group deliberated on various policy issues in the context of financing the Eleventh Five Year Plan of the States. These are discussed below:

1. The Report emphasises the need for greater fiscal discipline at the State level since the States would need to raise more resources from the market in future.
2. The existing system of financing plan expenditure, where borrowing has no relationship with the credit worthiness of the State and the end-use of funds, is largely responsible for the fiscal stress of many of the States.
3. The quality of the plan expenditure has deteriorated over the years with a high component of wages and salaries. Thus, it is necessary to establish an appropriate relationship between fiscal health and the ability to borrow.
4. The total borrowings of a State need to be limited by determining desirable limits of debt (relative to GSDP) and fiscal deficit. These limits should be determined by taking into account the growth rate, interest rate, existing debt to GSDP ratio and the need to limit interest payments relative to revenue receipts to a desirable level so that adequate current resources are available for financing essential general, social and economic services. These limits should be self-determined and self-imposed by the States and should take into account contingent liabilities.
5. In the opinion of the Working Group, the establishment of Loan Council recommended by TFC is essential to ensure that the sustainability of State level debt in the case of each State is examined by an independent body of experts on a continuing basis. This would impart greater transparency to the process of fixing borrowing caps for the States. Further, it has been opined that the Ministry of Finance (MoF) may fix global borrowing ceiling each year and permit the States to determine the pattern of raising loans.
6. In view of the likely reduction in statutory liquidity ratio (SLR) limits for various financial institutions in the coming years, the States may have to borrow from non-SLR sources, which may involve higher rates of interest. This issue needs to be carefully examined by the MoF and appropriate steps taken to provide relief, *e.g.*, by issuance of tax-free non-SLR bonds, to the States.
7. Although the contribution of the services sector to GDP/GSDP is increasing, the States are not in a position to realise revenue from it since the relevant Constitutional provisions do not permit the States to tax the services. The Working Group feels that the Planning Commission/MoF may consider pursuing the States to move towards a General Goods and Services Tax (GST) of their own through appropriate Constitutional changes.
8. The Report mentions about the proliferation of Centrally Sponsored Schemes, which makes the fund transfers to the States more discretionary than formulae based. According to the Report, this trend needs to be reversed in the interest of fiscal federalism. The Working Group feels that the whole process of distribution of Central Plan Assistance should be made transparent and the formula applied in a non-discretionary manner. Furthermore, the Gadgil Mukherjee formula should be suitably amended to improve inter-state equity in transfers by giving a higher weight to per capita income.
9. The present classification of expenditure into Plan and non-Plan has led to distortions in the allocation of resources imposed by an effort to preserve a larger plan size and present successively larger Plans. The Working Group opines that this distinction should be done away with and instead expenditures be classified only as development and non-development expenditures.

References:

Government of India (2007), Report of the Working Group on States' Resources for the Eleventh Five Year Plan (2007-2012), Planning Commission, July.

Table: Resource Projections for States and UTs for the Eleventh Plan (2007-12) – At current prices

(Rs. crore)

Item	Special Category States	Non-Special Category States	Total	Total States and UTs #
1	2	3	4	5
Aggregate Plan Resources (1 to 4)	**1,37,913**	**11,87,639**	**13,25,552**	**14,09,160**
1. BCR	**-31,216**	**4,23,146**	**3,91,930**	**4,41,742**
of which:				
a) Own Tax Revenues	71,196	18,29,885	19,01,082	19,85,801
b) Non-Tax Revenues	38,733	3,23,161	3,61,894	3,73,617
c) Share in Central Taxes	81,946	9,36,635	10,18,581	10,22,231
d) Non-Plan Grants	58,090	75,679	1,33,770	1,36,392
e) Non-Plan Revenue Expenditure	2,81,182	27,42,214	30,23,396	30,75,897
2. Central Assistance	**1,27,741**	**74,453**	**2,02,194**	**2,20,382**
3. Plan Grants	**1,526**	**9,131**	**10,656**	**11,584**
4. Net Borrowings	**39,862**	**6,80,909**	**7,20,772**	**7,35,453**

: UTs include both with and without legislature.

Table 13: Trends in Major Deficit Indicators of State Governments

(Amount in Rs. crore)

Year	Revenue Deficit		Gross Fiscal Deficit		Primary Revenue Balance		Primary Deficit	
1		2		3		4		5
1999-00	54,548	(2.8)	90,099	(4.6)	9,907	(0.5)	45,458	(2.3)
2000-01	55,316	(2.6)	87,923	(4.2)	4,331	(0.2)	36,937	(1.8)
2001-02	60,398	(2.6)	94,260	(4.1)	-1,198	(-0.1)	32,665	(1.4)
2002-03	57,179	(2.3)	99,726	(4.1)	-11,848	(-0.5)	30,699	(1.2)
2003-04	63,407	(2.3)	1,20,631	(4.4)	-16,989	(-0.6)	40,235	(1.5)
(Net of Power Bonds)			94,086	(3.4)				
2004-05	39,158	(1.3)	1,07,774	(3.4)	-47,263	(-1.5)	21,353	(0.7)
2005-06	7,013	(0.2)	90,084	(2.5)	-77,011	(-2.2)	6,060	(0.2)
2006-07 (RE)	5,566	(0.1)	1,13,913	(2.8)	-90,139	(-2.2)	18,209	(0.4)
2007-08 (BE)	-11,973	(-0.3)	1,08,323	(2.3)	-1,14,648	(-2.5)	5,648	(0.1)

RE: Revised Estimates. BE: Budget Estimates. Negative (-) sign indicates surplus.

Note : 1. Figures in parentheses are percentages to GDP.

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

Source : Budget Documents of the State Governments.

IV.4 Assessment

IV.4.1 Consolidated position

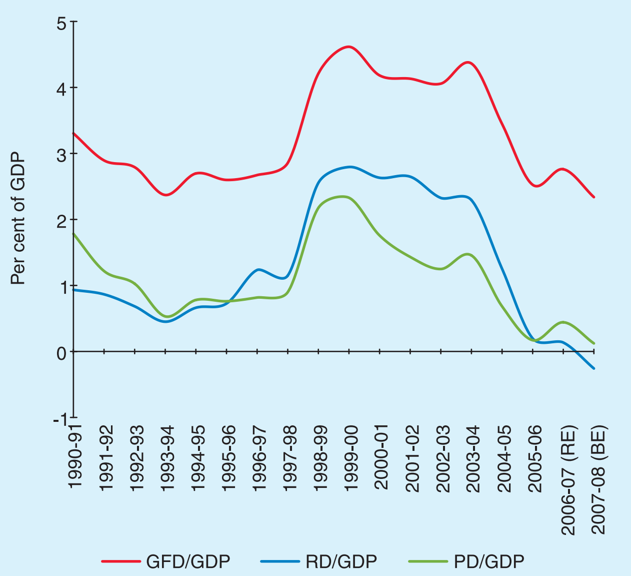
The trend in major deficit indicators as set out in Table 13 and Chart 7 reveals significant improvement witnessed in recent years after recording progressive deterioration from the second half of the 1990s (also see Appendix Table 1).

Continuing with the fiscal consolidation process, the State Governments have budgeted for a reduction in GFD-GDP ratio to 2.3 per cent (decline of 0.5 percentage points) during 2007-08. It may be pointed out that the GFD of the States had witnessed an increase by 0.3 per cent of GDP in 2006-07 (RE) over 2005-06 (Accounts) on account of increase in capital expenditure despite a decline in revenue deficit. The budgeted correction in GFD during 2007-08 is based on the turnaround envisaged in the revenue account, which has been budgeted to generate a surplus of 0.3 per cent of GDP (an improvement of 0.4 percentage points over the previous year). PD-GDP ratio is budgeted to decline to 0.1 per cent from 0.4 per cent in the previous year. Capital outlay-GDP ratio would increase to 2.6 per cent from 2.5 per cent in the preceding year. It is significant to mention that the State Governments have budgeted a consolidated surplus on the revenue account after two decades.

IV.4.2 State-wise Correction of Deficits

Notwithstanding the marked improvement in consolidated fiscal position, there are wide variations across the States. During 2007-08, twenty States have presented revenue surplus budgets. However, fifteen States have budgeted for higher GFD. Only a few States account for the major part of the envisaged overall correction. State-wise analysis of the fiscal correction process indicates

Chart 7: Trend in Major Deficit Indicators



that the non-special category States would account for 85 per cent of the correction in the revenue account and 73 per cent of the correction in GFD during 2007-08.

Bihar, Maharashtra, Uttar Pradesh and Haryana have proposed correction in the revenue balance of Rs.4,236 crore, Rs.3,703 crore, Rs.2,787 crore and Rs.1,802 crore, respectively. From among the Special Category States, Assam, Jammu and Kashmir and Uttarakhand have proposed correction of Rs.1,528 crore, Rs.875 crore and Rs.586 crore, respectively. Thus, correction in the consolidated revenue balance of the States would depend to a large extent on performance of the above mentioned States (Table 14).

Furthermore, Maharashtra and Bihar have envisaged correction in their GFD of Rs.4,462 crore and Rs.3,738 crore, respectively during 2007-08, together accounting for more than total GFD correction proposed by all the States. In the non-Special Category, States such as Uttar Pradesh (Rs.1,395 crore), Tamil Nadu (Rs.1,186 crore), Haryana (Rs.992 crore) and Karnataka (Rs.933 crore) have budgeted for higher GFD during 2007-08 over that of 2006-07 (RE). Among the Special Category States, Assam (Rs.1,583 crore) and Uttarakhand (Rs.417 crore) have proposed lower GFD than in the previous year, while Jammu and Kashmir (Rs.576 crore), Himachal Pradesh (Rs.246 crore) and Tripura (Rs.203 crore) have proposed an increase in GFD. The overall GFD correction of the States during 2007-08 would to a large extent depend upon the fiscal performance of Maharashtra and Bihar in the non-Special Category and Assam in the Special category.

IV.4.3 Decomposition and Financing of Gross Fiscal Deficit of States

The decomposition of consolidated GFD of all State Governments based on their budget documents reveals that the surplus in the revenue account would finance capital expenditure in 2007-08, while RD formed 4.9 per cent of GFD in the previous year. Accordingly, the share of capital outlay in GFD would move up from 92.1 per cent to 109.7 per cent over the year (Appendix Table 18). Securities issued to NSSF would continue to be the major financing item of GFD, though its share would come down due to the expected decline in

Table 14: State-wise Correction of RD and GFD – 2007-08 (BE) over 2006-07 (RE)

State	Revenue Deficit		Gross Fiscal Deficit	
	Correction over 2006-07 (RE) (Rs. crore)	Percentage to Total	Correction over 2006-07 (RE) (Rs. crore)	Percentage to Total
1	2	3	4	5
A. Non-Special Category				
1. Andhra Pradesh	-17	0.1	717	-17.5
2. Bihar	-4,236	28.2	-3,738	91.5
3. Chhattisgarh	-123	0.8	139	-3.4
4. Goa	-27	0.2	35	-0.9
5. Gujarat	152	-1.0	-171	4.2
6. Haryana	-1,802	12.0	992	-24.3
7. Jharkhand	-583	3.9	-788	19.3
8. Karnataka	1,205	-8.0	933	-22.8
9. Kerala	-665	4.4	-906	22.2
10. Madhya Pradesh	-243	1.6	121	-3.0
11. Maharashtra	-3,703	24.7	-4,462	109.2
12. Orissa	-298	2.0	104	-2.5
13. Punjab	-351	2.3	389	-9.5
14. Rajasthan	-118	0.8	319	-7.8
15. Tamil Nadu	-145	1.0	1,186	-29.0
16. Uttar Pradesh	-2,787	18.6	1,395	-34.1
17. West Bengal	-1,252	8.3	-352	8.6
Total (A)	**-14,994**	**100.0**	**-4,086**	**100.0**
B. Special Category				
1. Arunachal Pradesh	258	-10.1	-118	7.8
2. Assam	-1,528	60.0	-1,583	105.3
3. Himachal Pradesh	196	-7.7	246	-16.4
4. Jammu and Kashmir	-875	34.4	576	-38.3
5. Manipur	372	-14.6	-122	8.1
6. Meghalaya	-170	6.7	-3	0.2
7. Mizoram	14	-0.5	-175	11.6
8. Nagaland	-199	7.8	-157	10.4
9. Sikkim	65	-2.5	46	-3.1
10. Tripura	-92	3.6	203	-13.5
11. Uttarakhand	-586	23.0	-417	27.7
Total (B)	**-2,544**	**100.0**	**-1,504**	**100.0**
Grand Total (A + B)	**-17,539**	**100.0**	**-5,590**	**100.0**
Memo item:				
1. NCT Delhi	-1,049	–	938	–
2. Puducherry	55	–	269	–

RE : Revised Estimates. BE : Budget Estimates.
– : Not applicable.
Source : Budget Documents of the State Governments.

Box 6: National Small Savings Fund and Fiscal Deficit of State Governments

In recent years, the securities issued to the National Small Savings Fund (NSSF) have emerged as the dominant source, constituting over two-thirds of gross fiscal deficit (GFD) financing of the State Governments. Set up in 1999, the NSSF invests in special securities of the Central and State Governments. Between April 1999 and March 2000, the net small savings collections of the NSSF used to be invested in Special State Government Securities (SSGS) and Special Central Government Securities (SCGS) in the ratio 75:25 which was modified to 80:20 in 2000-01. From 2002-03 to 2006-07, the entire net collections credited to the NSSF were passed on to the States against the issue of special securities. These securities have a 25-year tenor with an initial five-year moratorium on repayment. The interest rate on the SSGS has been gradually reduced from 13.5 per cent in 1999-2000 to 9.5 per cent.

Following the recommendations of the Sub-Committee of the National Development Council (NDC) on Debt Outstanding of States against NSSF under the Chairmanship of the Union Finance Minister, it was announced in the Union Budget 2007-08 to reduce the share of the States to 80 per cent of net collections in the NSSF, with the option to the States to take up to 100 per cent of their net collections. Furthermore, the interest rate on loans taken by the State Governments from the NSSF from 1999-2000 to 2002-03 has been reset at 10.5 per cent effective April 1, 2007.

The States were required to use a portion of the flows from the NSSF (20 per cent in first year, 30 per cent in second year and 40 per cent in third year) to prepay their high cost liabilities to the Centre under the Debt Swap Scheme (DSS) during 2002-03 to 2004-05. With the expiry of the DSS, the States had access to the entire small savings collection from 2005-06 as against only 60 per cent in 2004-05. The investment in the SSGS against collections as on April 1, 2007 was estimated at Rs.4,49,892 crore.

During 1999-2002 (with 75/80 per cent share for State Governments), the NSSF, on an average, financed about 34 per cent of the GFD of the State Governments. With the increase in the share of State Governments to 100 per cent from 2002-03, flows from the NSSF, on an average, financed 53 per cent of the GFD during the period 2002-07. Following the reduction of share to 80 per cent effective April 1, 2007, the NSSF is budgeted to finance 48.8 per cent of GFD of the State Governments during 2007-08.

The NSSF is an autonomous source of funds as the State Governments cannot determine either the quantum or the cost of these borrowings. As a result, several State Governments have had funds in excess of their financing requirements. The accrual of the NSSF funds is reflected in the State Governments maintaining a high level of cash surplus on a continuous basis in the recent past.

During 2007-08, the State Governments have budgeted inflow of Rs.53,679 crore from NSSF as against Rs.46,990 crore estimated in the Union Budget. Restriction on investor category in small savings and diversion to term deposits on account of allowing income tax exemption under Section 80C of the Income Tax Act to investments made in term deposits of scheduled commercial banks with maturity of not less than five years has led to a decline in the inflow from NSSF to the State Governments from the peak level of Rs.73,815 crore during 2005-06.

References:

1. Government of India (2007), 'Union Budget 2007-08', February.
2. Reserve Bank of India (2007), 'Annual Report 2006-07', August.

net collections in keeping with the recent trends and the policy decision to reduce the minimum obligation of the States to borrow from the NSSF to 80 per cent of net collections from 100 per cent (Box 6). Market borrowings would correspondingly finance a higher share of GFD during 2007-08 at 24.3 per cent compared with 16.8 per cent during the previous year (Table 15) (Appendix Tables 19 and 20).

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

A perusal of Union Budgets in conjunction with State Budgets 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, which have been generally underestimated in State Budgets, have been overestimated in the State budgets in 2007-08. Loans from the Centre have been generally overestimated in the State budgets. 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 16.

In view of the underestimation of the shareable taxes from the Centre to the tune of Rs.6,267 crore in the State budgets of 2007-08 and overestimation of grants by Rs.17,737 crore, the level of revenue receipts would differ from those budgeted by the State Governments. The RD and GFD would, therefore, be somewhat higher than those budgeted by the State Governments.

With regard to financing of GFD, both loans and advances from the Centre and loans against Securities issued to the NSSF have been overestimated by Rs.3,501 crore and Rs.6,689

Table 15: Decomposition and Financing of Gross Fiscal Deficit – 2005-06 (Accounts) to 2007-08 (BE)

(Per cent to GFD)

Item	2005-06	2006-07 (RE)	2007-08 (BE)
1	2	3	4
Decomposition (1+2+3-4)	**100.0**	**100.0**	**100.0**
1. Revenue Deficit	7.8	4.9	-11.1
2. Capital Outlay	86.1	92.1	109.7
3. Net Lending	6.1	5.7	10.7
4. Non-debt Capital Receipts	0.0	2.7	9.3
Financing (1 to 11)			
1. Market Borrowings	17.0	16.8	24.3
2. Loans from Centre	0.0	1.8	6.0
3. Special Securities issued to NSSF/Small Savings	81.9	51.5	49.6
4. Loans from LIC, NABARD, NCDC, SBI & Other Banks	4.5	5.6	6.8
5. Small Savings, P.F., *etc.*	11.6	9.6	11.4
6. Reserve Funds	5.8	4.2	3.9
7. Deposits & Advances	8.1	1.6	1.4
8. Suspense & Miscellaneous	8.8	0.0	-1.3
9. Remittances	0.1	0.3	0.0
10. Others	0.0	-2.8	-0.9
11. Overall Surplus (-) / Deficit (+)	-37.7	11.6	-1.1

RE : Revised Estimates. BE : Budget Estimates.

Note : 1. See Notes to Appendix Table 19.

2. 'Others' include Compensation and Other Bonds, Loans from Other Institutions, Appropriation to Contingency Fund, Inter-state Settlement and Contingency Fund.

Source : Budget Documents of the State Governments.

crore respectively, in the State budgets of 2007-08. Thus, the financing pattern of GFD gets distorted due to such overestimation/underestimation of the budgetary heads of State Governments as compared with that of the Union Budget.

It may be noted that in their budgets for 2007-08, the consolidated position of revenue surplus of the State Governments has been estimated at Rs.11,973 crore (0.3 per cent of GDP), while GFD has been estimated at Rs.1,08,323 crore (2.3 per cent of GDP). Assessing the State Budgets in conjunction with Union Budget 2007-08 indicate that grants-in-aid have been overestimated by 17.8 per cent while shareable central taxes have been underestimated by 4.4 per cent. Adjusting for the data of Union Budget 2007-08, the revenue surplus of the State Governments would be placed lower at Rs.503 crore (0.01 per cent of GDP). Correspondingly, GFD would be placed higher at Rs.1,19,793 crore (2.6 per cent of GDP). Taking into account the data on loans from Centre and flows from NSSF based on Union Budget 2007-08 and allocation of market borrowings (as per Reserve Bank records), the consolidated financing pattern of the GFD of the State Governments is as set out in Table 17. There would be a decline in the share of flows from NSSF, market borrowings and loans from the Centre in financing of GFD.

Table 16: Budgetary Data Variation- State Budgets and Union Budget

(Amount in Rs. crore)

Item	2005-06 (BE)			2006-07 (BE)			2007-08 (BE)		
	State Budgets	Union Budget	Difference*	State Budgets	Union Budget	Difference*	State Budgets	Union Budget	Difference*
1	2	3	4	5	6	7	8	9	10
1. Shareable Taxes from Centre	90,002	94,959	-4,957 (-5.2)	109,420	113,448	-4,028 (-3.6)	136,184	142,450	-6,267 (-4.4)
2. Grants-in-Aid	78,297	77,275	1,023 (1.3)	99,291	83,098	16,193 (19.5)	117,320	99,583	17,737 (17.8)
3. Loans from Centre (Net)	17,507	-9,687	27,194 (280.7)	4,827	-2,507	7,334 (292.6)	6,485	2,984	3,501 (117.3)
4. NSSF (Net)	53,128	86,990	-33,862 (-38.9)	59,141	83,490	-24,349 (-29.2)	53,679	46,990	6,689 (14.2)

* : Negative (-)/Positive (+) sign implies underestimation/overestimation in State budgets in comparison with Union Budget estimates.

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

Source : Budget Documents of the State Governments and the Union Government.

Table 17: Financing of Gross Fiscal Deficit (GFD) – 2007-08 (Adjusted)

(Amount in Rs. crore)

Item	2007-08 (BE)		Variation	
	State Budgets	Adjusted	Amount	Per cent
1	2	3	4	5
Gross Fiscal Deficit (GFD)	**1,08,323 (100.0)**	**1,19,793 (100.0)**	**11,470**	**10.6**
1. Market Borrowings*	26,307 (24.3)	34,436 (28.7)	8,129	30.9
2. Loans from Centre@	6,485 (6.0)	2,984 (2.5)	-3,501	-54.0
3. Special Securities issued to NSSF@	53,679 (49.6)	46,990 (39.2)	-6,689	-12.5
4. Loans from LIC, NABARD, NCDC, SBI and other Banks	7,386 (6.8)	7,386 (6.2)	–	–
5. Small Savings and Provident Fund, *etc.*	12,396 (11.4)	12,396 (10.3)	–	–
6. Reserve Funds	4,235 (3.9)	4,235 (3.5)	–	–
7. Deposits and Advances	1,515 (1.4)	1,515 (1.3)	–	–
8. Suspense and Miscellaneous	-1,437 (-1.3)	-1,437 (-1.2)	–	–
9. Remittances	-44 (0.0)	-44 (0.0)	–	–
10. Others	-973 (-0.9)	-973 (-0.8)	–	–
11. Overall Surplus (-)/Deficit (+)	-1,225 (-1.1)	12,306 (10.3)	13,531	-1,104.4

* : Data are adjusted as per the allocation under market borrowing programme for the State Governments during 2007-08.
@ : Data are adjusted as per the Union Budget 2007-08. '–' : Nil.
Note : 1. Figures in brackets are percentages to GFD.
2. 'Others' include Compensation and Other Bonds, Loans from Other Institutions, Appropriation to Contingency Fund, Inter-state Settlement and Contingency Fund.
Source : Budget Documents of the State Governments and the Union Government and Reserve Bank records.

V. AN ASSESSMENT OF STATE-WISE FISCAL PERFORMANCE

The consolidated position of the State Governments witnessed noticeable fiscal correction in recent years as is evident from the analysis in Section IV. The state-wise analysis, however, reveals that fiscal correction has not been uniform across States, notwithstanding a strong commitment by almost all State Governments to carry forward the process of fiscal correction and consolidation. This Section presents State-wise assessment of fiscal situation based on revised estimates of 2006-07[4] as budget estimates generally undergo substantial revision.

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. The fiscal indicators are generally 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 recent years, wherever unavailable, has been projected based on previous three year growth rates. State-wise data on these fiscal indicators for 2003-06 (Average) and 2006-07 (RE) are presented in Tables 18 and 19, respectively. The median level of each fiscal indicator, in respect of Special and

[4] In this section, the revised estimates of 2006-07 are compared with the fiscal position that prevailed, on an average, during the triennium 2003-04 through 2005-06 (Accounts).

non-Special Category of States, is also highlighted in these tables. 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

48. Following the overall position, the analysis of fiscal indicators is undertaken separately for Special 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

Table 18: Fiscal Indicators – 2003-04 to 2005-06 (Average)

(Per cent)

State	Deficit Indicators						Revenue Performance			Expenditure Pattern				Debt Position	
	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
I. Non-Special Category															
1. Andhra Pradesh	3.9	1.0	0.5	-2.4	23.9	6.7	7.9	1.9	4.7	12.5	6.3	6.8	**2.8**	43.3	23.4
2. Bihar	5.4	0.0	-0.8	-6.1	-20.6	0.3	6.0	0.8	20.7	18.9	14.1	12.8	3.0	76.7	**22.4**
3. Chhattisgarh	3.2	-0.6	0.7	-3.2	-102.6	-2.3	8.0	2.9	6.9	14.8	5.6	9.1	3.1	29.4	14.8
4. Goa	5.4	**1.0**	1.9	-2.5	**19.2**	5.5	9.0	7.5	2.5	17.1	**7.3**	8.0	4.4	45.3	18.7
5. Gujarat	4.4	1.6	1.2	-1.7	31.1	13.9	7.1	1.7	2.5	10.5	5.5	5.4	2.5	38.5	28.8
6. Haryana	1.9	-0.2	-0.6	-2.7	-131.4	-1.2	8.9	2.8	1.8	9.9	5.6	4.2	1.1	29.1	18.9
7. Jharkhand	7.7	1.8	5.8	-0.1	17.8	10.7	5.8	2.9	9.0	18.1	7.3	11.9	4.4	30.5	10.9
8. Karnataka	2.7	-0.7	0.1	-3.2	-32.2	-3.8	10.5	2.5	4.2	12.7	6.6	6.6	3.0	29.9	14.9
9. Kerala	**4.7**	3.5	1.2	0.0	74.6	26.3	8.7	0.8	3.6	10.0	7.9	6.7	0.7	42.3	26.6
10. Madhya Pradesh	6.0	1.0	2.7	**-2.4**	11.3	**7.5**	7.6	2.6	7.3	16.5	7.1	7.5	4.5	**42.5**	19.2
11. Maharashtra	4.8	2.0	2.5	-0.3	40.7	18.9	**7.9**	1.2	1.8	10.0	5.7	5.6	2.3	33.3	21.8
12. Orissa	3.1	0.9	-2.5	-4.7	-32.0	5.3	7.0	2.2	10.6	**12.7**	10.6	8.1	1.7	62.9	28.2
13. Punjab	4.4	3.1	0.2	-1.1	67.9	20.4	8.0	5.4	2.2	9.0	11.0	4.2	1.0	51.6	27.1
14. Rajasthan	5.5	1.9	1.1	-2.5	31.4	12.5	7.4	**2.0**	6.2	13.7	7.6	8.7	3.2	52.0	28.4
15. Tamil Nadu	2.4	0.1	0.0	-2.4	-15.4	1.1	10.2	1.2	3.6	10.5	6.4	**6.9**	2.2	30.2	16.7
16. Uttar Pradesh	5.7	4.0	1.3	-0.4	59.3	26.7	6.8	1.1	8.2	14.0	9.1	7.0	3.4	58.5	27.9
17. West Bengal	5.4	4.0	**0.8**	-0.6	75.1	42.5	4.7	0.5	**4.5**	7.6	7.5	4.8	0.7	48.2	48.3
II. Special Category															
1. Arunachal Pradesh	11.4	-4.5	5.7	-10.1	-47.6	-7.0	1.9	6.2	54.0	54.9	18.6	25.3	15.8	78.0	9.1
2. Assam	2.5	-0.3	-0.9	-3.6	162.5	-0.3	6.1	2.6	13.8	17.4	8.8	9.9	3.0	39.1	15.1
3. Himachal Pradesh	8.5	4.8	0.7	-3.0	39.5	21.3	6.1	2.6	16.1	19.9	13.5	12.4	3.8	79.8	32.1
4. Jammu and Kashmir	3.9	-8.5	-1.8	-14.2	3,745.2	-18.1	6.7	2.8	37.8	32.6	18.6	15.2	12.2	77.9	**12.1**
5. Manipur	8.2	**-3.2**	2.4	**-9.1**	-51.4	**-6.3**	2.0	1.6	40.9	34.5	18.1	19.4	10.9	81.6	13.4
6. Meghalaya	4.4	-0.7	**1.0**	-4.1	**-22.2**	-2.3	**4.0**	**2.6**	23.0	23.1	11.3	**13.6**	4.7	45.1	11.5
7. Mizoram	11.4	-3.2	4.8	-9.7	-29.9	-5.7	1.5	3.0	50.5	48.2	19.0	24.7	14.0	105.6	11.8
8. Nagaland	1.8	-5.6	-2.5	-9.9	69.7	-13.6	1.4	1.4	**35.2**	**23.3**	**16.5**	12.0	7.4	46.6	11.6
9. Sikkim	**8.1**	-11.4	1.8	-17.7	-180.7	-10.3	8.0	53.8	49.8	54.8	65.0	29.9	19.5	**74.3**	5.8
10. Tripura	3.0	-4.5	-1.4	-8.8	-256.5	-13.7	3.1	1.8	27.0	21.8	12.7	13.3	**7.5**	58.8	13.8
11. Uttarakhand	8.7	3.1	5.2	-0.4	33.9	15.2	7.0	2.5	11.3	19.8	9.1	11.3	5.1	48.1	17.0
All States*	**3.4**	**1.2**	**0.8**	**-1.4**	**32.2**	**11.0**	**5.8**	**1.4**	**4.5**	**9.4**	**5.8**	**5.3**	**2.0**	**32.9**	**23.1**
Memo Item:															
1. NCT Delhi	1.5	-3.3	-0.2	-5.0	496.1	-34.2	7.8	1.2	0.6	8.0	3.1	4.4	1.3	18.4	17.5
2. Puducherry	4.9	-0.1	1.9	-3.1	-2.7	-0.4	8.4	9.0	14.2	29.4	7.2	14.0	5.1	33.3	9.5

GFD : Gross Fiscal Deficit. GSDP : Gross State Domestic Product. RD : Revenue Deficit.
PD : Primary Deficit. PRB : Primary Revenue Balance. RR : Revenue Receipts.
OTR : Own Tax Revenue. ONTR : Own Non-Tax Revenue. CT : Current Transfers.
DEV : Developmental Expenditure. NON-DEV : Non-Developmental Expenditure. SSE : Social Sector Expenditure.
CO : Capital Outlay. IP : Interest Payment.

* : Fiscal Indicators for All States are as percentage to GDP, except for RD/GFD, RD/RR and IP/RR.

Note : 1. Negative (-) sign indicates surplus in deficit indicators.
2. Figures in bold pertain to median States for the given indicator.
3. 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 the State Governments.

Table 19: Fiscal Indicators – 2006-07 (RE)

(Per cent)

State	Deficit Indicator						Revenue Performance			Expenditure Pattern				Debt Position	
	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
I. Non-Special Category															
1. Andhra Pradesh	3.0	0.0	0.0	**-3.0**	0.7	0.1	9.6	**2.1**	5.4	15.3	6.1	8.0	3.9	42.1	17.7
2. Bihar	10.4	1.1	4.6	-4.7	10.9	3.3	6.8	0.5	27.1	29.2	15.7	18.7	8.7	73.3	16.9
3. Chhattisgarh	2.9	-3.4	0.7	-5.5	-117.6	-14.1	10.7	2.9	10.4	20.2	6.2	13.5	5.1	28.7	8.9
4. Goa	4.7	0.2	1.8	-2.7	4.9	1.4	7.9	6.1	2.9	15.5	6.2	7.1	4.5	39.6	17.0
5. Gujarat	2.5	-0.7	-0.3	-3.6	-29.2	-5.9	7.5	1.6	3.2	10.3	4.9	5.3	3.4	36.4	22.9
6. Haryana	0.6	0.6	-1.4	-1.4	100.8	4.1	9.1	2.6	2.0	11.6	4.3	4.8	1.7	24.5	14.3
7. Jharkhand	9.8	2.0	8.4	0.6	20.7	10.7	5.8	2.7	10.4	22.1	**6.7**	13.8	5.1	40.0	7.7
8. Karnataka	2.8	-1.5	0.6	-3.6	-52.7	-7.5	12.3	2.2	5.1	15.1	6.5	**8.0**	4.1	27.5	11.1
9. Kerala	6.1	4.4	2.9	1.1	71.0	31.2	8.8	0.8	4.4	10.4	8.3	7.2	1.2	**40.2**	23.4
10. Madhya Pradesh	3.7	-1.4	**0.5**	-4.6	-38.9	-7.1	8.3	1.9	10.1	15.7	7.3	9.3	4.2	43.8	15.7
11. Maharashtra	3.1	0.6	0.8	-1.7	20.4	5.3	**8.1**	1.1	2.9	9.8	5.4	6.0	2.1	32.4	19.5
12. Orissa	1.3	-1.0	-3.3	-5.6	-81.2	-4.2	8.0	2.6	14.0	14.4	11.3	9.4	2.3	58.2	18.5
13. Punjab	4.8	1.9	1.1	-1.8	39.4	11.0	8.4	5.1	3.7	11.1	10.8	5.1	2.8	47.7	21.6
14. Rajasthan	**3.6**	-0.1	-0.5	-4.2	-1.9	-0.4	8.1	2.3	7.8	**14.4**	7.7	9.3	**3.8**	50.8	22.5
15. Tamil Nadu	2.7	**0.1**	0.5	-2.2	**3.7**	**0.6**	11.6	1.2	3.9	12.7	6.5	7.8	2.6	28.4	13.6
16. Uttar Pradesh	3.6	-1.1	0.2	-4.6	-30.3	-5.6	8.0	1.8	9.9	14.3	8.1	8.4	4.6	55.9	**17.7**
17. West Bengal	4.5	3.2	0.4	-0.9	71.1	31.1	4.8	0.5	**5.1**	8.0	6.9	5.6	0.8	47.2	40.2
II. Special Category															
1. Arunachal Pradesh	7.7	-12.5	**1.4**	-18.9	-162.8	-17.6	2.1	6.2	63.1	60.7	18.5	26.6	20.1	83.6	8.9
2. Assam	7.2	1.2	3.0	-3.0	17.3	3.9	7.0	3.2	21.3	26.0	12.7	15.5	5.7	38.0	13.3
3. Himachal Pradesh	3.9	0.2	-2.0	-5.7	4.9	0.8	5.4	**3.1**	16.1	17.3	11.2	10.7	3.8	**65.1**	24.0
4. Jammu and Kashmir	**5.8**	-7.6	1.0	-12.4	-131.0	-16.0	7.6	2.4	37.8	35.4	18.3	17.4	13.3	81.6	**10.0**
5. Manipur	4.3	-14.8	-0.9	-20.0	-340.7	-26.0	2.1	3.1	51.7	43.1	18.3	20.3	17.9	83.9	9.2
6. Meghalaya	1.4	**-5.4**	-2.0	-8.8	-395.5	-13.8	**4.3**	2.8	32.2	**29.4**	11.5	**15.6**	6.4	45.9	8.7
7. Mizoram	8.3	-5.1	1.8	-11.6	-61.2	-8.8	1.8	3.5	52.3	46.9	19.6	23.6	13.9	98.8	11.4
8. Nagaland	5.3	-5.5	1.6	-9.1	-103.8	**-14.8**	1.6	1.1	**34.0**	27.2	**14.9**	13.2	**10.7**	45.2	9.9
9. Sikkim	10.5	-23.4	4.4	-29.5	-222.8	-18.6	6.8	54.5	64.7	69.6	67.0	34.8	34.0	73.9	4.8
10. Tripura	4.6	-5.3	0.7	**-9.2**	**-116.3**	-17.2	3.4	0.7	26.7	21.7	13.2	13.7	9.8	54.0	12.6
11. Uttarakhand	6.3	-1.2	2.9	-4.6	-19.1	-5.2	7.9	2.1	12.9	20.0	8.6	12.1	7.5	45.8	14.8
All States*	**2.8**	**0.1**	**0.4**	**-2.2**	**4.9**	**1.0**	**6.2**	**1.3**	**5.3**	**10.2**	**5.4**	**5.9**	**2.5**	**30.8**	**18.0**
Memo Item:															
1. NCT Delhi	0.7	-3.6	-1.2	-5.4	-532.4	-34.7	8.4	1.2	0.7	7.1	3.6	4.6	1.7	21.4	18.0
2. Puducherry	7.9	2.1	5.0	-0.8	27.0	7.5	8.5	8.3	11.8	28.7	7.9	12.9	5.9	52.9	10.4

Note : See Notes to Table 18.

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 18 and 19 have also been exhibited through Charts 8 to 13.

V. 1 Overall Position – All States

Both the non-Special and Special Category States witnessed improvement in their fiscal performance during 2006-07 (RE) compared with the period 2003-06 as reflected in the improvement in the median value of most of the fiscal indicators (Table 20).

A comparative analysis indicates that the non-Special Category States have relatively higher OTR-GSDP ratio and conversely the Special 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 high 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 than the non-Special Category States.

Table 20: Median Value of Fiscal Indicators

(Per cent)

Indicator	Non-Special Category States		Special Category States	
	2003-06 (Avg.)	2006-07 (RE)	2003-06 (Avg.)	2006-07 (RE)
1	2	3	4	5
1. GFD/GSDP	4.7	3.6	8.1	5.8
2. RD/GSDP	1.0	0.1	-3.2	-5.4
3. PD/GSDP	0.8	0.5	1.0	1.4
4. PRB/GSDP	-2.4	-3.0	-9.1	-9.2
5. RD/GFD	19.2	3.7	-22.2	-116.3
6. RD/RR	7.5	0.6	-6.3	-14.8
7. OTR/GSDP	7.9	8.1	4.0	4.3
8. ONTR/GSDP	2.0	2.1	2.6	3.1
9. CT/GSDP	4.5	5.1	35.2	34.0
10. DEV/GSDP	12.7	14.4	23.3	29.4
11. NON-DEV/GSDP	7.3	6.7	16.5	14.9
12. SSE/GSDP	6.9	8.0	13.6	15.6
13. CO/GSDP	2.8	3.8	7.5	10.7
14. DEBT/GSDP	42.5	40.2	74.3	65.1
15. IP/RR	22.4	17.7	12.1	10.0

Note : Based on Tables 18 and 19.

V.2 Non-Special Category States

V.2.1 Overall Position

There exists a wide variation in fiscal performance across the non-Special Category States. States such as Haryana, Tamil Nadu, Chhattisgarh and Karnataka 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, have 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.

V.2.2 Deficit Indicators

Improvement in fiscal performance, in terms of deficit indicators, was clearly discernible across the States in 2006-07 (RE) as compared with the period 2003-06 (Average) (Charts 8-A, B & C) (also see Statements 1-5).

Improvement was evident in RD-GSDP ratio for the non-Special Category States with the ratio for the median State declining from 1.0 per cent during 2003-06 to 0.1 per cent in 2006-07 (RE). Seven States (Chhattisgarh, Karnataka, Madhya Pradesh, Uttar Pradesh, Orissa, Gujarat and Rajasthan) were in revenue surplus in 2006-07 (RE) as compared with three States (Chhattisgarh, Karnataka and Haryana) in 2003-06 (Table 21 and Chart 8-B). These States could achieve the target of elimination of RD two years ahead of the target recommended by the TFC to eliminate RD by end-March, 2009. Furthermore, the RD-GSDP ratio for three States was less than 0.5 per cent in 2006-07 (RE) as against two States in 2003-06.

Reflecting the decline in the RD-GSDP ratio, there was improvement in GFD-GSDP ratio, with the ratio for the median State declining from 4.7 per cent during 2003-06 to 3.6 per cent in 2006-07 (RE). The median value of PD-GSDP ratio also improved from 0.8 per cent to 0.5 per cent during the above period (Chart 8-C). The ratio of GFD to GSDP was below 3 per cent for seven out of seventeen non-Special Category States in 2006-07 (RE) (Haryana, Orissa, Gujarat, Karnataka, Tamil Nadu, Chhattisgarh and Andhra Pradesh) as against

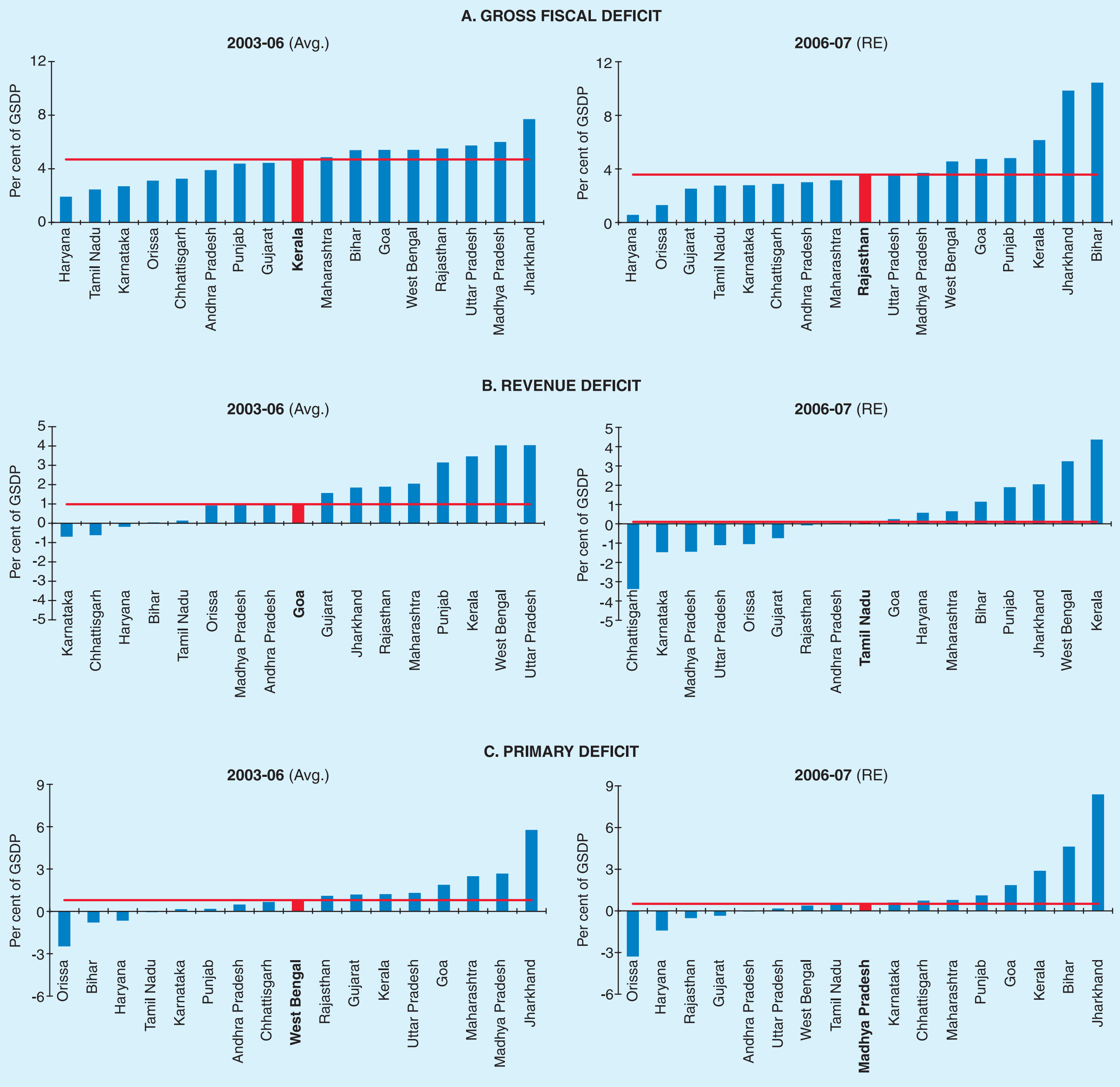
Table 21: Distribution of Non-Special Category States by the level of Revenue Balance / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Revenue Surplus	Karnataka, Chhattisgarh, Haryana	Chhattisgarh, Karnataka, Madhya Pradesh, Uttar Pradesh, Orissa, Gujarat, Rajasthan
Below 0.5	Bihar, Tamil Nadu	Andhra Pradesh, **Tamil Nadu**, Goa
0.5 to 1.0	Orissa, Madhya Pradesh, **Goa,** Andhra Pradesh	Haryana, Maharashtra
1.0 to 1.5	–	Bihar
1.5 to 2.0	Gujarat, Jharkhand, Rajasthan, Maharashtra	Punjab, Jharkhand
Above 2.0	Punjab, Kerala, Uttar Pradesh, West Bengal	West Bengal, Kerala

Avg. : Average. RE : Revised Estimates.

Note : 1. Based on Tables 18 and 19.
2. Bold indicates the median State.

Chart 8: Deficit Indicators - Non-Special Category States



three States (Haryana, Tamil Nadu and Karnataka) in 2003-06 (Table 22 and Chart 8-A). It may be mentioned that these seven States could achieve the target of 3 per cent of GFD three years ahead of the TFC target of end-March 2010.

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 several State Governments in 2006-07 (RE) *vis-à-vis* 2003-06 (Average). The RD-GFD median value improved substantially from 19.2 per cent during 2003-06 (Average) to 3.7 per cent in 2006-07 (RE). However, few State Governments, *viz*., Haryana, Bihar, Jharkhand and Tamil Nadu witnessed deterioration in RD-GFD ratio. The RD-GFD ratio of three States, *viz*., Haryana, Kerala and West Bengal remained high during 2006-07 (RE).

The median value of the RD-RR ratio in 2006-07 (RE) at 0.6 per cent showed marked improvement over that of 7.5 per cent in 2003-06 (Average). RD-RR ratio was high for Kerala (31.2 per cent), West Bengal (31.1 per cent), Punjab (11.0 per cent) and Jharkhand (10.7 per cent) in 2006-07 (RE) compared with the States of Andhra Pradesh and Tamil Nadu (with the ratio below 1.0 per cent).

The median level of primary revenue surplus (*i.e.,* revenue deficit *minus* interest payments) as ratio to GSDP witnessed an improvement from 2.4 per cent in 2003-06 (Average) to 3.0 per cent in 2006-07 (RE). Primary revenue deficit or a lower order of primary revenue surplus than the interest payment implies resort by the State Governments to borrowed funds to meet the interest payment obligations. In 2006-07 (RE), two non-Special Category States, *viz*., Kerala and Jharkhand, have primary revenue deficit. Out of the remaining fifteen States, primary revenue surplus was adequate to meet the interest payment obligations in case of seven States. In other words, ten non-Special category States resorted to borrowed funds for financing their entire or part of interest payments in 2006-07 (RE), which is a matter of concern.

Table 22: Distribution of Non-Special Category States by the level of Gross Fiscal Deficit / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 2	Haryana	Haryana, Orissa
2 to 3	Tamil Nadu, Karnataka	Gujarat, Tamil Nadu, Karnataka, Chhattisgarh, Andhra Pradesh
3 to 4	Orissa, Chhattisgarh, Andhra Pradesh	Maharashtra, **Rajasthan**, Uttar Pradesh, Madhya Pradesh
4 to 5	Punjab, Gujarat, **Kerala**, Maharashtra	Goa, Punjab, West Bengal
Above 5	Bihar, Goa, West Bengal, Rajasthan, Uttar Pradesh, Madhya Pradesh, Jharkhand	Kerala, Jharkhand, Bihar

Note : See Notes to Table 21.

V.2.3 Revenue Performance

All the State Governments witnessed improvement in their own tax revenue performance (as percentage of GSDP) during 2006-07 (RE) over 2003-06 (Average) with the median value of OTR-GSDP improving from 7.9 per cent to 8.1 per cent (Chart 9-A) (also see Statements 18-22). Karnataka (12.3 per cent), Tamil Nadu (11.6 per cent) and Chhattisgarh (10.7 per cent) had the highest own tax revenue-GSDP ratio during 2006-07 (RE), while West Bengal (4.8 per cent), Jharkhand (5.8 per cent) and Bihar (6.8 per cent) occupied the lowest position (Table 23).

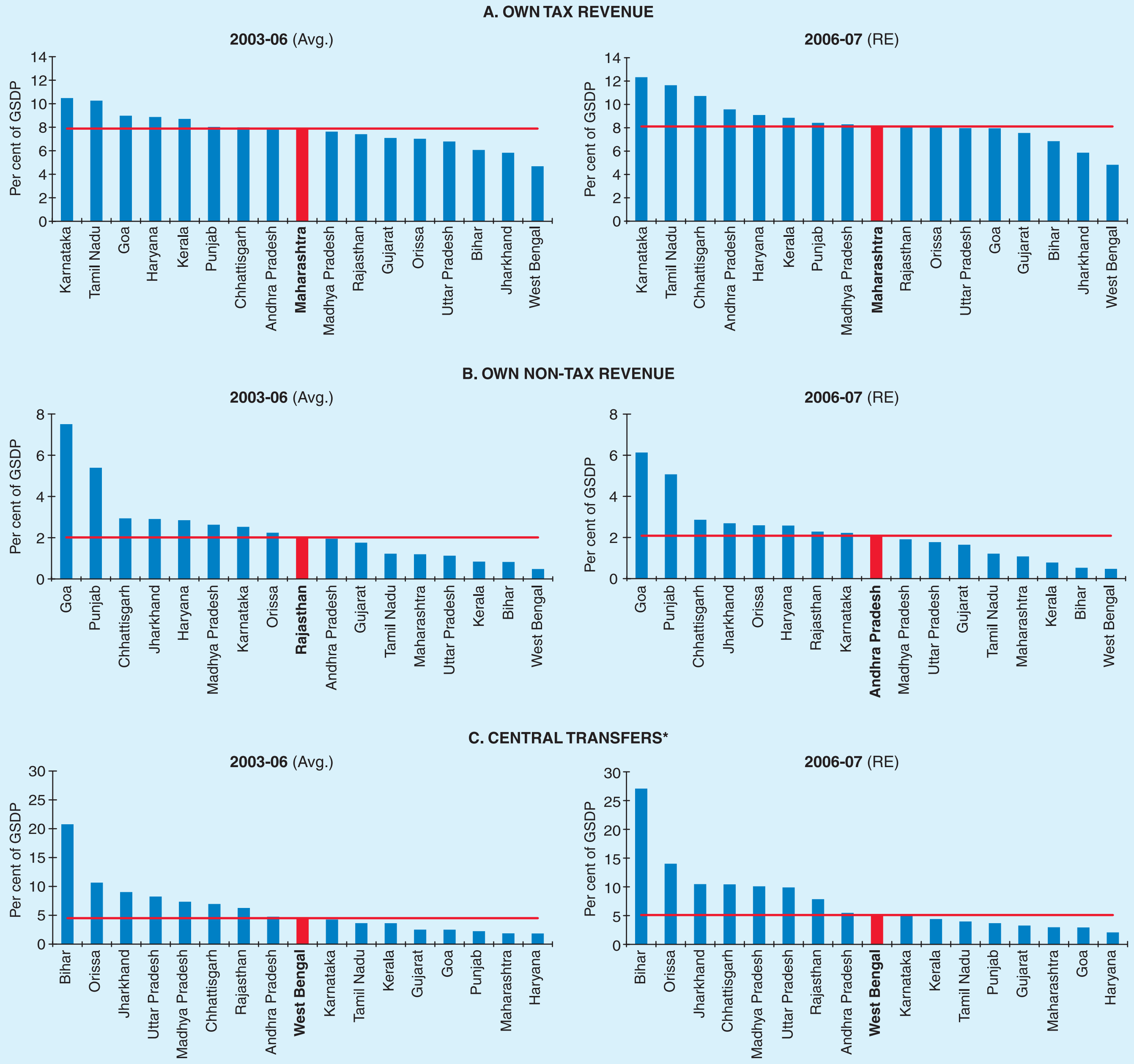
In contrast to the trend observed in own tax revenues, only a few State Governments showed improvement in own non-tax-GSDP ratio during 2006-07 (RE) over 2003-06 (Average). As a result, the median value of non-tax-GSDP ratio increased only marginally from 2.0 to 2.1 per cent (Chart 9-B). While Goa (6.1 per cent) and Punjab (5.1 per cent) continued to have high own non-tax–GSDP ratio, States like Bihar, West Bengal and Kerala had the ratio at less than 1.0 per cent. The low level of non-tax revenue is partly due to 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

Table 23: Distribution of Non-Special Category States by the level of Own Tax Revenue / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 5	West Bengal	West Bengal
5 to 7	Jharkhand, Bihar, Uttar Pradesh, Orissa	Jharkhand, Bihar
7 to 9	Gujarat, Rajasthan, Madhya Pradesh, **Maharashtra**, Chhattisgarh, Andhra Pradesh, Punjab, Kerala, Haryana,Goa	Gujarat, Goa, Uttar Pradesh, Orissa, Rajasthan, **Maharashtra**, Madhya Pradesh, Punjab, Kerala
Above 9	Tamil Nadu, Karnataka	Haryana, Andhra Pradesh, Chhattisgarh, Tamil Nadu, Karnataka

Note : See Notes to Table 21.

Chart 9: Revenue Performance - Non-Special Category States



* : Include share in Central taxes and grants-in-aid to states.

and roads (as observed in Section IV). There is a wide variation across the States in terms of cost recovery.

Current transfers (*i.e.,* shareable Central taxes and grants-in-aid) as a ratio to GSDP were high for States like Bihar, Orissa, Jharkhand, Chhattisgarh, Madhya Pradesh, Rajasthan and Uttar Pradesh, reflecting the principle of horizontal equity in such fiscal transfers (Chart 9-C).

V.2.4 Pattern of Expenditure

All States except Gujarat, Maharashtra, Madhya Pradesh and Goa witnessed increase in developmental expenditure (DEV)-GSDP ratio in 2006-07 (RE) over 2003-06 (Average) with the median value of DEV-GSDP rising from 12.7 per cent to 14.4 per cent over the period (Chart 10-A). It may be mentioned that the relatively underdeveloped States such as Bihar (29.2 per cent), Jharkhand (22.1 per cent) and Chhattisgarh (20.2 per cent) had the highest ranking in terms of developmental expenditure-GSDP ratio, whereas West Bengal (8.0 per cent) and Maharashtra (9.8 per cent) had the lowest ranking (Table 24).

The median value of non-developmental expenditure as ratio to GSDP declined from 7.3 per cent to 6.7 per cent in 2006-07 (RE) over 2003-06 (Average) (Chart 10-B). The ratio of non-developmental expenditure to GSDP was high in case of Bihar, Orissa and Punjab (above 10 per cent), while the ratio was lowest for Gujarat and Haryana (less than 5 per cent) in 2006-07 (RE) (also see Statements 12-16).

All States except Goa and Gujarat have shown substantial 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 2006-07 (RE) over that of 2003-06 (Average) with the median value improving from 6.9 per cent to 8.0 per cent. Amongst all the States, Bihar (18.7 per cent), Jharkhand (13.8 per cent) and Chhattisgarh (13.5 per cent) continued to have higher level of social sector expenditure (in terms of GSDP). On the other hand, Haryana (4.8 per cent), Punjab (5.1 per cent), Gujarat (5.3 per cent), Maharashtra (6.0 per cent) and West Bengal (5.6 per cent) have lower level of social sector expenditure-GSDP ratio.

All State Governments (barring Madhya Pradesh and Maharashtra) showed an increase in the ratio of capital outlay to GSDP during 2006-07 (RE) over 2003-06 (Average) with the median value rising from 2.8 per cent to 3.8 per cent (Chart 10-C). Bihar, Chhattisgarh, Jharkhand, Uttar Pradesh, Madhya Pradesh, Goa and Karnataka continued to maintain higher proportion of capital outlay in terms of GSDP (above 4 per cent), while Haryana, Kerala and West Bengal continued to have low capital outlay-GSDP ratio (below 2 per cent) (Table 25).

The proportion of consolidated expenditure (revenue and capital outlay) under education (including sports, art and culture) as percentage to aggregate disbursement has been budgeted lower in 2007-08 (Statement 41). On the other hand, the consolidated expenditure on health (medical and public health and family welfare) would be maintained at the previous year's level (Statement 42). There are, however, wide

Table 24: Distribution of Non-Special Category States by the level of Developmental Expenditure / GSDP Ratio

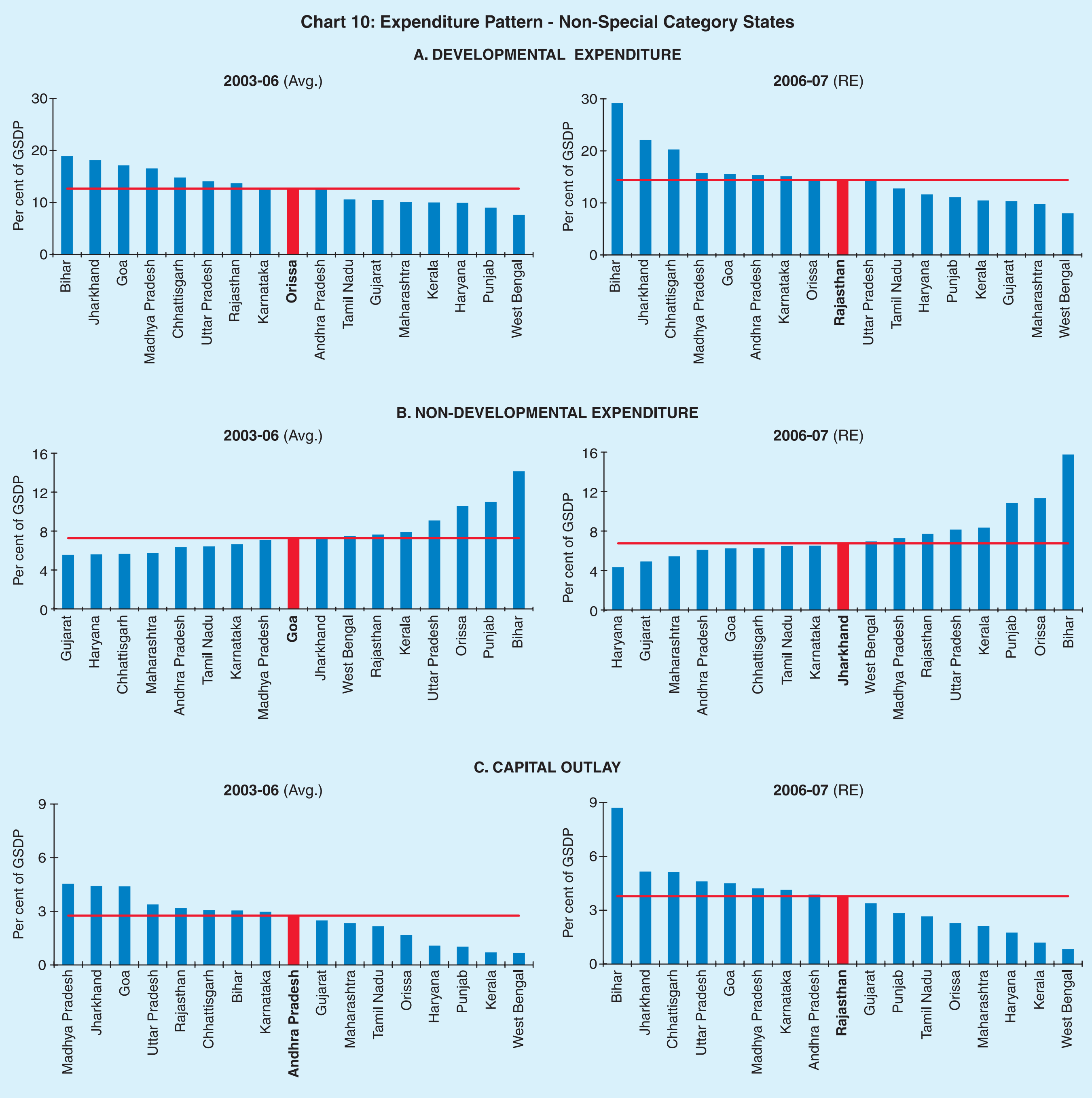
Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 10	West Bengal, Haryana, Punjab Kerala, Maharashtra	Maharashtra, West Bengal
10 to 13	Andhra Pradesh, Gujarat, Tamil Nadu, Karnataka, **Orissa**	Gujarat, Tamil Nadu Kerala, Punjab, Haryana
13 to 16	Rajasthan, Uttar Pradesh, Chhattisgarh	Uttar Pradesh, **Rajasthan**, Orissa, Karnataka, Andhra Pradesh, Goa, Madhya Pradesh
Above 16	Madhya Pradesh, Goa, Jharkhand, Bihar	Chhattisgarh, Jharkhand, Bihar

Note : See Notes to Table 21.

Table 25: Distribution of Non-Special Category States by the level of Capital Outlay / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 1	West Bengal, Kerala, Punjab	West Bengal
1 to 2	Haryana, Orissa	Kerala, Haryana
2 to 3	Tamil Nadu, Maharashtra, Gujarat, **Andhra Pradesh**, Karnataka, Bihar	Maharashtra, Orissa, Tamil Nadu, Punjab
3 to 4	Chhattisgarh, Rajasthan, Uttar Pradesh	Gujarat, **Rajasthan,** Andhra Pradesh
Above 4	Jharkhand, Goa, Madhya Pradesh	Karnataka, Madhya Pradesh, Goa, Uttar Pradesh, Chhattisgarh, Jharkhand, Bihar

Note: See Notes to Table 21.



variations across the States. In 2006-07 (RE), expenditure under education was less than 13.9 per cent (*i.e.,* average of non-Special Category States) of aggregate disbursements for ten States (Andhra Pradesh, Chhattisgarh, Goa, Gujarat, Haryana, Karnataka, Madhya Pradesh, Orissa, Punjab and Tamil Nadu). Similarly, expenditure under health services as ratio to aggregate disbursements was less than 4.1 per cent (*i.e.,* average of non-Special Category States) for ten States (Andhra Pradesh, Chhattisgarh, Gujarat, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab and Tamil Nadu). State Governments need to take steps to improve the share of expenditure on education and health in aggregate expenditures for making available these social services to larger section of population across the States.

V.3 Special Category States[5]

V.3.1 Overall Position

Most of the Special Category States (nine out of eleven) recorded revenue surplus during 2006-07 (RE) accompanied by high GFD-GSDP ratio on account of higher capital outlays. A few Special Category States have displayed improvement in their fiscal performance subsequent to implementation of FRL.

V.3.2 Deficit Indicators

It may be emphasised that nine out of the eleven States in the Special Category recorded a revenue surplus during 2006-07 (RE), same as in 2003-06 (Average), with the median value of revenue surplus to GSDP ratio rising from 3.2 per cent to 5.4 per cent (Table 26 and Chart 11-B). Uttarakhand and Himachal Pradesh witnessed improvement in the revenue account, while Assam experienced deterioration. Sikkim had the highest revenue surplus-GSDP ratio of 23.4 per cent in 2006-07 (RE), but at the same time had the highest GFD-GSDP ratio of 10.5 per cent.

The GFD-GSDP ratio worsened for five States in 2006-07 (RE) as compared with 2003-06 (Average), though the median value declined from 8.1 per cent to 5.8 per cent during the above period (Chart 11-A and Table 27). The median value of PD-GSDP ratio, however, deteriorated from 1.0 per cent to 1.4 per cent (Chart 11-C).

The primary revenue surplus (*i.e.,* revenue deficit minus interest payments) remained adequate for all the Special Category States, except Assam and Himachal Pradesh, to meet interest payment obligations in 2006-07 (RE).

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 4.3 per cent in 2006-07 (RE) from 4.0 per cent during 2003-06 (Average). The ratio

Table 26: Distribution of Special Category States by the level of Revenue Deficit / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Revenue Surplus	Sikkim, Jammu and Kashmir Arunachal Pradesh, Nagaland, Tripura, **Manipur**, Mizoram, Meghalaya, Assam	Sikkim, Jammu and Kashmir, Nagaland, Arunachal Pradesh, Tripura, Manipur, Mizoram, **Meghalaya**, Uttarakhand
Below 0.5	–	Himachal Pradesh
0.5 to 1.0	–	–
1.0 to 1.5	–	Assam
1.5 to 2.0	–	–
Above 2.0	Uttarakhand, Himachal Pradesh	–

Note: See Notes to Table 21.

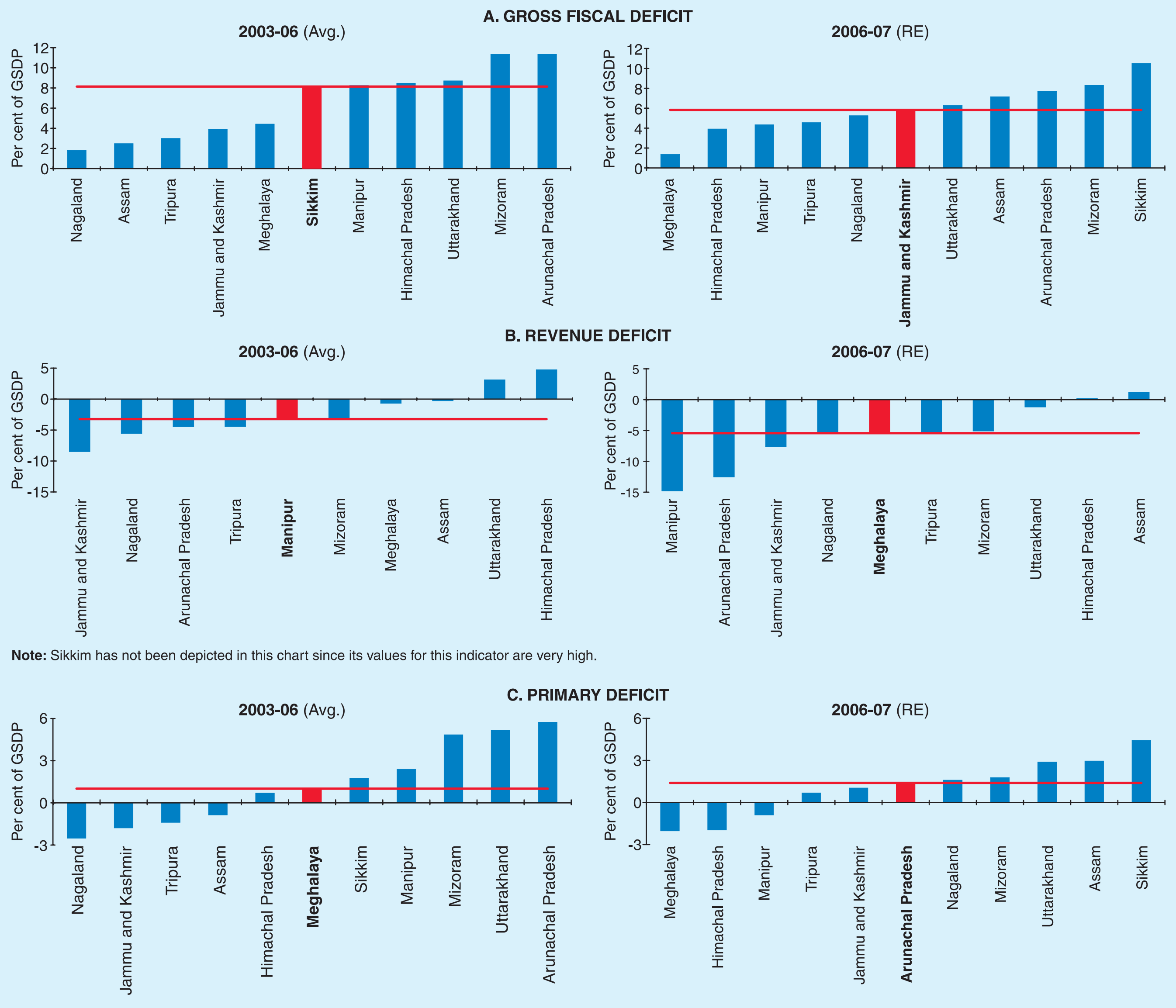
Table 27: Distribution of Special Category States by the level of Gross Fiscal Deficit / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
1 to 3	Nagaland, Assam, Tripura	Meghalaya
3 to 6	Jammu and Kashmir Meghalaya	Himachal Pradesh, Nagaland, Manipur, Tripura, **Jammu and Kashmir**
6 to 9	**Sikkim**, Manipur, Himachal Pradesh, Uttarakhand	Uttarakhand, Assam, Mizoram, Arunachal Pradesh
Above 9	Mizoram, Arunachal Pradesh	Sikkim

Note: See Notes to Table 21.

[5] 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 Uttarakhand.

Chart 11: Deficit Indicators - Special Category States

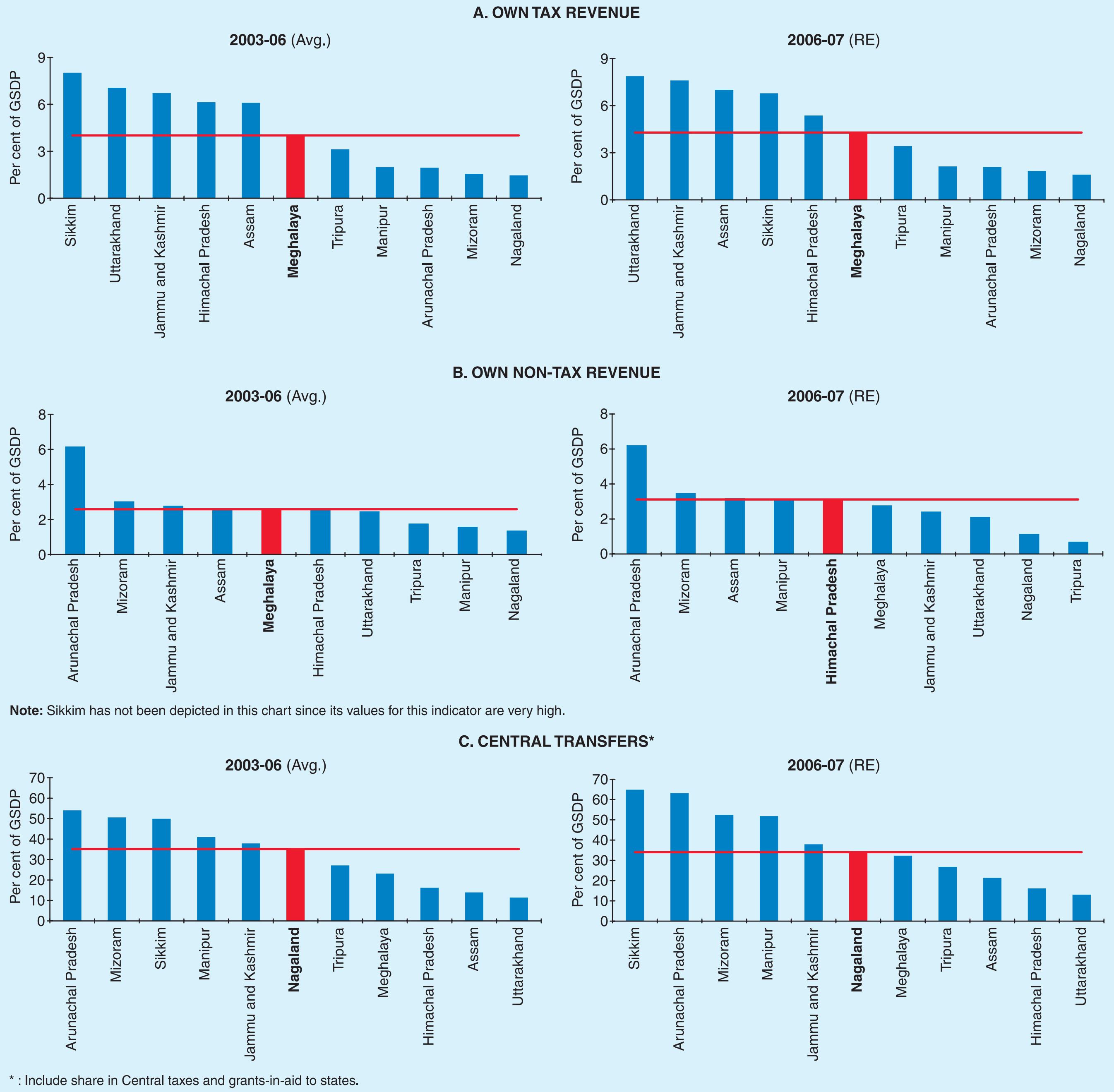


continued to be low in the case of Mizoram and Nagaland (less than 2 per cent) and was high in the case of Uttarakhand, Jammu and Kashmir, Assam and Sikkim (above 6 per cent) (Table 28 and Chart 12-A).

The own non-tax revenue to GSDP ratio of the Special Category States showed an increase in 2006-07 (RE) over 2003-06 (Average) with the median value of the ratio improving from 2.6 per cent to 3.1 per cent over the period (Chart 12-B). The ratio was exceptionally high in the case of Sikkim in both the periods, on account of revenue generated from State lotteries. The State-wise cost recovery (*i.e.,* ratio of non-tax receipts to non-plan revenue expenditure) in terms of education, health, irrigation, power and roads indicates that the cost recovery from these socio-economic services provided by the State Governments is low across the States. There is, therefore, a need to enhance cost recovery by way of levying appropriate user charges on these services, which would, however, require improvement in quality in service delivery.

The current transfer and devolution from the Centre (shareable Central taxes and grants-

Chart 12: Revenue Performance - Special Category States



* : Include share in Central taxes and grants-in-aid to states.

in-aid) continued to be a dominant source of revenues for all the Special Category States, even though the median value of CT-GSDP ratio declined marginally from 35.2 per cent during 2003-06 (Average) to 34.0 per cent in 2006-07 (RE) (Chart 12-C). The ratio of Central transfers was more than 50 per cent of GSDP in case of Arunachal Pradesh, Sikkim, Mizoram and Manipur in 2006-07 (RE), while the ratio was less than 20 per cent for Himachal Pradesh and Uttarakhand.

V.3.4 Pattern of Expenditure

Ratio of developmental expenditure to GSDP in Special Category States, which is generally much higher as compared to non-Special Category States, improved further with the

Table 28: Distribution of Special Category States by the level of Own Tax Revenue / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 2	Mizoram, Nagaland, Arunachal Pradesh	Mizoram, Nagaland
2 to 4	Manipur, Tripura, **Meghalaya**	Arunachal Pradesh, Manipur, Tripura
4 to 6	–	**Meghalaya**, Himachal Pradesh
Above 6	Assam, Himachal Pradesh, Jammu and Kashmir, Uttarakhand, Sikkim	Assam, Jammu and Kashmir, Uttarakhand, Sikkim

Note : See Notes to Table 21.

Table 29: Distribution of Special Category States by the level of Developmental Expenditure / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 20	Assam, Uttarakhand, Himachal Pradesh	Himachal Pradesh, Uttarakhand
20 to 40	Tripura, Meghalaya, Jammu and Kashmir, Manipur, **Nagaland**	Nagaland, Tripura, Assam, **Meghalaya**, Jammu and Kashmir
40 to 60	Mizoram, Sikkim, Arunachal Pradesh	Manipur, Mizoram
Above 60	–	Arunachal Pradesh, Sikkim

Note : See Notes to Table 21.

median value increasing by 6 percentage points to 29.4 per cent in 2006-07 (RE) from 23.3 per cent during 2003-06 (Average) (Chart 13-A). The ratio of developmental expenditure-GSDP was more than 60 per cent in case of Sikkim and Arunachal Pradesh in 2006-07 (RE), while it was less than 20 per cent for Himachal Pradesh (Table 29).

The median level of non-developmental expenditure as ratio to GSDP declined from 16.5 per cent in 2003-06 (Average) to 14.9 per cent during 2006-07 (RE), indicating improvement in expenditure management by the Special Category States (Chart 13-B). Uttarakhand, Himachal Pradesh, Meghalaya, Assam, Tripura and Nagaland continued to have low (below 15 per cent) non-developmental expenditure-GSDP ratio, while Arunachal Pradesh, Mizoram and Sikkim had high ratio in 2006-07 (RE). The non-developmental expenditure as ratio to GSDP for Sikkim continues to be substantially high (67.0 per cent).

There was significant improvement with regard to social sector expenditure in the Special Category States with the median value of SSE-GSDP ratio improving from 13.6 per cent during 2003-06 (Average) to 15.6 per cent in 2006-07 (RE). Arunachal Pradesh and Sikkim continued to maintain high proportion of SSE (as ratio to GSDP), while Himachal Pradesh and Uttarakhand had lower proportion of SSE during both the periods.

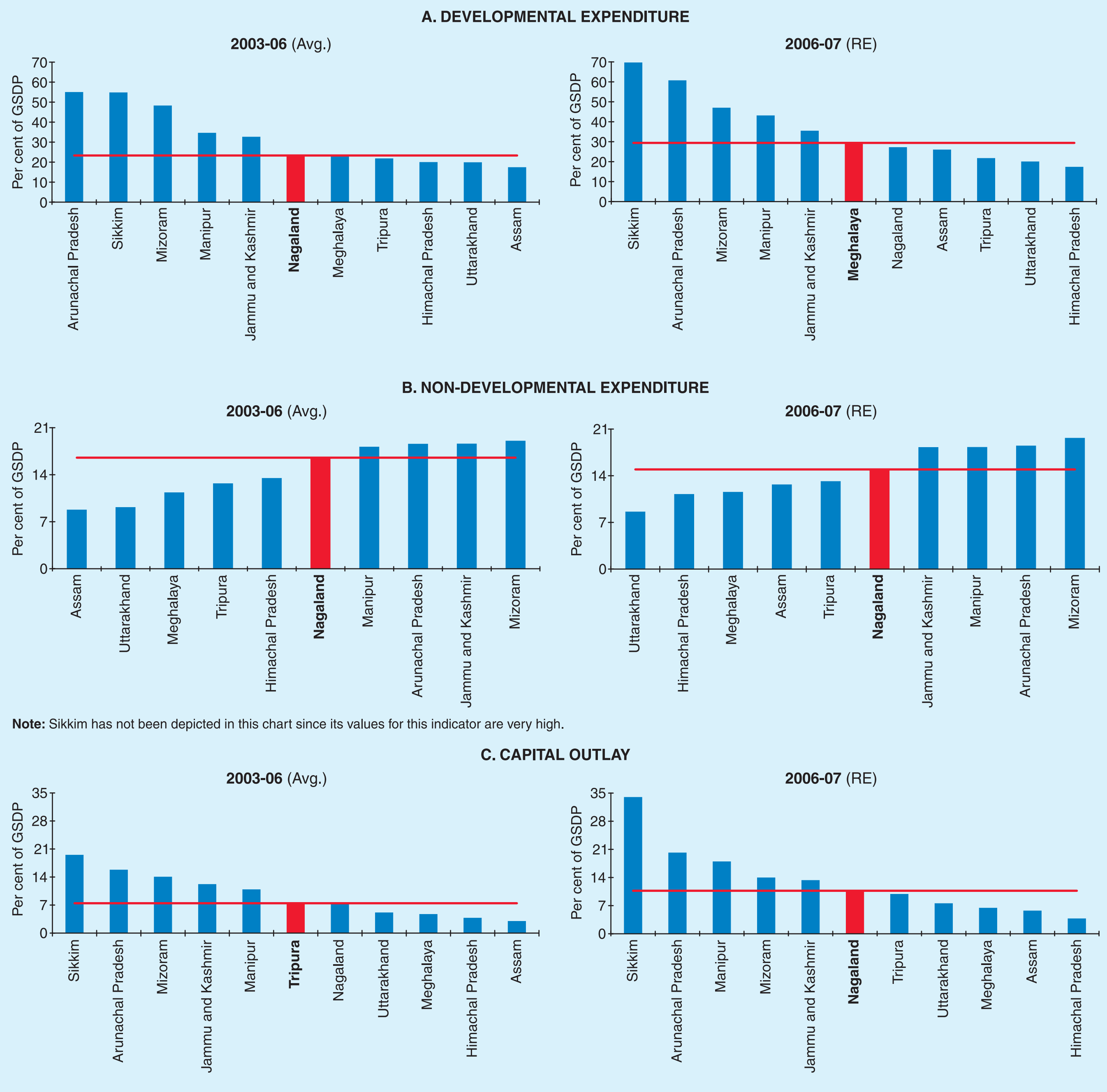
The high level of capital outlay (as a ratio to GSDP) of the Special Category States showed further improvement with the median level improving significantly from 7.5 per cent during 2003-06 (Average) to 10.7 per cent in 2006-07 (RE) (Chart 13-C). While the capital outlay-GSDP ratio continued to be high in the States like Arunachal Pradesh and Sikkim, it was low for Assam, Himachal Pradesh, Meghalaya, Tripura and Uttarakhand in both the periods (Table 30).

Table 30: Distribution of Special Category States by the level of Capital Outlay / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 5	Assam, Himachal Pradesh, Meghalaya	Himachal Pradesh
5 to 8	Uttarakhand, Nagaland, **Tripura**	Assam, Meghalaya, Uttarakhand
8 to 11	Manipur	**Nagaland**, Tripura
11 to 14	Jammu and Kashmir, Mizoram	Mizoram, Jammu and Kashmir
Above 14	Arunachal Pradesh, Sikkim	Manipur, Arunachal Pradesh, Sikkim

Note: See Notes to Table 21.

Chart 13: Expenditure Pattern - Special Category States



The expenditure on education (as ratio to aggregate disbursements) witnessed improvement in case of a number of Special Category States in 2006-07 (RE) over 2005-06 (Accounts) (Statement 41). Six Special Category States (Arunachal Pradesh, Himachal Pradesh, Jammu and Kashmir, Mizoram, Nagaland and Tripura) witnessed an improvement in expenditure on education (as ratio to aggregate disbursements) over this period. There are marked differences among the Special Category States in the share of expenditure on education in total disbursements with the ratio being as high as 18.9 per cent for Assam in 2006-07 (RE) whereas it was as low as 9.8 per cent for Sikkim. The ratio of expenditure on health services to aggregate disbursements improved for about half of the Special Category States (Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Mizoram and Tripura) in 2006-07 (RE) over 2005-06 (Accounts) (Statement 42). However, the ratio was highest at 6.4 per cent for Tripura in 2006-07 (RE), while it was lowest at 2.3 per cent for Sikkim.

Notwithstanding the marked improvement in the consolidated fiscal position of the State Governments in the recent years, wide variation in fiscal position across the States exists. It may be mentioned that TFC has recommended a uniform fiscal restructuring plan based on targets for fifteen fiscal parameters to be realised by all State Governments by 2009-10.

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

The large and growing GFD of States, particularly since the latter half of the 1990s, led to accumulation in the outstanding debt of the State Governments. The loans from Centre, which accounted for a significant share of States' debt over the years, have shown a decline. On the other hand, the share of market borrowings and NSSF has increased as compared to the 1990s. This section analyses the outstanding liabilities, market borrowings, contingent liabilities and WMA/OD of the State Governments.

VI.1 Outstanding Liabilities[6]

VI.1.1 Magnitude

The outstanding liabilities of the State Governments as at end-March 1991 were placed at Rs.1,28,155 crore (or 22.5 per cent of GDP). The debt-GDP ratio, which was at a low of 20.9 per cent as at end-March 1997, rose sharply to 32.7 per cent as at end-March 2006 but declined to 30.8 per cent as at end-March 2007 (Table 31). The outstanding liabilities of State Governments are budgeted at Rs.13,78,663 crore as at end-March 2008 with the debt-GDP ratio placed at 29.8 per cent (also see Appendix Tables 21 and 22).

Table 31: Outstanding Liabilities of State Governments
(As at end-March)

Year	Amount	Annual Growth	Debt /GDP
	(Rs.crore)	(Per cent)	
1	2	3	4
1991	1,28,155	–	22.5
1992	1,47,030	14.7	22.5
1993	1,68,365	14.5	22.5
1994	1,87,875	11.6	21.9
1995	2,16,473	15.2	21.4
1996	2,49,535	15.3	21.0
1997	2,85,898	14.6	20.9
1998	3,30,816	15.7	21.7
1999	3,99,576	20.8	23.0
2000	5,09,529	27.5	26.1
2001	5,94,148	16.6	28.3
2002	6,90,747	16.3	30.3
2003	7,86,427	13.9	32.0
2004	9,13,376	16.1	33.0
2005	10,29,174	12.7	32.9
2006	11,67,866	13.5	32.7
2007 (RE)	12,68,683	8.6	30.8
2008 (BE)	13,78,663	8.7	29.8

RE : Revised Estimates. BE : Budget Estimates.

Source: 1. Budget Documents of the State Governments.
2. Combined Finance and Revenue Accounts of the Union and State Governments in India, CAG, Government of India.
3. Ministry of Finance, Government of India.
4. Reserve Bank records.
5. Financial Accounts of the Union Government, GOI.

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

[6] Data on outstanding liabilities since 2003-04 have been compiled according to the methodology explained in Box 7.

VI.1.2 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 a corresponding increase in the share of special securities issued to NSSF, market borrowings and loans from banks and other financial institutions. Significantly, reserve funds and deposits and advances have constituted over 10 per cent of the outstanding liabilities in the last few years. Loans from NSSF would remain the dominant component (34.7 per cent) during 2007-08 (BE), followed by market borrowings (19.5 per cent) and loans from the Centre (12.0 per cent). Other important sources of debt are small savings, State provident funds, *etc.* (13.4 per cent) and loans from banks and financial institutions (6.8 per cent) (Chart 14).

The broad composition of outstanding debt is indicated in Table 32. The detailed composition of consolidated outstanding liabilities of the State Governments from 1990-91 to 2007-08 (BE) are set out in Appendix Tables 21 and 22, while the State-wise composition of outstanding liabilities are provided in Statements 26-28[7].

It may be mentioned that there is no single source of composition-wise information on outstanding

Chart 14: Composition of Outstanding liabilities
(As at end-March)

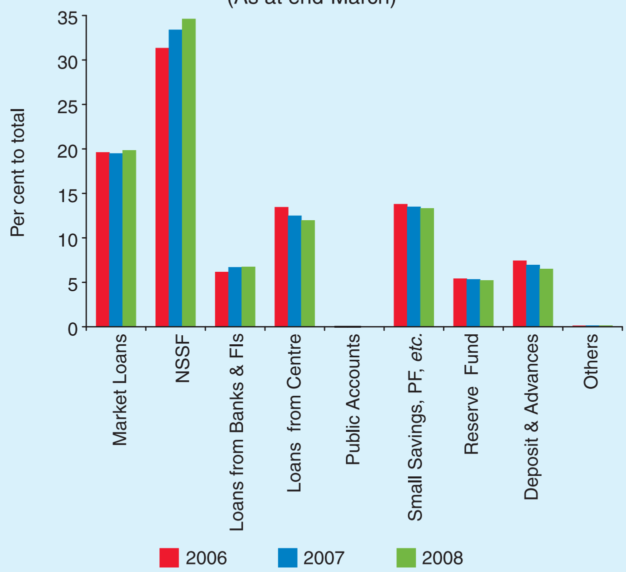


Table 32: Composition of Outstanding Liabilities of State Governments
(As at end-March)

(Per cent)

Item	1991	2000	2005	2006	2007 (RE)	2008 (BE)
1	2	3	4	5	6	7
1. Internal Debt	15.0	24.6	57.8	59.8	61.5	62.7
of which:						
(i) Market Borrowings	12.2	14.8	20.7	19.6	19.1	19.5
(ii) Special Securities issued to NSSF	–	5.0	27.4	31.3	33.5	34.7
(iii) Loans from Banks and FIs	2.0	3.4	6.6	6.2	6.7	6.8
2. Loans and Advances from the Centre	57.4	45.2	15.6	13.4	12.5	12.0
3. Public Accounts (i to iii)	26.8	29.9	26.6	26.6	25.9	25.1
(i) Small Savings, State PF, *etc.*	13.2	15.8	14.2	13.8	13.5	13.4
(ii) Reserve Funds	3.7	3.9	5.1	5.4	5.4	5.2
(iii) Deposits & Advances	10.0	10.2	7.3	7.4	7.0	6.5
4. Contingency Fund	0.8	0.3	0.1	0.1	0.1	0.1
Total Liabilities (1 to 4)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Total Liabilities (Rs. crore)	**1,28,155**	**5,09,529**	**10,29,174**	**11,67,866**	**12,68,683**	**13,78,663**

RE : Revised Estimates. BE : Budget Estimates.
'–' : Not applicable.
Source : Same as Table 31.

[7] For state-wise data series on outstanding liabilities of State Governments starting with 1990-91 and up to 2002-03, please refer to Statement 26 of the 'State Finances – A Study of Budgets of 2006-07'.

liabilities of the State Governments. The outstanding liabilities of the State Governments since 2003-04 have been compiled in this study using the methodology explained in Box 7. Furthermore, the budget documents of the State Governments do not provide sufficient details of their outstanding liabilities such as the amounts under various categories and associated terms and conditions (such as rate of interest and maturity structure). Consequently, in-depth analysis of the debt position of the State Governments remains circumscribed.

VI.1.3 State-wise Debt Position

The detailed State-wise component-wise break-up of outstanding liabilities are provided in Statements 26-28. It may be mentioned that the outstanding liabilities as at end-March 2000 of the three bifurcated States (Bihar, Madhya Pradesh and Uttar Pradesh) have been apportioned to the three newly formed States (Jharkhand, Chhattisgarh and Uttarakhand), respectively on the basis of their respective proportion of population. The States (non-Special and Special) have been grouped by the levels of their debt-GSDP and IP-RR ratios and the comparative position is provided in Annex 3.

Non-Special Category States

The median value of debt-GSDP ratio for non-Special Category States declined from 42.5 per cent during 2003-06 to 40.2 per cent at end-March 2007 reflecting the impact of efforts by the State Governments to reduce their levels of debt in line with the commitments made under their FRL and debt restructuring initiatives based on TFC's recommendations (Chart 15A). While States like Haryana, Karnataka, Tamil Nadu, Chhattisgarh and Maharashtra continued to have relatively lower debt-GSDP ratios (below 35.0 per cent) during 2003-06 (Average) and 2006-07 (RE), States like Bihar, Orissa and Uttar Pradesh had much higher debt-GSDP ratio at more than 55 per cent during both the periods (Table 33).

Box 7: Outstanding Liabilities of State Governments – Methodology of Compilation

The availability of consistent time series data on the outstanding liabilities of State Governments is important as it would throw light on their debt servicing capacity and sustainability of debt. For having unanimity on the definition and composition of State Government liabilities, a Working Group on the Methodology and Compilation of the State Government Liabilities was constituted in August 2004 (for details, see 'State Finances – A Study of Budgets of 2006-07'). The Group, which submitted its Report in December 2005, suggested that the State Governments may publish the data on outstanding liabilities in a prescribed format. The State Governments are, however, not publishing this information in their budget documents.

The main source of data on the outstanding liabilities of State Governments is the Combined Finance and Revenue Accounts of Union and State Governments published by the Comptroller and Auditor General of India (CAG), which is available to the researchers and policy makers with a time lag of about two years. However, consistent data series for all States are not available in respect of NSSF, loans from Centre and power bonds in the CAG Report. These figures are otherwise independently available with the Ministry of Finance (MoF), Government of India and the Reserve Bank.

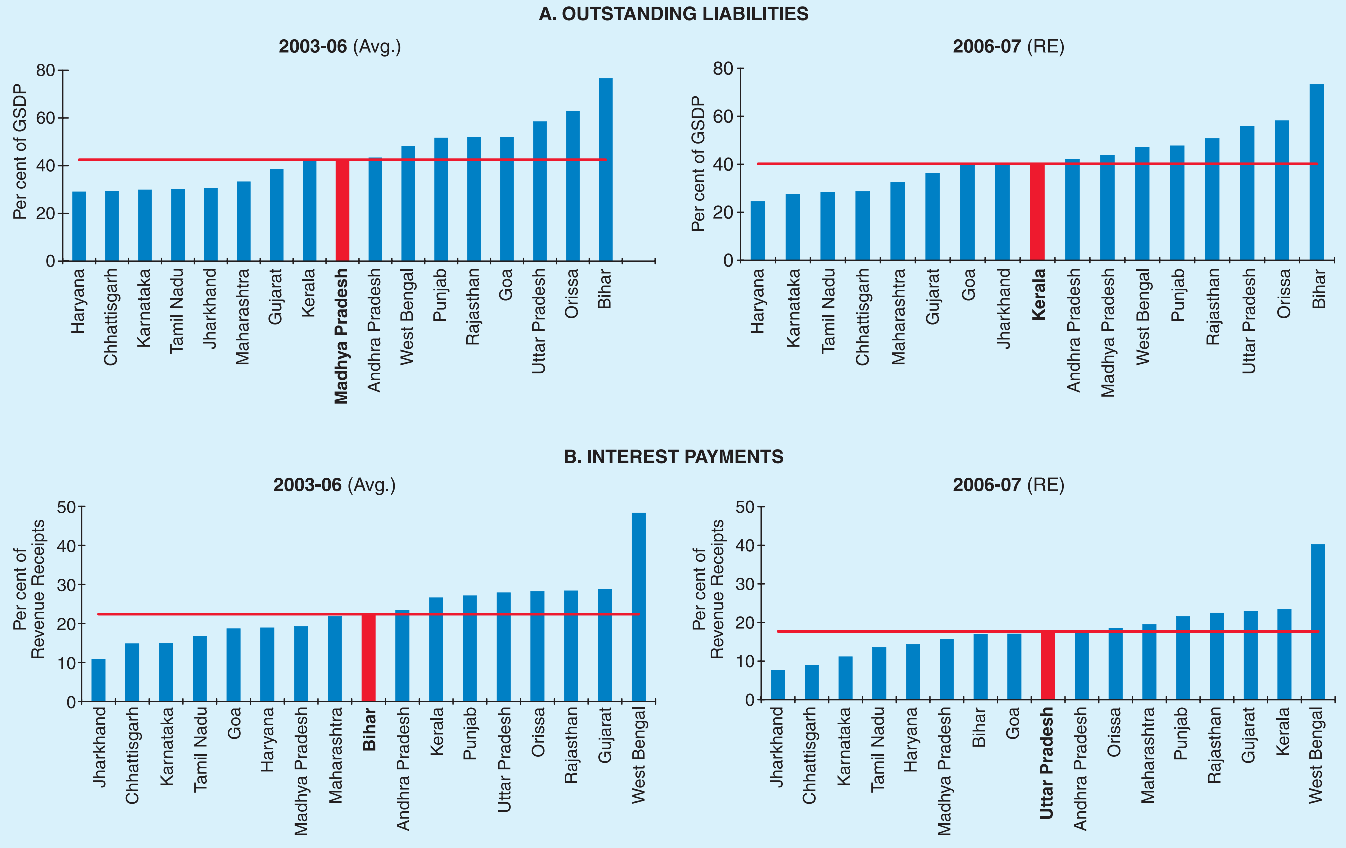
Therefore, an attempt has been made to compile the data on outstanding liabilities of the State Governments with the following methodology for the year for which Accounts data are available (2005-06):

1. Data on market borrowings (State Development Loans), power bonds and compensation bonds are sourced from Reserve Bank records.
2. Loans from the Centre to States are taken from Finance Accounts of the Union Government.
3. Outstanding amounts under NSSF are taken from the MoF.
4. All other debt items are taken from the CAG publication.

While compiling the outstanding liabilities for 2005-06, power bond figures reported under the head 'Loans from Other Institutions' in the CAG Report were netted out, as power bonds figures are taken separately from the Reserve Bank records.

A similar exercise was undertaken for end-March 2007, where the figures for market borrowings, power bonds and compensation bonds were taken from Reserve Bank records and NSSF from MoF. For all other items, the flow figures compiled from the budget documents of the State Governments were added to the end-March 2006 outstanding figures. With regard to end-March 2008, the flow figures from the budget documents were added to the outstanding figure for end-March 2007 compiled as per the above. In the case of power bonds, the repayment of power bonds figures from the Reserve Bank records were taken and deducted from the outstanding power bonds as on end-March 2007. Following this methodology, the outstanding liabilities of the State Governments have been compiled in this report in the absence of any other consistent data source. Following the same methodology, an exercise to revise the debt position for the previous years, *viz.*, end-March 2004 and end-March 2005 was also undertaken.

Chart 15: Outstanding Liabilities - Non-Special Category States



The extent of pre-emption of revenue receipts by interest payments (IP/RR), an important indicator of debt sustainability, showed noticeable improvement with the median value declining sharply from 22.4 per cent during 2003-06 (Average) to 17.7 per cent in 2006-07 (RE) (Chart 15B). The ratio was relatively low for Jharkhand, Karnataka and Chhattisgarh in both the periods (below 15.0 per cent), while it was high for West Bengal (above 30 per cent) (Table 34). 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

Table 33: Distribution of Non-Special Category States by the level of Debt / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 35	Haryana, Tamil Nadu, Karnataka, Chhattisgarh, Maharashtra, Jharkhand	Haryana, Karnataka, Tamil Nadu, Chhattisgarh, Maharashtra
35 to 50	Gujarat, Andhra Pradesh, Kerala, **Madhya Pradesh** West Bengal	Gujarat, **Kerala,** Goa Andhra Pradesh, Jharkhand, Punjab, West Bengal, Madhya Pradesh
50 to 70	Goa, Rajasthan, Punjab, Uttar Pradesh, Orissa	Rajasthan, Uttar Pradesh, Orissa
Above 70	Bihar	Bihar

Note : See Notes to Table 21.

and also bring it to the sustainable level by way of enactment of FRL, setting up of Consolidated Sinking Fund and Guarantee Redemption Fund and placing ceiling on guarantees.

Special Category States

The median value of the debt-GSDP ratio of Special Category States declined sharply from 74.3 per cent during 2003-06 (Average) to 65.1 per cent during 2006-07 (RE). The present level of debt-GSDP ratio of the Special Category States is perceived to be relatively high notwithstanding the large variation that exists across these States (Chart 16A). While Mizoram and Manipur continued to have very high level of debt (above 80 per cent of their respective GSDP), some other States, *viz.*, Arunachal Pradesh and Jammu and Kashmir witnessed sharp increase in their debt-GSDP ratio in 2006-07 (RE) from the level during 2003-06 (Average), taking the ratio above 80 per cent. Himachal Pradesh, on the other hand, witnessed a noticeable reduction in its debt-GSDP ratio from 79.8 per cent during 2003-06 (Average) to 66.5 per cent in 2006-07 (RE). Assam, Nagaland, Uttarakhand and Meghalaya continued to have relatively lower level of debt-GSDP ratio (less than 50 per cent) during both the periods (Table 35).

The median level for IP/RR declined from 12.1 per cent during 2003-06 (Average) to 10.0 per cent in 2006-07 (RE) (Chart 16B). The debt servicing burden (IP/RR) for all Special Category States, except for Himachal Pradesh (24.0 per cent), was below 15 per cent during 2006-07, the target set by the TFC to be achieved by end-March 2010. A few Special Category States had IP-RR ratio at below 10 per cent (Table 36).

Table 34: Distribution of Non-Special Category States by the level of Interest Payments / Revenue Receipts Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 15	Jharkhand, Chhattisgarh, Karnataka	Jharkhand, Chhattisgarh, Karnataka, Tamil Nadu, Haryana
15 to 25	Tamil Nadu, Goa, Haryana, Madhya Pradesh, Maharashtra, **Bihar**, Andhra Pradesh	Madhya Pradesh, Bihar, Goa, **Uttar Pradesh**, Andhra Pradesh, Orissa, Maharashtra, Punjab, Rajasthan, Gujarat, Kerala
25 to 30	Kerala, Punjab, Uttar Pradesh, Orissa, Rajasthan, Gujarat	–
Above 30	West Bengal	West Bengal

Note: See Notes to Table 21.

VI.2 Market Borrowings

VI.2.1 Consolidated Position

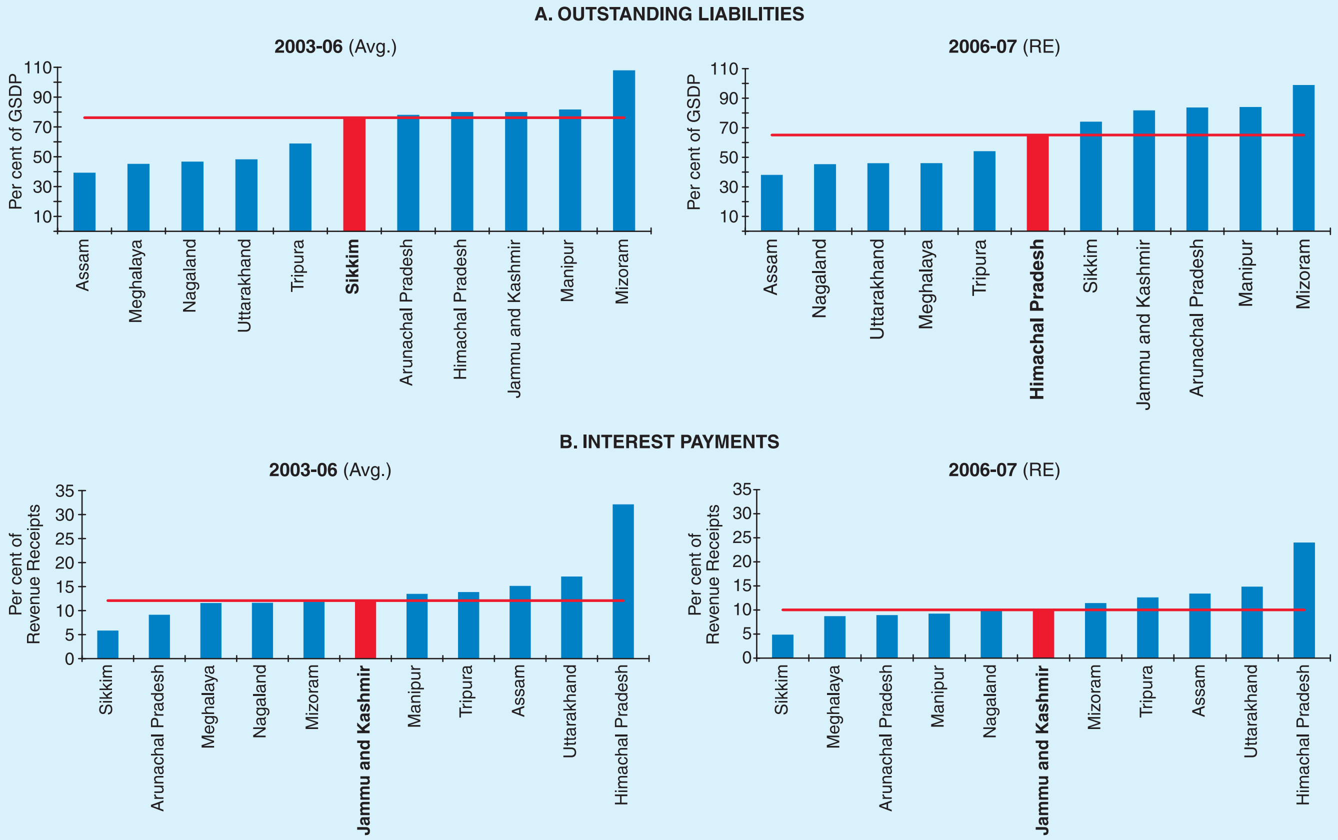
The State Governments issue dated securities of varying tenures that are mostly subscribed by the banks and financial institutions. The share of market borrowings in the aggregate outstanding liabilities of State Governments gradually moved up from 12.2 per cent at end-March 1991 to 14.8 per cent at end-March 2000 to 20.7 per cent at end-March 2005 (Table 32). 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

Table 35: Distribution of Special Category States by the level of Debt / GSDP Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 40	Assam	Assam
40 to 50	Meghalaya, Nagaland, Uttarakhand	Uttarakhand, Nagaland, Meghalaya
50 to 60	Tripura	Tripura
Above 60	Jammu and Kashmir, Manipur, Himachal Pradesh, **Sikkim**, Mizoram, Arunachal Pradesh	**Himachal Pradesh**, Arunachal Pradesh, Jammu and Kashmir, Manipur, Sikkim, Mizoram

Note : See Notes to Table 21.

Chart 16: Outstanding Liabilities - Special Category States



resources for Plan programmes[8]. The share of market borrowings by the State Governments in their total debt has stabilised around 19.5 per cent since end-March 2006.

Table 36: Distribution of Special Category States by the level of Interest Payments / Revenue Receipts Ratio

Range (Per cent)	**2003-06** (Avg.)	**2006-07** (RE)
1	2	3
Below 10	Sikkim, Arunachal Pradesh	Sikkim, Meghalaya, Arunachal Pradesh, Manipur, Nagaland
10 to 15	Meghalaya, Nagaland, Mizoram, **Jammu and Kashmir,** Manipur, Tripura	Mizoram, Tripura, Assam , Uttarakhand, **Jammu and Kashmir**
15 to 20	Assam, Uttarakhand	–
Above 20	Himachal Pradesh	Himachal Pradesh

Note : See Notes to Table 21.

The declining trend in share of high cost market loans of State Governments continued during 2006-07. As at end-March 2007, the share of outstanding market borrowings with interest rate of 10 per cent and above declined by nearly 5 percentage points to 27.5 per cent from 32.2 per cent as at end-March 2006 (Table 37).

VI.2.2 Allocation of Market Borrowings during 2007-08

The net allocations of market borrowings to the State Governments, as per Reserve Bank records, have increased steadily (Table 38 and Statement 29). Additional allocations which witnessed a decline till 2006-07, have increased during 2007-08. The net allocation under market

[8] Many State Governments, however, continue to make budgetary provisions under receipts in respect of loans from the Centre.

Table 37: Interest Rate Profile of the Outstanding Stock of State Government Securities
(As at end-March)

Range of Interest Rate	Outstanding Amount (Rs. crore)		Percentage to Total	
	2006	2007	2006	2007
1	2	3	4	5
5.00-5.99	33,825	33,825	14.8	13.9
6.00-6.99	58,563	58,564	25.6	24.1
7.00-7.99	49,601	59,638	21.7	24.5
8.00-8.99	8,004	18,791	3.5	7.7
9.00-9.99	5,412	5,412	2.4	2.2
10.00-10.99	14,563	14,468	6.4	6.0
11.00-11.99	17,062	16,934	7.5	7.0
12.00-12.99	26,146	25,960	11.4	10.7
13.00-13.99	15,722	9,186	6.9	3.8
Total	**2,28,898**	**2,42,777**	**100.0**	**100.0**

Source : Reserve Bank records.

borrowing programme for State Governments is placed at Rs.28,811 crore during 2007-08, an increase of 67.1 per cent over the previous year. Taking into account repayments of Rs.11,555 crore and additional allocation of Rs.5,625 crore, the gross allocation amounts to Rs.45,990 crore, higher by 72.9 per cent over the previous year (Appendix Table 23). During 2007-08 (up to November 30, 2007), the States have raised market borrowings amounting to Rs.30,875 crore (or 67.2 per cent of gross allocation) through auctions with cut-off rate in the range of 8.00-8.90 per cent. The weighted average interest rate on market borrowings which had declined since the mid-1990s up to 2003-04, firmed up to 8.39 per cent during 2007-08 (up to November 30, 2007) in line with that of the Central Government securities, reflecting the general upward movement in interest rates (Table 39). In 2007-08 so far (up to November 30, 2007), the entire amount of market borrowings was raised through the auction route as in 2006-07, indicating State Governments' intention to raise market borrowings based on their improved financial condition.

Table 38: Market Borrowings of State Governments

(Rs. crore)

Item	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08*
1	2	3	4	5	6	7
1. Net Allocation	12,722	12,767	13,969	16,112	17,242	28,811
2. Additional Allocation	6,422	4,893	3,236	3,522	2,803	5,625
3. Allocation under DSS	10,000	29,000	19,766	–	–	–
4. Total (1+2+3)	29,144	46,660	36,971	19,634	20,046	34,436
5. Repayments	1,789	4,145	5,123	6,274	6,551	11,555
6. Gross Allocation (4+5)	30,933	50,805	42,094	25,908	26,597	45,990
7. Amount raised under DSS	10,000	26,623	16,943	–	–	–
8. Amount raised to prepay RIDF loans	–	–	1,386	–	–	–
9. Total Amount Raised (i + ii)	30,853	50,521	39,101	21,729	20,825	30,875
(i) Tap Issues	27,880	47,626	38,216	11,186	–	–
(ii) Auctions	2,973	2,895	885	10,543	20,825	30,875
	(13)	(8)	(3)	(24)	(22)	(21)
10. Net Amount Raised (9-5)	29,064	46,376	33,978	15,455	14,274	19,320
11. Net Amount Raised (other than DSS) (10-7)	19,064	19,753	17,035	15,455	14,274	19,320
12. Net Amount Raised (other than DSS & RIDF) (11-8)	19,064	19,753	15,649	15,455	14,274	19,320
Memo item:						
(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	8.00-8.90
(ii) Weighted Average Interest Rate (%)	7.49	6.13	6.45	7.63	8.10	8.39
(iii) Average Maturity (in years)	10.00	10.05	10.01	10.00	10.00	10.00

* : Amount raised up to November 30, 2007.
DSS : Debt Swap Scheme. '–' : Nil/Not Applicable.
Note : (i) Figures in brackets represent number of States opting for the auction route.
(ii) The data on market borrowings as per RBI records may differ from that reported in the budget documents of the State Governments.
Source : Reserve Bank records.

Table 39: Weighted Average Yield of State Government Securities

Year	Range (Per cent)	Weighted Average (Per cent)	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	8.10	20,825
2007-08*	8.00-8.90	8.39	30,875

* : Up to November 30, 2007.
Source : Reserve Bank records.

VI.3 Liquidity Position and Cash Management

Based on the recommendations of the Advisory Committee on Ways and Means Advances and Overdrafts to the State Governments (Chairman: Shri M.P.Bezbaruah), a revised WMA Scheme for State Governments was put in place 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. The State-wise limits of Normal WMA were reviewed towards the end of the year. It was perceived that the extant Normal WMA limits were adequate, *inter alia*, on account of (i) low utilisation of WMA by the State Governments during 2006-07; (ii) acclimatisation of the State Governments to the changes in the fiscal environment as envisaged by the TFC, thereby signaling the end of the transition; and (iii) expected persistence of comfortable liquidity position of the State Governments during 2007-08. Accordingly, it was decided to retain the extant State-wise Normal WMA during 2007-08 (Table 40).

Table 40: Normal WMA Limits – 1996 to 2007

Period	Amount (Rs. crore)	Increase over earlier limits (Per cent)
1	2	3
i. August 1996 to February 1999	2,234	Nil
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

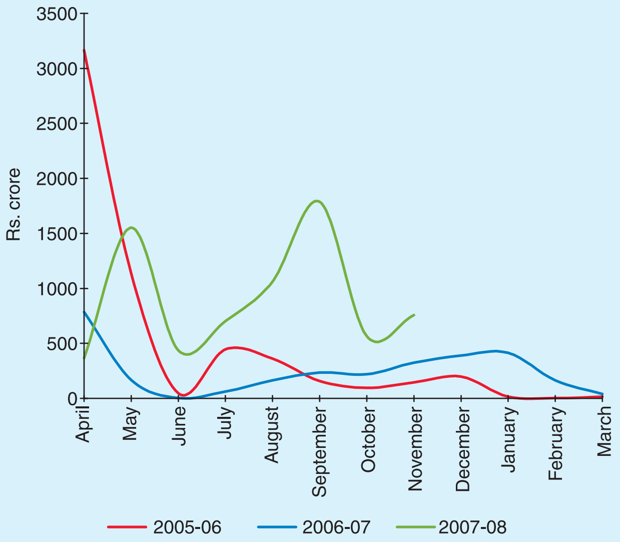
Source : Reserve Bank records.

During 2006-07, the average utilisation of normal WMA, special WMA and overdrafts by the States remained low. There was a reduction in the number of States that availed WMA during 2006-07 (8 States as compared with 12 States in 2005-06). Similarly, there was a reduction in the number of the State Governments availing overdraft during 2006-07 (two States as compared with eight States in 2005-06) (Statement 38). This reflected improvement in the overall cash position resulting in build-up of high level of surplus cash balances by most of the State Governments.

The utilisation of WMA and overdraft (average of daily outstandings) by the States at Rs.904 crore during 2007-08 (up to November 30, 2007) was substantially higher than that of Rs.246 crore in the corresponding period of the previous year (Chart 17). During 2007-08 (up to November 30, 2007), seven States availed of WMA for a period of 1-155 days, of which three States resorted to overdraft for a period ranging between 3-65 days (Statement 38). The higher utilisation of WMA reflects temporary mismatches between receipts and expenditure in respect of a few States notwithstanding maintenance of high level of surplus cash balances by a number of 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 not a direct source of monetary expansion. As per

Chart 17: Utilisation of WMA and Overdraft by State Governments
(Average of Daily Outstandings)



extant guidelines, the special WMA should be availed before recourse to normal WMA. Data on Centre's (gross) WMA to the State Governments, as reported in the budget documents of the State Governments, during 2000-01 to 2007-08 (BE) are set out in Statement 39. The total amount of such advances has consistently declined from Rs.3,329 crore in 2002-03 (twelve States) to Rs.400 crore in 2006-07 (RE) (two States) and is budgeted at the same level of Rs.400 crore in 2007-08 (two States). Assam among the Special Category States and Kerala among the non-Special Category States have budgeted for such advances during 2007-08.

VI.4 Contingent Liabilities

State Governments have been issuing guarantees and letters of comfort on behalf of PSUs and other institutions (including Urban Local Bodies) to enable them to raise resources to meet the requirements of the public investment. This is primarily because the States are not in a position to provide budgetary support for such investments. The outstanding guarantees of State Governments increased from Rs.1,32,029 crore (6.8 per cent of GDP) as at end-March 2000 to Rs.2,19,658 crore (7.9 per cent of GDP) as at end-March 2004, but declined to Rs.1,96,914 crore (5.5 per cent of GDP) as at end-March 2006 (Table 41 and Statement 43).

Table 41: Outstanding Guarantees of State Governments

Year (end-March)	**Amount** (Rs. crore)	**Percentage of GDP**
1	2	3
1992	40,158	6.1
1993	42,515	5.7
1994	48,865	5.7
1995	48,479	4.8
1996	52,631	4.4
1997	65,339	4.8
1998	73,751	4.8
1999	79,457	4.6
2000	1,32,029	6.8
2001	1,68,719	8.0
2002	1,65,386	7.3
2003	1,84,294	7.5
2004 P	2,19,658	7.9
2005 P	2,04,426	6.5
2006 P	1,96,914	5.5

P : Provisional.
Note : Data pertain to 17 States up to 2005 and 16 States for 2006.
Source : Information received from State Governments and Budget documents of States.

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 in their FRL or otherwise and are also in the process of setting up Guarantee Redemption Fund (GRF) through earmarked guarantee fees as recommended by the TFC. So far, ten State Governments have set up GRF. The total investments in GRF at end-June 2007 were placed at Rs.2,481 crore. The Bezbaruah Committee had recommended that the net incremental annual investment of States in CSF/GRF may be made eligible for availing Special WMA up to a ceiling of their Normal WMA limit. Following these recommendations, the Reserve Bank had circulated revised model schemes for GRF amongst the State Governments in May 2006. As on June 30, 2007, three of the ten States had adopted the revised GRF scheme.

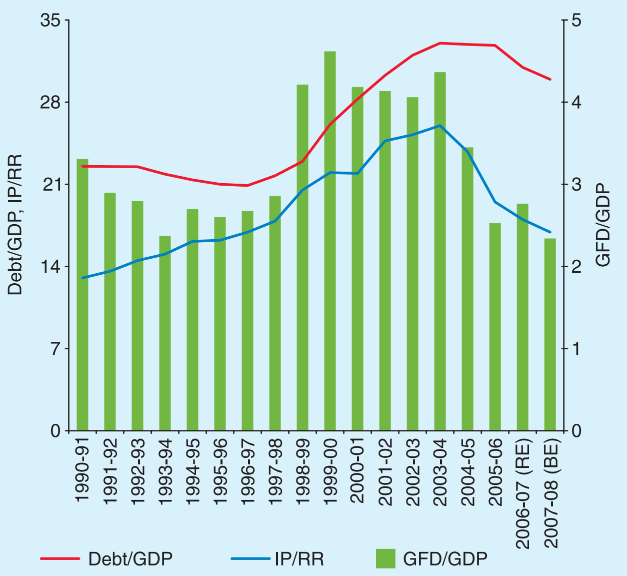
VI.5 Assessment of Debt Position of State Governments

The debt position of State Governments depends not only on the absolute level of their outstanding liabilities but also various indicators which determine the sustainability of the debt. This section assesses the sustainability of the debt of State Governments in terms of burden of interest payments and maturity pattern of State Government securities and issues arising in the context of liquidity management by the State Governments.

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 26.0 per cent in 2003-04, but declined thereafter largely due to the DSS (2002-03 to 2004-05). It is budgeted at 16.9 per cent during 2007-08. This ratio is required to be gradually brought down to 15 per cent by all States by the end of the terminal year (2009-10) of the award period of the TFC as per its suggested restructuring path for State finances. The burden of interest payments if not contained may lead to a vicious circle of deficit, debt and interest payments for the State Governments (Chart 18).

Chart 18: Deficit, Debt and Interest Burden



The deceleration in the growth of debt in recent years is the manifestation of the efforts of the State Governments towards containing RD and GFD. The debt relief provided by the Centre to the States in terms of recommendations of TFC has facilitated in reining the debt level in recent years. The impact of an array of initiatives taken by the Central Government and the State Governments including recent DSS to prepay high cost debt to the Centre is evident from the reduction in the average interest rate on the outstanding debt of the State Governments from the peak level of 11.2 per cent in 1999-2000 to 9.5 per cent in 2004-05 and 8.1 per cent in 2007-08 (BE) (Table 42).

VI.5.2 Maturity Profile of State Government Securities

In terms of maturity profile, 41.2 per cent of the outstanding stock of State Government securities belonged to the maturity bracket of above seven years as at end-March 2007 and 67.1 per cent was above five years maturity. Only 17.4 per cent of outstanding loans were in the 0-3 year maturity bracket and 32.9 per cent were under 5 years maturity bracket (Table 43).

Table 42: Average Interest Rate on Outstanding Liabilities of State Governments

(Per cent)

Year	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	8.2
2006-07 (RE)	8.2
2007-08 (BE)	8.1

RE : Revised Estimates. BE : Budget Estimates.

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

Source : Same as Table 31.

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 DSS (Table 44 and Statements 34-35). The State-wise and security-wise details of outstanding market loans are presented in Statement 32.

VI.5.3 Investment of Cash balances

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 (ITBs) (Chart 19). The State Governments also invest their surplus cash balances in auction Treasury Bills (TBs). The consolidated investments by the State Governments in 14-day ITBs and auction TBs stood at Rs.62,996 crore as on November 23, 2007. Since the States get a lower rate of return on these

Table 43: Maturity Profile of Outstanding State Government Securities
(As at end-March 2007)

State	Per cent of Total Amount Outstanding				
	0-1 years	1-3 years	3-5 years	5-7 years	Above 7 years
1	2	3	4	5	6
1. Andhra Pradesh	4.28	16.48	17.13	26.03	36.08
2. Arunachal Pradesh	2.44	4.57	12.37	14.62	66.00
3. Assam	5.10	12.62	15.07	21.62	45.59
4. Bihar	7.50	11.84	22.12	23.94	34.59
5. Chattisgarh	6.86	17.24	20.34	22.99	32.57
6. Goa	2.77	16.11	16.94	23.80	40.38
7. Gujarat	3.74	12.63	16.88	37.88	28.87
8. Himachal Pradesh	1.67	8.78	14.36	28.55	46.63
9. Haryana	5.07	12.15	13.10	31.64	38.04
10. Jammu and Kashmir	3.35	7.19	16.50	27.74	45.22
11. Jharkhand	6.93	10.95	20.25	22.85	39.02
12. Karnataka	3.95	16.06	19.28	27.36	33.35
13. Kerala	5.16	11.52	16.45	18.98	47.88
14. Madhya Pradesh	4.54	11.41	13.16	22.86	48.02
15. Maharashtra	3.88	8.43	11.98	27.39	48.31
16. Manipur	4.28	9.32	10.78	14.22	61.40
17. Meghalaya	4.30	13.83	15.31	12.54	54.02
18. Mizoram	2.56	9.16	11.12	20.93	56.23
19. Nagaland	4.20	13.07	17.11	17.29	48.33
20. Orissa	8.07	14.81	19.65	24.64	32.83
21. Punjab	3.47	11.02	9.10	30.59	45.82
22. Rajasthan	4.69	15.86	17.05	24.94	37.46
23. Sikkim	4.96	18.59	9.24	7.07	60.14
24. Tripura	3.92	15.00	14.35	17.18	49.55
25. Tamil Nadu	4.96	10.26	16.31	26.84	41.63
26. Uttarakhand	2.23	6.25	8.03	40.17	43.32
27. Uttar Pradesh	5.82	16.35	16.00	20.10	41.72
28. West Bengal	4.16	8.64	11.74	29.67	45.79
All States	**4.76**	**12.64**	**15.54**	**25.83**	**41.23**

Source : Reserve Bank Records.

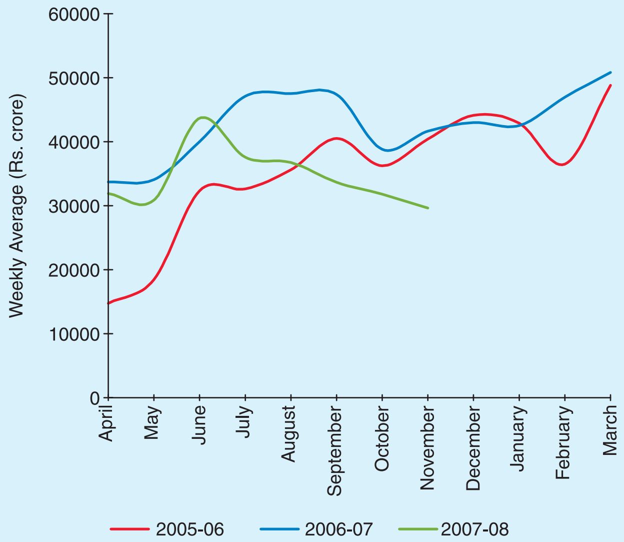
Table 44: Maturity Profile of Outstanding State Loans and Power Bonds
(As at end-March 2007)

(Rs. crore)

Year	State Loans	Power Bonds	Total
1	2	3	4
2007-08	11,555	1,453	13,008
2008-09	14,371	2,907	17,278
2009-10	16,315	2,907	19,222
2010-11	15,734	2,907	18,641
2011-12	21,999	2,907	24,906
2012-13	30,628	2,870	33,498
2013-14	32,079	2,870	34,949
2014-15	33,384	2,870	36,254
2015-16	35,191	2,907	38,098
2016-17	31,522	1,453	32,975
Total	**2,42,777**	**26,051**	**2,68,828**

Source : Reserve Bank Records.

Chart 19: Investments in 14-day Intermediate Treasury Bills by State Governments
(Average of Daily Outstandings)



investments compared to the cost of borrowings for these resources, there would be an adverse impact on their revenue account.

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 (seven Special Category and twelve Non-Special Category) have recorded a negative opening cash balance in the budget estimates for 2007-08, varying between (-) Rs.5 crore (West Bengal) and (-) Rs.2,470 crore (Assam). Many of these State Governments had recorded negative opening cash balance in the past as well. An opening cash deficit signifies *ex ante* liquidity problems, which could be exacerbated by the extent to which total receipts fall short of total expenditures (*i.e.,* the conventional budget deficit) during the year, unless alleviated by additional resource mobilisation. This would, in turn, necessitate the drawing down of cash/investment balances or recourse to WMA/OD from the Reserve Bank.

VI.5.4 Debt Consolidation and Relief

The TFC put forward a debt relief package for consolidation of Central loans under Debt Consolidation and Relief Facility (DCRF) for the State Governments. The DCRF has two components – (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. The availment of DCRF is subject to the enactment of FRL, the quantum of reduction in RD in each successive year and the containment of GFD at the level of 2004-05. Twenty-four State Governments benefitted out of debt consolidation so far (as on August 30, 2007). Further, fourteen State Governments benefitted out of debt write-off and twenty-one State Governments received interest relief so far. The total amount of consolidated loans of the State Governments stands at Rs.1,09,977 crore, debt write-off stands at Rs.8,474 crore and interest relief stands at Rs.8,387 crore as on August 30, 2007 (Statement 46).

VII. FISCAL TRANSFERS TO THE STATE GOVERNMENTS

Fiscal transfers plays an important role in a federal structure of Government by addressing the imbalances between the national and sub-national governments arising on account of the allocation of functions and financial resources to different levels of Government. Under the federal system in India, while the State Governments have a major responsibility with regard to provision of economic and social infrastructure, their own resources fall far short of the requirements, necessitating fiscal transfers from the Centre to the States (Annex 4). As per the provisions in the Indian Constitution, the Finance Commissions (FCs) facilitate the division of financial resources between the Union and the State Governments. Starting with the Ninth FC, the FCs have adopted a normative approach to transfers instead of a gap-filling approach. In view of the need to ensure a larger role for equalisation transfers, the Twelfth FC proposed to increase the share of grants in the total transfers. As regards devolution of taxes, the Tenth FC proposed an alternative scheme of tax devolution giving States a share in the total net proceeds of all Central taxes. However, the scheme was made operational from the Eleventh FC onwards. This devolution scheme gave greater freedom and flexibility to the Central Government in pursuing the tax reforms in an integrated manner and enabled the States to share the aggregate buoyancy of Central taxes.

With the State Governments budgeting a revenue surplus at the consolidated level in 2007-08, the financial position of the States is slated to witness a turnaround after two decades[9]. It is important to analyse and assess the role of fiscal transfers in the context of enactment of Fiscal Responsibility and Budget Management (FRBM) Act by the Union Government and FRL by most of the States (twenty-six so far). This section examines the role of fiscal transfers in determining the fiscal position of the States during the period of four FCs, *viz.*, the Ninth FC (1990-95), the Tenth FC (1995-2000), the Eleventh FC (2000-05), and the Twelfth FC (2005-06 to present).

[9] The consolidated revenue account of the State Governments turned into a deficit starting with the year 1986-87.

VII.1 Concepts, Constitutional Provisions and Institutional Arrangements

VII.1.1 Concepts

In a federal set-up, fiscal transfers take place through tax devolution and grants, which are supplemented by loans from the Centre to the States. In line with the practice followed in other federal countries, fiscal transfers in India are guided by the principle of "equalisation", which neutralises deficiency in fiscal capacity across States but not in revenue effort. The normative approach to fiscal transfers neutralises adverse incentives as States are assessed in terms of revenues that they ought to raise given their respective capacities. Similarly, expenditures are assessed on the basis of needs consistent with an average or minimum acceptable level of service and the relevant cost norms and not driven by the past history of expenditures. The fiscal transfer system in major federations of Australia and Canada is set out in Box 8.

The objective of fiscal transfers is to correct the vertical and horizontal imbalances. Vertical imbalances arise because higher resources have been assigned to the Central Government while State Governments are entrusted with larger responsibilities. Horizontal imbalances arise on account of different fiscal capacities and needs of the States as also the differences in the costs of providing the services (Box 9). Transfers from the Central Government to the State Governments taken together are aimed at correcting vertical imbalances. The allocation of transfers among the State Governments aims at correcting horizontal imbalances. In the present scheme of transfers, tax devolution plays a dual role of correcting vertical as well as horizontal imbalances, while grants-in-aid are mainly targeted towards achieving a degree of equalisation. Apart from statutory grants under the recommendations of the FC, there are plan grants covering Central assistance for State plans as decided by the Planning Commission (PC), as well as plan grants given by the Central Ministries for implementation of plan schemes (Box 10). Another type of grants, which is much smaller in magnitude, consists of discretionary grants given by the Central ministries to States on the non-plan side.

VII.1.2 Constitutional Provisions

In India, fiscal transfers from the Centre to the States take place through mechanisms provided in the Constitution. There are both mandatory and enabling provisions in the Constitution for facilitating a wide-ranging transfer of resources through[10]

a) levy of duties by the Centre but collected and retained by the States (Article 268);

b) taxes and duties levied and collected by the Centre but assigned in whole to the States (Article 269);

c) mandatory sharing of the proceeds of income tax (Article 270);

d) permissible participation in the proceeds of Union excise duties (Article 272);

e) statutory grants-in-aid of revenue to States (Article 275);

f) grants for any public purpose (Article 282); and

g) grant of loans for any public purpose (Article 293).

The sharing of resources as between the Central and State Governments has been entrusted to the Finance Commission (Article 280). It recommends the distribution, between the Union and the States as also among the States, of the net proceeds of taxes and also grants-in-aid of the revenues of States. The main considerations before the FC relate to (a) determining the aggregate share of States, (b) specifying criteria that may be used for deciding shares of the individual States, and (c) determining the weights attached to different allocation criteria. The criteria for *inter se* share of transfers are based on three sets of consideration, *viz*., needs, cost disabilities and fiscal efficiency.

[10] **Source:** Vithal, B.P.R. and M.L.Sastry (2001), "Fiscal Federalism in India", Oxford University Press.

Box 8: Fiscal Transfers in Australia and Canada

Vertical and horizontal imbalances are a common phenomenon across the federal States, requiring institution of system of fiscal transfer from Central to the State Governments. The features of the federal transfers in two of the major federations, *viz.,* Australia and Canada, are discussed below.

Australia

Australia has a well-established institutional set up to address the vertical and horizontal aspects of fiscal transfers. While the Council of Australian Governments decides the vertical transfers, the Ministerial Council for Commonwealth-State Financial Relations provides a platform to discuss the grant allocations to the States, which form a segment of the vertical transfers. In addition, the Special Purpose Ministerial Councils look after Special Purpose Payments (SPP) given to the States by the Commonwealth Government. The Commonwealth Grants Commission (CGC), an advisory body set up in 1933, recommends the criteria for the distribution of horizontal fiscal transfers. The CGC does not look into the issues of vertical imbalance. The Loan Council coordinates the borrowings of the Commonwealth and State Governments.

The evolution of the extent and shape of vertical transfers in Australia can be seen in terms of four distinct phases: (i) prior to 1976, when general revenue assistance was given to States, (ii) 1976 to 1985, when revenue sharing arrangements were put in place, (iii) 1986 to 1997, when the system of financial assistance grants was reintroduced, and (iv) after the Inter-Governmental Agreement in 1999, which provides for the sharing of the GST revenues (Rangarajan and Srivastava, 2004). Vertical transfers in Australia consist of the GST collections, Health Care Grants (HCG) and numerous SPPs. SPPs are recurrent and capital grants given for specific state functions like social services (health, education), social security and welfare, economic services (roads, transport, industry assistance, water resources), and other services (like housing and urban renewal, regional development, disaster relief and debt charges). The SPPs form nearly half of the vertical transfers in Australia. The Commonwealth collects the GST at a uniform rate of 10 per cent across Australia. However, after the Inter-Governmental Agreement (IGA) in 1999, the collections under the GST are fully transferred to the States. Thus, the vertical transfers to the extent of GST collections get determined automatically in Australia.

The Horizontal Fiscal Equalisation (HFE) followed by CGC tries to equalise the fiscal capacities of the different State Governments keeping in mind a uniform standard of public services to be ensured in all the States. The HFE has three pillars, namely, capacity equalisation, internal standards and policy neutrality. The CGC has operated under a formula based process for transfer across the States. Over the years, the CGC refined its criteria for HFE. In 2005, 46.2 per cent of the total revenue of the State Governments constituted grants from the Commonwealth Government and 13.2 per cent of the total revenue of the local governments constituted grants from the higher levels of government (GFS, 2006).

Canada

The inter-governmental transfers in Canada consist of equalisation grants, Canadian Health and Social Service Transfers (CHST) and Territorial Formula Financing (TFF). In addition to these, there is a new facility called the Health Reform Fund (HRF). The equalisation grants aimed at equalising fiscal capacities are mandated in the constitution since 1982. These grants constitute nearly one-fourth of the total inter-governmental transfers in Canada. The absolute amount of equalisation grants is determined by the method of Representative Tax System Approach. Under this approach, the absolute amount of grants to a particular province is calculated by applying the average revenue effort to the difference between standard base and the actual base for that province with respect to various revenue sources. In Canada, the standard base is taken as the average of five provinces.

The CHST is the largest federal transfer to the provincial and territorial governments. The CHST transfers are meant to finance health, education and other social services. The CHST has two forms, *i.e.,* cash and tax transfer points. The tax transfer points, introduced in 1977, are a unique feature of the Canadian system of federal transfers. Under this system, the federal government agreed to reduce its personal and corporate income tax rates and subsequently allowed the provincial and territorial governments to collect revenue from the same tax bases at the rate vacated by the federal government.The extent of tax points are determined by the negotiations between the individual provincial or territorial governments and the federal Government. The large provinces have higher tax points since their tax bases are very large. The CHST cash transfers are computed as residual by deducting the amount of transfer under tax points from the provincial per capita total entitlements. The CHST constitutes almost three-fourth of the total inter-Governmental transfers in Canada.

The three territorial governments in Canada receive a part of their funds from the Federal Government through the TFF. These are special transfers meant to compensate the territories for the higher per capita costs of providing services arising due to small size of population, large area and extreme weather conditions. The TFF is a 'gap filling' formula which takes into account the difference between the expenditure needs and own resources of the territorial governments. The volume of TFF in the total inter-Governmental transfers in Canada accounts for a small share.

In 2005, the provincial Governments and local Governments in Canada received 17.6 per cent and 40.2 per cent of their total revenue through inter-governmental transfers, respectively (GFS, 2006).

References:

1. Rangarajan, C. and Srivastava, D. K. (2004), "Fiscal Transfers in Australia: Review and Relevance to India", Working Paper No: 20, National Institute of Public Finance and Policy, New Delhi.
2. Rangarajan, C. and Srivastava, D. K. (2004), "Fiscal Transfers in Canada: Drawing Comparisons and Lessons", Working Paper No: 18, National Institute of Public Finance and Policy, New Delhi.
3. Ma Jun (1997), "Inter-governmental Fiscal Transfer – A Comparison of Nine Countries", The World Bank.
4. International Monetary Fund (2006), Government Finance Statistics (GFS).
5. Commonwealth Grants Commission (2002), Guidelines for Implementing Horizontal Fiscal Equalisation.

Box 9: Horizontal and Vertical Equity

Inter-Governmental fiscal relations in any federal system need to arbitrate vertical and horizontal imbalances that may arise due to allocation of functions and financial sources to different levels of Government. In the Indian federation, while the Union Government is vested with all functions of national importance such as defence, external affairs, constitution organisation of Supreme Court and the High Courts, elections, *etc*., the States have to perform important functions touching on the life and welfare of the people such as public order, police, public health, agriculture, water, *etc*. The powers of taxation are also divided between the Union Government and the States, with the former collecting tax on income other than agricultural income, excise duties, customs, and corporation tax, and the latter collecting land revenue, excise on alcoholic liquors, tax on agricultural income, estate duty, taxes on sale/purchase of goods, taxes on vehicles, professions, luxuries, entertainment, stamp duties, *etc*.

A vertical imbalance between the Centre and the States is built into the Constitution by the provisions relating to powers of taxation, which is further accentuated by the assignment of several key functions involving public expenditure to the States on the grounds that being nearest to the people they would be better able to discharge such responsibilities. Sharp horizontal imbalance exists between the States on account of differences in their levels of development due to endowment of natural resources, historical backgrounds and other factors. In India, not only the number of States is large, they differ in various respects such as area, size of population, income, tax base, and mineral and forest resources. Importantly, the share in population of the poorer States requiring transfers is relatively large as compared to the share in population of the richer states. The fiscal transfers from the Centre to the States aim at correcting such in-built vertical and horizontal imbalances for an even and equitable development of all the regions of the country by sharing with the States the resources available to the Centre and equalisation grants. Vertical imbalance in most federations is corrected through tax assignment, revenue sharing and grants. In India, the vertical imbalance is sought to be corrected by revenue sharing, and the horizontal imbalance through the formula of distribution of the shareable revenues amongst States supplemented by grants. A Finance Commission, constituted every five years, facilitates the fiscal transfers by recommending the distribution, between the Union and the States as also among the States, of the net proceeds of taxes and grants-in-aid.

An important feature of other countries, which follow the federal system of Government, also is the high degree of imbalance between the revenue sources and expenditure responsibilities of the State Governments as well as differences in fiscal capacities across States, giving rise to important role played by fiscal transfers in correcting the imbalance. The Australian federal system has high degree of vertical imbalance and a relatively smaller degree of horizontal imbalance. These imbalances are corrected through tax sharing arrangements and specific purpose grants. On the other hand, the Canadian federalism is marked by a very high degree of both vertical and horizontal imbalances due to substantial inter-Provincial and intra-Provincial variations. Therefore, Canada has an equalising and liberal system of federal transfers that include statutory subsidies and transfers under the Federal-Provincial Fiscal Arrangements and Established Programmes Financing Act, 1977. Both levels of Government in Canada also share costs through conditional matching grants on a wide variety of activities. In USA too, which has a multiple layering of Governments, there is a considerable degree of fiscal imbalance among the States and the mechanism of transfers includes categorical (conditional) grants, block grants and general revenue sharing. A comparative assessment of the inter-Governmental fiscal relations in four countries, *viz*., Australia, Canada, USA and India, is presented in the following Table.

Table: Inter-Governmental Fiscal Relations: A Comparison

	India	Australia	Canada	USA
Division of functions				
1. Important functions like defence, foreign affairs, communications with the Centre	Yes	Yes	Yes	Yes
2. Functions relating to education, law and order, health, *etc.,* with the States	Yes	Yes	Yes	Yes
Division of tax powers				
1. Important and elastic taxes with the Centre	Yes	Yes	Yes	Yes
2. Centre has overriding powers over States	Yes	Yes	No	No
3. Centre can levy all taxes	No	Yes	Yes	Yes
4. Considerable degree of overlapping	No	No	Yes	Yes
Inter-governmental fiscal relations				
1. Formal	Yes	Yes	–	–
2. Informal	–	–	Yes	Yes
3. Vertical imbalances	Large	Large	Large	Large
4. Horizontal imbalances	High	High	High	High
5. Correction of imbalances	Partial	Very high	High	Not High

References :

1. Vithal, B.P.R. and M.L.Sastry (2001), 'Fiscal Federalism in India', Oxford University Press.
2. Government of India (2004), Report of the Twelfth Finance Commission (2005-10), November.

Box 10: Centrally Sponsored Schemes

In India, funds are transferred from the Centre to the States under both statutory and non-statutory routes. Under statutory route, the Finance Commission recommends the States' share in the shareable taxes and non-plan grants from the Centre for every five years. In addition, funds are transferred from the Centre to the States by the Planning Commission under two non-statutory routes. The first is via support to States' plans called the Central Plan Assistance (CPA) and the second is *via* the Centrally Sponsored Schemes (CSS) of the Central Ministries, which is provided as specific purpose grants under Article 282 of the Constitution.

CSS are not meant to bridge vertical gap, but to provide States additional resources for expenditure which the Central Government considers to be of national/regional priority, although the implementation of these programmes is normally in the domain of the State Governments. The CSS are designed by several Ministries, who then pass the funds to the States from the Central plan budget that the Ministries control. However, approval and clearance of the schemes by the Planning Commission is required, after which the Central Ministries make the State-wise allocations. The outlay and nature of the individual schemes is determined by the provisions and guidelines attached to schemes, which cannot be altered by the States.

In its originality, CSS were to be formulated only where an important national objective such as poverty alleviation was to be addressed, or the programme had a regional or inter-State character or was in the nature of pace setter, or for the purpose of survey or research. However, the number of CSS proliferated by including considerable areas of activity performed by the States. The important reasons for increased involvement of Centre on State subjects are: inability of the States to provide adequate resources for socially relevant programmes, lack of a clear strategy to implement social sector programme by the States and inadequate commitment of resources on priority programmes. The most important contributory factor, however, is the availability of external funding for social programme, a State subject, which was earlier available only for economic activities of the Government. The external funding on social sector, provided as soft loan by the external agencies, requires the conditionality of ensuring accountability and close monitoring and evaluation of the programmes for smooth flow of funds.

Specific purpose grants and loans in the form of specific purpose schemes, which was termed as CSS in 1969, have been a discord between the Centre and the States. States have maintained that if the Centre had additional resources the same could be transferred to States as untied or block assistance, and not as conditional assistance as in CSS. The National Development Council (NDC) in 1969 thus took a decision that Central assistance to State plans should be by and large in the form of block/unconditional assistance and limit the CSS amount to 1/6th of the block assistance. However, CSS has grown enormously both in terms of number and amount of assistance.

There are two types of CSS in the Central Plan. The first category (Category I) of CSS includes those schemes for which outlays are explicitly recognised as CSS schemes in the union budget, and is routed through the State budgets. Category II CSS are not recognised as transfers to the States in the union budget and include those schemes which are budgeted with a separate programmatic minor/sub-minor head under the specific functional head of the department. Category II CCS are either fully or partially routed through the State budgets or bypass the State budgets and go to the State/district agencies directly. As per the Union Budget 2007-08, the amount allocated under category I CSS would be Rs.21,880 crore forming 47.0 per cent of central assistance for State and UT plans for 2007-08 and showing an increase of 42.3 per cent over that of 2006-07 (RE). It is estimated that in 2006-07 there were in total 196 CSS (both category I and II). Of these, 154 CSS involving Rs. 24,802 crore were budgeted to be routed through the State budgets and the remaining 41 CSS involving Rs.36,516 crore would by-pass the State budgets and go directly to the implementing agencies such as Panchayati Raj Institutions (PRIs) (Rao, Gupta and Jena, 2007). The total budgeted outlay under CSS formed 46.7 per cent of the gross budgetary support for Central plan and 33.3 per cent of the approved plan outlay of State Governments in 2006-07.

Even though CSS are mostly funded by the Centre as grants, the States are also required to make matching contributions. In the 1980's, it was generally a matching contribution of 50 per cent by the States, but was reduced to 25 per cent in the 1990's in view of the difficult fiscal situation faced by the States. In view of this required contribution by the States, it has been observed that relatively better off States benefit more from the CSS, as they have better matching resources and better implementation capability. Some of the schemes started in the current decade such as the Pradhan Mantri Gram Sadak Yojana (PMGSY) and Rastriya Sam Vikas Yojana (RSVY), Sarva Shiksha Abhiyan (SSA), Mid Day Meals (MDM) and National Rural Employment Guarantee (NREG) are operated through 100 per cent grants from the Centre.

A few issues relating to CSS have been raised in the academic literature. It has been often stated that proliferation of CSSs creates administrative problems for the State and local bodies. Further, with ever increasing CSS, the fiscal transfer to the States becomes more discretionary rather than formulae based, which may not be desirable in the interest of fiscal federalism. A problem associated with CSSs is that the Central Government designs the parameters within which the schemes operate and this often deprives State Governments of the flexibility that may be needed to take account of local conditions. Another problem is that releases of Central assistance are linked to timely submission of utilisation certificates, a discipline imposed to ensure that transfers lead to actual expenditures. It has been stated that the practice of requiring utlisation certificates before releasing subsequent tranches of assistance can harm implementation, especially when certain types of works can only be done in certain months of the year.

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1. Dikshit A., Renuka Viswanathan and T. R. Raghunandan (2007), "Efficient Transfer of Funds for Centrally-Sponsored Schemes", Economic and Political Weekly, June 9.
2. Garg, Subash Chandra (2006), "Transformation of Central Grants to States – Growing Conditionality and Bypassing State Budgets", Economic and Political Weekly, December 2.
3. Rao, C Bhujanga, Manish Gupta and Pratap Ranjan Jena (2007), "Central Flows to Panchayats – A Comparative Study of Madhya Pradesh", Economic and Political Weekly, February 3.

The shares of States in divisible taxes recommended by the Twelve FCs so far are presented in Annex 5. Prior to the enactment of the Constitution (Eightieth Amendment) Act, 2000, two main Central taxes were shared with the States, *viz*., income tax excluding corporation tax (Art. 270) and Union excise duties (Art. 272). The sharing of the income tax was mandatory, while that of the Union excise duties was discretionary. The 80th constitutional amendment altered the pattern of sharing of Union taxes in a fundamental way. All Central taxes were brought into a shareable pool (Article 270) and it became mandatory to assign a share from each Central tax to the States, except taxes under article 268 and 269, earmarked cesses, and surcharges under article 271. The amended article 269 contains only CST and consignment tax, which is not levied. The basis for this change was the recommendation by the Tenth FC in its alternative scheme of tax devolution that instead of sharing of individual taxes, the States may have a share in the total net proceeds of all Central taxes excluding surcharges and cesses. The Eleventh FC was the first to implement the above scheme. The new devolution scheme gave greater freedom and flexibility to the Centre in pursuing the tax reforms in an integrated manner and enabled the States to share the aggregate buoyancy of Central taxes. In the Seventh Schedule to the Constitution, the powers to tax services have been assigned to the Central Government. Under article 268A, however, service tax has been taken out of the divisible pool of Central taxes and consequently out of the jurisdiction of the FC.

As regards horizontal sharing, over the past few FCs, the distributive criteria have converged toward the following: (a) among the need factors, population and income distance have gained acceptance; (b) among the cost disability factors, area and infrastructure index distance have tended to be the preferred indicators; and (c) among the fiscal efficiency factors, tax effort and fiscal discipline as measured by the ratio of own tax revenue to revenue expenditure, are regarded as appropriate. The criteria and weights used for tax devolution by successive finance commissions are presented in Annex 6.

The other instrument of horizontal sharing is “grants-in-aid”. With respect to grants, there are two duties cast upon the FC under articles 280(3)(b) and 270. Article 280(3)(b) requires the FC to make recommendations as to the “principles” which should govern such grants-in-aid. Article 275(1) refers to specific “sums” to be recommended to be paid to the States which are assessed to be in “need of assistance”. Need is to be assessed in relation to services provided by the States, the standard of these services in relation to the average or other desirable norms, and the extent to which these requirements can be met by own revenues. Services are interpreted as public goods like general administration and law and order and merit goods like education and health.

It may be mentioned that while grants are provided in terms of absolute amounts and therefore remain fixed, the amount in respect of shareable taxes varies depending upon tax mobilisation of the Central Government, as the transfer is in terms of the proportion of total taxes mobilised.

VII.1.3 Institutional Arrangements

The statutory transfers consisting of sharing of Central tax revenues and grants are distributed based on the recommendations of the FC. In addition to these, plan assistance is given to the States, which consists of grants and loans. The grant-loan ratio for the general category States is 30:70, whereas for the special category States, this ratio is 90:10. In normal central assistance, 30 per cent is earmarked for the special category States. The Central assistance for States from the PC for State Plans, Central Plans, Centrally Sponsored Schemes and Central Sector Plans is determined on the basis of the ‘Gadgil formula’ and subsequent modification and revision of the same (Box 11). The Twelfth FC recommended that the system of imposing a 70:30 ratio between loans and grants for extending plan assistance to non-Special Category States (10:90 in the case of Special Category States) should be done away with.

Furthermore, as States cannot borrow externally, the Government of India acts as an

Box 11: Gadgil Formula and its Variants

1. ***Original Gadgil Formula approved by the NDDC in September 1968***

(1) The requirements of Assam, Jammu and Kashmir and Nagaland should first be met out of the total pool of Central assistance.

(2) The balance of the Central assistance should then be distributed among the remaining fourteen States on the basis of the following criteria:

(i) 60 per cent on the basis of population - 1965 mid-year population estimates.

(ii) 10 per cent on the basis of per capita State Domestic Product (SDP) - average of three years (1962-63 to 1964-65); assistance to go to those States only whose per capita SDPs are below the national average. Deviation method to be used in distribution.

(iii) 10 per cent on the basis of tax efforts of States - State's own per capita tax receipts (1967-68) as percentage of per capita SDP (average of 1962-65).

(iv) 10 per cent on the basis of spill-over into the Fourth Plan, of major continuing irrigation and power projects, each costing more than Rs.20 crore and with expenditure of at least 10 per cent incurred.

(v) 10 per cent for special problems of individual States.

2. ***Updated Gadgil Formula***

(1) Requirements of Assam, Himachal Pradesh, Jammu and Kashmir, Nagaland, Manipur, Meghalaya, Sikkim, and Tripura first to be met out of the total Central assistance.

(2) Balance to be distributed as under:

(i) 60 per cent on the basis of population – 1971 population.

(ii) 10 per cent on the basis of per capita SDP - average of 1970-73 to States below the average only.

(iii) 10 per cent on the basis of tax efforts of States - State's own per capital tax receipts (1973-74) as percentage of per capita SDP (average of 1970-73).

(iv) 10 per cent on the basis of continuing major irrigation and power projects.

(v) 10 per cent on the basis of special problems of individual States.

(Here, there is no change from the original Gadgil Formula. Only the data base has been updated.)

3. ***Modified Gadgil Formula***

(1) Lump sum amount to be set apart for eight Special Category States.

(2) Balance amount to be distributed among the remaining 14 states as under:

(i) 60 per cent – 1971 population.

(ii) 10 per cent – tax effort - 1978-79 tax receipts and 1973-76 per capita SDP.

(iii) 20 per cent - average per capita SDP for 1973-76 to States below the average.

(iv) 10 per cent - special problems of States.

4. ***Revised Gadgil Formula***

The National Development Council, in its meeting held in December 1991, approved a revised formula for the non-special category States as under:

(i) 60 per cent – 1971 population.

(ii) 25 per cent – per capita SDP:

(a) 20 per cent for States below the average per capita SDP - Deviation Method.

(b) 5 per cent for all States - Distance Method.

(iii) 7.5 per cent for performance - In tax effort, fiscal management, population control, female literacy, on-time completion of externally aided projects and land reforms.

(iv) 7.5 per cent - Special problems of individual States.

Source: B.P.R.Vithal and M.L.Sastry (2002), "*The Gadgil Formula for Allocation of Central Assistance for State Plans*", Centre for Economic and Social Studies.

intermediary and transfers funds received for externally aided projects to the States. The Central Government bears the exchange rate risk on these loans and on-lends the funds to the State Governments at a fixed rate of interest determined from time to time. The Twelfth FC recommended that external assistance may be transferred to States on the same terms and conditions as attached to such assistance by external funding agencies thereby making Government of India a financial intermediary without any gain or loss. The exchange rate risk in this case would be borne by the State Governments.

As regards accounting arrangement for fiscal transfers to the States, all transfers on the revenue account (share in Central taxes and grants-in-aid) and capital account (loans from Centre) take place from the Consolidated Fund of India.

VII.2 Magnitude of Fiscal Transfers[11]

VII.2.1 Consolidated Position

The analysis in the following paragraphs covers the trend in fiscal transfers during past two decades, both in gross and net terms, followed by trend in various components namely, share in Central taxes, grants-in-aid and loans from Centre. In addition, the trend in fiscal transfers through FCs and others are also covered.

Gross Devolution and Transfers

Gross devolution and transfers (GDT) comprising share in Central taxes (SCT), grants-in-aid (GIA) and loans from Centre (LFC) have increased steadily over the years, but for the decline in a single year during 1999-00 (Table 45 and Chart 20). Component-wise, the shares of SCT and GIA in GDT have moved up in recent years with phasing out of LFC to the States in terms of recommendations of the TFC.

GDT is budgeted to be 5.8 per cent of GDP in 2007-08 (Appendix Table 24). On an average, the ratio of GDT to GDP during the first three years of Twelfth FC (2005-08) was higher at 5.5 per cent than the Eleventh FC period (5.2 per cent) (Table 46). GDT constituted around 33 per cent of aggregate disbursements and aggregate receipts of the States during 2005-08. The GDT as percentage of GDP witnessed a decline in the 1990s and early 2000s coinciding with the period of Tenth FC and Eleventh FC. During the period of Twelfth FC so far, the

Table 45: Composition of Gross Devolution and Transfers

Year	Share in Central Taxes	Grants-in-Aid	Loans from Centre	Total	Share in Central Taxes	Grants-in-Aid	Loans from Centre	Total
	(Rupees crore)				(Per cent to total)			
1	2	3	4	5	6	7	8	9
1986-87	8,384	6,985	7,703	23,072	36.3	30.3	33.4	100.0
1987-88	9,660	8,275	9,034	26,969	35.8	30.7	33.5	100.0
1988-89	10,736	9,660	9,937	30,333	35.4	31.8	32.8	100.0
1989-90	13,097	8,505	11,259	32,862	39.9	25.9	34.3	100.0
1990-91	14,242	12,643	13,974	40,859	34.9	30.9	34.2	100.0
1991-92	16,848	15,226	13,069	45,143	37.3	33.7	29.0	100.0
1992-93	20,580	17,759	13,100	51,439	40.0	34.5	25.5	100.0
1993-94	22,395	21,176	14,277	57,848	38.7	36.6	24.7	100.0
1994-95	24,885	19,911	18,742	63,538	39.2	31.3	29.5	100.0
1995-96	29,048	20,873	18,804	68,725	42.3	30.4	27.4	100.0
1996-97	35,038	22,949	22,931	80,918	43.3	28.4	28.3	100.0
1997-98	40,411	23,853	29,744	94,009	43.0	25.4	31.6	100.0
1998-99	39,421	23,480	39,367	1,02,268	38.5	23.0	38.5	100.0
1999-00	44,121	30,177	21,354	95,652	46.1	31.5	22.3	100.0
2000-01	50,734	37,289	18,707	1,06,730	47.5	34.9	17.5	100.0
2001-02	52,215	42,601	24,396	1,19,213	43.8	35.7	20.5	100.0
2002-03	56,655	45,170	26,831	1,28,657	44.0	35.1	20.9	100.0
2003-04	67,080	50,834	25,871	1,43,785	46.7	35.4	18.0	100.0
2004-05	78,550	56,322	25,878	1,60,750	48.9	35.0	16.1	100.0
2005-06	94,024	76,750	8,097	1,78,871	52.6	42.9	4.5	100.0
2006-07 (RE)	1,15,737	1,02,955	10,197	2,28,889	50.6	45.0	4.5	100.0
2007-08 (BE)	1,36,184	1,17,320	14,918	2,68,422	50.7	43.7	5.6	100.0

RE : Revised Estimates. BE : Budget Estimates.
Source : Budget Documents of the State Governments.

[11] Data for this section are based on the budget documents of the State Governments. For the period under Twelfth FC, data are available for first three years, *i.e.*, 2005-06 to 2007-08. Therefore, data relating to Twelfth FC are not strictly comparable with the earlier period.

Table 46: Gross Devolution and Transfers* – Annual Averages

Period	GDT (Rs. crore)	GDT/GDP	GDT/AD	GDT/AR	GDT (AAGR)
		(Per cent)			
1	2	3	4	5	6
Ninth FC (1990-95)	51,765	6.8	42.6	42.3	14.2
Tenth FC (1995-00)	88,314	5.7	38.4	38.7	8.9
Eleventh FC (2000-05)	1,31,827	5.2	30.4	30.2	11.0
Twelfth FC (2005-08)	2,25,394	5.5	33.4	33.0	18.8

* : Gross devolution and transfers (GDT) include share in Central taxes, grants-in-aid from the Centre and gross loans from the Centre.
GDT : Gross Devolution and Transfers. GDP : Gross Domestic Product.
AD : Aggregate Disbursements. AR : Aggregate Receipts.
AAGR : Annual Average Growth Rate.
Source : Budget Documents of the State Governments.

compound annual growth rate (CAGR) of GDT at 22.5 per cent was substantially higher than during previous three Finance Commissions (Chart 21).

Net Devolution and Transfers

The net devolution and transfers (NDT) from the Centre comprising gross devolution and transfers net of repayments and interest payments are budgeted at 5.3 per cent of GDP in 2007-08 (Appendix Table 25). On an average, the share of NDT during the first three years of Twelfth FC was higher at 4.9 per cent of GDP than the Eleventh FC (3.3 per cent) and Tenth FC (4.1 per cent) periods (Table 47). NDT constituted around 30 per cent of aggregate disbursements and aggregate receipts. NDT increased at a faster rate (CAGR of 25.2 per cent) during the period of Twelfth FC so far as compared to the earlier periods (Chart 21). Furthermore, CAGR of NDT during 2005-08 surpassed that of GDP, reversing the trend witnessed during the earlier three five year periods when CAGR of GDP was higher than that of NDT.

Share in Central Taxes

As noted above, SCT has the objectives of correcting vertical and horizontal imbalances. On an

Chart 20: Gross Transfer of Resources from the Centre

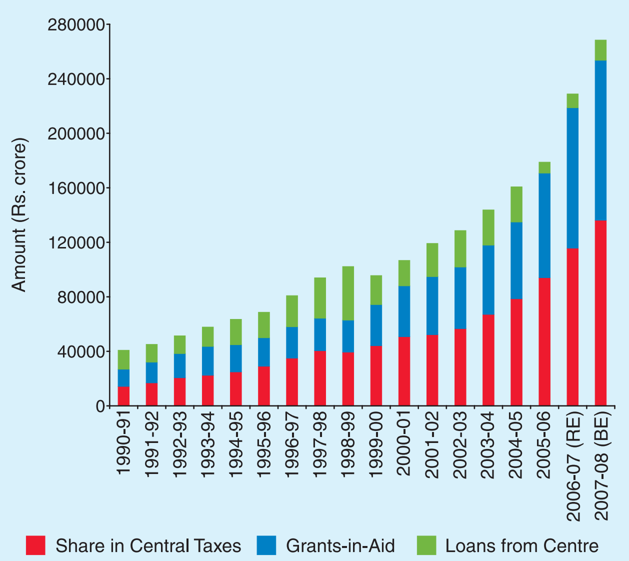


Chart 21: Compound Annual Growth Rates of GDT and NDT

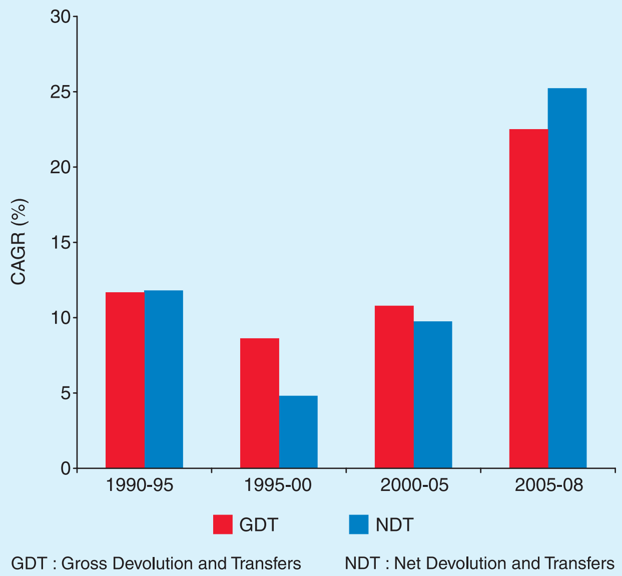


Table 47: Net Devolution and Transfers* – Annual Averages

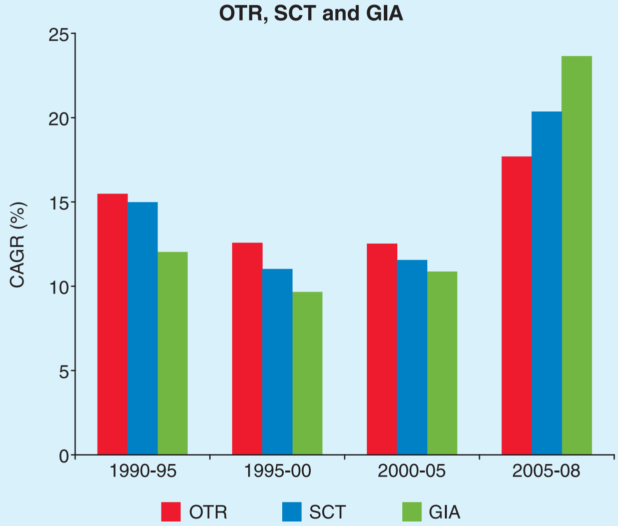
Period	NDT (Rs. crore)	NDT/GDP	NDT/AD	NDT/AR	NDT (AAGR)
		(Per cent)			
1	2	3	4	5	6
Ninth FC (1990-95)	39,798	5.2	32.8	32.5	14.7
Tenth FC (1995-00)	62,965	4.1	27.6	27.8	5.2
Eleventh FC (2000-05)	84,515	3.3	19.4	19.3	11.7
Twelfth FC (2005-08)	2,04,058	4.9	30.1	29.8	35.6

* : Net devolution and transfers are gross devolution and transfers net of loan repayments and interest payments.
NDT : Net Devolution and Transfers. GDP : Gross Domestic Product.
AD : Aggregate Disbursements. AR : Aggregate Receipts.
AAGR : Annual Average Growth Rate.
Source : Budget Documents of the State Governments.

average basis, the share of SCT in GDT increased from 38.0 per cent during Ninth FC to 42.6 per cent during Tenth FC and further to 46.2 per cent during Eleventh FC. In the first three years of Twelfth FC, the ratio of SCT to GDT increased to 51.3 per cent. SCT as a percentage of GDP increased to 2.8 per cent during 2005-08 as compared with an average of 2.4 per cent during Eleventh FC (Table 48). SCT forms around 22 per cent of the revenue receipts of the States and around one-third of the total tax revenue of States (Appendix Table 26). Thus, SCT has emerged as the major component of GDT during the recent years (also see Table 45).

The CAGR of SCT during 2005-08 at 20.3 per cent was higher than that of States' own tax revenue (OTR) of 17.7 per cent, reversing the trend witnessed during the Ninth, the Tenth and the Eleventh FCs (Chart 22).

Chart 22: Compound Annual Growth Rates of OTR, SCT and GIA



OTR : Own Tax Revenue SCT : Share in Central Taxes
GIA : Grants-in-aid

Table 48: Share in Central Taxes – Annual Averages

Period	SCT (Rs. crore)	SCT/GDT	SCT/GDP	SCT/RR	SCT/TR	SCT (AAGR)
		(Per cent)				
1	2	3	4	5	6	7
Ninth FC (1990-95)	19,790	38.0	2.6	21.4	32.5	13.8
Tenth FC (1995-00)	37,608	42.6	2.4	22.7	32.4	12.4
Eleventh FC (2000-05)	61,047	46.2	2.4	21.4	30.1	12.4
Twelfth FC (2005-08)	1,15,315	51.3	2.8	22.0	31.1	20.2

SCT : Share in Central Taxes. GDT : Gross Devolution and Transfers. GDP : Gross Domestic Product.
RR : Revenue Receipts. TR : Tax Revenue. AAGR : Annual Average Growth Rate.
Source : Budget Documents of the State Governments.

Table 49: Grants-in-Aid – Annual Averages

Period	SG	NSG	GIA (2+3)	GIA/GDT	SG/GDP	NSG/GDP	GIA/GDP	GIA (AAGR)
	(Rs. crore)			(Per cent)				
1	2	3	4	5	6	7	8	9
Ninth FC (1990-95)	2,382	14,961	17,343	33.4	0.3	1.9	2.3	19.8
Tenth FC (1995-00)	2,935	21,332	24,267	27.7	0.2	1.4	1.6	9.1
Eleventh FC (2000-05)	9,792	36,651	46,443	35.2	0.4	1.4	1.8	13.4
Twelfth FC (2005-08)	20,620	78,389	99,008	43.9	0.5	1.9	2.4	28.1

SG : Statutory Grants. NSG : Non-Statutory Grants. GIA : Grants-in-aid.
GDT : Gross Devolution and Transfers. GDP : Gross Domestic Product. AAGR : Annual Average Growth Rate.
Source : Budget Documents of the State Governments.

Grants-in-Aid

The share of GIA in GDT declined from 33.4 per cent during Ninth FC to 27.7 per cent during Tenth FC, but increased to 35.2 per cent during Eleventh FC. In the first three years of Twelfth FC, the ratio of GIA to GDT increased to 43.9 per cent (Table 49). GIA contributed nearly 19 per cent of revenue receipts of the States and comprise around two-third of non-tax revenue of the States (Appendix Table 27). GIA grew at CAGR of 23.6 per cent during 2005-08, surpassing the growth in SCT as well as States' OTR (Chart 22). The increase was observed in both statutory and non-statutory components.

Loans from Centre

With the change in accounting framework of small savings and constitution of NSSF with effect from April 1, 1999 and abolition of Plan loans from the Centre to the States from 2005-06 in line with the recommendations of Twelfth FC, SCT and GIA remain two major components of GDT from the Centre to the States.

The share of gross LFC in GDT declined from 18.6 per cent during Eleventh FC to 4.8 per cent during Twelfth FC. There has also been a sharp decline in LFC as percentage of GDP and its share in total capital receipts of the States (Table 50 and Appendix Table 28). The decline in the importance of LFC reflects discontinuation of plan loans since April 1, 2005 in accordance with the recommendations of the TFC. In the Union Budget for 2005-06, it was indicated that the States and UTs with Legislature would raise loans directly from the market for financing their annual plans. Thus, block loans (plan) will not be available to the State Governments. The required amount, in consonance

Table 50: Loans from Centre

Period	GLFC	NLFC	GLFC/GDT	NLFC/NDT	GLFC/GDP	NLFC/GDP	GLFC/CR	GLFC (AAGR)
	(Rs. crore)		(Per cent)					
1	2	3	4	5	6	7	8	9
Ninth FC (1990-95)	14,632	10,384	28.6	26.3	1.9	1.4	48.3	11.6
Tenth FC (1995-00)	26,440	19,190	29.6	29.9	1.7	1.3	43.2	7.7
Eleventh FC (2000-05)	24,337	4,601	18.6	5.9	1.0	0.2	16.5	4.9
Twelfth FC (2005-08)	11,071	2,817	4.8	1.2	0.3	0.1	7.1	1.2

GLFC : Gross Loans from Centre. NLFC : Net Loans from Centre. GDT : Gross Devolution and Transfers.
NDT : Net Devolution and Transfers. GDP : Gross Domestic Product. CR : Capital Receipts.
AAGR : Annual Average Growth Rate.
Source : Budget Documents of the State Governments.

Table 51: Finance Commission Devolution and Other Current Transfers

(Amount in Rs. crore)

Period	SCT	SG	FCT (2+3)	OCT	Total (4+5)
1	2	3	4	5	6
Ninth FC (1990-95)	19,790	2,382	22,172	14,961	37,133
	(2.6)	(0.3)	(2.9)	(1.9)	(4.9)
Tenth FC (1995-00)	37,608	2,935	40,542	21,332	61,874
	(2.4)	(0.2)	(2.6)	(1.4)	(4.0)
Eleventh FC (2000-05)	61,047	9,792	70,839	36,651	1,07,490
	(2.4)	(0.4)	(2.8)	(1.4)	(4.2)
Twelfth FC (2005-08)	1,15,315	20,620	1,35,935	78,389	2,14,323
	(2.8)	(0.5)	(3.3)	(1.9)	(5.2)

SCT : Share in Central Taxes. SG : Statutory Grants.
OCT : Other Current Transfers. FCT : Finance Commission Transfers.
Note : 1. Figures in brackets are as percentage to GDP.
2. Other Current Transfers are same as non-Statutory grants.
Source : Budget Documents of the State Governments.

with the approved plan size, will be raised by the State Governments from the market. This decision was in accordance with the principle of prudent fiscal management to allow States to borrow in terms of their credit risk and to disassociate Central Government from acting as an intermediary.

Finance Commission Transfers and other Current Transfers

The FC transfers comprising SCT and statutory grants and grants for natural calamities, on an average, account for around two-thirds of total current transfers to the States. In terms of GDP, the FC transfers were 3.3 per cent of GDP during the Twelfth FC period, which is the highest ever FC transfers since the Ninth FC (Table 51 and Appendix Table 29). This is because along with SCT, there is substantial increase in the grant component in terms of recommendations of the TFC.

It may be recalled that the Twelfth FC recommended a greater role for grants in overall FC transfers on the following grounds: (a) grants are determined in absolute terms and the amounts are, therefore, known; (b) grants can be targeted better; and (c) in determining grants, better account can be taken of cost disabilities and redistributive considerations that are not adequately captured in the tax devolution formula. Accordingly, the Twelfth FC allowed increase in share of grants in total FC transfers to 18.87 per cent during the award period 2005-10, from 8.96 per cent during Tenth FC period and 13.47 per cent during Eleventh FC period. Data for 2005-06 to 2007-08 indicate that, on an average, share of grants in FC transfers was 15.2 per cent while that of tax devolution was 84.8 per cent.

Other current transfers comprising transfers from the PC and the Ministry of Finance also witnessed significant increase relative to GDP during the Twelfth FC.

VII.2.2 State-wise Position

An assessment of the state-wise position reveals wide variations across the States in devolution and transfers on account of differences in the size of the population, revenue-generating capacity and development needs of the States. The State-wise position in terms of gross and net devolution and transfers, share in Central taxes, grants-in-aid, loans from Centre, FC transfers and other current transfers, revenue receipts before and after transfers and role of loans from Centre in financing of GFD are set out in Statements 49-56.

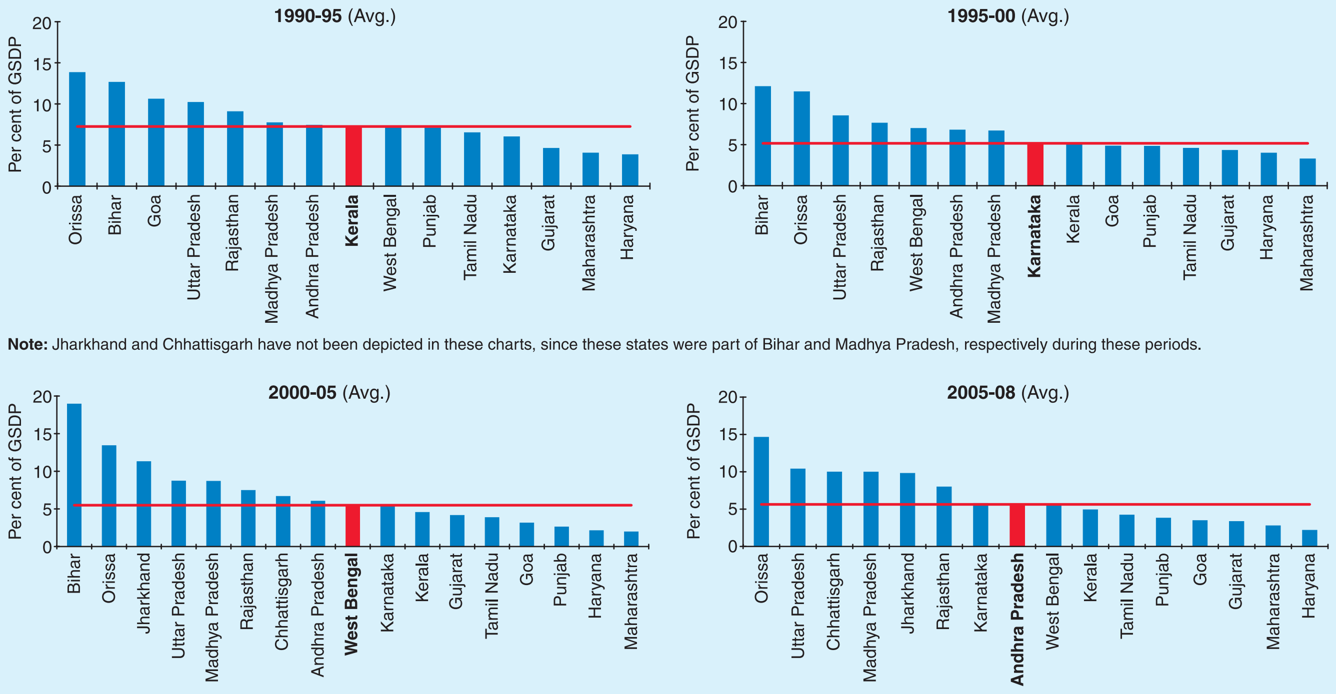
Table 52: Distribution of Non-Special Category States by the level of GDT / GSDP ratio

Range (Per cent)	**1990-95** (Avg.)	**1995-00** (Avg.)	**2000-05** (Avg.)	**2005-08** (Avg.)
Below 5	Haryana, Maharashtra, Gujarat	Maharashtra, Haryana, Gujarat, Tamil Nadu, Punjab, Goa	Maharashtra, Haryana, Punjab, Goa, Tamil Nadu, Gujarat, Kerala	Haryana, Maharashtra, Gujarat, Goa, Punjab, Tamil Nadu, Kerala
5 to 10	Karnataka, Tamil Nadu, Punjab, West Bengal, **Kerala**, Andhra Pradesh, Madhya Pradesh, Rajasthan	Kerala, **Karnataka**, Madhya Pradesh, Andhra Pradesh, West Bengal, Rajasthan, Uttar Pradesh	Karnataka, **West Bengal,** Andhra Pradesh, Chhattisgarh, Rajasthan, Madhya Pradesh, Uttar Pradesh	West Bengal, **Andhra Pradesh,** Karnataka, Rajasthan, Jharkhand
Above 10	Uttar Pradesh, Goa, Bihar,Orissa	Orissa, Bihar	Jharkhand, Orissa, Bihar	Uttar Pradesh, Orissa, Bihar, Madhya Pradesh, Chhattisgarh

Non-Special Category States

Among non-Special Category States, the dependence (measured in terms of ratio of GDT-GSDP) of States like Bihar, Orissa, Chhattisgarh, Uttar Pradesh and Madhya Pradesh on resource transfer from the Centre is higher (above 10 per cent) than that of other non-special category States (Table 52 and Chart 23). It may, however, be mentioned that the GDT-GSDP ratio would work out to be low for States having high GSDP relative to other States, even though in absolute terms the devolution and transfer for such States may be high. Further, for some of the under-developed States with high population levels, even though the GDT-GSDP ratio may be higher than the median level, the ratio may be low in per capita terms.

Chart 23: Gross Devolution and Transfers - Non-Special Category States



Note: Jharkhand and Chhattisgarh have not been depicted in these charts, since these states were part of Bihar and Madhya Pradesh, respectively during these periods.

Note: Bihar has not been depicted in this chart since its value for this indicator is very high during 2005-08.

Table 53: Distribution of Non-Special Category States by the level of FC Devolution / GSDP ratio

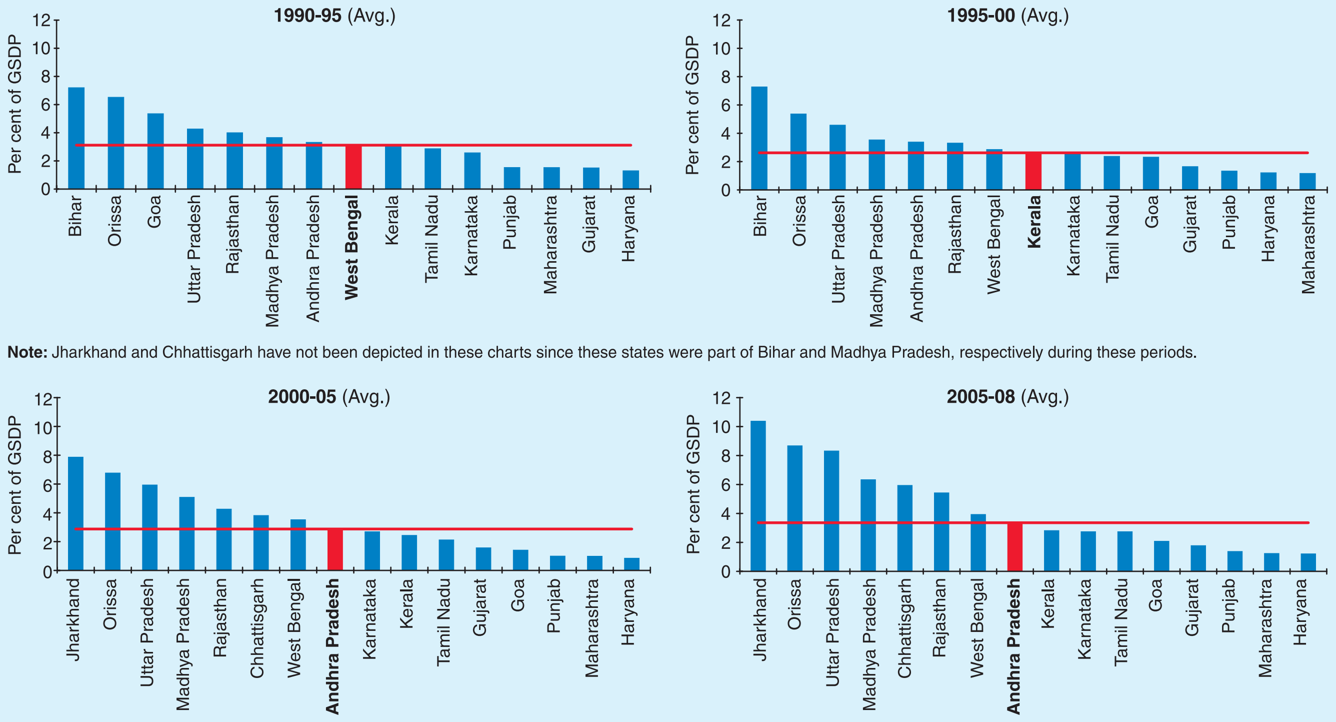
Range (Per cent)	**1990-95** (Avg.)	**1995-00** (Avg.)	**2000-05** (Avg.)	**2005-08** (Avg.)
Below 2	Haryana, Gujarat, Maharashtra, Punjab	Maharashtra, Haryana, Punjab, Gujarat	Haryana, Maharashtra, Punjab, Goa, Gujarat	Haryana, Maharashtra, Punjab, Gujarat
2 to 5	Karnataka, Tamil Nadu, Kerala, **West Bengal**, Andhra Pradesh, Madhya Pradesh, Rajasthan, Uttar Pradesh	Goa, Tamil Nadu, Karnataka, **Kerala**, West Bengal, Rajasthan, Andhra Pradesh, Madhya Pradesh, Uttar Pradesh	Tamil Nadu, Kerala, Karnataka, **Andhra Pradesh**, West Bengal, Chhattisgarh, Rajasthan	Goa, Tamil Nadu, Karnataka, Kerala, **Andhra Pradesh**, West Bengal
5 to 8	Goa, Orissa, Bihar	Orissa, Bihar	Orissa, Uttar Pradesh, Madhya Pradesh, Jharkhand	Rajasthan, Chhattisgarh, Madhya Pradesh
Above 8	–	–	Bihar	Uttar Pradesh, Jharkhand, Bihar, Orissa

The ratio of FC devolution to GSDP witnessed improvement in the first three years of the Twelfth FC, *i.e.*, 2005-08, for all the non-Special Category States. The FC devolution-GSDP ratio was more than 8 per cent in case of States like Bihar, Jharkhand, Orissa and Uttar Pradesh (Table 53 and Chart 24).

Special Category States

The devolution and transfers to Special Category States are much higher in terms of their GSDP and their aggregate disbursements than the non-Special Category States. There are, however, substantial variations across States.

Chart 24: Finance Commission Devolution - Non-Special Category States



Note: Bihar has not been depicted in these charts since its value is very high for this indicator during 2000-05 and 2005-08.

Table 54: Distribution of Special Category States by the level of GDT / GSDP ratio

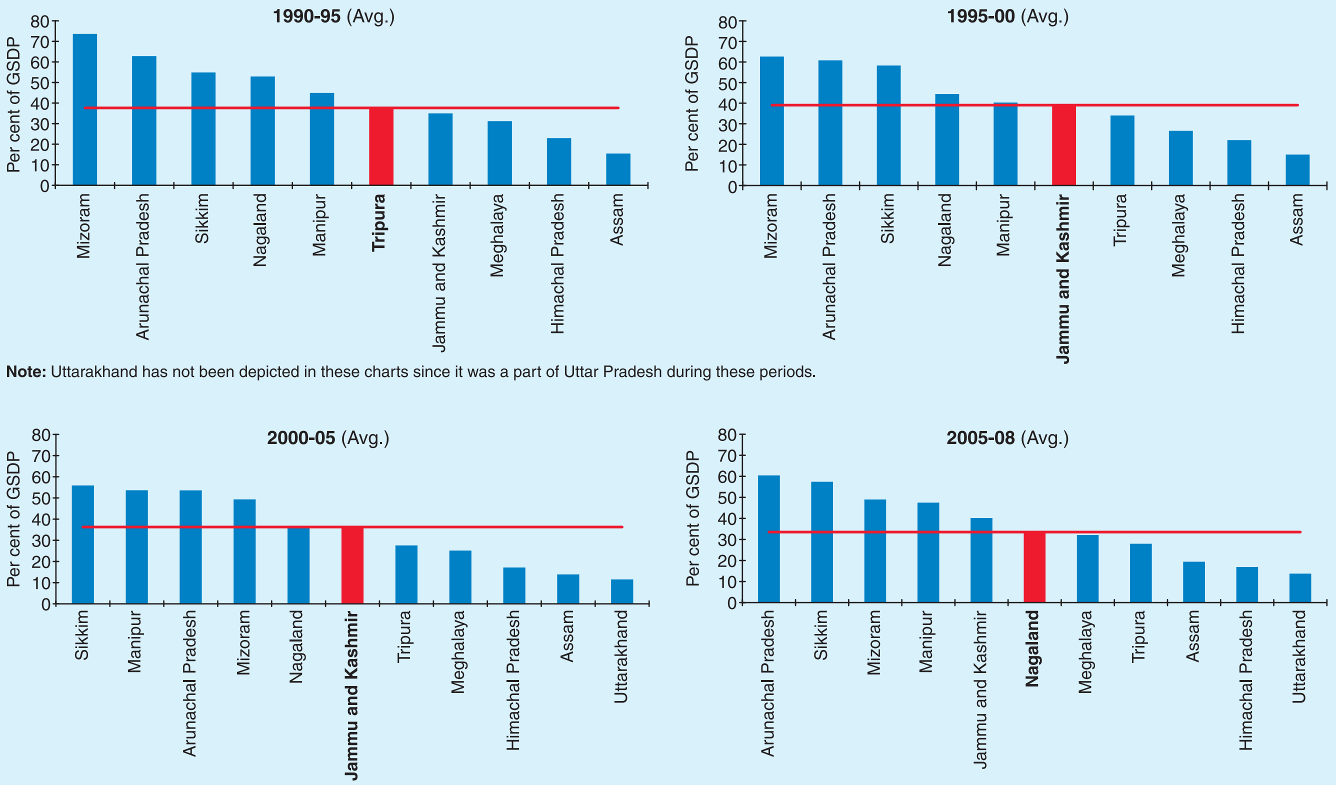
Range (Per cent)	**1990-95** (Avg.)	**1995-00** (Avg.)	**2000-05** (Avg.)	**2005-08** (Avg.)
Below 20	Assam	Assam	Assam, Uttarakhand, Himachal Pradesh	Uttarakhand, Himachal Pradesh, Assam
20 to 35	Himachal Pradesh, Meghalaya, Jammu and Kashmir	Himachal Pradesh, Meghalaya, Tripura	Meghalaya, Tripura,	Tripura, Meghalaya, **Nagaland**
35 to 50	**Tripura**, Manipur,	**Jammu and Kashmir**, Manipur, Nagaland	Mizoram, **Jammu and Kashmir,** Nagaland	Manipur, Mizoram, Jammu and Kashmir
Above 50	Arunachal Pradesh, Mizoram, Sikkim, Nagaland	Arunachal Pradesh, Mizoram, Sikkim	Arunachal Pradesh, Manipur, Sikkim	Arunachal Pradesh, Sikkim

During 2005-08, the GDT-GSDP ratio was more than 50 per cent in case of Arunachal Pradesh and Sikkim, while it was less than 20 per cent in case of Assam, Himachal Pradesh and Uttarakhand (Table 54 and Chart 25). The FC devolution-GSDP ratio was high (more than 20 per cent) in case of Mizoram, Manipur and Arunachal Pradesh, while it was low (less than 10 per cent) in case of Assam, Meghalaya and Uttarakhand (Table 55 and Chart 26).

VII.3 Impact of Fiscal Transfers

As alluded to earlier, the consolidated financial position of the States is slated to witness a turnaround in 2007-08 (BE), with the State Governments aiming to achieve a revenue surplus after two decades. In 2007-08 (BE), the State Governments have estimated a consolidated revenue surplus of Rs.11,973 crore or 0.3 per cent of GDP. The key factors that have enabled the

Chart 25: Gross Devolution and Transfers - Special Category States



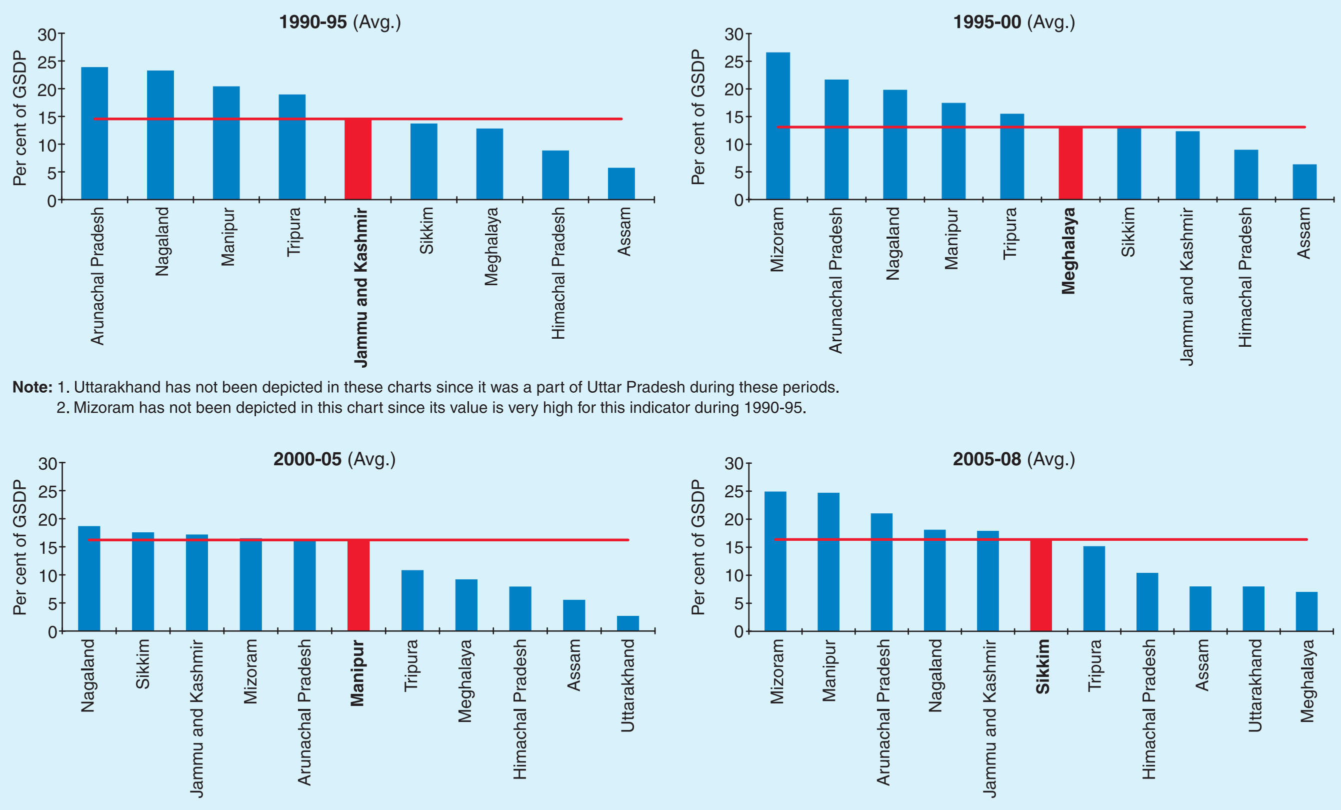
Note: Uttarakhand has not been depicted in these charts since it was a part of Uttar Pradesh during these periods.

Table 55: Distribution of Special Category States by the level of FC Devolution / GSDP ratio

Range (Per cent)	**1990-95** (Avg.)	**1995-00** (Avg.)	**2000-05** (Avg.)	**2005-08** (Avg.)
Below 10	Assam, Himachal Pradesh	Assam, Himachal Pradesh	Uttarakhand, Assam, Himachal Pradesh, Meghalaya	Meghalaya, Uttarakhand, Assam
10 to 20	Meghalaya, Sikkim, **Jammu and Kashmir,** Tripura	Jammu and Kashmir, Sikkim, **Meghalaya,** Tripura, Manipur, Nagaland	Tripura, **Manipur**, Arunachal Pradesh, Mizoram, Jammu and Kashmir, Sikkim, Nagaland	Himachal Pradesh, Tripura, **Sikkim**, Jammu and Kashmir, Nagaland
Above 20	Manipur, Nagaland, Arunachal Pradesh, Mizoram	Arunachal Pradesh, Mizoram	–	Arunachal Pradesh, Manipur, Mizoram

improvement in fiscal position of the State Governments are: (i) enactment of FRL by a majority of State Governments, which has set in a rule-based process of fiscal correction and consolidation; (ii) buoyancy in States' own tax revenue, which is budgeted to grow by 14.4 per cent in 2007-08 on top of an increase of 21.1 per cent in 2006-07 (RE); (iii) expenditure management by the State Governments, and (iv) high current transfers from the Central Government, which are budgeted to grow by 15.9 per cent in 2007-08 on top of an increase of 28.1 per cent in 2006-07 (RE). The impact of fiscal transfers from the Centre to the State Governments is reflected in the revenue account through augmentation of States' revenue receipts and consequent reduction in RD.

Chart 26: Finance Commission Devolution - Special Category States



Note: 1. Uttarakhand has not been depicted in these charts since it was a part of Uttar Pradesh during these periods.
2. Mizoram has not been depicted in this chart since its value is very high for this indicator during 1990-95.

Table 56: Revenue Receipts before and after Devolution and Transfers

Period	RRBT	RRAT	RRBT/GDP	RRAT/GDP
	(Rs. crore)		(Per cent)	
1	2	3	4	5
Ninth FC (1990-95)	55,546	92,679	7.2	12.1
Tenth FC (1995-00)	1,03,542	1,65,416	6.7	10.7
Eleventh FC (2000-05)	1,78,171	2,85,661	7.0	11.2
Twelfth FC (2005-08)	3,08,738	5,23,061	7.5	12.7

RRBT : Revenue Receipts before Devolution and Transfers.
RRAT : Revenue Receipts after Devolution and Transfers.
GDP : Gross Domestic Product.
Source : Budget Documents of the State Governments.

Revenue Account

During the period from Ninth to Eleventh Finance Commissions, revenue receipts of the State Governments before transfers averaged 7.0 per cent of GDP, while revenue receipts after transfers averaged 11.3 per cent of GDP. In the first three years of the Twelfth FC, revenue receipts before and after transfers have averaged 7.5 per cent and 12.7 per cent of GDP, respectively (Table 56 and Appendix Table 30). Higher devolution and transfer of resources to the State Governments has facilitated the fiscal correction and consolidation process particularly in achieving substantial improvement on the revenue account.

Capital Account

On the capital account, transfers from the Centre in the form of loans facilitate financing of GFD of the States. Historically, loans from Centre were the largest source of financing GFD till 1998-99. There has been a steep reduction in importance of net LFC in GFD financing – from an average of 48.7 per cent during 1990-95 and 39.7 per cent during 1995-00 to 4.6 per cent during 2000-05 and further to 2.6 per cent during 2005-08 (Table 57 and Appendix Table 31). The decline in LFC to the State Governments, however, was compensated by higher open market borrowings and negotiated loans. The changing milieu of financing pattern of GFD of States also reflects the changes in the accounting norms in respect of small savings on account of institution of NSSF effective April 1, 1999. The collections under NSSF, which are passed on to the State Governments against issue of Special State Government Securities, have turned out to be a buoyant source of funds during past few years. Before institution of NSSF, small savings were treated as loans from Centre to the State Governments.

The introduction of DSS for the period 2002-03 to 2004-05 also significantly reduced the importance of LFC as a financing item of the GFD. Under this Scheme, the States repaid the high cost liabilities owed to the Centre by utilising the proceeds from additional market borrowings and a portion of their current net small savings proceeds over a three-year period ending 2004-05. Under this scheme, the States swapped high cost loans from the Centre amounting Rs.1,03,652 crore during 2002-03 and 2004-05. This helped the State Governments in reducing their interest burden.

To conclude, with the change in accounting framework of small savings and constitution of

Table 57: Net Loans from Centre and GFD

Period	NLFC	GFD	NLFC/GFD	Others*/GFD	NLFC/GDP	GFD/GDP
	(Rs. crore)		(Per cent)			
1	**2**	**3**	**4**	**5**	**6**	**7**
Ninth FC (1990-95)	10,384	21,250	48.7	51.3	1.4	2.8
Tenth FC (1995-00)	19,190	54,860	39.7	60.3	1.3	3.4
Eleventh FC (2000-05)	4,601	102,063	4.6	95.4	0.2	4.0
Twelfth FC (2005-08)	2,817	104,107	2.6	97.4	0.1	2.5

* : Others include market borrowings, loans from banks/financial institutions, State Provident Fund, Reserve Fund, *etc.*
NLFC : Net Loans from Centre. GFD : Gross Fiscal Deficit. GDP : Gross Domestic Product.
Source : Budget Documents of the State Governments.

NSSF with effect from April 1, 1999 and abolition of Plan loans from the Centre to the States from 2005-06 in line with the recommendations of Twelfth FC, the share in Central taxes and grants-in-aid remain two major components of gross devolution and transfer from the Centre to the States. The gross devolution and transfer from the Centre to the State Governments, comprising share in Central taxes, grants-in-aid and loans from the Centre has reached the average level of 5.5 per cent of GDP during the first three years of Twelfth FC (2005-08) as compared with the average level of 5.2 per cent during Eleventh FC period. The higher devolution of Central taxes and transfer of grants during the first three years of the award period of Twelfth FC apart from the buoyant own tax revenues of the States has facilitated improvement in fiscal position of the State Governments. Further, the State-wise analysis indicates higher devolution to poorer States (in terms of GDT-GSDP ratio) reflecting the principle of equalisation.

It is also pertinent to note that there are differences in the data as reported in the Budget Documents of the Union Government and the State Governments. As the data on share in Central taxes as well as grants differ in the budgets of the Centre and States, there is an element of underestimation/ overestimation in the State budget data, which is discernible from Table 58. The reconciliation of Union budget data and State budget data remains constrained as state-wise data are not available in the Union Budget documents.

Table 58: Budgetary Data Variation – Union and State Budgets

(Rs. crore)

Year	Share in Central Taxes	Grants	Plan Grants	Non-plan Grants
1	2	3 = 4+5	4	5
1986-87	-91	-729	-528	-200
1987-88	62	-855	-607	-248
1988-89	67	-463	-204	-259
1989-90	-135	-369	-101	-268
1990-91	-293	-529	-636	108
1991-92	-349	-853	-867	13
1992-93	58	-659	-770	101
1993-94	154	-340	-191	-149
1994-95	45	-610	-547	30
1995-96	-237	-1,114	-825	-167
1996-97	-23	-1,076	284	-1,154
1997-98	-3,137	473	68	774
1998-99	276	-2,225	-743	-1,099
1999-00	640	-63	864	-781
2000-01	-954	-2,332	905	-3,072
2001-02	-627	-301	3,388	-3,532
2002-03	533	1,159	1,439	-93
2003-04	1,314	3,328	5,285	-1,766
2004-05	-45	3,756	4,222	-256
2005-06	-361	4,532	2,790	1,742
2006-07 (RE)	-4,640	14,874	14,938	-65
2007-08 (BE)	-6,266	15,629	20,152	-4,523

RE : Revised Estimates. BE : Budget Estimates.

Note: (-) Underestimation / (+) Overestimation in State budget data.

Source : 1. Budget Documents of the State Governments.
2. Union Budget Documents.

VIII. ISSUES AND PERSPECTIVES

VIII.1 The Path of Fiscal Adjustment

The analysis of consolidated fiscal position of the State Governments indicates noticeable reduction in their fiscal imbalances in the recent years reflecting initiation of fiscal correction and consolidation measures by the States in terms of the fiscal restructuring path suggested by the TFC. The States have also come out with Medium Term Fiscal Plans in terms of their FRL. While presenting their budgets for 2007-08, the State Governments have envisaged to carry forward the process of fiscal correction and consolidation and have budgeted a consolidated surplus in the revenue account after a gap of two decades. The GFD-GDP ratio has been budgeted lower at 2.3 per cent in 2007-08 (BE) (a decline of 0.5 percentage points) after witnessing an increase 0.3 per cent of GDP in 2006-07 (RE) over 2005-06 (Accounts) on account of increase in capital outlay. The budgeted correction in GFD during 2007-08 is based on the turnaround envisaged in the revenue account, which has been budgeted to generate a surplus of 0.3 per cent of GDP as compared to the deficit of 0.1 per cent of GDP in the previous year.

While the path of fiscal correction of the State Governments has been enduring, it may be relevant to flag certain related issues. In particular, the quality of fiscal correction assumes significance.

Several State Governments have achieved the targets of reduction in fiscal deficits (both RD and GFD) ahead of the targets prescribed by the TFC and rules framed under their FRL. While the revenue receipts of the States improved to 12.9 per cent of GDP in 2006-07 (RE) from the average level of 12.1 per cent of GDP during the first half of the 1990s, revenue expenditure increased marginally from the average level of 12.8 per cent of GDP to 13.0 per cent of GDP during the same period. Total developmental expenditure as a ratio to GDP at 10.2 per cent in 2006-07 (RE) remained lower than the average level of 10.8 per cent in first half of 1990s. The capital outlay as a ratio to GDP, however, went up from 1.5 per cent to 2.5 per cent during the above period. On the other hand, non-developmental expenditure went up from the average level of 4.3 per cent of GDP to 5.4 per cent of GDP in the above period.

Prudent fiscal management prescribes that durable fiscal consolidation should be attempted through fiscal empowerment, *i.e.,* by expanding the scope and size of revenue flows. A fiscal strategy based on revenue maximisation would also provide the necessary flexibility to shift the pattern of expenditure towards developmental purposes. On the other hand, fiscal adjustment predominantly based on expenditure reduction may result in welfare losses and risks the danger of triggering a downturn in overall economic activity. There has been some progress in reforming the tax framework in terms of improvement in tax administration and reduction in tax distortion. The introduction of VAT by the State Governments has been an unqualified success. States' own tax revenue has also witnessed buoyancy in recent years. However, it may be mentioned that States' own non-tax revenue as ratio to GDP has declined from 1.8 per cent in the first half of the 1990 to 1.3 per cent in the recent years. Thus, augmenting resource mobilisation from non-tax revenues through appropriate user charges, cost recovery from social and economic services and restructuring of State PSUs assumes importance. The health of State finances would benefit vastly from improvement in cost recovery of various public services and rationalisation of subsidies. 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.

VIII.2 Expenditure Management

A disconcerting aspect of State Government finances is that while developmental expenditure, as ratio to GDP, has hovered between 9-10 per cent in recent years down from the level of around 11 per cent in the first half of 1990s, non-developmental expenditure (comprising, *inter alia*, interest payments, pensions and administrative services), as a ratio to GDP, has moved up in the range of 5-6 per cent from the level of around 4 per cent. A sizable reduction in non-developmental expenditure may not be feasible in the short-term, given the committed nature of many of its constituent items. Within non-developmental expenditure, pension payments are likely to increase in the future in the context of the demographic changes. It is noteworthy that as many as nineteen State Governments have initiated the creation of pension funds based on defined contributions for newly recruited employees, which could to some extent contain future outgo on account of pension. As far as interest payments are concerned, the DSS has resulted in definite savings on interest costs. Debt relief based on the recommendations of TFC would also benefit the States. It is, however, well recognised that such schemes provide only a temporary palliative, and a durable reduction in interest payments would occur *pari passu* with a reduction in outstanding debt. On the other hand, moderation in administrative and establishment expenditures may be feasible if the initiatives taken by some of the States with regard to the restructuring and redeployment of staff gain wider acceptability and momentum. A reorientation of expenditure towards productive purposes may necessitate the adherence to the principles of public expenditure management. In this context, the international experience indicates a wide variety of methods including placing limits on certain expenditures, prioritisation of expenditure, greater decentralisation of executive functions, improved cash management and greater accountability in the delivery of services against specified targets. The adoption of some of these principles could facilitate a qualitatively superior process of fiscal consolidation.

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. As per the millennium development goals (MDGs) prescribed by the United Nations in 2000, the countries need to achieve certain targets particularly relating to the social sector by 2015. The goals relate to (i) reducing extreme poverty and hunger by half from their 1990 levels; (ii) ensuring universal access to primary education; (iii) eliminating gender disparity; (iv) reducing under-five year mortality rate by two-thirds and the maternal mortality rate by three-fourths; (v) reversing the spread of diseases such as HIV/AIDS and malaria; (vi) preserving environmental resources through the integration of sustainable development policies, and (vii) halve the population without access to safe drinking water and sanitation. A recent report by the Asian Development Bank indicates that India appears on track or has already achieved benchmarks for enrolling more children in primary school, fighting HIV/AIDS and tuberculosis and improving access to clean water. The report, however, states that India significantly lags behind many developing countries in respect of certain goals. In addition to slow progress on important indicators of poverty, hunger, maternal and child health and sanitation, the report says that India appears to be regressing on some climate change issues. As most of the millennium development goals relate to social sectors, the State Governments have a major role to play in reaching the targets. The State Governments may plan for adequate investment in social sector, so that the country would be able to achieve the millennium development goals.

Closely related to expenditure management is the issue of monitoring and evaluation of Government programmes. Traditionally, plan monitoring has been done by the States by tracking expenditure levels achieved in relation to outlays. While expenditure is an important measure of the pace of implementation, it is not a measure of effectiveness. Therefore, it is necessary to move from outlays and expenditures to final outcomes. The Central Government has made a beginning in outcome budgeting starting with the budget for 2005-06. Several State Governments such as Chhattisgarh, Himachal Pradesh, Madhya Pradesh, Rajasthan and Tripura have also proposed to introduce outcome budgets. At times the causal chain in determining outcomes may involve factors outside the programme itself. This is evident, for example, in the case of health where improvements in health status are often the result not of interventions in the area of curative health but in the provision of clean drinking water, sanitation and education on hygiene, all of which are targeted by other programmes. These considerations point to the need for systematic monitoring of programmes conducted by independent agencies outside those actually implementing these programmes. Such independent monitoring however requires that there be agreed benchmarks for evaluating performance. According to the Approach Paper of the Eleventh Five Year Plan, the Planning Commission is considering making it a firm condition that all proposals submitted to it must require sufficient benchmarking before approval. It also plans to strengthen its evaluation capacity by involving research institutes and civil society organisations which have the capability of undertaking rigorous evidence based evaluation. State Governments may consider initiating similar measures for improving the monitoring and evaluation of plan programmes.

Gender budgeting has been gaining increasing recognition with several countries across the world having introduced gender budgeting in their budgetary exercise. In India, the Annual Plan 2006-07 of Government of India carried forward two important on-going strategies of Women Component Plan (WCP) and Gender Budgeting. The main objective is to mainstream gender perspective in all sectoral policies and programmes and to work towards the ultimate goal of elimination of gender discrimination and creating enabling environment for gender justice and empowerment of women. The WCP envisages that not less than 30 per cent of funds/benefits are earmarked under various schemes of women related Ministries/ Departments for women. Gender budgeting is perceived as a powerful tool for tracking not only allocation of resources for women but also implementation issues and outcomes. Apart from quantification of allocation of resources for women, the other initiatives include mainstreaming gender concerns in policies and implementation process, collection and compilation of gender disaggregated data, gender development indices, and review and analysis of programmes, policies/interventions with a gender perspective. State Governments have also undertaken steps in this regard. Governments of Madhya Pradesh and Uttarakhand placed a document on gender budget along with their budgets for 2007-08 providing details of allocation of funds for women related schemes. The other State Governments may consider steps to integrate gender budgeting into their mainstream budgets.

VIII.3 Fiscal Transparency and Budget Integrity

Fiscal transparency, which is considered to be one of the cornerstones of good governance, has been gaining critical importance in the recent period in the context of prudent fiscal management and attainment of macroeconomic balance. Fiscal transparency requires providing comprehensive and reliable information about past, present and future impact of economic policy decisions. Transparency in Government fiscal operations at State levels would need to be strengthened in tandem with the process of fiscal consolidation and the financial sector reforms so as to enhance credibility of the fiscal stance of the Government. The need for adequate availability of information through State budgets is not only important to aid policy makers or to enhance transparency at the State level, but also for investors to take ‘informed’ decisions. Further, fiscal transparency benefits citizens by giving them the information they need to hold the Government accountable for its policy choices.

It may be mentioned that the International Monetary Fund (IMF) introduced a *Code of Good Practices on Fiscal Transparency* in 1998. This led to a voluntary program of fiscal transparency assessments by the countries. In 2007, the IMF revised the codes by taking into account several recent developments. The four pillars of the code are as follows: (i) Clarity of roles and responsibilities, (ii) Open budget processes, (iii) Public availability of information, and (iv) Assurances of integrity. It may be mentioned that the fiscal transparency at the State level has improved of late after the enactment of the FRL by most of the State Governments.

One of the important issues at the State Government level relates to lack of uniformity in the accounting practices. One example is the accounting of power bonds in the budget, where States have followed diverse practices. Some states (Karnataka and Himachal Pradesh) provide power bonds under loans from other institutions (Code 6003(109)). Few States (for example Uttarakhand) provide power bonds under market borrowings (Code 6003(101)) and some other States such as Bihar, Chhattisgarh, Haryana, *etc.,* provide power bonds under compensation and other bonds (Code 6003(106)). Another example is the accounting of loans from NSSF. After the change in accounting practice in 1999-2000, the securities issued to NSSF are required to be shown under internal debt. However, some of the States (for example Andhra Pradesh, Assam, Tripura, Goa, Gujarat, Karnataka, Rajasthan, *etc.*) continue to show these under loans and advances from the Central Government (Code 6004). Further, two States, *viz.,* Arunachal Pradesh and Jammu and Kashmir, do not provide details of ‘Discharge of Internal Debt’ in their budget. Such practices make it difficult to compile information on item-wise net borrowings and GFD financing of the State Governments. Some of the State Governments such as West Bengal, Nagaland, Kerala, Manipur (for the accounts year) and Tamil Nadu do not provide code-wise and plan/non-plan-wise summary of all grants in the budgets. Some other State Governments such as Maharashtra, West Bengal, Manipur and Gujarat do not provide detailed code-wise summary of internal debt (Code - 6003) from all the demands. Some States such as Maharashtra, Jammu and Kashmir, Arunachal

Pradesh and Gujarat do not provide the code-wise summary details of interest payments (Code 2049) in the budgets. Adopting uniform practices with regard to data reporting in the budgets may be considered by the State Governments.

Yet another issue which deserves special mention in the context of fiscal transparency is the lack of availability of data on the outstanding liabilities and contingent liabilities. Most of the State budgets are silent on these two important fiscal variables. As discussed in the last year's Study, the Working Group on Compilation of State Government Liabilities had prescribed a format, in which the State Governments need to publish the data on the outstanding liabilities in their budget documents. A related problem is the lack of data on wages and salaries and operations and maintenance in the State budgets. Further, the States have also pointed out difficulties in the estimation of pension liabilities on an actuarial basis, since many of the required data are not available at the State Government level. States may also need to take steps to provide the details of off-budget borrowings in the budgets, if any. States would need to enhance transparency in reporting and provide comprehensive information on fiscal developments including data on the items discussed above. In addition, public dissemination of fiscal data on a more frequent basis, say quarterly basis, would be desirable.

The persistently large deviations between the budget estimates and the accounts data particularly in respect of revenue receipts of the State Governments raise serious concerns since these adversely impact upon the credibility of the budget estimates and preclude a proper assessment of the likely fiscal outcome for the year.

VIII.4 Debt Sustainability

An important issue relating to sustainability of debt is the concern about the ability of the State Governments to service their debt obligations. Over the years, large revenue deficits have led to large fiscal deficits and spiraling debt resulting in the emergence of a vicious cycle of deficit, debt and debt service payments for most of the State Governments. The consolidated level of debt of the State Governments relative to GDP has increased significantly from 22.5 per cent at end-March 1991 to 32.7 per cent at end-March 2006. Such increase was more prominent during the period 2001-05. In the context of sustainable level of debt, the Eleventh Finance Commission recommended that the proportion of interest payments (IP) to revenue receipts (RR) should be reduced to 18 per cent as compared to the then average of 22 per cent. The TFC report, however, mentioned that from 2000-03, the average ratio in respect of seventeen States was above 18 per cent, of which elevan States were above 22 per cent. Thus, in terms of interest payments-revenue receipts criterion, TFC concluded that seventeen out of twenty-eight States had unsustainable debt. A Study[12] on debt sustainability undertaken by the Reserve Bank had emphasised the measures for expenditure compression, improvement in own revenue collection effort and several institutional changes to contain the problem of State level debt in India. Important measures of institutional changes included enactment of FRL for making the process of fiscal discipline legally binding, introduction of guarantee ceilings, participation in the Consolidated Sinking Fund and the Guarantee Redemption Fund. It is noteworthy that the FRLs of several State Governments include provisions for caps on the debt-GSDP ratio as well as State guarantees.

For ensuring sustainability of debt in terms of a stable debt to GSDP ratio, generation of a primary surplus is a necessary condition, given that the rate of growth of nominal GSDP and nominal rate of interest on the debt stock are equal. In a situation of primary deficit, the debt stabilisation condition requires that rate of growth of nominal GSDP is greater than the nominal rate of interest on the debt stock. In this context, it is important to note that despite an improvement in major deficit indicators of the State Governments, the primary balance of many of the States, and consequently at the consolidated level, continues to be in deficit.

[12] Rajaraman, I., S. Bhide and R.K. Pattnaik (2005), "A Study of Debt Sustainability at State Level in India", RBI, Mumbai.

However, due to higher economic growth and the favourable interest rate environment in the recent years, the debt to GSDP ratio of the States has declined in the recent period. It is also important to recognise the large hump in repayments which will take place during 2012-13 to 2015-16 due to high amount of borrowings during 2002-03 to 2004-05 under the DSS. This will require a larger quantum of gross borrowings and can put an upward pressure on the interest rates at which the State Governments borrow, which may further destabilise the debt sustainability condition. It may be mentioned that the State Governments have budgeted interest payments as ratio of revenue receipts for 2007-08 at 16.9 per cent against the TFC target of 15 per cent for the year 2009-10. The State Governments may make efforts through fiscal restructuring to contain their debt at sustainable level.

The TFC had emphasised the need to determine borrowing limits for each State taking account of borrowings from all sources including small savings and States' public accounts and reserve funds. Several countries have debt and deficit rules at the sub-national level. In the US, all but two States have laws requiring balanced budgets and limits on raising of debt by the States. Nine provinces and territories of Canada have fiscal rules with balanced budgets requiring them to take debt only for the purpose of financing investment projects. Debt ceiling can serve as a useful adjunct to deficit rules. In practice, debt ceilings have been driven by the concern about reducing high debt levels and are generally chosen on the basis of experience of the individual countries.

It may be mentioned that State Governments have been mobilising substantial amounts of off-budget borrowings through Special Purpose Vehicles (SPVs). These are in the nature of guarantees/contingent liabilities, which may ultimately become liabilities for the respective State Governments. In view of the fiscal implications of rising level of guarantees, which were recognised by the State Finance Secretaries' Report on State Government Guarantees (1999) constituted by the Reserve Bank, many States have taken initiatives to place statutory/administrative ceilings on guarantees. Following the recommendations made in the above mentioned Report, the Reserve Bank had circulated guidelines on the setting up of the GRF in August 2001, which were amended in 2006. The Group of State Finance Secretaries to Assess the Fiscal Risk of State Government Guarantees (2002) had suggested a methodology for assessing the fiscal risk of guarantee obligations. To sensitise the State Government officials on the various issues arising from the fiscal risks arising out of guarantees and to provide technical inputs on the process, the RBI has conducted workshops. Furthermore, the State Finance Secretaries' Working Group on Fiscal Responsibility Legislation at State level has suggested a ceiling on the risk-weighted guarantees to be provided by a State. In this connection, it is noteworthy that the FRL of some of the State Governments contain provisions relating to a cap on the debt-GSDP ratios as also on the guarantees.

Few State Governments have made efforts to raise resources under non-debt capital receipts through sale of lands for reducing their GFD. Such measures for raising resources by disposing off unutilised land may, however, provide only a transitory solution for reducing GFD and thus containing the level of debt. On the other hand, due to buoyancy in small savings collection over the last few years and the formula based share in these collections, the autonomous component of State Governments' borrowings have been more than the required amount for financing their GFD. This more than proportionate increase in the level of outstanding debt of State Governments gets reflected in large surplus cash balances maintained by most of the State Governments in the form of investment in 14-Day Intermediate and Auction Treasury Bills, which at the consolidated level stands at around Rs.62,996 crore as of November 23, 2007. Since the States get a lower rate of return on these investments compared to the cost of borrowings for these resources, there would be an adverse impact on their revenue account.

VIII.5 Infrastructure Financing

Provision of quality and efficient infrastructure services is essential to realise the full growth potential of the economy. It may be mentioned that the States are responsible for most infrastructure services except for telecommunications, civil aviation, railways and major ports. Inadequate investment in infrastructure has constrained the growth and development of the States. The States would need to strengthen their finances through fiscal, structural and institutional reforms which would enable them to release adequate budgetary resources as also enable them to mobilise funds more easily for financing infrastructure. In view of budget constraints under the rule based fiscal regime, the State Governments also need to promote PPP projects in the area of economic infrastructure. The awareness of concerns and issues relating to PPPs is still lacking and not evenly spread across the different States. With a view to promoting the PPP programme, all State Governments and Central Ministries have been advised by the Government of India to set up a PPP Cell with a senior level officer deputed as PPP nodal officer. Technical assistance (TA) from the Asian Development Bank has been received for overall capacity building in State Governments for PPPs. The TA would fund strengthening of the PPP Cell of the respective State Governments, including hiring of consultants and training of personnel.

IX. CONCLUDING OBSERVATIONS

An assessment of the fiscal position of the State Governments indicates visible improvement in the key deficit indicators in the recent years. Reflecting this, in the revised estimates of 2006-07, the consolidated RD and GFD of States, as ratios to GDP, have been placed at 0.1 per cent and 2.8 per cent, respectively. Continuing with the fiscal correction process, the State Governments have budgeted for a further reduction in GFD as a ratio to GDP to 2.3 per cent during 2007-08. The reduction in GFD is based on a turnaround envisaged in the revenue account, which is budgeted to generate a surplus of 0.3 per cent of GDP. It is significant to mention that the State Governments have budgeted a consolidated surplus on the revenue account after two decades. In this context, it may also be mentioned that several State Governments have achieved the targets of reduction in RD and GFD ahead of the path of restructuring recommended by the TFC and their own FRL.

The key factors that have enabled the improvement in fiscal position of the State Governments are: (i) a rule-based process of fiscal correction and consolidation adopted under the FRL by a majority of State Governments; (ii) buoyancy in States' own tax revenue; (iii) expenditure management by the State Governments, and (iv) high current transfers from the Central Government. Higher devolution and transfer of resources to the State Governments has facilitated the fiscal correction and consolidation process particularly in achieving substantial improvement on the revenue account. Higher devolution and current transfers to the poorer States as a ratio of their GSDP also reflect the principle of equalisation.

Given the importance of revenue augmentation in sustaining fiscal correction, the State Governments have announced measures for mobilisation of additional resources through simplification/rationalisation of tax structure, better enforcement and tax compliance. The States have made commitments to contain non-plan revenue expenditure and introduced new pension schemes to contain future pension obligations. The State Governments have also taken into account the priorities laid down in the Eleventh Five Year Plan (2007-12) in the State Budgets for 2007-08. Accordingly, allocations for the social sector and rural infrastructure are proposed to be raised by the States.

The overall improvement in the consolidated fiscal position of the State Governments, however, does not reveal the wide variation that exists in fiscal performance across the States. The State-wise analysis reveals that fiscal correction has not been uniform across States, notwithstanding a strong commitment by almost all State Governments to carry forward the process of fiscal correction and consolidation. Only a few States 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 85 per cent of the correction in the revenue account and 73 per cent of the correction in GFD. With TFC recommending a uniform target oriented fiscal restructuring path to be attained by all the States by end of 2009-10, the fiscally weak States may initiate measures to catch up with the fiscally sound States within the timeframe.

While the State Governments have achieved noticeable improvement in their fiscal position in the recent years, they would have to strive to make the fiscal consolidation durable through strengthening the revenue flows into the budget while placing emphasis on targeting expenditures to meet the developmental objectives. The strength in overall macroeconomic conditions has resulted in higher own revenue receipts and greater fiscal capacity for the States. The buoyancy in revenue mobilisation also needs to be channelised for productive expenditure and investment. It is crucial to ensure that the process of fiscal correction does not adversely affect capital outlay and expenditure on social sectors.

The high level of deficit of State Governments in the past resulted in accumulation of high level of debt by the State Governments. In case of several States, the present level of debt-GSDP ratio is perceived to be alarmingly high. Furthermore, there are concerns about the ability of the State Governments to service their debt obligations. The TFC had emphasised the need to determine borrowing limits for each State taking into account borrowings from all sources including small savings and States' public accounts and reserve funds. In ensuring debt sustainability in terms of a stable debt to GSDP ratio, given the growth rate and the rate of interest, the status of primary balance is of crucial importance. Despite an improvement in the number of fiscal parameters, the primary balance of many of the States, and consequently at the consolidated level, continues to be in deficit. However, due to higher economic growth and the favourable interest rate environment in the recent years, the debt to GDP ratio of the States has been contained from rising. It may be mentioned that the State Governments have budgeted ratio of interest payment to revenue receipts for 2007-08 at 16.9 per cent against the TFC target of 15 per cent for the year 2009-10. The State Governments may make efforts through fiscal restructuring to contain their debt at sustainable level.

With a view to improving monitoring and evaluation of programmes, the State Governments may consider strengthening their evaluation capacity with a focus on outcome. They may aim at a system which is responsible and responsive for improving the efficiency and effectiveness of spending.

With fiscal transparency gaining critical importance, the State Governments may need to make efforts to enhance transparency by providing adequate details in their budgets on items such as outstanding and contingent liabilities, subsidies, *etc.* In addition, public dissemination of fiscal data on a more frequent basis, say quarterly basis, may be considered. With large deviation observed between budget estimates and the accounts data, particularly in the revenue account of the States in the recent years, it would be useful to improve the entire budget estimation process and methodology. In view of the constitution of the Sixth Pay Commission in October 2006 to examine the pay and pension structure of the Central Government employees, it is important to note that 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 State finances experienced deterioration in the latter part of 1990s subsequent to adopting the recommendations of the Fifth Pay Commission for their employees. The States, therefore, need to base their decisions relating to salary levels after due consideration to their fiscal capacity, employee strength, size of population and the required complementary expenditure for productive employment.

To conclude, the improvement in the fiscal position of the State Governments has resulted from buoyancy in their tax revenues along with higher current transfers from the Centre. The State

Governments would, however, have to devise strategies for augmenting resource mobilisation from non-tax sources of revenue. With regard to expenditure management, the State Governments may emphasise improvement in effectiveness of service delivery mechanism. The States would also need to make continuous efforts towards ensuring the channelisation of resources to meet the development needs in line with the priorities laid down in the Eleventh Five Year Plan, while initiating steps to bring down the levels of non-developmental expenditure.