FISCAL CONSOLIDATION BY CENTRAL AND STATE GOVERNMENTS: THE MEDIUM TERM OUTLOOK

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The paper examines the fiscal consolidation process under the FRBM/FRLs Acts both at the Centre and State level and attempts to provide a medium term outlook. It finds that up to 2007-08, under the rule based framework, both the levels of Government were able to recover from the severe fiscal stress experienced starting with mid/late nineties till early part of this decade. The high growth rate leading to improved revenue buoyancy or growth dividend played an important role in the improvement of key deficit indicators. At the same time, the paper notes that despite the significant fiscal correction both at the Centre and States, the fiscal consolidation process remained inadequate on several fronts. Based on the macroeconomic trend prevailing up to 2007-08, the paper projects a medium term fiscal outlook (2010-15) for both the Central Government and State Governments. The paper also sets out alternate fiscal outlooks in the annex based on possible lower growth scenario. It is, however, cautioned that the medium term outlook estimated in the paper crucially hinges on the realization of assumed growth rate and inflation. While highlighting the need for designing appropriate post FRBM/FRL fiscal architecture to carry forward the process of fiscal correction and consolidate the gains on a durable basis, the paper suggests some elements of future design of the fiscal architecture for deliberation and consideration.

JEL Classification : H62, H68

Key words : Fiscal Consolidation, FRBM, Deficit, Debt

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INTRODUCTION

In the aftermath of the macroeconomic and balance of payments crisis of 1991, a comprehensive reform programme was launched in India. To a large extent the external payments crisis in 1991 was an inevitable consequence of the deteriorating fiscal situation during the 1980s. Therefore, fiscal consolidation constituted a major plank of the policy response. The fiscal performance during the reform period, however, was characterized by a clear divide in the mid-1990s in the attainment of fiscal targets. There was evidence of the successful fiscal correction during 1991-92 to 1996-97 (except for 1993-94) in terms of a significant reduction in the fiscal deficit indicators. Since then, there has been a significant reversal of trend mostly up to 2002-03. In an effort to renew the process of fiscal consolidation and provide for long-term macroeconomic stability, the Central Government enacted the Fiscal Responsibility and Budget Management Legislation in August 2003. At the State level, several State Governments have enacted a similar legislation on fiscal responsibility.

Recognizing that any deviation from the self imposed targets prescribed in the fiscal legislations would exacerbate the fiscal stress, both Central and State Governments responsibly adhered to the legislations. Incidentally, the fiscal correction process has been faster for the States as compared with that of the Centre. In totality, the fiscal reforms undertaken over the past decade and half have resulted in increased revenue mobilization, some compression in expenditure and consequent reduction in fiscal deficit. Achievements of the current fiscal consolidation process although praise worthy, it remains incomplete in following respects: (a) incomplete FRBM achievement in case of Centre, (b) no qualitative expenditure management, (c) debt level remains unsustainable and (d) deficit level needs further reduction to achieve debt sustainability.

In this connection, it may be noted that the Finance Minister in his Budget speech for 2008-09 mentioned that "after the obligations on account of the Sixth Central Pay Commission become clear, I intend to request the Thirteenth

Finance Commission to revisit the roadmap for fiscal adjustment and suggest a suitable revised roadmap."

Against this backdrop, this paper aims at a closer examination of the present fiscal consolidation process both at the Centre and State level and attempts to provide a medium term outlook of the same problem. The rest of the paper is organized as follows. Section II presents a thematic survey of literature and Sections III and IV provide an assessment of the Centre and States, respectively. Section V provides the Medium-Term Outlook. Section VI is devoted to architectural changes during the post-FRBM/FRL period followed by conclusions in Section VII.

Section II
FISCAL CONSOLIDATION: THEMATIC SURVEY OF LITERATURE

In the empirical literature, a host of issues relating to fiscal consolidation have been debated and discussed. The major issues are briefly set out in this Section.

II.1 Fiscal Consolidation and Macroeconomic Conditions

There are three main theoretical perspectives with regard to fiscal policy and its impact on macroeconomic conditions namely Neo-classical, Keynesian and Ricardian Equivalence. Depending upon circumstances and the relevant theoretical perspectives, fiscal deficit may be bad, indifferent or good. In the Neo-classical perspective, fiscal deficits will have a detrimental effect on investment and growth owing to lower savings (revenue deficit) and pressure on interest rate resulting in crowding out of private investment. The Neo-classical economists assume that markets clear so that full employment of resources is attained. In contrast the Keynesian view argues, when there are unemployed resources, autonomous increase in government expenditure, whether through investment or consumption, financed through borrowings would cause output to expand through a multiplier process. In terms of Ricardian equivalence, fiscal deficits are treated as neutral in terms of their impact on growth as deficit in any current period equals the present value of future taxation that is required to pay off the incremental debt resulting from the deficit. While the Neo-classical and Ricardian schools focus on the long run, the Keynesian view emphasises the short run effects. As empirical support in favour of the Ricardian view is rather weak (Elmendorf and Mankiw, 1998), the two major competing theories are the Neo-classical and Keynesian approaches.

In terms of empirical literature, large fiscal consolidation have been associated with a positive macroeconomic development (Daniels *et al*, 2006). High quality fiscal adjustment can help mobilize domestic savings, increase the efficiency of resource allocation and boost confidence and expectations. The possibility of expansionary fiscal contraction is confirmed by Gupta *et al* (2002) for a panel of low-income countries. In a study of transitional countries, Segure-Ubioergo *et al* (2006) find that fiscal adjustment has been associated with higher growth primarily through two channels: (i) reduced Government borrowing requirements, which curtailed the need to monetize budget deficits; and (ii) a credibility effect that signaled a political commitment to long-term fiscal sustainability and macro-economic stability. Further, Baldacci *et al* (2003) state that the most important transmission mechanism through which fiscal adjustment stimulates growth in low-income countries is factor productivity. The Task-Force on FRBM (Government of India, 2004) underlined the importance of several channels of 'expansionary fiscal consolidation' in the Indian context.

II.2 Tax Enhancement versus Expenditure Compression based Fiscal Consolidation

The strategy of fiscal adjustment based on the experiences of European countries during the decades of 1980s and 1990s has been broadly categorised into two types (Alesina and Perotti, 1996). First, during the 1980s, most of the European countries followed a strategy of broad-based increase in tax mostly falling on households and social security contributions. The increase in taxes were supplemented by expenditure cuts on almost all public investment, while Government wages, employment and transfers were completely left untouched, or only slightly affected. Second, most of the European countries in the 1990s changed the strategy of fiscal consolidation relying primarily on cuts in expenditure on transfers, social security and Government wages and employment. On the other hand, taxes on households were either not raised or even reduced. The empirical results show that for the same size of fiscal adjustment the strategy followed in the 1990s has been more lasting and expansionary than the strategy followed in the 1980s. It has also been observed that adjustments made through broad-based increase in taxes were often reversed soon due to economic contraction leading to further deterioration of the budget. Moreover, there is evidence that composition of fiscal consolidation is important for saving and growth, with spending based consolidation resulting in lower household saving and higher GDP growth (Bassanini *et al,* 2001).

In a recent study, it was stated that despite the case in favour of spending based efforts, revenue increases accounted for a larger fraction of the total reduction in the cyclically adjusted primary balance (Guichand, 2007). It may reflect that some countries relied on "Switching Strategies" meaning that Government starts fiscal consolidation by raising taxes and/or cutting investment and then, subsequently, moves on to a broader strategy which would involve reducing current spending (which is more politically sensitive and takes more time to implement) (Von Hogen, 2002).

II.3 Fiscal Rules and Fiscal Consolidation

The experiences on fiscal consolidation process in the 1990s have another noteworthy feature, which was the introduction of a sound fiscal framework supported by institutional reforms (OECD, 2007). Recognising the difficulties associated with discretionary fiscal policies, several advanced countries enacted fiscal responsibility legislations (FRLs) during the 1990s as permanent institutional devices aiming to promote fiscal discipline in a credible, predictable and transparent manner. New Zealand was at the forefront of these reforms, adopting FRL in 1994 followed by Australia, United Kingdom and the European Union. In emerging market economies, adoption of fiscal responsibility has been more recent and limited mainly to Latin America (Argentina, Brazil, Chile and Peru) and Asia (India, Indonesia, Pakistan and Sri Lanka).

In practice, fiscal rules have been adopted for a wide variety of reasons such as: (a) to ensure macroeconomic stability, as in post-war Japan; (b) to enhance the credibility of the Government's fiscal policy and aid in deficit elimination, as in some Canadian provinces; (c) to ensure long-term sustainability of fiscal policy, especially in light of population ageing, as in New Zealand; or (d) to minimize negative externalities within a federation or international arrangement, as in the European Economic and Monetary Union (Kennedy and Suzanne, 2001). In the emerging countries, the immediate motivation has been to reverse the building of public debt, to restore fiscal sustainability and more generally, to enhance the credibility of macroeconomic management (Kopits, 2004).

Present fiscal policy rules are fairly diverse in both design and implementation. While Anglo-Saxon countries (Australia, New Zealand, United Kingdom) emphasise procedural rules aiming to enhance transparency, accountability and fiscal management, continental Europe (EMU Stability and Growth Pact) and emerging market economies (Argentina, Brazil, Columbia, India, Pakistan, Peru and Sri Lanka) rely far more on a set of numerical reference values (targets, limits) on performance indicators. There are four main types of numerical fiscal rules: deficit rules (*e.g.,* balanced budget); debt rules (*e.g.,* debt ceilings); borrowings rules (*e.g.,* prohibition of central bank financing) and expenditure rules (*e.g.,* ceilings on some types of public expenditure or public expenditure growth).

It has been documented that countries with fiscal rules achieved better results. Fiscal rules with embedded expenditure targets tended to be associated with larger and longer fiscal adjustments and higher success rates. Furthermore, adoption of a spending rule on top of a budget balance rule helped in the achievement and maintenance of a primary balance that was sufficient to stabilize the debt-to-GDP ratio (OECD, 2007). Since, in most countries FRLs have not been around for more than few years, evidence on their effectiveness is still preliminary. Still, there seems to be broad agreement that the quality of fiscal institutions does matter for fiscal performance. In this sense, FRL holds the potential of improving fiscal management, if supported by strong political management to fiscal prudence and sufficiently developed fiscal institutional framework. A well designed FRL may help contain fiscal deficits and expenditure biases, address issues of time inconsistency, help reduce borrowing costs and output variability and enhance transparency and accountability (Corbacho and Scwartz, 2007).

II.4 Role of Fiscal Agencies

There is a growing recognition that the design and implementation of economic policies depend to a considerable extent on the incentives of policymakers. A common objective of reform has been to reshape policymakers' incentives. One way to achieve this is to delegate activities susceptible to "government failure" to independent agencies or to establish arrangements that raise the reputational and electoral costs of distorted policies. In the literature there has been discussion on two types of fiscal agencies i.e., independent fiscal authorities (IFAs) which would to some extent mimic on the fiscal side independent central banks and fiscal councils (FCs). An IFA could help reduce deficit bias and improve policy design and implementation. Although no country has so far instituted a body similar to an IFA, a wide spectrum of proposal has delineated different mandates for such bodies. An IFA could be mandated with setting both the long-term fiscal objectives and the annual targets for the budget balance. An IFA could be instituted as impartial enforcer of an existing fiscal rule (Debrun *et al*, 2007).

FCs would not receive any specific authority over fiscal policy but would undertake analysis and assessment of fiscal developments and policies. They would essentially provide independent projections and analysis and thereby affect policymaker's incentives through external scrutiny and democratic debate. FCs could help reduce the deficit bias while leaving discretion to the political representatives. They could contribute to greater transparency and therefore accountability of fiscal policy in terms of credibility of the policymakers. A variety of FCs has been in operation in a number of countries. Experience indicates that FCs have contributed to fiscal discipline in several countries. FCs providing normative assessments of fiscal policy appear to have been more effective than those limited to non-normative analysis (Debrun *et al*, 2007).

It is evident from the review of literature on fiscal consolidation that several important issues need to be addressed. First, what should be the size of the fiscal adjustment to be made? Second, whether the adjustment needs to be carried out through cuts in expenditure or by raising revenue or a combination of both? Third, what components of expenditure and revenue should be adjusted? Fourth, which policy mix must accompany a major fiscal adjustment? Fifth, how will the non-policy factors such as global economic growth affect the consolidation process? Sixth, what are the chances of reversibility of the fiscal consolidation process? Seventh, will there be possible adverse macroeconomic impact of fiscal adjustment? Eighth, what should be the appropriate accounting standards so as make budgeting transparent and accountable? Ninth, what sort of fiscal consolidation is required for a federal structure? Finally, whether discretionary or rule based framework need to be adopted for fiscal consolidation. Many of these issues have contemporary relevance for India and would be raised in the paper.

Section III
FISCAL CONSOLIDATION AT CENTRE: AN ASSESSMENT

III.1 Historical Backdrop

The finances of Central Government since independence may be classified into five distinct phases. Phase I (1951-1981), Phase II (1982-1991), Phase III (1992-1997), Phase IV (1998-2003) and Phase V (2004 to the present). The first two phases related to pre-reform period and the subsequent three phases reflect the development process during the reform period which started in July 1991. The first phase was a period of surplus in revenue account (revenue deficit originated starting with the year 1979-80) (Pattnaik *et al*, 2004).

The macroeconomic crisis in 1990-91 necessitated concerted efforts to restore fiscal balance in terms of a fiscal adjustment programme starting with July 1991. The reforms, *inter alia*, comprised tax and non-tax reforms, expenditure management and institutional reforms. These initiatives resulted in a significant fall in fiscal deficit and in public debt as a ratio to GDP till 1996-97, but the trend reversed shortly thereafter. Reversal of fiscal correction during the fourth phase was largely on account of downward rigidity in revenue expenditure, fall in tax buoyancy, slow down in PSU restructuring and implementation of award of Fifth Pay Commission for the government employees.

With the debate for a rule based fiscal framework gathering momentum, the fiscal position of Central Government improved starting with 2003-04. Since 2004-05, the Centre has been operating under Fiscal Responsibility and Budgetary Management (FRBM) the FRBM Act, 2003 and FRBM Rules, 2004. There has been considerable improvement in fiscal position of the Central Government during the Fifth Phase as documented in reports of Government of India (Economic Surveys) and Reserve Bank of India (Annual Reports).

III.2 Analysis of Major Fiscal Indicators

As alluded to earlier, the Central Government had a phase of fiscal reform during 1992-97 following the crisis year of 1991. The process of fiscal correction had a reversal during 1998-2003 due to several factors enumerated earlier. Following placing of FRBM Bill in the Parliament in 2003, fiscal consolidation was accorded high priority and resulted in noticeable improvement in fiscal position of the Central Government during 2004-08. The Union budget for 2008-09 had envisaged to carry forward the process further.

It would be useful to distinguish the two phases of fiscal reforms *i.e.*, 1992-97 and 2004-09. The first phase of fiscal correction was initiated following an economic crisis necessitating compression of expenditure under a stabilization programme. The second phase of fiscal consolidation during 2004-09 is regarded more robust due to two very important factors. First, it has taken place under the guidance of a rule based fiscal framework (FRBM Act, 2003 and FRBM Rules, 2004). Secondly, the period is characterized by a sustained elevated real growth of the economy.[1] Empirically, low level of fiscal deficit in India has been associated with high level of real GDP growth and *vice versa*.

One important aspect of India's fiscal reform has been far reaching reforms both in direct and indirect taxes (Rao, 2005 and Acharya, 2005 and Rao and Rao, 2005). Significant decline in custom duties and excise duties did not yield in terms of higher revenue mobilization. In contrast, reforms of direct taxes improved their buoyancy resulting in higher tax collection. It may be highlighted that the share of direct tax in gross tax revenue of the Centre moved up from less than 20 per cent in 1990-91 to more than 50 per cent in 2007-08 (Revised Estimates). Furthermore, the share of corporate income tax in total direct tax went up from below 50 per cent to above 60 per cent during the above period. It may be emphasised that a major drag on public finances was the decline in the gross tax-GDP ratio of the Central Government from 10.3 per cent in 1991-92 to 9.4 per cent in 1996-97 and further to a low of 8.2 per cent in 2001-02. The tax-GDP ratio, however, has moved up significantly in

1 During 2008-09, however, due to the impact of global financial crisis, there has been significant slowdown in the economy. The fiscal positions of the Governments have also worsened significantly due to revenue losses as a result of the slowdown and duty cuts combined with increase in expenditure to provide fiscal stimulus to contain the slowdown. Consequently, the average for 2003-04 to 2008-09 in the following tables, which is based on the budget estimates for 2008-09, would undergo substantial changes with revised estimates.

recent years reaching the level of 12.5 per cent in 2007-08, reflecting beneficial impact of the rationalisation of direct tax on revenue mobilization. Higher growth has contributed to the rise in tax-GDP ratio. Notwithstanding improvement in dividends and profits and returns on economic services during the current period, the non-tax revenue of the Centre as a ratio to GDP has declined in the current phase due to decline in interest receipts (Table 1).

Central Government budgets in the 1990s contemplated a number of measures to curb built-in growth in expenditure and to bring about structural changes in composition of expenditure. These included measures such as subjecting all on-going schemes to zero-based budgeting and assessing manpower requirements of all subsidies, review of budgetary support to autonomous institutions and encouragement to PSUs to maximize generation of resources, downsizing of Government and reducing its role through ban on creation of new posts for two years, introduction of voluntary retirement scheme (VRS) and redeployment of surplus staff in various Government departments and autonomous institutions and privatization of PSUs. The total expenditure of the Central Government relative to GDP declined from 15.8 per cent during 1992-97 to 15.1 per cent during 2004-09, with the ratio tending towards 14 per cent in recent years. Revenue expenditure has moved up from 12.1 per cent of GDP to 12.5 per cent of GDP during the above period. Thus, there has been decline in the component of capital expenditure. Most importantly the share of capital expenditure declined sharply from 23.4 per cent to 17.2 per cent during the above period, though this happened partly because of the cessation of loans from the States, which were classified as capital expenditures. However, the decline in capital expenditure does suggest some moderation in public investment over the period as reflected in the decline in non-defence capital outlay relative to GDP.

The exercise of expenditure reform has not been easy as most of the Government expenditure is non-discretionary. With increasing fiscal deficits, interest payments have formed a significant proportion of Government expenditure. In the recent years, the interest payments of the Central Government have begun to reduce with reduction in interest rates and decline in fiscal deficit. A significant non-discretionary portion of Central Government expenditure is the transfer it

Table 1: Major Fiscal Indicators of the Central Government (Per cent of GDP)

Item		1991-92 to 1996-97	1997-98 to 2002-03	2003-04 to 2008-09
			(Average)	
	1	2	3	4
A.	**Revenue Indicators**			
I.	**Revenue Receipts (Centre) (3+4)**	9.3	9.0	10.3
1.	**Gross Tax Revenue**	9.5	8.7	11.0
	a) Income Tax	1.2	1.3	1.8
	b) Corporation Tax	1.3	1.6	3.2
	c) Customs Duty	3.0	2.2	2.0
	d) Excise Duty	3.7	3.2	3.0
	e) Service Tax	0.2	0.1	0.8
2.	**State Share in Taxes**	2.6	2.4	2.8
3.	**Net Tax Revenue (1-2)**	6.9	6.3	8.1
4.	**Non-Tax Revenue**	2.4	2.7	2.2
	a) Interest Receipts	1.6	1.6	0.7
	b) Dividend & Profits	0.3	0.6	0.7
	c) Economic Services	0.2	0.3	0.5
B.	**Expenditure Indicators**			
II.	**Total Expenditure**	15.8	15.8	15.1
Revenue Expenditure		12.1	12.9	12.5
	a) Interest Payments	4.2	4.6	3.9
	b) Non-interest Revenue Expenditure	7.9	8.3	8.6
	c) Grants to States	2.1	1.7	2.0
	d) Subsidies	1.3	1.4	1.4
	c) Grants to States	2.1	1.7	2.0
	e) Administrative Services	0.4	0.5	0.4
Capital Expenditure		3.7	2.8	2.6
	a) Non-Defence Capital Outlay	0.8	0.5	0.7
C.	**Deficit Indicators**			
	i) Revenue Deficit	2.8	3.9	2.2
	ii) Gross Fiscal Deficit	5.6	5.9	3.6
	iii) Primary Deficit	1.4	1.3	0.0
D.	**Debt Indicators**			
	i) Debt	52.6	55.5	61.7
	ii) Interest Payments/Revenue Receipts	44.0	50.5	40.9

Source: Budget Documents of Government of India, various years.

makes to State Governments. Wage bill and pension obligations are also non-discretionary. However, Government has succeeded in arresting the growth in Government personnel since the early 1990s, so the wage bill has been relatively stable (as reflected in 'administrative services'). Subsidies on food, fertilizer and oil have proved to be difficult to reduce, despite various attempts at targeting them better. Taking these into account, the non-interest revenue expenditure as a ratio to GDP rose from 7.9 per cent during 1992-97 to 8.6 per cent during 2004-09. Thus, the overall correction in Central Government expenditure has been owing to lower interest costs and reduction in capital expenditure.

The movement in major deficit indicators *i.e.* revenue deficit (RD), gross fiscal deficit (GFD) and primary deficit (PD) shows substantial decline during 2004-09 compared to the earlier periods. Debt servicing (interest payment to revenue receipts) shows some improvement notwithstanding the rise in debt-GDP ratio. These aspects would be discussed in details, subsequently.

III.3 Fiscal Sustainability Analysis

Sustainability is basically about good housekeeping by the Government. It essentially involves determining whether the Government can continue to pursue its set of budgetary policies (in the present and probable future policy settings). Traditionally, fiscal sustainability has been assessed in terms of indicator analysis. Reflecting this, a large and growing research efforts have not only been directed towards developing indicators or summary measures of sustainability but also assessing the fiscal policy with the help of these indicators. Of late, the theoretical literature has focused on whether current fiscal policy can be continued into future without jeopardizing stability and growth, which does not necessarily imply that debt has to be non-decreasing. Thus, the Government's inter-temporal or present value of budget constraint is the central theme of the research on sustainability. According to the inter-temporal budget constraint, the present value of revenues must be equal to the present value of spending including interest on the public debt plus repayment on the debt itself.[2]

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2 For a detailed discussion on literature on fiscal sustainability and empirical analysis in Indian context, refer to Pattnaik *et al* (2004)

III 3.a Analysis of Sustainability Indicators

It may be seen from Table 2 that some of the necessary conditions of debt sustainability during the current phase of fiscal reforms are fulfilled for the Central Government *i.e.*, higher rate of nominal growth than the growth rate of

Table 2: Fiscal Sustainability of Centre: Indicator Analysis

Sl. No	Indicators	Symbolic representation	1991-92 to 1996-97	1997-98 to 2002-03	2003-04 to 2008-09
			(Average)		
	1	2	3	4	5
1	Rate of nominal growth of GDP (*Y*) should be more than rate of growth of debt (*D*)	*Y* *D* *Y – D >0*	15.88 13.62 2.26	10.12 14.96 -4.84	13.71 11.95 1.76
2	Real output growth (*y*) should be higher than real interest rate (*r*)	*Y* *R* *y – r > 0*	6.31 3.14 3.17	5.49 5.93 -0.44	8.39 1.90 6.50
3 (a)	Primary balance (*PB*) should be in surplus	*PB*/ *GDP* > 0	-1.36	-1.30	0.03
3 (b)	Primary revenue balance (*PRB*) should be in surplus and adequate enough to meet interest payments (*IP*)	*PRB / GDP > 0* *PRB/IP>100*	1.44 34.2	0.74 16.3	1.69 45.0
4 (a)	Proportion of repayments (*REP*) to Gross Market Borrowings (*GMB*) should be falling over time	*REP / GMB*↓↓	29.31	31.60	35.70
4 (b)	Interest payments (*IP*) and repayments (*REP*) adjusted for primary revenue surplus (*PRS*) should not exceed Gross Market Borrowings (*GMB*)	*{(IP + REP – PRS) / GMB} < 1*	1.34	1.05	0.87
4 (c)	Interest Burden defined by interest payments (*IP*) to GDP ratio should decline over time	*IP / GDP*↓↓	4.21	4.60	3.85
4 (d)	Interest payment as a proportion of revenue expenditure should decline overtime	*IP / RExp*↓↓	34.85	35.80	30.82
4 (e)	Interest payment as a proportion of revenue receipts should fall over time	*IP / RR*↓↓	45.30	51.10	37.60

debt, higher real output growth than real interest rate and generation of surplus primary balance. However, interest burden measured as a ratio to GDP, revenue receipts and revenue expenditure continues to be high and primary revenue surplus is not adequate enough to meet interest payments.

III 3.b Sustainability Analysis: Present Value of Budget Constraint Approach

Sustainability of debt under the present value of budget constraint approach emphasises solvency of the Government. This requires that the future primary surpluses should be sufficient to repay the current stock of public debt. According to this approach, the present value (*PV*) of the sum of future primary surpluses should not be less than the current outstanding liabilities of the Government. An assessment of sustainability under this approach involves discounting of nominal stock of Government debt retrospectively to a given date with an appropriate discount rate. Thereafter, the discounted series is tested for stationarity. If the series is non-stationary it implies the insolvency of the debt.

To examine sustainability of Government debt, unit root tests for stationarity were performed on the present discounted value of the total liabilities (*PVDL*) of the Central Government for the period 1980-81 to 2007-08. The average interest rate, defined as interest payments divided by the outstanding stock of debt in the previous year, was used for discounting the debt. The results are presented in Table 3.

Table 3: Unit Root Test Results of PVDL - Centre

			Zivot-Andrews		
Variable	**ADF**	**PP**	**Break in Intercept**	**Break in Trend**	**Break in Both Intercept and Trend**
1	2	3	4	5	6
PVDL-Centre (Intercept)	3.17	2.61	0.10	-1.92	-1.98

Note: ADF – Augmented Dicky-Fuller Test and PP – Phillips-Perron Test.
* denotes significance.

The results of the unit root tests based on ADF and PP indicate that the null hypothesis of a unit root could not be rejected at any of the conventional level of significance for the Centre. As the explaining power of these two unit root tests get significantly reduced in the presence of structural breaks, we also performed Zivot-Andrews unit root test with one-time structural break. It is seen that even after allowing for structural break the null hypothesis of a unit root could not be rejected. In other words, the debt series is found to be non-stationary with the inference that liabilities of the Central Government are not sustainable.

III.4 Twelfth Finance Commission (TFC) Restructuring Path and Fiscal Performance

Twelfth Finance Commission (TFC) in the chapter on restructuring of public finances suggested a target oriented restructuring path involving 14 fiscal parameters to be achieved by the Central Government by the year 2009-10. A look at Table 4 indicates that the Central Government has over achieved the targets with regard to tax revenue, while there has been some shortfall with regard to target for non-tax revenue. While the Central Government is approaching towards the target for total expenditure, it seems to be out of sync when the target for composition of revenue and capital component is considered. Total revenue expenditure as a ratio to GDP remains much higher compared to the target. Concomitantly, there is a shortfall from the target with regard to capital expenditure. The target with regard to GFD has been achieved while that relating to RD is unlikely to be achieved. Debt target has been achieved and the target for debt servicing is also likely to be achieved. Thus, excepting the targets for non-tax revenue and revenue-capital composition of expenditure, the Central Government is on track as per the fiscal restructuring path suggested by the TFC.

III.5 Fiscal Performance under FRBM Act, 2003

The fiscal responsibility legislation at the Centre had its root in the announcement by the Union Finance Minister in his budget speech for 2000-01

Table 4: Summary of Restructuring of Central Finances – Twelfth Finance Commission

					Actual Position (Per cent to GDP)					
Item	**2004-05**	**2009-10**	**2009-10 minus 2004-05**	**Average Adjust-ment per year**	**2004-05**	**2005-06**	**2006-07**	**2007-08 RE**	**2008-09 BE**	**Average Adjust-ment per year**
1	2	3	4	5	6	7	8	9	10	11
Gross Tax Revenue	9.7	10.9	1.2	**0.24**	9.7	10.2 (0.5)	11.4 (1.2)	12.5 (1.1)	13.0 (0.5)	**0.82**
Tax Revenue (Net to the centre)	7.2	7.9	0.7	**0.14**	7.1	7.5 (0.4)	8.5 (0.9)	9.2 (0.7)	9.6 (0.4)	**0.61**
Non-Tax Revenue	2.2	2.2	–	**–**	2.6	2.1 (-0.4)	2.0 (-0.1)	2.0 (-0.0)	1.8 (-0.2)	**-0.19**
Total revenue Receipts	9.4	10.2	0.8	**0.16**	9.7	9.7 (-0.0)	10.5 (0.8)	11.2 (0.7)	11.4 (0.2)	**0.41**
Interest Payment	4.2	2.8	-1.4	**-0.28**	4.0	3.7 (-0.3)	3.6 (-0.1)	3.7 (0.0)	3.6 (-0.1)	**-0.11**
Total Revenue Expenditure	11.9	10.2	-1.7	**-0.34**	12.2	12.3 (0.1)	12.4 (0.1)	12.5 (0.1)	12.4 (-0.1)	**0.05**
Capital expenditure	3.0	3.5	0.5	**0.10**	3.6	1.9 (-1.8)	1.7 (-0.2)	2.6 (0.9)	1.7 (-0.8)	**-0.47**
Total expenditure	14.8	13.7	-1.1	**-0.22**	15.8	14.1 (-1.7)	14.1 (-0.1	15.1 (1.0)	14.2 (-1.0)	**-0.42**
Primary Expenditure	10.7	10.8	0.1	**0.02**	11.8	10.4 (-1.4)	10.4 (0.0)	11.4 (1.0)	10.6 (-0.9)	**-0.31**
Revenue Deficit	2.5	–	-2.5	**-0.50**	2.5	2.6 (0.1)	1.9 (-0.6)	1.4 (-0.6)	1.0 (-0.3)	**-0.36**
Fiscal Deficit	4.5	3.0	-1.5	**-0.30**	4.0	4.1 (0.1)	3.4 (-0.7)	3.1 (-0.4)	2.5 (-0.5)	**-0.37**
Primary Deficit	0.3	0.2	-0.1	**-0.02**	-0.0	0.4 (0.4)	-0.2 (-0.6)	-0.4 (-0.2)	-0.7 (-0.3)	**-0.17**
Int.Payment/revenue Receipts	44.5	28.0	-16.5	**-3.30**	41.5	38.2 (-3.3)	34.6 (-3.6)	32.8 (-1.8)	31.6 (-1.1)	**-2.46**
Debt (end-year adj liabilities) * $	53.0	43.7	-9.3	**-1.86**	55.4	53.8 (-0.1)	51.0 (-2.3)	46.7 (-1.7)	43.5 (-3.2)	**-1.83**

BE: Budget Estimates. RE: Revised Estimates.

Note: Figures in parentheses indicate change over the previous year.

* : Debt adjusted for amount included under market stabilisation scheme and National Small Savings Fund.

$: External debt are at current exchange rate for the years 2004-05 to 2006-07 and at book value for 2007-08 and 2008-09.

to set up a Committee (Pattnaik *et al*, 2004). Following the submission of the Committee's Report (Chairman: E.A.S. Sarma) and the legislative procedures, the FRBM Act, 2003 and Rules made by the Government under the Act were brought in force on July 05, 2004. The structure and content of the FRBM Act go beyond the conventional fiscal legislation *i.e.*, setting the ceiling on the fiscal indicators. The legislation lays down the fiscal management principles and combines fiscal transparency, budget integrity and accountability, which has further streamlined the budget presentation process of the Union Government. The FRBM Act, 2003 provides the responsibility of the Central Government to ensure inter-generational equity in fiscal management and long-term macroeconomic stability by achieving sufficient revenue surplus and removing fiscal impediments in the effective conduct of monetary policy and prudential debt management consistent with fiscal sustainability through limits on the Central Government borrowings, debt and deficits, greater transparency in fiscal operations of the Central Government and conducting fiscal policy in a medium-term framework and for matters connected therewith or incidental thereto.

Obligations of the Government under the FRBM Act, 2003 and FRBM Rules, 2004, as amended through the Finance Act, 2004 are as follows:

- To eliminate the revenue deficit by the financial year 2008-09. The FRBM Rules prescribe a minimum annual reduction in the revenue deficit by 0.5 per cent of GDP.
- To reduce the fiscal deficit by at least 0.3 per cent of the GDP annually, so that fiscal deficit is less than 3 per cent of GDP by the end of 2008-09.
- To limit Government guarantees to at most 0.5 per cent of the GDP in any financial year.
- To limit additional liabilities (including external debt at current exchange rate) to 9 per cent of GDP in 2004-05, 8 per cent of GDP in 2005-06, 7 per cent of GDP in 2006-07, 6 per cent of GDP in 2007-08.
- Not to borrow directly from the Reserve Bank of India w.e.f. April 01, 2006.
- To present three statements before the Parliament along with the annual budget: Macroeconomic Framework Statement, Fiscal Policy Strategy Statement and Medium-term Fiscal Policy Statement incorporating three

year rolling targets for prescribed fiscal indicators and underlying assumptions.

- To move towards greater fiscal transparency and start disclosing specified information such as arrears of unrealized revenue, guarantees and assets latest by 2006-07.
- Furthermore, the FRBM Act requires that the Finance Minister conduct quarterly review of receipts and expenditure and place the outcome of these reviews before the Parliament. He is obliged to take remedial measures to check deterioration in fiscal position, which may not only include measures to increase revenues but also to curtail expenditures. The Finance Minister is also obliged to make a statement in the Parliament explaining the reasons for any deviations from the obligations cast on the Government under the FRBM Act and remedial measures that are proposed to be taken to rectify the situation.

Thus, the FRBM Act not only mandates minimum quantifiable targets for reducing the growth of debt, deficit and guarantees in a time bound manner but also embeds a series of improvements in the area of fiscal transparency and medium-term fiscal planning to improve budget management and catalyse the process of true democratic control of fiscal policy through informed public opinion on the risks inherent in unabated growth in debt and deficit.

The progress with regard to the realization of the targets under FRBM Act, 2003 and Rules thereunder has been encouraging as may be seen from Table 5. The Central Government had taken a 'pause' in 2005-06 in the path set under the FRBM Rules, 2004 for operationalising the recommendations of the TFC and implementation of State level VAT. In the penultimate year of FRBM Act (2008-09), the Government announced in the Budget 2008-09 that the target with regard to GFD (3 per cent of GDP) would be achieved while that relating to eliminating the revenue deficit would be rescheduled by a year, in view of commitments of certain revenue intensive expenditure oriented towards social sector.[3]

[3] As indicated in footnote 1, the financial positions of the Central Government have worsened significantly from those of the budget estimates due to economic slowdown and the fiscal measures undertaken by the Government to contain the slowdown.

Table 5: FRBM Rules for the Central Government

Parameter	Provisions in the FRBM	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
1	2	3	4	5	6	7	8
Fiscal Deficit (GFD)	To be reduced by 0.3 per cent or more of GDP every year, beginning with the year 2004-05, so that it does not exceed 3 per cent of GDP by end-March 2009.	4.5	4.0	4.1 (-0.1)	3.4 (0.7)	3.1 (0.3)	2.5 (0.6)
Revenue Deficit (RD)	To be reduced by 0.5 per cent or more of GDP at the end of each year, beginning from 2004-05, in order to achieve elimination of the RD by March 31, 2009.	3.6	2.5	2.6 (-0.1)	1.9 (0.7)	1.4 (0.5)	1.0 (0.4)
Contingent Liabilities	The Central Government shall not give incremental guarantees aggregating an amount exceeding 0.5 per cent of GDP in any financial year beginning 2004-05.	–	0.64	0.07	-0.02	–	–
Additional Liabilities	Additional liabilities (including external debt at current exchange rate) shall not exceed 9 per cent of GDP for the year 2004-05. In each subsequent year, the limit of 9 per cent of GDP shall be progressively reduced by at least one percentage point of GDP.	–	8.0	6.4	6.7	5.4*	3.1*

*: External debt for the years 2007-08 and 2008-09 are at book value.

Note: Figures in parentheses indicate reduction over the previous year. Negative sign indicates increase.

Section IV
FISCAL CONSOLIDATION AT STATE LEVEL: AN ASSESSMENT

IV.1 Historical Backdrop

The fiscal position of the State Governments broadly followed the pattern witnessed for the Central Government. There has been a severe fiscal stress in respect of finances of State Governments since the mid-Eighties. The fiscal stress emanated from inadequacy of receipts in meeting the expenditure requirements. The low and declining buoyancies in tax and non-tax receipts, constraints on internal resource mobilization due to losses incurred by State Public Sector Undertakings and decelerating resources transfer from Centre contributed to worsening of State finances. A survey on worsening State finances in RBI (2003) reveals that the following factors were responsible: (1) reluctance to raise additional resources, (2) competitive reduction in taxes, absence of service tax and agricultural income tax, (3) sluggishness in Central Transfer reflecting the deterioration of Center's own finances and (4) inappropriate user charges. One major reason for the sharp deterioration in the finances of State Governments in the late 1990s was the implementation of Fifth Pay Commission award. It is important to recognize that there are large disparities across the States in terms of level of income and the tax and expenditure policies pursued by respective Governments. Finances of States have, however, witnessed a significant improvement in recent years. Since 2002-03, States started enacting fiscal responsibility legislations (FRLs) with all but two States (Sikkim and West Bengal) having enacted FRLs by now. The consolidated fiscal position indicates that fiscal correction has been faster for the States than the Centre in the recent period. The fiscal consolidation process of the States under the rule based framework has been well documented in the studies on State Finances of the Reserve Bank of India.

IV.2 Analysis of Fiscal Indicators

In recent years, finances of State Governments have witnessed noticeable improvement with the major deficit indicators showing substantial decline.

However, average level of gross fiscal deficit during the current phase of fiscal reforms (2004-08) has been higher than those during the earlier phase of fiscal reform (1992-97) (Table 6).

Table 6: Major Fiscal Indicators-State Governments

(Per cent of GDP)

Item	1991-92 to 1996-97 (Average)	1997-98 to 2002-03 (Average)	2003-04 to 2007-08 (Average)
1	2	3	4
A. Revenue Indicators			
1. Tax Revenue(a+b)	7.8	7.6	8.6
(a) State own tax revenue	5.3	5.2	6.0
of which			
Sales Tax/VAT	3.1	3.2	3.6
Other Taxes	2.1	2.1	2.3
(b) Share in Central Taxes	2.6	2.4	2.6
2. Non-tax Revenue (c+d)	3.9	3.1	3.5
(c) States own non-tax revenue	1.9	1.5	1.4
(d) Grants	2.1	1.7	2.2
3. Total Own Revenue	7.1	6.7	7.3
4. Total Current Transfers	4.6	4.0	4.8
I. Total Revenue Receipts (1 + 2)	11.8	10.7	12.1
B. Expenditure Indicators			
II. Total Expenditure	15.4	15.7	17.0
1. Revenue Expenditure	12.5	13.1	12.8
(a) Interest Payments	1.8	2.4	2.5
(b) Pensions	0.6	1.1	1.2
(c) Administrative Services	1.2	1.2	1.0
(d) Non-Interest Revenue Expenditure	10.8	10.9	10.5
2. Capital Expenditure	2.9	2.7	4.1
(a) Capital Outlay	1.5	1.4	2.2
3. Development Expenditure	10.2	9.3	9.7
4. Social Sector Expenditure	5.5	5.5	5.4
(i) Social Services(Revenue+Capital Exp.)	4.7	4.9	4.7
(ii) Economic Services (Revenue+ Capital Exp.)	0.8	0.7	0.7
C. Deficit Indicators			
III. Revenue Deficit	0.8	2.3	0.7
IV. Gross Fiscal Deficit	2.7	4.0	3.1
V. Primary Deficit	0.9	1.6	0.6
D. Debt Indicators			
VI. Debt	21.6	26.9	31.7
VI. IP/RR (per cent)	15.4	22.0	20.8

Source: State Finances - A Study of Budgets, various years.

The process of fiscal correction indicates that there has been a rise in total expenditure involving both revenue and capital components accompanied by some rise in revenue receipts. While tax-revenue as a ratio to GDP rose to 8.6 per cent during 2004-08 from 7.8 per cent during 1997-2002 owing to rise in own-tax revenue, non-tax revenue as a ratio to GDP declined from 3.9 per cent to 3.5 per cent due to fall in own non-tax revenue. Non-discretionary components of expenditure like interest payments and pension showed a rise over the period while administrative services stabilized around 1 per cent of GDP. There has been some marginal decline in the non-interest revenue expenditure. Very significantly, capital expenditure as a ratio to GDP during the current phase of about 4 per cent has been much higher than that in the earlier phases (around 2.8 per cent of GDP). Capital outlay, which reflects the investment spending, has also moved up.

IV.3 Latest Trend in Revenue and Expenditure

A look at the latest data on revenue and expenditure indicates that the process of fiscal correction of the States has taken place through reduction in expenditure as well as rise in revenue. The expenditure reduction is observed since 2004-05, while revenue enhancement is more pronounced in recent years.

On the revenue side, the States have two sources, *i.e.,* own revenue (tax and non-tax) and devolution and transfers from the Centre (share in Central taxes and grants-in-aid). The revenue receipts of the States as a ratio to GDP have moved up continuously from 10.9 per cent in 2001-02 to 13.3 per cent in 2007-08 (RE) and are budgeted to rise further to 13.5 per cent in 2008-09 (BE) (Table 7). The revenue enhancement of the States has been largely facilitated by devolution and transfers from the Centre through shareable taxes and grants-in-aid based on recommendations of the TFC. Improved macroeconomic fundamentals also aided the process. The own tax revenue (OTR) as a ratio to GDP also moved up continuously, albeit slowly, from 5.4 per cent in 2001-02 to 6.2 per cent in 2007-08 (RE) and is budgeted to improve

Table 7: Trend in Revenue Receipts

(Per cent of GDP)

Item	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 (RE)	2008-09 (BE)
1	2	3	4	5	6	7	8	9	10
RR (1 + 2)	**11.1**	**10.9**	**11.1**	**11.2**	**11.5**	**12.0**	**12.7**	**13.3**	**13.5**
1. OR (a +b)	6.9	6.8	7.0	6.9	7.3	7.3	7.6	7.5	7.6
a. OTR	5.4	5.4	5.6	5.6	5.8	5.9	6.1	6.2	6.3
of which									
Sales tax/VAT	3.3	3.2	3.3	3.4	3.5	3.6	3.7	3.8	3.8
b. ONTR	1.5	1.4	1.4	1.4	1.5	1.3	1.5	1.3	1.3
2. CT (a + b)	4.2	4.2	4.1	4.3	4.3	4.8	5.1	5.7	5.9
a. SCT	2.4	2.3	2.3	2.4	2.5	2.6	2.9	3.1	3.2
b. Grants	1.8	1.9	1.8	1.8	1.8	2.1	2.2	2.6	2.6

RR : Revenue ReceiptsOR: Own RevenueVAT: Value Added Tax
OTR : Own Tax RevenueCT: Current Transfers SCT: Share in Central Taxes
ONTR: Own Non-Tax Revenue

Source: Study on State Finances, RBI , various years and Budget Documents of State Governments, 2008-09

further to 6.3 per cent in 2008-09. Implementation of value added tax (VAT) in lieu of sales tax by the States has proved to be successful in raising OTR of the States.

The total expenditure (revenue and capital) of the State Governments as a ratio to GDP came down from 18.7 per cent in 2003-04 to 16.7 per cent in 2007-08 (RE) and would be maintained at that level in 2008-09 (BE). In particular, revenue expenditure as a ratio to GDP declined from 13.7 per cent in 2000-01 to 12.1 per cent in 2006-07 (Accounts) but is estimated to go up to 12.9 per cent during 2007-08 (RE) and 2008-09 (BE). Among the components of revenue expenditure, interest payments as a ratio to GDP rose from 2.4 per cent in 2000-01 to 2.9 per cent in 2003-04 but declined to 2.2 per cent in 2007-08 (RE), primarily due to the Debt Swap Scheme (2002-05) and Debt Consolidation and Relief Facility recommended by the TFC. Pension payments as a ratio to GDP have been maintained at around 1.2 per cent. Expenditure on administrative services as a ratio to GDP has come down from 1.2 per cent in 2000-01 to 0.9 per cent in 2006-07 (Accounts). However, it increased to 1.0 per cent in 2007-08 (RE) and is budgeted to increase to 1.2 per cent in 2008-09 (BE) (Table 8).

The most interesting aspect of expenditure pattern of the State Governments is that expenditure for developmental purposes has not been compressed during the fiscal correction process. The total developmental expenditure (revenue and capital) as a ratio to GDP has moved up from 9.1 per cent in 2004-05 to 10.5 per cent in 2007-08 (RE). The developmental expenditure to GDP ratio is budgeted at 10.4 per cent in 2008-09 (BE). The social sector expenditure (social services, rural development and food storage and warehousing) as a ratio to GDP also moved up from 5.2 per cent in 2004-05 to 6.1 per cent in 2007-08 (RE) and is budgeted at 6.2 per cent in 2008-09 (BE). Capital outlay as a per cent of GDP, has moved up from 1.4 per cent in 2000-01 to 2.7 per cent in 2007-08 (RE). Further, as a per cent to GDP, capital outlay would be maintained at 2.7 per cent in 2008-09 (BE).

Table 8: Trend in Expenditure

(Per cent of GDP)

Item	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08** (RE)	**2008-09** (BE)
1	2	3	4	5	6	7	8	9	10
Total Expenditure	16.2	16.2	16.7	18.7	17.6	15.7	15.8	16.7	16.7
of which									
Revenue Expenditure	13.7	13.6	13.5	13.5	12.8	12.2	12.1	12.9	12.9
of which									
Interent Payments	2.4	2.7	2.8	2.9	2.7	2.3	2.2	2.2	2.0
Pension	1.2	1.2	1.3	1.2	1.2	1.1	1.1	1.2	1.2
Administrative Services	1.2	1.2	1.1	1.0	1.0	1.0	0.9	1.0	1.2
Capital Outlay	1.4	1.4	1.5	1.9	1.9	2.2	2.3	2.7	2.7
Memo item:									
Development Expenditure	9.8	9.3	9.0	9.9	9.1	9.2	9.4	10.5	10.4
Social Sector Expenditure	5.9	5.7	5.4	5.3	5.2	5.3	5.4	6.1	6.2

Source: Study on State Finances, RBI , various years and Budget Documents of State Governments, 2008-09.

This signifies that fiscal correction process has not been inimical to expenditure for development purposes.

As a corollary of the combination of the revenue enhancement and expenditure rationalisation, the movement in the key deficit indicators of the State Governments indicates to significant improvement in their fiscal position in the recent past (Table 9).

IV. 4 Fiscal Sustainability Analysis

The analysis in the Section III on Central Government is extended to the State Governments here.[4]

IV.4.a Analysis of Sustainability Indictors

The analysis of sustainability indicators states that the essential conditions like higher growth of GDP than debt growth and higher real output growth than real interest rate are fulfilled for the State Governments (consolidated position) during the current phase of fiscal reform. However, primary balance continues to be in deficit. The primary revenue balance on average has also been not adequate enough to meet interest payments, though this condition has been met since 2006-07. Interest burden continues to remain high in terms of its ratio to GDP, revenue expenditure and revenue receipts, though a declining trend in discernible during the recent years.

Table 9: Key Deficit Indictors of State Governments

(Per cent to GDP)

Item	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 (RE)	2008-09 (BE)
1	2	3	4	5	6	7	8	9	10
Revenue Deficit	2.6	2.7	2.3	2.3	1.2	0.2	-0.6	-0.5	-0.5
Fiscal Deficit	4.2	4.1	4.1	4.4	3.4	2.5	1.9	2.3	2.1
Primary Deficit	1.8	1.4	1.3	1.5	0.7	0.2	-0.4	0.1	0.1

Source: Studies of State Finance, RBI and Budget Documents of State Governments, 2008-09

4 For a detailed analysis of debt sustainability at State level in India, refer to Rajaraman et al (2005)

Table 10: Fiscal Sustainability of States: Indicator Analysis					
					(Per cent)
Sl. No	Indicators	Symbolic representation	1991-92 to 1996-97	1997-98 to 2002-03	2003-04 to 2007-08
1	2	3	4	5	6
1	Rate of nominal growth of GDP (Y) should be more than rate of growth of debt (D)	Y D Y - D >0	15.88 14.32 1.56	10.12 18.46 -8.34	13.85 11.92 1.93
2	Real output growth (y) should be higher than real interest rate (r)	y r y - r > 0	6.31 3.54 2.77	5.49 6.16 -0.67	8.57 2.03 6.54
3 (a)	Primary Balance should be in surplus	PB/GDP >0	-0.85	-1.64	-0.57
3 (b)	Primary Revenue Balance (PRB) should be in surplus and adequate enough to meet interest payments (IP)	PRB / GDP > 0 PRB/IP>100	1.04 57.44	0.02 0.71	1.78 74.66
4	Proportion of repayments (REP) to Gross Market Borrowings (GMB) should be falling over time	REP / GMB↓↓	0.04	0.08	0.21
5	Interest Payments (IP) and repayments (REP) adjusted for Primary Revenue Surplus (PRS) should not exceed Gross Market Borrowings (GMB)	{(IP + REP - PRS) / GMB} < 1	5.74	3.35	5.49
6	Interest Burden defined by Interest Payments (IP) to GDP ratio should decline over time	IP / *GDP*↓↓	1.81	2.37	2.50
7	Interest Payment as a proportion of Revenue Expenditure should decline overtime	IP / *RExp*↓↓	14.45	18.05	19.46
8	Interest Payment as a proportion of Revenue Receipts should fall over time	IP / *RR*↓↓	15.41	22.04	20.84

IV.4.b Sustainability Analysis: Present Value of Budget Constraint Approach

Following the method adopted for Central Government in Section III, the sustainability analysis of consolidated debt position of the State Government is attempted by adopting the present value of budget constraint approach. The results are presented in Table 11.

Table 11: Unit Root Test Results of PVDL - States					
			Zivot-Andrews		
Variable	**ADF**	**PP**	**Break in Intercept**	**Break in Trend**	**Break in Both Intercept and Trend**
1	2	3	4	5	6
PVDL-States (Intercept and Trend)	**-2.10**	**-1.80**	**-5.94***	**-2.75**	**-2.83**

Note: ADF – Augmented Dicky-Fuller Test and PP – Phillips-Perron Test.
* denotes significance.

It is seen from Table 11 that both ADF and PP tests cannot reject the null hypothesis of a unit root at any of the conventional level of significance. Zivot-Andrews unit root test allowing for one-time structural break also cannot reject the null hypothesis of a unit root, except for one model. Thus, the liabilities of the State Governments may also be inferred as unsustainable.

IV.5 Fiscal Restructuring Path of TFC and Performance of State Governments

The TFC suggested a uniform fiscal restructuring path for the State Governments involving 15 fiscal indicators. It may be seen from Table 12 that the consolidated position of the State Governments indicates that unlike the Centre, the States are yet to reach their revenue targets. However, they have been able to reach the expenditure and debt targets. The States have reached the deficit targets ahead of schedule and are approaching the debt servicing targets. It may be mentioned that the consolidated data do not reveal the wide variations that exist across the States. It is, however, significant to note that the targets of TFCs restructuring path applies uniformly to all the States.

IV.6 Fiscal Responsibility Legislation and Fiscal Performance

The State Governments have adopted a rule-based framework for fiscal correction and consolidation through progressive enactment of Fiscal Responsibility Legislation (FRL). Karnataka was the first to enact the FRL in

Table 12: Summary of Suggested Restructuring of State Finances Actual Position

(Per cent of GDP)

S. No	Item	2004-05	2009-10	Average Adjustment per year	2004-05	2005-06	2006-07 (RE)	2007-08 (BE)	Average Adjustment per year (2005-06 and 2007-08)
1	2	3	4	5	6	7	8	9	10
1	States' Own Tax Revenues	5.9	6.8	0.17	5.8	5.9	6.2	6.3	0.11
2	Tax Revenues	8.4	9.7	0.25	8.3	8.6	9.0	9.2	0.20
3	Own Non-tax Revenue	1.2	1.4	0.03	1.5	1.3	1.3	1.3	-0.03
4	Non Tax revenues	3.2	3.5	0.07	3.3	3.5	3.8	3.8	0.09
5	Total Revenue Receipts	11.6	13.2	0.32	11.5	12.0	12.8	12.9	0.30
6	Interest Payments	2.9	2.0	-0.18	2.7	2.3	2.3	2.2	-0.05
7	Total Revenue Expenditure	13.6	13.2	-0.08	12.8	12.2	13.0	12.7	0.15
8	Capital Expenditure	2.6	3.1	0.10	4.8	3.5	3.6	3.7	0.07
9	Total Expenditure	16.2	16.3	0.01	17.6	15.7	16.6	16.3	0.22
10	Primary Expenditure	13.3	14.3	0.20	14.8	13.3	14.3	14.1	0.27
11	Revenue Deficit	2.0	0.0	-0.40	1.2	0.2	0.1	-0.3	-0.15
12	Fiscal Deficit	4.5	3.0	-0.30	3.4	2.5	2.7	2.3	-0.07
13	Primary Deficit	1.6	1.0	-0.12	0.7	0.2	0.4	0.1	-0.02
14	Interest Payments/ Revenue Receipts	24.9	15.0	-1.99	23.8	19.5	18.0	16.9	-0.86
15	Debt (end-Year Adjusted Liabilities)	30.3	30.8	0.11	32.7	32.6	30.6	29.4	-1.08

September 2002 followed by Kerala and Tamil Nadu in 2003, and Punjab in 2004. Subsequently, twenty-two more States enacted the FRLs. All State Governments barring Sikkim and West Bengal have enacted FRLs so far. The enactment of FRLs 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 for ensuring prudent debt management and greater transparency. Recognising this, the TFC recommended that each State should enact FRL, which would be a pre-condition for availing debt relief. 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 (Annex 1).

It may be mentioned that but for three all States have proposed revenue surplus budget during 2008-09. Similarly, excluding 3 non-special category and 3 special category States, rest have proposed to achieve GFD below 3 per cent of GSDP by 2008-09. On the whole, majority of the States are reaching the deficit targets stipulated in their FRLs well ahead of the schedule.

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 FRLs.[5]

5 Like the Central Government, the State Governments may experience difficulties in adhering to the FRLs during 2008-09 in view of likely shortfall in revenues and increase in expenditure.

SECTION V
MEDIUM TERM OUTLOOK FOR CENTRAL AND STATE GOVERNMENTS[6]

The discussion in earlier section revealed that both Centre and States have been witness to substantial improvements in their fiscal position during the current phase of fiscal reform. With this in the backdrop, we attempt to project the medium-term outlook for both Central and State Governments.

Based on the analytical framework laid out in the Annex II and under alternative assumptions of growth and inflation, we generate the key fiscal indictors during the medium term for 2010-11 to 2014-15. Under the baseline scenario of real GDP growth of 9.0 per cent and inflation rate of 4.0 per cent, continuation of the existing trends would lead to improvement in the all the key fiscal indicators and debt of the Central Government up to 2014-15.[7] This would primarily follow from the buoyancy of tax revenue, which would raise the gross tax revenue to about 16.0 per cent of GDP, with an average of about 14.8 per cent during 2010-11 to 2014-15. Consequently, the net tax revenue to GDP ratio would also increase, and on an average be around 11.0 per cent of GDP. Thus, total revenue receipts would steadily increase despite

6 It may be noted that forecasts of the financial positions for the period 2010-11 to 2014-15 are based on the average of the data prevailing upto 2007-08. As indicated earlier, the fiscal situations during 2008-09 has worsened significantly from those envisaged in the Budget due to the impact of economic slowdown and the fiscal stimulus provided by the Government to contain the slowdown. The situation, however, is expected to revert back with the revival of the economy to its trend path, possibly by 2010-11. Therefore, the actual turn out during 2008-09 to 2009-10 could significantly diverge from our forecast, but this is not the period the paper focuses and not reported also. Over the medium term of 2010-11 to 2014-15, with return to normalcy, the forecast would still be relevant, with 2008-09 to 2009-10, as the aberrations.

7 The impact of pay revision of Government employees recommended by the Sixth Pay Commission, debt waiver scheme and custom and excise duty revision on petroleum products recently announced (June, 2008) have not been factored in the medium term outlook. While the adverse impact of these policy measures on the finances of the Governments may be gauged in the immediate to near term with some degree of accuracy, it may not be possible for the medium term. However, it is likely that the medium term outlook would to some extent be impacted by these uncertain variables.

marginal decline in the non-tax revenue to GDP ratio. Improvement in revenue receipts would more than offset the increase in non-interest expenditure to GDP ratio. The interest payments to GDP ratio would also decline. As a result, the revenue deficit is expected to decline and then turn into surplus, which would yield more or less a balanced revenue account during 2010-11 to 2014-15. If the existing trend of declining capital expenditure to GDP persists, the Central Government could reduce the fiscal deficit to below 1.0 per cent by 2014-15. Consequently, the Central Government would be in a position to reduce the debt to GDP ratio substantially (Annex II - Table 3). However, with moderate decline in growth by 1.0 percentage points to 8.0 percent, the improvement in fiscal indicators becomes far less evident (Annex II - Table 4).

In contrast to the Central Government, the State Governments would be in a position to build up substantial surplus in the revenue account due to buoyancy of its own taxes, the shared taxes and the ability of the Central Government to increase grants, while maintaining the current tempo of revenue expenditure. Because of the increasing revenue surplus, the State Governments would be in a position to steadily hike up the capital expenditure to GDP ratio, while at the same time maintaining the fiscal deficit to a little over 2.0 per cent of GDP. The debt to GDP ratio would slowly keep inching downward and the interest burden on both revenue receipts and as a ratio to GDP would also decline steadily (Annex II - Table 5). Moderate decline in growth would also adversely impact the fiscal position of State Governments, but the path of consolidation would be sustained (Annex II - Table 6).

The trend in fiscal deficit emerging from the baseline scenario, however, may not be sustained during 2010 to 2015, as the Government may attempt to stick to a targeted level of fiscal deficit. Therefore, while allowing the trends in revenue receipts and non-interest revenue expenditure to continue, we superimpose a fiscal deficit target of 2.5 per cent of GDP for both the Central and State Governments and generate the fiscal outlook during 2010-15.

Table 13 provides the outlook for the Central Government. It is seen that there would be improvement in the revenue account due to revenue buoyancy. However, due to higher interest burden, the improvement would be slower. On the other hand, by maintaining a constant GFD to GDP ratio, the improvement in revenue balance would enable the government to raise the capital expenditure

Table 13: Medium Term Outlook of Central Government with GFD 2.5% of GDP

(Per cent to GDP)

Fiscal Indicators (Average)		2010-11	2011-12	2012-13	2013-14	2014-15	2010-15 (Average)
1		2	3	4	5	6	7
I.	Gross Tax Revenue (a to e)	13.83	14.30	14.80	15.33	15.90	14.83
	a) Income Tax	2.81	2.92	3.03	3.14	3.26	3.03
	b) Corporate Tax[8]	4.95	5.33	5.74	6.18	6.66	5.77
	c) Excise Duty	2.50	2.43	2.37	2.30	2.24	2.37
	d) Customs Duty	2.27	2.29	2.32	2.34	2.36	2.31
	e) Other Tax	1.30	1.32	1.34	1.37	1.39	1.34
II.	Share of State in Central Taxes	3.67	3.79	3.92	4.06	4.21	3.93
III.	Net Tax Revenue (I-II)	10.17	10.51	10.88	11.27	11.69	10.90
IV.	Non-Tax Revenue	1.96	1.95	1.94	1.94	1.93	1.94
V.	Revenue Receipts	12.13	12.46	12.82	13.20	13.62	12.84
VI.	Revenue Expenditure	12.80	12.89	12.98	13.08	13.19	12.99
	a) Interest Payments	3.63	3.63	3.63	3.65	3.67	3.64
	b) Non-Interest Revenue Expenditure	9.17	9.26	9.35	9.44	9.53	9.35
	c) Grants to States	2.29	2.31	2.34	2.36	2.38	2.34
VII.	Revenue Deficit	0.67	0.43	0.16	-0.12	-0.42	0.14
VIII.	Capital Expenditure	1.83	2.07	2.34	2.62	2.92	2.36
IX.	Gross Fiscal Deficit	2.5	2.5	2.5	2.5	2.5	2.5
X.	Debt	62.27	62.34	62.55	62.93	63.46	62.71
XI.	Interest Payments to Revenue Receipts	29.95	29.13	28.35	27.61	26.94	28.40

8 The estimated buoyancy for corporate tax during 1996 to 2008 was high at 1.94 which might not be sustained. Further, it is indicated that there will be substantial loss of revenue under corporation tax due to tax relief on Special Economic Zones (SEZs), which as per the Eleventh Plan would amount to 10.0 to 15.0 per cent of gross corporate tax that could have been collected. Therefore, the geometric mean of the coefficients for the sub-sample 1981-1995 and 1996-2008 of 1.44 was considered for the projection, which is much lower than that of 1.98 estimated by Eleventh Plan for forecasting of resources for the Plan.

to GDP ratio. The debt to GDP ratio, however, would follow a slowly rising path, given the trend in the other components of liabilities.

With regard to State Governments, maintaining GFD to GDP ratio of 2.5 per cent would be consistent with a steadily declining debt path, while at the same time maintaining a rising share of capital expenditure to GDP ratio. The interest burden on both revenue receipts and GDP ratio would also steadily decline. This likely comfortable position of the States would emanate from the increasing surplus generated in the revenue account from buoyancy of revenue (Table14).

Table 14: Medium Term Outlook of State Governments with GFD 2.5% of GDP

(Per cent to GDP)

Fiscal Indicators (Average)	2010-11	2011-12	2012-13	2013-14	2014-15 (Average)	2010-15
1	2	3	4	5	6	7
I. Own Tax Revenue	6.97	7.22	7.48	7.75	8.03	7.49
a) Sales Tax (VAT)	4.21	4.36	4.52	4.68	4.84	4.52
b) Other Taxes	2.76	2.86	2.97	3.08	3.19	2.97
II. Share from Central Taxes	3.29	3.39	3.50	3.62	3.75	3.51
III. Total Tax Revenue	10.64	11.01	11.40	11.82	12.25	11.42
IV. Own Non-Tax Revenue	1.17	1.15	1.14	1.12	1.10	1.14
V. Grants from Centre	2.61	2.65	2.68	2.72	2.75	2.68
VI. Total Non-Tax Revenue	3.78	3.80	3.82	3.84	3.85	3.82
VII. Total Transfer from Centre	5.90	6.04	6.19	6.34	6.50	6.19
VIII. Total Own Revenue	8.14	8.38	8.62	8.87	9.14	8.63
IX. Total Revenue Receipts	14.04	14.42	14.81	15.21	15.64	14.82
X. Revenue Expenditure	12.51	12.53	12.55	12.58	12.62	12.56
c) Interest Payments	1.97	1.92	1.88	1.84	1.81	1.88
d) Non-Interest Revenue Expenditure	10.55	10.61	10.67	10.74	10.81	10.68
XI. Revenue Deficit	-1.53	-1.89	-2.25	-2.63	-3.02	-2.26
XII. Capital Expenditure	4.03	4.39	4.75	5.13	5.52	4.76
XIII. Gross Fiscal Deficit	2.5	2.5	2.5	2.5	2.5	2.5
XIV. Debt	26.80	26.22	25.70	25.24	24.84	25.76
XV. Interest Payments to Revenue Receipts	14.0	13.31	12.68	12.10	11.56	12.73

Further, it is seen that when the GFD is targeted at such a level, decline in growth to 8.0 per cent would make Central Government debt unsustainable and would not be in position to generate any revenue surplus during the medium term. State Governments at the consolidated level would be in a much better position to withstand the adverse impact of deceleration in growth (Annex II - Tables 7 and 8).

SECTION VI

FISCAL ARCHITECTURE DURING POST-FRBM PERIOD FOR CENTRE AND POST-FRL PERIOD FOR STATES

Our analysis in the previous sections indicates that the fiscal performance of the Central and State Governments under the rule based framework has been encouraging. However, the fiscal consolidation has been incomplete in several respects. Debt level of both Centre and States continues to be high and unsustainable. The fiscal reform process has been basically revenue-led but lacked focus with regard to expenditure management, particularly in respect of reprioritizing expenditure for developmental purposes. Thus, the fiscal architecture for the future has to be designed taking into account the experience gained so far so that the fiscal correction of both national and sub-national levels can be consolidated and carried forward. In this Section, we attempt to provide some elements for designing of future fiscal architecture of both the Centre and the States.

VI.1 Further Reduction in Fiscal Deficit

Achievement of the current fiscal deficit targets under the rule-based fiscal framework would still leave the combined fiscal deficit in India at around 6 per cent of GDP and somewhat higher if off-budget items are accounted for. By international standards this is still very high (Table 15). If this level

Table 15: Fiscal Deficit – Select Countries

(Per cent of GDP)

Country	Fiscal Deficit			
	2003	2004	2005	2006P
1	2	3	4	5
China	2.2	1.3	1.2	0.5
Republic of Korea	-0.1	0.5	1	1.3
India	4.5	4	4.1	3.5
Indonesia	1.7	1	1	1
Malaysia	5.3	4.3	3.8	2.6
Thailand	-0.5	-0.3	-0.2	-0.1

Source: Asian Economic Monitor and Budget Documents of Government of India continues, it would be difficult to make much of a correction to debt-GDP ratio to bring it down to desirable level in near future. This will have the accompanying elements of draft on private sector savings and hence it may not be possible to reduce substantially the various stipulations that mandate banks and other financial institutions to invest in government securities, thereby constraining further development in the monetary policy and financial sector framework. The existence of such a high level of fiscal deficit also contributes to the persistence of an interest rate differential with rest of the world which then also constrains progress towards full capital account convertibility. It may be mentioned that the reduction in fiscal deficit since 2003-04 has been associated with a phase of high GDP growth. Thus, lower fiscal deficit, which is a major ingredient of macroeconomic stability, provides a conducive environment for propelling growth of the economy. It is suggested that Gross Fiscal Deficit, each for Centre and States (consolidated) may be fixed at 2.5 of GDP. Accordingly, each State may fix fiscal deficit target in terms of their GSDP.

Attempts may be made to make incremental debt consistent with fiscal deficit. One way of doing this is to take into account the off-budget debts like oil and fertilizer bonds for calculation of fiscal deficit.

VI.2 Setting out Debt Rules

The high level of fiscal deficits both at the Centre and the States led to debt accumulation over the period resulting in a rise in the debt to GDP ratio. The combined debt-GDP ratio of Centre and States was about 81.0 per cent during 2004-06. Following the impact of fiscal responsibility legislations at both the Centre and States, the combined debt-GDP ratio has come down in recent years to 73.6 per cent in 2007-08. Still this level of debt-GDP ratio is high by international standards (Table 16).

Countries like Colombia, Ecuador, Panama, Pakistan and Sri Lanka have definite debt-GDP targets. In India, under the FRBM Act, the Centre has a rule for incremental debt. Many States have debt-GSDP rules under their FRLs. In

Table 16: Debt-GDP Ratio – Select Countries				
				(Per cent of GDP)
Country	**Public Debt**			
	2003	**2004**	**2005**	**2006P**
1	2	3	4	5
China	19.2	18.5	17.9	17.3
Republic of Korea	21.9	25.2	29.5	32.2
India	62.9	63.9	63.4	61.5
Indonesia	58.3	55.7	46.5	40.9
Malaysia	68.8	66.7	62.5	56.5
Thailand	50.7	49.5	47.4	42.3

Source: Asian Economic Monitor and Budget Documents of Government of India.

order to make the rule more transparent and target oriented, a defined Debt-GDP rule may be prescribed for the Centre. Each State may also prescribe a target for debt-GSDP. The objective should be to reduce the combined debt-GSDP ratio of Centre and States to a level of about 60 per cent in the medium term and to about 50 per cent in the long term.

In addition to the debt-GDP rule, it is suggested that a rule may be prescribed for primary revenue balance (PRB); PRB should be in surplus and adequate enough to meet interest payments both for the Centre and the States.

VI.3 Expenditure Rules

Fiscal responsibility laws of many countries like Argentina, Colombia and Ecuador have numerical rules for expenditure. The FRBM Act of the Centre and FRLs of the States do not provide for any expenditure rules. With revenue side showing reasonable buoyancy it may be desirable to fix some numerical targets in respect of certain categories of expenditure. This would enable reprioritization of expenditure in the desirable direction. In terms of a preliminary exercise, the following suggestions are made with regard to expenditure rules.

VI.3.a Central Government

Targets may be fixed for non-interest revenue expenditure (NIRE). As a ratio to GDP, NIRE has increased from 8.3 per cent during 1998-2003 to 8.6 per cent during 2004-09. With continuation of revenue buoyancy, a target for NIRE may be fixed at about 10 per cent. Within NIRE, there are two components which are treated as productive *i.e.*, plan revenue expenditure on social services and plan revenue expenditure on economic services. These two components accounted for 2.0 per cent of GDP during 2004-09 compared to 1.4 per cent of GDP during 1998-2003. Another productive component of total expenditure relates to non-defense capital outlay which as a ratio to GDP improved from 0.5 per cent during 1998-2003 to 0.7 per cent during 2004-09. Combining plan revenue expenditure on social and economic services with non-defense capital outlay, a concept of core expenditure may be evolved. All the three components, individually as well as collectively, may have numerical targets to be achieved in the medium term.

VI.3.b. State Governments

Similar numerical expenditure rules as proposed for the Centre may also be prescribed for the State Governments. State Governments, which spends on an average about 5.5 per cent of GDP on social sector, may have an additional numerical target for social sector expenses.

VI.4 Instruments for Financing Fiscal Deficit

Presently, the Centre and States have a number of instruments at their disposal for financing their gross fiscal deficit. Central Government basically rely on market borrowings for financing fiscal deficit apart from support from few instruments under public account. The financing pattern of States is witnessing a compositional shift with market borrowings emerging as the dominant source and a declining role for flows from national small savings funds (NSSF).

It is suggested that the instruments for financing fiscal deficit should be negotiable instruments with their yield determined by the market. In this context, market borrowings stand out to be the ideal instrument. As regards public accounts, the Governments act as bankers. It is suggested that the public accounts may be managed on a professional basis by setting up of separate trusts and these funds may not be used for financing deficit of the Government sector.

VI.5 Scheme of Incentives for States

TFC recommended that the scheme of Debt Consolidation and Relief Facility be made conditional to enactment of FRLs by the States. The incentive scheme did work as under the rule based fiscal policy framework, the fiscal position of the State Governments showed noticeable improvement. Thus, attainment of fiscal prudence by the State Governments may be continued to be incentivised for their future fiscal consolidation on a durable basis.

VI.6 Devolution and Transfer to States

Devolution and transfer to States is an extensive area and beyond the scope of this paper. We have gauged some rough ideas with regard to possible amount of central transfer to States in terms of shareable tax and grants in aid. Given the precarious condition of finances of Panchayats and growing requirements of infrastructure in urban areas, there is a need to follow some normative approach to devolve grants to urban and rural local bodies.

SECTION VII
CONCLUDING OBSERVATIONS

The fiscal performance of the Centre and the States under the rule based framework has been encouraging. Both the levels of Government were able to recover from the severe fiscal stress experienced starting with mid/late nineties till early part of this decade. The major highlight of the improvement has been in the direction of reducing the key deficit indicators in terms of targets set under the fiscal regulations (FRBM/FRLs). The soundness of the macroeconomy aided the process of fiscal correction.

The medium term outlook (2010-15) for both the Central Government and State Governments estimated based on an econometric exercise and assumptions with regard to future growth and inflation is perceived to be rosy. In terms of the medium-term outlook for 2010-15, the gross and net tax revenue of the Centre would hover around 15 per cent and 11 per cent of GDP, respectively. Both revenue receipts and revenue expenditure would be around 13 per cent of GDP. Capital expenditure would improve in a gradual manner to about 2.34 per cent during 2010-15. Thus, the Centre's revenue account would balance and the fiscal deficit would be 2.5 per cent of GDP.

In case of States, the own tax revenue is on a rising trend and would average about 7.5 per cent of GDP during 2010-15. Share of central taxes and grants to States would be around 3.5 per cent of GDP and 2.7 per cent of GDP, respectively. With revenue receipts and revenue expenditure estimated at 14.8 per cent and 12.6 per cent of GDP, respectively, the State Governments would have revenue surplus of about 2.2 per cent of GDP. With the gross fiscal deficit fixed at 2.5 per cent of GDP, capital expenditure would rise to about 4.8 per cent of GDP.

The medium term outlook estimated in the paper would materialise subject to realization of assumptions with regard to growth and inflation.

Elements like implementation of award of Sixth Pay Commission, debt waiver and debt relief schemes and policy changes with regard to oil and petroleum products would also impact on the medium term outlook. In view of uncertainty and unpredictability, these elements have not been factored in the estimation for the medium term outlook.

While the fiscal correction both at the Centre and States has been significant during the current phase of fiscal reforms, the fiscal consolidation has been inadequate as has been discussed in this paper. Designing appropriate post FRBM/FRL fiscal architecture would carry forward the process of fiscal correction further to consolidate the gains on a durable basis. Some elements of future design of fiscal structure have been suggested in this paper for deliberation and consideration. Notwithstanding the temporary halt to the fiscal consolidation process during 2008-09 and 2009-10 in view of difficulties and uncertainties arising as a fallout of the global financial turmoil, the fiscal reform process needs to be put in place, once the economy stabilizes.

Annex I: Fiscal Responsibility Legislation of States

	States	Year of Enactment	Targets for Revenue Deficit (RD)	Targets for Gross Fiscal Deficit (GFD)	Targets for Liabilities
1	Karnataka	August 2002 (came into force on April 2003)	Nil by March 2006	3% of GSDP by March 2006	25 % of GSDP by March 2015
2	Kerala	September 2003 (Amended in 2005)	2% of GSDP by 2005-06, Nil by 2006-07	3.5% of GSDP by 2005-06 and 2% of GSDP by 2006-07	–
3	Tamil Nadu	May 2003 (Amended in 2005)	Eliminate RD by 2008-09	3% of GSDP by March 2008	–
4	Punjab	May 2003	Reduce RD/RR at least 5% points from the previous year, until revenue balance is achieved.	Contain annual growth rate of GFD to 2 per cent in nominal terms till GFD is below 3% of GSDP	Ratio of Debt-GSDP to be 40 % by 2006-07
5	Uttar Pradesh	February 2004	Nil by March 2009	3% of GSDP by March 2009	Not to exceed 25% of GSDP by March 2018
6	Gujarat	March 2005	Nil by March 2008.	3 % of GSDP by March 2009.	Ratio of Debt-GSDP to be 30% by March 2008.
7	Himachal Pradesh	April 2005	Reduce RD-RR ratio at least by 2% points each year until revenue surplus is achieved.	–	–
8	Maharashtra	April 2005	Eliminate RD by 2009	Shall specify by rules, for reduction of GFD.	–
9	Orissa	May 2005	Nil by 2008-09	3 % of GSDP by 2009; annual reduction of 1.5% of GSDP from 2004-05.	(i) Debt stock to be limited to 300 % of RR by 2007-08 (ii) IP/RR ratio to be limited to 18-25 %.
10	Rajasthan	May 2005	Nil by March 2009 with an average annual reduction of 3% in RD-RR ratio.	3 % of GSDP, annual reduction of 0.4 per cent of GSDP.	Outstanding Debt not to exceed twice the receipts in the Consolidated Fund of the State.

Annex I: Fiscal Responsibility Legislation of States *(Contd.)*					
	States	**Year of Enactment**	**Targets for Revenue Deficit (RD)**	**Targets for Gross Fiscal Deficit (GFD)**	**Targets for Liabilities**
11	Assam	May, 2005	Nil by March 2010.	3 % of GSDP by March 2010.	Restrict total Debt stock including the Government guarantees to 45 % of GSDP of the previous year at current prices by March 2010.
12	Tripura	June, 2005	Strive to have revenue balance and remain revenue surplus.	3% of GSDP by March 2010.	Not to exceed 40 per cent of GSDP by 2010
13	Haryana	July, 2005	Nil by 2008-09 and generate revenue surplus thereafter.	3% of GSDP by March 2010.	Ensuring outstanding total debt including contingent liabilities to 28% of GSDP by March 2010.
14	Manipur	August, 2005	Strive to have revenue balance and remain revenue surplus.	3% of GSDP.	–
15	Nagaland	August, 2005	Strive to have revenue balance and remain revenue surplus.	3% of GSDP by March 2009.	Total debt stock not exceeds more than 40% of the GSDP by March 2010.
16	Madhya Pradesh	August, 2005	Nil by March 2009	3% of GSDP by March 2009.	Not to exceed 40% of GSDP by 2015
17	Chhattisgarh	September, 2005	Nil by March 2009	3% of GSDP by March 2009	–
18	Andhra Pradesh	October, 2005	Nil by March	3% of GSDP by March 2010.	Not to exceed 35% of GSDP by March 2010
19	Uttaranchal	October, 2005	Nil by March 2009	3% of GSDP by March 2009.	Total outstanding liabilities not more than 25% of the GSDP by March 2015.
20	Arunachal Pradesh	March, 2006	Nil by March 2009.	3% of GSDP by March 2010.	–
21	Meghalaya	March, 2006	Nil by 2008-09.	3% of GSDP by 2008-09.	Total outstanding liabilities not more than 28% of the GSDP.

Annex I: Fiscal Responsibility Legislation of States *(Concld.)*

	States	Year of Enactment	Targets for Revenue Deficit (RD)	Targets for Gross Fiscal Deficit (GFD)	Targets for Liabilities
22	Bihar	April, 2006	Nil by 2008-09.	3 % of GSDP from 2008-09 onwards.	–
23	Goa	May, 2006	Nil by March 2009. annual reduction of 1.5 % of RD/RR from April 2006.	3 % of GSDP by March 2009 annual reduction of 0.5 % of GSDP from April 2006.	Total outstanding liabilities not more than 30 % of the GSDP by March 2009. Ratio of IP/RR not to exceed 20 % by March 2009.
24	Jammu and Kashmir	August 2006	• Maintain revenue surplus. • Initiate steps to strengthen revenue surplus.	• 3 per cent of GSDP by March 2010. • Reduce GFD/GSDP by 0.5 per cent in each financial year beginning April 2006.	• The total outstanding liabilities shall not exceed 55 percent of estimated GSDP in 2010. • Annual reduction in the outstanding liabilities/GSDP ratio by 500 basis points every year.
25	Mizoram	October 2006	• Nil by March 31, 2009.	• 3 per cent of GSDP by March 2009. • Reduce GFD/GSDP by such percentage points in each financial year so as to achieve 3 per cent of GSDP in March 2009.	• Total outstanding debt, excluding public account, in a year shall not exceed twice that of the estimated receipts in the consolidated fund of the State at the close of the financial year.
26	Jharkhand	May 2007	• Nil by March 31, 2009.	• 3 per cent of GSDP by March 2009. • Reduce GFD/GSDP by such percentage points in each financial year so as to achieve 3 per cent of GSDP in March 2009.	• The total debt stock should be limited to 300 per cent of the TRR of the State by 2007-08. • In order to bring the debt stock to a sustainable level, interest payments (IP) to revenue receipts (RR) ratio is to be limited to 18 to 25 per cent.

Source: Respective State Governments.

Annex II : The Framework for Medium Term Outlook for Central and State Governments

We use a simple budgetary identity for the projection of deficit and debt, which is as follows:

Central Government

GFD = NIRE + IP + CE – TR – NTR (1)

The notations and the functional relations are,

GFD = Gross fiscal deficit

NIRE = Non-interest revenue expenditure = f{nominalGDP, NIRE(-1)} (2)

IP = Interest payments = {average interest rate * debt(-1)} (3)

CE = Capital expenditure = f{nominalGDP, CE(-1)} (4)

NTR = Non-tax revenue = f{nominalGDP, NTR(-1)} (5)

TR = Net tax receipts = CT + IT + CUS + EXC + OT

Where,

CT = Corporate tax = f(manufacturing output) (6)

IT = Income tax = f(realGDP, GDPdeflator) (7)

CUS = Custom duty = f{import, CUS(-1)} (8)

EXC = Excise duty = f(trend) (9)

OT = Other taxes = f(trend) (10)

In the present system of budget accounting in case of the Central Government, there is a large difference between change in debt and gross fiscal deficit. Of late, a major component of this difference has been the borrowing under market stabilisation scheme, which is not used for financing deficit but has impact on GFD from the due interest payments. Therefore, we define

Debt = Debt(-1) + ΔDebt (11)

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Where, ΔDebt is the change in debt, which varies with the size of the gross fiscal deficit. Thus,

$\Delta Debt = f\{GFD, \Delta Debt(-1)\}$ (12)

State Governments

A similar framework was also used for the States, which is as follows:

GFD = NIRE + IP + CE – OWT – OWNT – SCT – GIA (13)

Where NIRE = f{realGDP, GDPdeflator, NIRE(-1)} (14)

CE = f(realGDP, GDPdeflator) (15)

OWT = Own tax = f(realGDP, GDPdeflator) (16)

OWNT = Own non-tax = f{nominalGDP, OWNT(-1)} (17)

SCT = Shared central taxes (a multiple of the figure from the Central Budget) (18)

GIA = Grants-in-Aid (a multiple of the figure from the Central Budget) (19)

Debt = Debt(-1) + GFD (20)

The components of receipts and expenditure as defined by the functions (2) to (10) for the Central Government and (14) to (19) were estimated for varying periods ending with 2007-08 (revised estimates).[9] The estimated parameters (details are presented in Annex II - Tables 1 and 2) are:

Central Government

a) Corporate tax buoyancy = 1.45 with respect to manufacturing output

b) Income tax buoyancy = 1.4 with respect to real GDP and 1.16 with respect to price

c) Customs duty buoyancy = 0.49 with respect to value of imports

d) Excise duty trend growth = 9.85 per cent

[9] We considered varying periods for different components of receipts and expenditure due to structural breaks in the series. The time period with the best diagnostic statistics of the estimates was chosen.

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

e) Non-tax revenue buoyancy = 0.97 with respect to nominal GDP

f) Non-interest revenue expenditure buoyancy = 1.08 with respect to nominal GDP

g) Capital expenditure buoyancy = 0.53 with respect to nominal GDP

h) Change in debt = 1.23 time of GFD.

States

a) Own tax revenue buoyancy = 1.75 with respect to real GDP and 0.34 with respect to price

b) Own non-tax revenue buoyancy = 0.87 with respect to nominal GDP

c) Non-interest revenue expenditure buoyancy = 1.18 with respect to real GDP and 0.73 with respect to price

d) Capital expenditure buoyancy = 3.18 with respect to real GDP and -1.15 with respect to price

e) It is observed that consolidated shared central taxes obtained from the State budgets is about 88 per cent of the figure reported in the Central budget, while the corresponding grants-in-aid figures are 118 per cent.

Medium-Term Outlook under Alternative Scenarios

We considered two alternative scenarios of GDP growth viz., 9.0 per cent and 8.0 per cent with rate of inflation of 4.0 per cent. For the two GDP growth scenarios, the nominal growths in manufacturing output are 15.0 per cent and 13.85 per cent, growth in imports in Rupee terms of 28.0 per cent and 25.0 per cent, excise duty growth of 9.8 per cent and 9.1 per cent, respectively. Other taxes are assumed to grow by 27.0 per cent in 2008-09 and thereafter decline to 15.0 per cent as its base expands with GDP growth of 9.0 per cent and decelerate to 25.0 per cent in 2008-09 and thereafter to 13.85 per cent with GDP growth of 8.0 per cent.

The following Tables provide baseline scenario of medium-term outlook for Central and State Governments under alternative growth scenario.

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Annex II - Table 1: Buoyancy and Growth Rates of Taxes and Expenditure-Centre

Variables	Corporate Tax	Income Tax	Customs	Excise	Non-tax Revenue	Non-interest Revenue Expenditure	Capital Expenditure	Change in Outstanding Debt
Sample Period	1996 to 2008	1991 to 2008	1985 to 2007	1991 to 2008	1984 to 2008	1991 to 2008	1982 to 2008	1984 to 2008
1	2	3	4	5	6	7	8	9
Constant	-13.93 (-27.1) *	-10.1 (-2.1) ***	1.75 (4.3) *	8.1 (234.4) *	-1.30 (1.6)	-0.79 (-2.4) **	1.25 (3.1) *	-1.43 (-2.3) **
Manufacturing (nominal)	1.94 (48.0) *							
GDP (nominal)					0.41 (2.2) **	0.26 (2.6) **	0.21 (2.6) **	
GDP (real)		1.40 (4.2) *						
GDP Deflator		1.16 (3.8) *						
Import (nominal)			0.18 (3.3) *					
Lag of Dependent Variable			0.63 (6.6) *		0.58 (3.2) *	0.76 (7.6) *	0.60 (4.4) *	0.39 (2.5) **
Trend				0.985 (85.4) *				
Gross Fiscal Deficit								0.75 (4.0) *
R-bar square	0.995	0.99	0.98	0.998		0.998	0.963	0.966
DW-Statistics	1.82	1.76	1.51	2.01		2.03	1.66	1.64

*, ** and *** denotes significance at 1%, 5% and 10% critical value.

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Annex II - Table 2: Buoyancy and Growth Rates of Taxes and Expenditure-States

Variables	Own Tax	Sales Tax (VAT)	Own Non-Tax	Non-interest Revenue Expenditure	Capital Expenditure	Shared Central Tax	Grants in Aid
Sample Period	1992 to 2008	1992-2008	1982 to 2008	1991 to 2008	1992 to 2008	1995 to 2008	1995 to 2008
1	2	3	4	5	6	7	8
Constant	-13.8 (-11.6) *	-13.67 (-10.8) *	-1.35 (-2.3) **	-2.77 (-2.2) **	-35.47 (-7.2) *	4805.0 (3.92) *	-6512.0 (-4.8) *
GDP (nominal)			0.52 (2.8) *				
GDP (real)	1.75 (21.5) *	1.71 (19.6) *		0.68 (4.5) *	3.18 (9.3) *		
GDP Deflator	0.34 (3.8) **	0.42 (4.3) *		0.42 (2.5) **	-1.15 (-3.0) *		
Lag of Dependent Variable			0.41 (2.0) ***	0.42 (3.0) *			
Shared central Tax from Central Budget						0.88 (53.3) *	
Grants-in-aid from Central Budget							1.18 (45.6) *
R-bar square	0.999	0.998	0.992	0.998	0.98	0.995	0.994
DW-Statistics	1.80	1.99	1.74	1.94	1.68	1.93	2.09

*, ** and *** denotes significance at 1%, 5% and 10% critical value.

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Annex II - Table 3: Medium Term Outlook of Central Government - Baseline Scenario

(Growth 9% and Inflation 4%) (Per cent to GDP)

Fiscal Indicators		2010-11	2011-12	2012-13	2013-14	2014-15	2010-15 Average
1		2	3	4	5	6	7
I.	Gross Tax Revenue (a to e)	13.83	14.30	14.80	15.33	15.90	14.83
	a) Income Tax	2.81	2.92	3.03	3.14	3.26	3.03
	b) Corporate Tax	4.95	5.33	5.74	6.18	6.66	5.77
	c) Excise Duty	2.50	2.43	2.37	2.30	2.24	2.37
	d) Customs Duty	2.27	2.29	2.32	2.34	2.36	2.31
	e) Other Tax	1.30	1.32	1.34	1.37	1.39	1.34
II.	Share of State in Central Taxes	3.67	3.79	3.92	4.06	4.21	3.93
III.	Net Tax Revenue (I-II)	10.17	10.51	10.88	11.27	11.69	10.90
IV.	Non-Tax Revenue	1.96	1.95	1.94	1.94	1.93	1.94
V.	Revenue Receipts	12.13	12.46	12.82	13.20	13.62	12.84
VI.	Revenue Expenditure	12.81	12.89	12.91	12.89	12.79	12.86
	a) Interest Payments	3.65	3.63	3.57	3.45	3.27	3.51
	g) Non-Interest Revenue Expenditure	9.17	9.26	9.35	9.44	9.53	9.35
	h) Grants to States	2.29	2.31	2.34	2.36	2.38	2.34
VII.	Revenue Deficit	0.68	0.42	0.10	-0.32	-0.83	0.01
VIII.	Capital Expenditure	1.67	1.61	1.54	1.46	1.39	1.53
IX.	Gross Fiscal Deficit	2.36	2.03	1.63	1.14	0.56	1.55
X.	Debt	62.26	61.21	59.20	56.02	51.47	58.03
XI.	Interest Payments to Revenue Receipts	30.06	29.12	27.83	26.13	23.98	27.43

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Annex II - Table 4: Medium Term Outlook of Central Government – Alternative Baseline Scenario

(Growth 8% and Inflation 4%) (Per cent to GDP)

Fiscal Indicators		**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2010-15 Average**
1		2	3	4	5	6	7
I.	Gross Tax Revenue (a to e)	13.75	14.17	14.62	15.10	15.60	14.65
	a) Income Tax	2.79	2.88	2.98	3.08	3.19	2.99
	b) Corporate Tax	4.88	5.23	5.60	6.01	6.44	5.63
	c) Excise Duty	2.52	2.45	2.39	2.33	2.27	2.39
	d) Customs Duty	2.28	2.30	2.32	2.33	2.34	2.31
	e) Other Tax	1.28	1.31	1.33	1.35	1.37	1.33
II.	Share of State in Central Taxes	3.64	3.76	3.87	4.00	4.14	3.88
III.	Net Tax Revenue (I-II)	10.11	10.42	10.74	11.09	11.47	10.77
IV.	Non-Tax Revenue	1.98	1.97	1.97	1.96	1.95	1.97
V.	Revenue Receipts	12.08	12.39	12.71	13.06	13.42	12.73
VI.	Revenue Expenditure	13.08	13.25	13.39	13.48	13.52	13.35
	f) Interest Payments	3.78	3.83	3.86	3.85	3.80	3.82
	g) Non-Interest Revenue Expenditure	9.30	9.42	9.53	9.63	9.73	9.52
	h) Grants to States	2.33	2.35	2.38	2.41	2.43	2.38
VII.	Revenue Deficit	1.00	0.86	0.68	0.43	0.10	0.61
VIII.	Capital Expenditure	1.70	1.64	1.58	1.51	1.44	0.61
IX.	Gross Fiscal Deficit	2.70	2.51	2.25	1.93	1.54	2.19
X.	Debt	65.17	65.67	65.54	64.57	62.58	64.21
XI.	Interest Payments to Revenue Receipts	31.25	30.94	30.38	29.52	28.29	30.08

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Annex II - Table 5: Medium Term Outlook of State Governments - Baseline Scenario

(Growth 9% and Inflation 4%) (Per cent to GDP)

Fiscal Indicators		2010-11	2011-12	2012-13	2013-14	2014-15	2010-15 Average
1		2	3	4	5	6	7
I.	Own Tax Revenue	6.97	7.22	7.48	7.75	8.03	7.49
	a) Sales Tax (VAT)	4.21	4.36	4.52	4.68	4.84	4.52
	b) Other Taxes	2.76	2.86	2.97	3.08	3.19	2.97
II.	Share from Central Taxes	3.29	3.39	3.50	3.62	3.75	3.51
III.	Total Tax Revenue	10.64	11.01	11.40	11.82	12.25	11.42
IV.	Own Non-Tax Revenue	1.17	1.15	1.14	1.12	1.10	1.14
V.	Grants from Centre	2.61	2.65	2.68	2.72	2.75	2.68
VI.	Total Non-Tax Revenue	3.78	3.80	3.82	3.84	3.85	3.82
VII.	Total Transfer from Centre	5.90	6.04	6.19	6.34	6.50	6.19
VIII.	Total Own Revenue	8.14	8.38	8.62	8.87	9.14	8.63
IX.	Total Revenue Receipts	14.04	14.42	14.81	15.21	15.64	14.82
X.	Revenue Expenditure	12.49	12.48	12.48	12.49	12.51	12.49
	c) Interest Payments	1.94	1.87	1.80	1.75	1.70	1.81
	d) Non-Interest Revenue Expenditure	10.55	10.61	10.67	10.74	10.81	10.68
XI.	Revenue Deficit	-1.56	-1.94	-2.33	-2.72	-3.13	-2.33
XII.	Capital Expenditure	3.66	4.02	4.41	4.83	5.30	4.45
XIII.	Gross Fiscal Deficit	2.11	2.08	2.08	2.11	2.17	2.11
XIV.	Debt	26.11	25.19	24.37	23.68	23.73	24.50
XV.	Interest Payments to Revenue Receipts	13.83	12.97	12.19	11.47	10.84	12.26

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Annex II - Table 6: Medium Term Outlook of State Governments – Alternative Baseline Scenario

(Growth 8% and Inflation 4%) (Per cent to GDP)

Fiscal Indicators		2010-11	2011-12	2012-13	2013-14	2014-15	2010-15 Average
1		2	3	4	5	6	7
I.	Own Tax Revenue	6.84	7.05	7.26	7.47	7.70	7.26
	a) Sales Tax (VAT)	4.14	4.26	4.39	4.52	4.65	4.39
	b) Other Taxes	2.70	2.79	2.87	2.96	3.05	2.87
II.	Share from Central Taxes	3.28	3.37	3.46	3.57	3.68	3.47
III.	Total Tax Revenue	10.12	10.41	10.72	11.04	11.38	10.74
IV.	Own Non-Tax Revenue	1.18	1.16	1.15	1.13	1.12	1.15
V.	Grants from Centre	2.65	2.69	2.73	2.77	2.81	2.73
VI.	Total Non-Tax Revenue	3.83	3.86	3.88	3.90	3.92	3.88
VII.	Total Transfer from Centre	5.92	6.06	6.20	6.34	6.49	6.20
VIII.	Total Own Revenue	8.02	8.21	8.40	8.61	8.81	8.41
IX.	Total Revenue Receipts	13.95	14.27	14.60	14.95	15.30	14.61
X.	Revenue Expenditure	12.56	12.54	12.53	12.52	12.52	12.53
	c) Interest Payments	1.99	1.93	1.87	1.81	1.76	1.87
	d) Non-Interest Revenue Expenditure	10.57	10.61	10.66	10.71	10.76	10.66
XI.	Revenue Deficit	-1.39	-1.73	-2.07	-2.42	-2.79	-2.08
XII.	Capital Expenditure	3.48	3.75	4.05	4.37	4.71	4.07
XIII.	Gross Fiscal Deficit	2.09	2.03	1.98	1.94	1.92	1.99
XIV.	Debt	26.71	25.88	25.08	24.34	23.65	25.13
XV.	Interest Payments to Revenue Receipts	14.29	13.53	12.81	12.13	11.49	12.85

Given the above assumptions of the baseline scenarios, while estimating the revenue receipts and non-interest expenditure through the estimated relationships above, we fixed the GFD to GDP ratio to 2.5 per cent of GDP. The adjustment to keep the GFD at the targeted level was made in the capital expenditure. Here also two growth scenarios of 9.0 per cent and 8.0 per cent were considered. The medium term outlooks with 9.0 per cent growth are reported in the text while for 8.0 per cent growth are set out in the following tables.

Annex II : The Framework for Medium Term Outlook for Central and State Governments *(Contd.)*

Annex II - Table 7: Medium Term Outlook of Central Government - GFD under Alternative Baseline Scenario 2.5% of GDP

(Growth 8% and Inflation 4%) (Per cent to GDP)

Fiscal Indicators		**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2010-15 Average**
1		2	3	4	5	6	7
I.	Gross Tax Revenue (a to e)	13.75	14.17	14.62	15.10	15.60	14.65
	a) Income Tax	2.79	2.88	2.98	3.08	3.19	2.99
	b) Corporate Tax	4.88	5.23	5.60	6.01	6.44	5.63
	c) Excise Duty	2.52	2.45	2.39	2.33	2.27	2.39
	d) Customs Duty	2.28	2.30	2.32	2.33	2.34	2.31
	e) Other Tax	1.28	1.31	1.33	1.35	1.37	1.33
II.	Share of State in Central Taxes	3.64	3.76	3.87	4.00	4.14	3.88
III.	Net Tax Revenue (I-II)	10.11	10.42	10.74	11.09	11.47	10.77
IV.	Non-Tax Revenue	1.98	1.97	1.97	1.96	1.95	1.97
V.	Revenue Receipts	12.08	12.39	12.71	13.06	13.42	12.73
VI.	Revenue Expenditure	13.04	13.18	13.31	13.44	13.57	13.31
	f) Interest Payments	3.74	3.76	3.78	3.81	3.85	3.79
	g) Non-Interest Revenue Expenditure	9.30	9.42	9.53	9.63	9.73	9.52
	h) Grants to States	2.33	2.35	2.38	2.41	2.43	2.38
VII.	Revenue Deficit	0.95	0.79	0.60	0.38	0.15	0.58
VIII.	Capital Expenditure	1.55	1.71	1.90	2.12	2.35	1.92
IX.	Gross Fiscal Deficit	2.50	2.50	2.50	2.50	2.50	2.50
X.	Debt	63.91	64.30	64.80	65.41	66.14	64.91
XI.	Interest Payments to Revenue Receipts	30.92	30.33	29.75	29.19	28.66	29.77

Annex II - Table 8: Medium Term Outlook of State Governments - GFD 2.5% of GDP under Alternative Baseline Scenario

(Growth 8% and Inflation 4%) (Per cent to GDP)

Fiscal Indicators		2010-11	2011-12	2012-13	2013-14	2014-15	2010-15 Average
1		2	3	4	5	6	7
I.	Own Tax Revenue	6.84	7.05	7.26	7.47	7.70	7.26
	a) Sales Tax (VAT)	4.14	4.26	4.39	4.52	4.65	4.39
	b) Other Taxes	2.70	2.79	2.87	2.96	3.05	2.87
II.	Share from Central Taxes	3.28	3.37	3.46	3.57	3.68	3.47
III.	Total Tax Revenue	10.12	10.41	10.72	11.04	11.38	10.74
IV.	Own Non-Tax Revenue	1.18	1.16	1.15	1.13	1.12	1.15
V.	Grants from Centre	2.65	2.69	2.73	2.77	2.81	2.73
VI.	Total Non-Tax Revenue	3.83	3.86	3.88	3.90	3.92	3.88
VII.	Total Transfer from Centre	5.92	6.06	6.20	6.34	6.49	6.20
VIII.	Total Own Revenue	8.02	8.21	8.40	8.61	8.81	8.41
IX.	Total Revenue Receipts	13.95	14.27	14.60	14.95	15.30	14.61
X.	Revenue Expenditure	12.58	12.59	12.60	12.63	12.65	12.61
	c) Interest Payments	2.02	1.98	1.95	1.92	1.90	1.95
	d) Non-Interest Revenue Expenditure	10.57	10.61	10.66	10.71	10.76	10.66
XI.	Revenue Deficit	-1.36	-1.68	-1.99	-2.32	-2.65	-2.00
XII.	Capital Expenditure	3.86	4.18	4.49	4.82	5.15	4.50
XIII.	Gross Fiscal Deficit	2.50	2.50	2.50	2.50	2.50	2.50
XIV.	Debt	27.41	26.97	26.58	26.23	25.92	26.62
XV.	Interest Payments to Revenue Receipts	14.45	13.88	13.35	12.85	12.39	13.38

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