Finances of State Governments: 2000-01* a Summary of Major Features

This article presents an overview[1] of the finances of the State Governments during 2000-01 mainly based on their budgets[2] . The fiscal position of States continues to be in imbalance in 2000-2001, notwithstanding the stated intentions in the budgets of States to make efforts to augment revenues and reduce expenditures. Fiscal correction as envisaged in the budgets reflects the increasing sensitivity of the States to the need for putting in place structural reforms. The consolidated fiscal deficit of 26 States as a ratio of gross domestic product (GDP) is budgeted at 4.1 per cent for 2000-01 compared with the budgeted 3.9 per cent and the revised estimate of 4.9 per cent during 1999-2000.

The article is divided into five Sections. A broad overview of the policy initiatives as proposed in the budgets for 2000-01 by the State Governments is presented in Section I, followed by a brief analysis of the revised estimates for the previous year (1999-2000) in Section II. The budget estimates for 2000-01 setting out the trends in receipts and expenditures are outlined in Section III. An analysis of aggregate public debt and outstanding liabilities of the State Governments is presented in Section IV. Section V concludes by outlining fiscal consolidation and the attendant issues in State finances.

Section I

Policy Development

Fiscal reforms form the major agenda of the budgets for 2000-01 of the State Governments. The relevant policy initiatives proposed in the budgets could be classified broadly into institutional, sectoral and fiscal consolidation.

The institutional reforms proposed in the State budgets aim essentially at playing a supporting role in strengthening fiscal consolidation within a given time frame. Many States have proposed a freeze on fresh recruitment as well as reviewing manpower requirements with a view to reducing the cost of administration. Some States have proposed to adopt decentralisation as the main policy plank through which expenditure moderation is to be achieved. As the financial health and management of State level public sector undertakings have been a cause for concern in the last few years, Maharashtra has proposed to set up a Board for Financial and Managerial Restructuring while Punjab has decided to undertake a comprehensive review of the functioning of the State Public Sector Undertakings, which includes closure of non-viable undertakings, after providing for suitable safety nets to the employees including the offer of voluntary retirement schemes (VRS).

Other institutional measures proposed to stabilise State finances include the establishment of Consolidated Sinking Fund for retiring public debt, prescribing a ceiling on guarantees and setting up of Guarantee Redemption Funds. The States like Andhra Pradesh, Arunachal Pradesh, Goa, Maharashtra, Mizoram, Nagaland and West Bengal have taken initiatives for setting up of Consolidated Sinking Funds to help retire debt repayments. The States of Gujarat, Rajasthan and Karnataka have already prescribed limits on guarantees. Following the steps taken by these

States, Tamil Nadu has in the current year's budget, proposed to impose a ceiling on guarantees while Rajasthan and Tripura have proposed Guarantee Redemption Funds. Furthermore, as a measure to enhance transparency in their budgetary practices, several States have published summary critical fiscal indicators in their budgets for 2000-01 along the lines of '*Budget at a Glance*' as presented by the Centre, on the recommendation of the Committee of State Finance Secretaries. The States of Assam, Karnataka and Maharashtra have recently presented White Papers capturing the fiscal health of the States in 2000, and giving detailed picture of the issues and state of affairs of finances of these States.

Sectoral reforms proposed by States relate to strengthening of basic infrastructures, agriculture and information technology (IT). The States' efforts towards improving infrastructure are intended to provide better infrastructural services to villages, with focus on agricultural research to enhance productivity. Rural development continues to be an important agenda for States. Orissa has given industry status to agriculture so as to promote the agricultural sector. Tripura has proposed to set up an Infrastructure Development Fund with a corpus of Rs.10 crore and Karnataka has proposed an infrastructure cess. Environmental protection is another important agenda for action proposed in the State budgets. Goa has proposed a 'Green Goa Fund' to be set up through a cess imposed on mining activity and a 'Plastic Containment Fund' through a cess on industries using plastic packaging material and plastic mineral water bottles. Information technology sector has been identified by many States, as an important driving force of economic activities and the measures to facilitate development of this sector include the setting up of separate funds, creation of software parks and training institutes. West Bengal has proposed to set up a Venture Capital Fund for information technology.

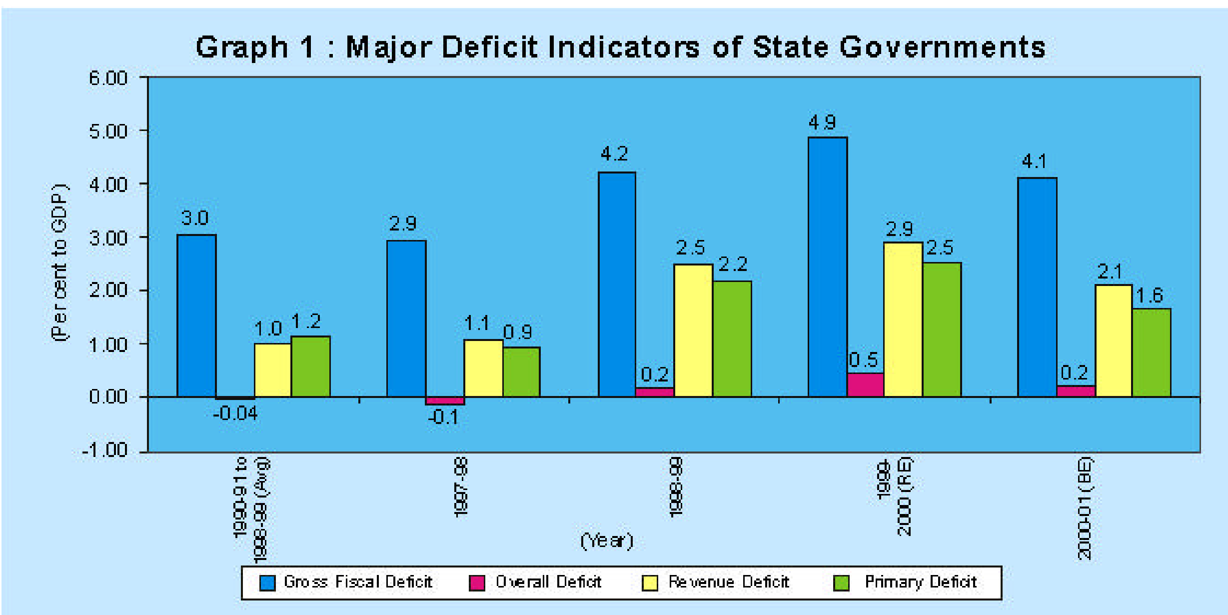
Maintenance and enhancement of social welfare and human resource development constitutes an area of importance from the policy point of view of State budgets focussing upon the welfare of the vulnerable sections of society such as the senior citizens, women and socially backward classes, etc. The important measures that would impact on the welfare of weaker sections of society are : provision of old age pension, pension for the physically handicapped, farmers and fishermen, and provision of social security for women. The State of Gujarat has identified certain milestones on the human development front to be achieved in a medium time frame, which include upgradation of the level of literacy, improvement in health services, increased construction of houses, improvement in connectivity of villages and creation of permanent sources of drinking water.

Fiscal consolidation measures proposed in the State budgets broadly explore ways of moderation of expenditure and revenue augmentation. Andhra Pradesh has identified performance indicators to assess the quality of expenditure restructuring. The measures include the setting up of Expenditure Reforms Committees proposed by some of the States. States have also initiated measures for reduction in non-merit subsidies, through better targeting and reduction of non-productive expenditures as part of expenditure management. In regard to revenue augmentation, the budget proposal includes enhancement/restructuring of land revenue rates, vehicle tax, entertainment tax, sales tax, betting tax, etc. The State Governments have through a landmark agreement, decided to implement a harmonised floor rate of sales tax, as a prelude to the introduction of a uniform Value Added Tax (VAT) by the States. In fact, almost all the States with the exception of a few have achieved total or near total compliance in the implementation of uniform sales tax rates. The proposal to strengthen non-tax revenue flows comprises the levy of electricity duty and enhancement of power tariff. Punjab has indexed user charges and fees for sectors like transport and power to the cost of fuel, electricity, salaries and wages as may be relevant.

Section II

Revised Estimates: 1999-2000

The revised estimates for 1999-2000 placed the consolidated revenue deficit at 2.9 per cent of GDP, 0.9 percentage point higher than 2.0 per cent envisaged in the budget estimate. The gross fiscal deficit (GFD) of States touched the level of 4.9 per cent of GDP surpassing the previous level of 4.2 per cent in 1998-99 (Graph 1) and 3.9 per cent envisaged in the budget. In absolute terms, GFD amounted to Rs.94,739 crore, exceeding the budget estimates by Rs.16,951 crore (21.8 per cent) or 0.9 percentage point of GDP. Expenditure overruns, in relation to GDP, had contributed to 0.6 percentage point in the GFD slippage, while revenue shortfall accounted for the balance 0.3 percentage point. The primary balance, a broad indicator of sustainability of current fiscal policies, registered a deficit of 2.5 per cent of GDP compared with the budgeted level of 1.6 per cent in 1999-2000 (Table 1).



The expenditure side of State finances was under intense pressure mainly on account of a persistent rise in administrative expenditure, in which wages and salaries constituted the major component. Revenue receipts, on the other hand, showed a shortfall of Rs.5,344 crore (2.4 per cent) in the revised over the budget estimates of Rs.2,20,154 crore in 1999-2000 (Table 2). The shortfall in States' own taxes was to the extent of Rs.5,681 crore, mainly due to lower realisation in taxes on commodities presumably on account of the initial losses due to rationalisation and harmonisation measures being undertaken as a move towards a uniform VAT. The States' own tax revenue suffered slippage of 5.1 per cent in the revised estimates for 1999-2000 over the budgeted level (Table 3). This was mainly due to shortfall in the taxes on property, and commodities and services which declined by 4.6 per cent and 5.4 per cent, respectively, over the budgeted level. As a result, the share of the States' own taxes in the total revenue receipts declined to 49.2 per cent in the revised estimates as compared to 50.6 per cent projected in the budget estimates.

The deficiency in States' own taxes was offset partially by a rise of Rs.369 crore from States' own non-tax receipts and Rs.1,380 crore in grants from the Centre. The current transfers from the Centre (share in Central taxes and grants) at Rs.79,539 crore, was slightly lower than the budgeted levels. Even in respect of revenue transfer from the Centre, the share in Central taxes remained lower by 3.1 per cent over the budget estimates reflecting the general sluggishness in Centre's tax collection witnessed in 1999-2000. The States' capital receipts in the revised estimates on the other hand were higher by Rs.13,174 crore (14.9 per cent) than the budget estimates (Table 4). Of this rise, almost a quarter (23.2 per cent or Rs. 3,053 crore) was realised through market borrowings and other borrowings from banks and financial institutions, 36.0 per cent or Rs.4,746 crore was obtained through the increase in small savings and provident fund collections of States, and loans from the Centre accounted for 20.8 per cent of the increase. Deposits and advances encompassing mainly the deposits of local bodies, defence and postal deposits contributed 15.5 per cent or Rs.2,040 crore to the rise in capital receipts.

Aggregate expenditures of States surpassed the budget estimates by Rs.14,348 crore during 1999-2000. Both revenue and capital components contributed to the excessive growth in overall expenditures. Revenue expenditure exceeded the budget estimates by 4.1 per cent, while capital expenditure overshot by 7.2 per cent. The major component which has contributed to the growth in expenditures has been the non-Plan component which formed almost 80 per cent of the total disbursements in 1999-2000. The principal non-Plan components which triggered the expenditure overruns were pensions (Rs.2,203 crore), interest on market loans (Rs.3,283 crore), additional expenditures on natural calamities (Rs.1,043 crore) and compensation and assignments to local bodies (Rs.1,234 crore). Although, capital expenditures showed a rise of 7.2 per cent (Rs.3,614 crore) in the revised estimates over the budgeted levels of 1999-2000, a significant portion of this has been on account of debt servicing obligations, which accounted for around 43.7 per cent of the rise in capital expenditures. Repayment of loans to Centre rose by Rs.1,483 crore over the budget estimates. Loans and advances extended by the States were higher by Rs.1,984 crore over the budget estimates.

The expenditure overruns which stemmed largely from the persistent rise of committed revenue expenditures, left the States with little maneuverability to undertake higher investment in social and economic services. The developmental expenditure grew by 13.4 per cent on an average during the period 1990-99, while non-developmental expenditure showed a higher growth of 18.3 per cent. In the revised estimates for 1999-2000, the non-developmental expenditure showed an even faster growth at 27.4 per cent as compared with the 20.6 per cent growth in developmental expenditure over 1998-99 (Tables 7 and 8).

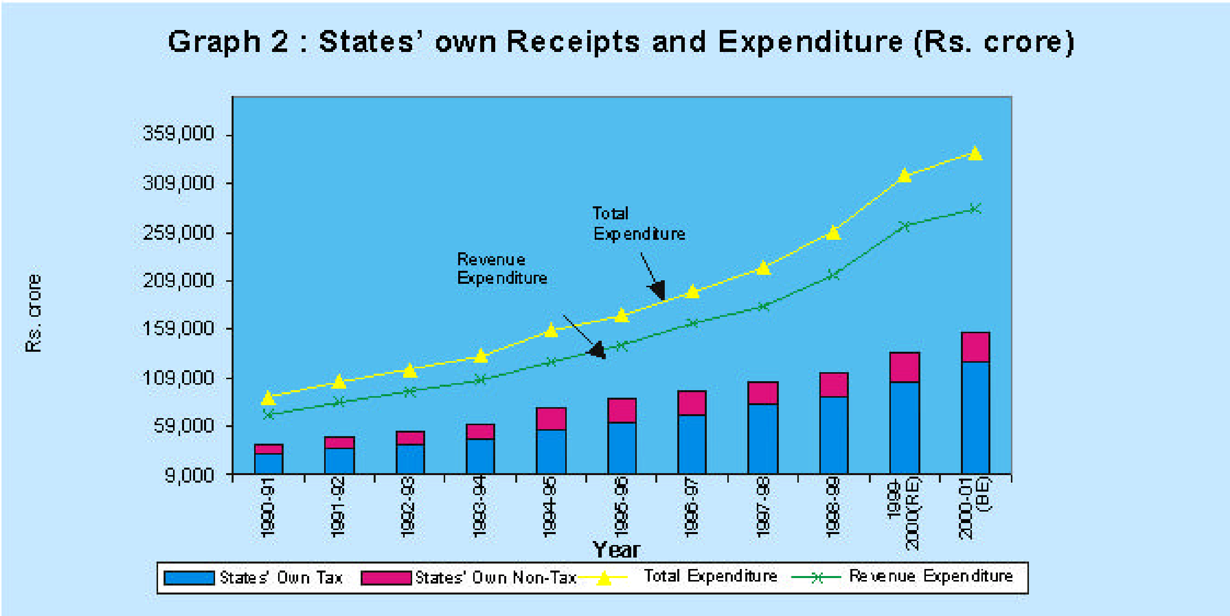
The stress in the finances of States during 1999-2000 was reflected not only in the substantial growth in fiscal deficit, but also in the continued preemption of a major portion of borrowed funds for financing the revenue gap. The revenue deficit formed 60.0 per cent of the GFD as compared with 58.8 per cent in 1998-99 and 29.9 per cent in 1991-92. This preemption has resulted in reduction in capital outlay (or investment expenditure), which had declined from 31.1 per cent of GFD in 1998-99 to 30.3 per cent in 1999-2000. The shift in the utilisation pattern towards revenue expenditures, in particular charged and committed expenses, has implications for the future fiscal health of States. On the financing side, although loans from the Centre continue to be the prime source of financing of the GFD, market borrowings and other liabilities, in particular provident funds and small savings have been increasing in absolute amounts. As a result, the servicing costs of borrowings have gone up.

Section III

Budget Estimates 2000-01

The State Government budgets for 2000-01 envisage fiscal stabilisation mainly through limiting revenue imbalances. The consolidated revenue deficit is budgeted to decline substantially by 19.5 per cent and is estimated at Rs.45,702 crore in 2000-01 as compared with Rs.56,802 crore in the previous year. In terms of GDP, the revenue deficit would be reduced to 2.1 per cent, compared with 2.9 per cent in 1999-2000 and 2.5 per cent in 1998-99. With the compression in revenue deficit, the fiscal deficit is projected to decline by 4.9 per cent at Rs.90,092 crore in 2000-01 from Rs.94,739 crore in 1999-2000 (revised estimates) and as ratio of GDP would decline to 4.1 per cent as against 4.9 per cent in 1999-2000. The primary deficit is budgeted lower at Rs.35,821 crore (1.6 per cent of GDP), a decline of 26.8 per cent over the previous year (Rs.49,213 crore or 2.5 per cent of GDP), reflecting the extent of correction envisaged in the non-interest expenditures as also the intentions of State Governments to contain their maneuverable expenses.

The consolidated revenue receipts of State Governments including the receipts from additional resource mobilisation (ARM), are budgeted higher at Rs. 2,44, 920 crore, recording a growth of 14.0 per cent over the revised estimates of Rs. 2,14,810 crore (Table 2). During 2000-01, 1 4 States proposed ARM to the tune of Rs.2,677 crore through both tax and non-tax measures. Tax receipts, inclusive of ARM[3], are budgeted to rise by 17.5 per cent to Rs.1,76,409 crore as compared with Rs.1,50,095 crore in 1999-2000. The States' own taxes are budgeted to record a rise of 18.9 per cent to Rs.1,25,60 4 crore with sales tax at Rs.74,896 crore contributing to 58.9 per cent to the rise in States' taxes. The States' own non-tax receipts at Rs.31,548 crore would record an increase of 6.5 per cent over that of Rs.29,634 crore during 1999-2000, a deceleration compared to the growth of 22.6 per cent in 1999-2000, mainly due to slowdown in the growth of interest receipts. The States' own resources are expected to finance 54. 1 per cent of the revenue expenditure and 44. 8 per cent of the aggregate expenditure, as compared with 49.8 per cent and 41.5 per cent, respectively, in 1999-2000 (Tables 2 and 3 and Graph 2).



The resource transfers from the Centre in the form of share in Central taxes, grants and loans are anticipated to be of a higher order. The shareable taxes are estimated to show 14.3 per cent rise to Rs. 50,805 crore as compared with Rs.44,458 crore (12.8 per cent) in the previous year, this is being attributed to the enhancement in the States' share in Central tax on the basis of the recommendations of the Eleventh Finance Commission(EFC)[4]. The gross transfer of resources from the Centre (comprising shareable taxes, grants and loans), budgeted at Rs.1,39,661 crore is higher by Rs.10,596 crore over Rs.1,29,066 crore in 1999-2000. However, in terms of rate of growth, it shows a deceleration to 8.2 per cent, as compared with the growth of 24.5 per cent in 1999-2000. The deceleration is reflected mainly in grants and loans from the Centre. *Grants-in-aid* are budgeted to decelerate to 5.4 per cent in 2000-01 from 47.0 per cent in 1999-2000, and loans and advances to 4.8 per cent from 22.8 per cent in the previous year (Table 9). The EFC has recommended a distribution of 29.5 per cent of the net proceeds of all shareable Central taxes and duties amongst all States for each of the five years 2000-01 to 2004-05. The EFC has indicated the total quantum of devolution of Central taxes/duties, *grants-in-aid* and Plan grants to be transferred to the States to be at a notional limit of 37.5 per cent of the gross revenue receipts of the Centre (Box: Major Recommendations of The Eleventh Finance Commission (2000-05).

BOX: Major Recommendations of The Eleventh Finance Commission (2000-2005)

The Eleventh Finance Commission (EFC) was constituted on July 3, 1998 (Chairman: Professor A.M.Khusro) under Article 280 of the *Constitution of India* to give recommendations on specified aspects of Centre-State fiscal relations during 2000-05.

The terms of reference were such that the EFC was required to make recommendations not only on the sharing of resources between the Centre and States but also to suggest measures for the restructuring of public finances of the Union and the States jointly and severally in order to restore budgetary balance and maintain macro economic stability. As per the terms of reference, the EFC was required to make recommendations on the following aspects:

(a) The distribution between the Union and States of the net proceeds of taxes which are to be, or may be, divided between them under Chapter 1 of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

(b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States which are in need of assistance by way of *grants-in-aid* of their revenues under Article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that Article;

(c) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the *Panchayats* in the State on the basis of the recommendations made by the Finance Commission of the State;

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

The Commission had earlier submitted an *interim* Report on January 15, 2000 making provisional tax sharing arrangements for 2000-01. The Commission submitted its report on July 7, 2000, covering all aspects of its original mandate. The major recommendations of the EFC are as follows:

(a) The Commission has recommended that 28 per cent of the net proceeds of all shareable Central taxes and duties may be distributed amongst all States for each of the five years 2000-01 to 2004-05. In addition, 1.5 per cent of the net proceeds of all shareable Central taxes and duties may be distributed amongst such States which do not levy and collect sales tax on sugar, textiles and tobacco. Thus, the total share of the States in the net proceeds of shareable Union taxes and duties would be 29.5 per cent. The Government has accepted these recommendations of the Commission.

(b) The Commission has recommended *Grants-in-aid* under *Article* 275(1) of the Constitution, amounting to Rs.35,359 crore to be provided to such States which will still have deficit on non-Plan revenue account even after the devolution of Central tax revenues, equal to the amount of deficits assessed during the period 2000-05. The Government has accepted this recommendation.

(c) The Commission has recommended grants totaling to Rs.4,972.63 crore towards upgradation of standards of administration and special problem grants to States, for the five years commencing from April 1, 2000 and the Government has accepted this recommendation.

(d) The Commission has recommended grants amounting to Rs.10,000 crore for local bodies (*Panchayats* and Municipalities) during 2000-05 to be utilised (except the amount earmarked for maintenance of accounts and audit and for development of data base) for maintenance of Civic Services (excluding payment of salaries and wages). *Inter-se* share of States in the grants provided for *Panchayats* and Municipalities is based on the rural/urban population of the State, index of decentralisation, distance from the highest per capita income, revenue effort of the local bodies and geographical area. The Government has accepted the above recommendations subject to certain modifications.

(e) The Commission has suggested the continuation of the existing scheme for providing for contribution at the ratio of 75:25 by Centre and States, respectively to the Calamity Relief Fund (CRF). At the same time, the Commission has recommended the discontinuation of the existing National Fund for Calamity Relief. Instead, the Commission has recommended that a National Calamity Contingency Fund (NCCF) be created in the Public Account of the Government of India. Any assistance provided by the Centre to the States for calamity relief would be financed by levy of a special surcharge on Central taxes for a limited period. The Government of India should contribute an initial core amount of Rs.500 crore to this fund, to be replenished by the levy of special surcharge as and when any drawals are made from it. The Government has accepted the above recommendations and the recommendation regarding the setting up of the NCCF would be implemented after the necessary legislation is enacted.

(f) The EFC has proposed to continue the existing debt relief scheme, which is linked to improvement in the revenue receipts to revenue expenditure ratio of a State with enhanced incentives. It has recommended debt relief to Punjab and Jammu and Kashmir on the basis of specified expenditure incurred on security. The EFC has also suggested fixing limits on guarantees given by the Centre and States under suitable legislation and also setting up of sinking funds for amortisation of debt. The Government has accepted these recommendations of the Commission.

(g) The EFC suggested that in deciding the level of revenue transfers from Centre to States all transfers have to be taken in their totality and their components like tax devolution, *grants-in-aid* and grants in other forms like Plan grants, should be decided in the light of the overall ceiling. In setting this ceiling, the EFC has indicated that the total quantum of devolution of Central taxes/duties, *grants-in-aid* and Plan grants to be transferred to the States to be at a notional limit of 37.5 per cent of the gross revenue receipts of the Centre. The Government has accepted the above recommendations, although this would not necessarily imply the establishment of the principle of mandatory sharing of a fixed percentage of Centre's revenue receipts with the States.

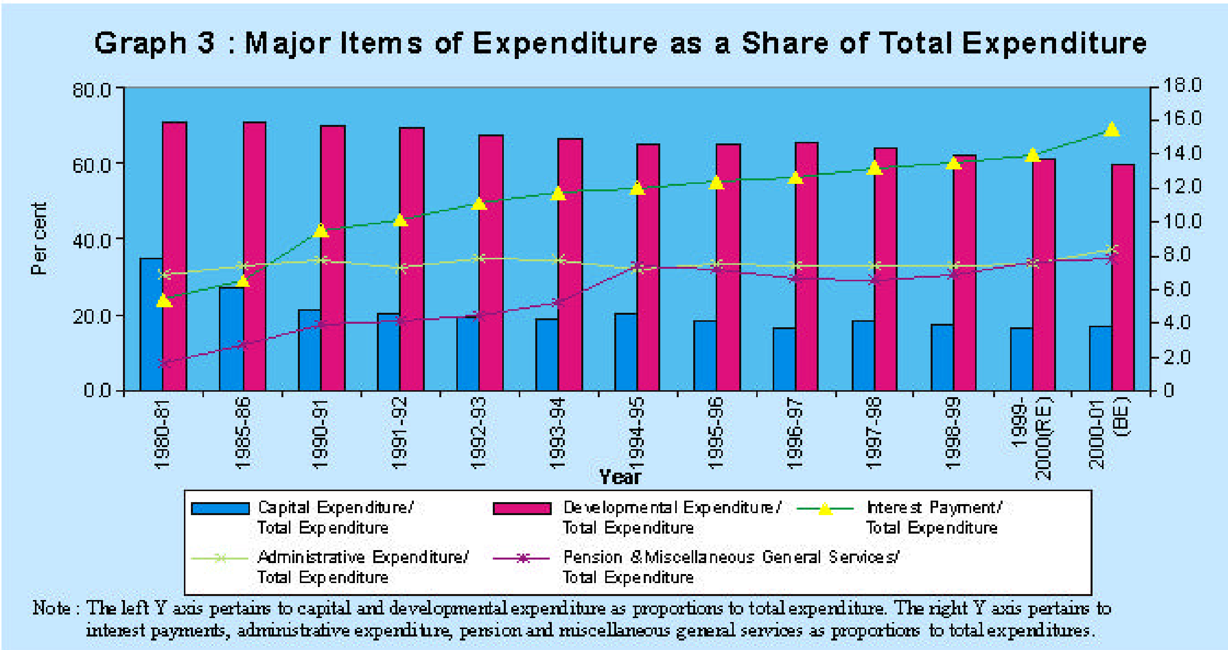
(h) As measures to widen the tax base, the Commission recommended for better exploitation of land based taxes, better administration of property and other taxes, and revision of ceiling on profession tax through a constitutional amendment. The Commission also suggested to include the services under the tax net for improving the buoyancy of indirect taxes.

(i) The EFC suggested that user charges should be linked to input costs, so that the process of periodic revision becomes automatic. Autonomous tariff commissions should be appointed to advise the Government on the revision of power tariff, railway tariffs, bus fares and other administered prices. There should also be regular revision of the royalties on minerals.

The Commission has remarked that the overall scheme of resource transfers would be characterized by providing a structure of incentives designed to reward fiscal prudence and discourage fiscal profligacy. The EFC has indicated that its recommendations would help reverse the period of negative fiscal finance by ending the era of revenue deficits and unsustainable fiscal deficits and consequent indebtedness. The States on the aggregate should, following from the EFC recommendations, reach the level of zero revenue deficit by the end of the reference period, i.e. 2004-05.

The consolidated capital receipts of the State Governments are projected at Rs.1,01,544 crore, showing a marginal decline of 0.1 per cent over Rs.1,01,612 crore in 1999-2000. Of this, the non-debt component, comprising recovery of loans and advances and disinvestment proceeds amounting to Rs.3,929 crore, constitutes only 3.9 per cent of the total capital receipts. The balance is in the nature of borrowings and public account liabilities. The decline in capital receipts is mainly on account of a budgeted decline in provident fund and small savings collections by 14.4 per cent, recovery of loans and advances by 12.1 per cent, and deposits and advances by 56.3 per cent. The loans from the Centre is budgeted to record a modest rise of 4.8 per cent to Rs. 51,893 crore in 2000-01 (Table 4).

The non-developmental components continue to surge up due to sharp rise in committed expenditures *viz*., interest payments (Rs. 8,745 crore), administrative services (Rs.4, 795 crore) and pensions (Rs.1, 526 crore) (Graph 3). As a result, the expenditures towards the developmental heads moved down with an overall adverse impact on social and economic services expenditures. The social services (including loans and advances) are budgeted to rise by a mere 2.4 per cent in 2000-01 to Rs.1,13,310 crore as compared with the rise of 25.6 per cent in the previous year, while expenditure on economic services (including loans and advances) are budgeted to decelerate to 8.4 per cent in 2000-01, as compared with the growth of 14.7 per cent in the previous year.



Graph 3 : Major Items of Expenditure as a Share of Total Expenditure

Note : The left Y axis pertains to capital and developmental expenditure as proportions to total expenditure. The right Y axis pertains to interest payments, administrative expenditure, pension and miscellaneous general services as proportions to total expenditures.

The budget estimates reflect that revenue deficit would absorb about 50.7 per cent of the GFD in 2000-01 as against 60.0 per cent in 1999-2000 (Table 6). However, it remains substantially higher than that of 28.3 per cent in 1990-91 with the result, the proportion of borrowed funds for financing investment expenditures (capital outlay) is placed at 38.9 per cent as compared with 30.3 per cent in 1999-2000. On the financing side, loans from Centre and market borrowings would contribute 46.8 per cent and 13.0 per cent to the GFD, respectively, suggesting the continued dependence of States on borrowed funds to meet the expenditure commitments (Table 5). Similarly, other liabilities, mainly comprising the State provident funds and small savings have been gaining predominance in the last few years.

Section IV

Debt and Liabilities

Market Borrowings

The market borrowings of State Governments during 1999-2000 amounted to Rs.13,706 crore (gross) and Rs.12,405 crore (net) as against Rs. 12,114 crore (gross) and Rs. 10,700 crore (net), respectively, in 1998-99. Through the pre-announced issues the State Governments had raised a gross amount of Rs.12,906 crore. Reflecting the general downward movement in interest rates in the economy, the interest rate on pre-announced issues of State borrowings declined from 12.25 per cent in the first tranche (April 1999) to 11.00 per cent in the fourth tranche (March 2000). Besides the pre-announced issues, Andhra Pradesh mobilised Rs.400 crore at a weighted average yield of 11.75 per cent and Tamil Nadu raised Rs.200 crore at 11.72 per cent on August 19, 1999, through auctions. Karnataka also entered the market on January 18, 2000 and mobilised Rs.200 crore through an auction at an even lower weighted average yield of 11.07 per cent. The gains from auction based borrowings by these States were reflected in the cut-off yield in auctions settling below the pre-announced coupon rates for the same maturity loans. The weighted average interest rate on market borrowings of States declined to 11.89 per cent in 1999-

2000 from 12.35 per cent in 1998-99.

For the fiscal year 2000-01, the provisional allocation of net market borrowings to States is placed at Rs.11,000 crore (gross Rs. 11,420 crore). In the first tranche of '10.52 per cent State Development Loans, 2010' on April 25, 2000, 25 States raised Rs.5,837.70 crore as against a notified amount of Rs. 4,369 crore. In the first auction for 10-year stocks held on August 8, 2000, Andhra Pradesh, Maharashtra, Tamil Nadu and West Bengal together raised Rs. 1,220 crore. Government of Kerala raised Rs. 200 crore through the sale of 10-year stock by auction on August 29, 2000. With this, the State Governments have so far (up to September 8, 2000) mobilised an aggregate amount of Rs. 7,257.70 crore. The interest rate on the pre-announced issue at 10.52 per cent, is 48 basis point lower than the similar maturity loan issued in March 2000. The auction results witnessed the cut-off yield on Maharashtra and Tamil Nadu auctions emerging at 11.70 per cent and for Andhra Pradesh and West Bengal at 11.80 per cent. The cut-off yield was 11.75 per cent for Kerala.

Debt Position

The mounting expenditure pressure and the shortfall in revenues have raised the level of States' deficits and led to a steady accumulation of debt. The outstanding stock of debt of State Government s rose to Rs.4,18,474 crore or 21.5 per cent of GDP at end-March 2000 as against 19.4 per cent of GDP at end-March 1999. As a result, the debt/GDP ratio is estimated to further go up to 22.9 per cent at end-March 2001 (Table 5). The recent accretion of debt has been at relatively high interest rate, given the implicit average interest rate on the outstanding State debt of about 13.0 per cent. Besides, with the debt growing at a faster rate during the nineties, along with relatively high interest rates, the interest payments burden has grown from 13.0 per cent of revenue receipts in 1990-91 to as high as 21.2 per cent in 1999-2000. Moreover, with mounting borrowing requirements and subdued/ moderate growth in revenues, the repayment obligations on debt have been high. While the high level of States indebtedness to Centre implies the problem of repayment accumulations and the need for extension of maturities, the high recourse to market borrowings would lead to bunching of repayments as the amounts to be earmarked for repayments on market borrowings every year would be on the rise in the medium term.

Contingent Liabilities

In addition to the burden of debt, the State Governments are presently faced with the problem of addressing contingent liabilities arising out of the guarantees extended by them as means to maintain public investments at the State level. The outstanding State Government guarantees (17 major States) as ratio to GDP stood at 4.7 per cent at end-March 1999, lower than the level of 6.5 per cent at end-March 1992. The nominal stock of guarantees, however, witnessed an annual average growth of 11.1 per cent between end-March 1992 and end-March 1999.

Apart from the explicit contingent liabilities, the State Governments have been issuing letters of comfort to banks/financial institutions, which are in the nature of implicit guarantees and are not included in the present estimates of guarantees. These letters of comfort, are however, internationally treated as guarantees since there is an implicit liability arising out of a letter of comfort. Recognising the need to contain guarantees devolving upon the State government, the

Technical Committee on State Government Guarantees recommended that the Government may eschew the practice of providing letters of comfort and where comfort from State Government is required, credit enhancement may be provided only through guarantees within the overall limit fixed for the purpose. Since the guarantees provided through this route have important implications from the viewpoint of the transparency in the budgetary practices and integrity of the fiscal accounts, the implicit guarantees provided by the State Governments need to be disclosed in the budget and included in the accounting of the stock of contingent liabilities.

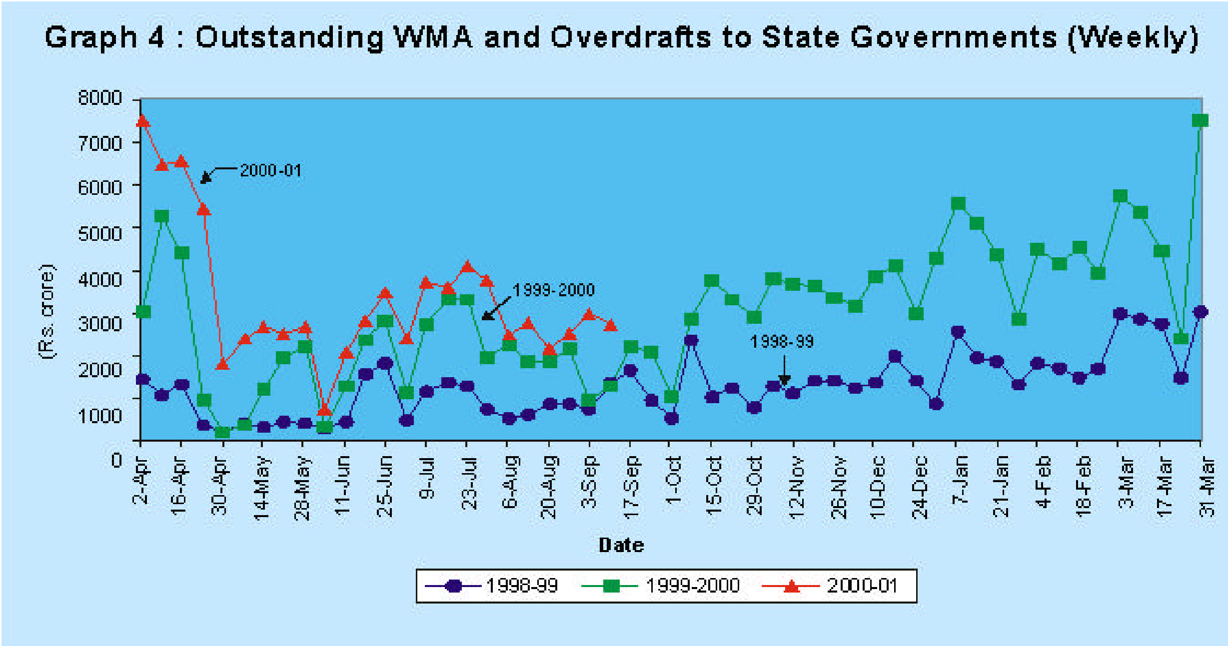
Ways and Means Advances

The Reserve Bank has raised the WMA (normal and special limits) for the State Governments with effect from March 1, 1999 to Rs.3,685 crore from Rs. 2,234.4 crore towards facilitating the management of temporary mismatches in receipt and payments of State Governments. Despite this enhancement, several States have continued to frequently resort to WMA and overdrafts during 1999-2000 (Graph 4). This was reflected in the higher outstanding level of WMA and overdrafts of States from the Reserve Bank at Rs.7,519 crore as on March 31, 2000 than that of Rs.4,818 crore in the previous year. During 1999-2000, nineteen States resorted to overdrafts, seven of them frequently. Two States could not clear their overdrafts with the Reserve Bank within the stipulated time limit and consequently the Reserve Bank had to stop payments on their behalf. During 2000-01, up to September 18, 2000, as many as eighteen States resorted to overdraft with the Reserve Bank and three States could not clear their overdraft with the Reserve Bank, leading to suspension of their payments.

Section V

Concluding Observations

The financial position of the State Governments continued to show sharp deterioration during 1999-2000. The strain on State finances experienced in the recent years is largely the outcome of limited resource base in the context of the significant growth in committed expenditures. The items of expenditure which have placed severe pressure on State finances are those relating to wages and salaries, pensions and interest payments which together constitute a major segment of non-Plan expenditure and absorb a sizeable portion of the revenue receipts. The major cause for concern on the revenue front is the near stagnation in States' tax-GDP ratio at around 5.4 per cent throughout the eighties and nineties.



The revenue expenditure mismatches and the consequential rise in the borrowings by the States added further stress to State finances and fiscal sustainability. While borrowings of State Governments have grown sharply, a major portion of the high-cost borrowed funds has been diverted to bridging the revenue gap, leaving very little of funds for investment in core sectors. The adverse impact of this trend is reflected in the slowdown in resource allocation for social and economic sectors.

The steady rise in States' debt/GDP ratio, which is budgeted to reach 22.9 per cent at end-March 2001 as against 20.5 per cent at end-March 1992, is a cause for concern from the viewpoint of future sustainability of budgetary policies of States. There are major challenges in the management of State debt, because the relatively high debt stock implies high interest burden, increasing repayment burden of loans, and large preemption of borrowed funds for unproductive expenditures. In addition there are other liabilities incurred through issue of guarantees, without prudent risk assessment. The inherent structural weakness of the State finances is also reflected in the liquidity management of State Governments. Despite the fact that the Reserve Bank has revised the Ways and Means Advances in March 1999, the States have often resorted to higher order of WMA and overdrafts in 1999-2000.

In the budgets for 2000-01, many State Governments have proposed measures towards fiscal consolidation. The resource gaps measured in terms of revenue deficit and gross fiscal deficit are projected at lower levels for 2000-01 through expenditure corrections and revenue augmentation. Some of the State Governments have taken initiatives for sector-specific measures and for institutional strengthening. The efficacy of the proposed initiatives, however, would depend upon how far the final budgetary outcomes of the States would be closer to the projected levels of revenue mobilization and expenditure patterns.

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* Prepared in the Division of Fiscal Analysis of the Department of Economic Analysis and Policy.

[1] A detailed study of the State Budgets is under preparation and will be published separately.

[2] The analysis is based on the budgets of 26 State Governments including the National Capital Territory of Delhi and uses supplementary information on additional resource mobilisation measures received from State Governments up to end-August 2000. The word 'States' is used interchangeably with the words 'State Governments' throughout this Article.

[3] As per the details received from State Governments upto August 31, 2000.

[4] The Eleventh Finance Commission in its *interim* report had recommended the States' share of the net proceeds of divisible income tax to be 80 per cent and 52 per cent share in the net proceeds of divisible special basic excise duties, as against 77.5 and 47.5 per cent, respectively proposed by the Tenth Finance Commission. In the Report submitted on July 7, 2000, it has suggested that the total share of the States in the net proceeds of Union taxes and duties would be 29.5 per cent.