Report
of
The Group on
Model Fiscal Responsibility Legislation
at State Level

The views expressed in the Report do not represent that of the Reserve Bank of India and that it is a Report of a Group of State Finance Secretaries

Reserve Bank of India

January 2005

January 19 , 2005

Smt. Shyamala Gopinath
Deputy Governor
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Mumbai

Madam,

Submission of the Report of the Group of
State Finance Secretaries on
Model Fiscal Responsibility Legislation at State Level

We submit herewith the Report of the Group of State Finance Secretaries on Model Fiscal Responsibility Legislation at State Level.

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Acknowledgements

First and foremost the Working Group is deeply indebted to the Chairman of the 12th Finance Commission, Dr.C.Rangarajan, for having spared his valuable time to address the Group and provide direction and focus to the deliberations. Gratitude is also expressed to Dr.D.K.Srivastava, Member, Finance Commission. The Group is grateful to Smt. Shyamala Gopinath, Deputy Governor, for taking a keen interest in the progress made by this Group. The Group gratefully acknowledges the support received from Smt.Usha Thorat, Executive Director. The Group places on record its appreciation for the team of senior officials from the RBI, in particular, Dr.Narendra Jadhav, Principal Adviser and Chief Economist, Department of Economic Analysis and Policy (DEAP) and Dr.R.K.Pattnaik, Adviser, DEAP, Shri G.S.Hegde, Jt.Legal Adviser, Legal Department, Dr.B.N.Ananthaswamy, Director, Internal Debt Management Department (IDMD), Smt.Abha Prasad, former Director, IDMD and Smt. R. Kausaliya, Director, DICGC. The invaluable contributions rendered by the resource persons Shri Arghya Kusum Mitra, Assistant Adviser, IDMD and Smt.Anupam Prakash, Assistant Adviser, DEAP in drafting the report is most deeply appreciated.

Among the State Government officials, the Group acknowledges the contributions of Shri A.K.D.Jadhav, Former Principal Secretary, Finance, Maharashtra, Shri Sudhir Srivastava, Finance Secretary, Maharashtra, and Shri J.S.Sahani, Principal Secretary, Reforms, Maharashtra, Shri Brajendra Navnit, Deputy Secretary, Tamil Nadu and Shri Amlan Aditya Biswas, Deputy Secretary, Finance, Karnataka.

The Group acknowledges the assistance received from Shri V.K.Srivastava, Research Officer, Smt Swati Joshi, Assistant Manager and Shri S.A.K.Nair, Assistant Manager, IDMD in the administrative and organisational work relating to the Group and from Shri V.Y.Thatte, Shri D.C.Jeyapaul, Smt. S.N.Perumal and Shri G.K.Mankar, for typing assistance.

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REPORT OF TH E WORKING GROUP ON MODEL FISCAL RESPONSIBILITY LEGISLATION AT STATE LEVEL

EXECUTIVE SUMMARY

In the twelfth Conference of the State Finance Secretaries held on August 1, 2003, it was decided that the Reserve Bank of India (RBI) would provide technical assistance in the preparation of a model fiscal responsibility bill for State Governments. Accordingly, a Group was constituted in October 2003 with the State Finance Secretaries of Kerala, Karnataka, Maharashtra, Punjab and Tamil Nadu and a representative from the Government of India, Ministry of Finance, as members. The Government of India nominated Shri Madhusudan Prasad, Joint Secretary (FRBM), Ministry of Finance, Department of Economic Affairs as their representative. Shri H.R. Khan, Chief General Manager-in-Charge, Internal Debt Management Department (IDMD) of the Reserve Bank of India (RBI), was the Convenor of the Group. Members shared their rich experience on State finances during the deliberations. This is a technical report of the Group intended to guide the States in enacting their fiscal responsibility legislations. Technical inputs were provided by the Department of Economic Analysis and Policy (Division of State and Local Finances) and the Legal Department of RBI. The Group held eight meetings between October 21, 2003 and January 19, 2005. In its third meeting, the Group had the benefit of the views of Dr. C. Rangarajan, Chairman, the Twelfth Finance Commission, on the subject. The draft Report was discussed in the 14th Conference of the State Finance Secretaries held on August 13, 2004. All the State Finance Secretaries were requested to forward their comments by August 31, 2004.

2. The Group decided that the model legislation would generally follow the Central FRBM Act, and build upon the State fiscal responsibility legislations enacted so far. The Group also took into account the international best practices available in the area as well the recommendations of the Committees on issues related to voluntary disclosure of information by the State Governments and fiscal transparency. The Group felt that the model bill would provide guidance to the States for enacting their fiscal responsibility legislations with reference to certain benchmarks. The objective was to design a template for the fiscal responsibility legislation for States on the basis of "workability" and enforceability taking into account the diverse requirements of various States. It was considered desirable to allow individual States to take a view on sequencing the adoption of the various provisions, fixing the actual targets and time frame thereof for implementation and allocate the provisions between the Act and the Rules depending on their fiscal capabilities and further refine the provisions given in the model bill within the overall framework of fiscal prudence and sustainability. Various dimensions of the fiscal legislative framework, such as, the choice of targets, the road map for achievement of the targets, need for a detailed set of illustrative rules, independent evaluation criteria, prioritisation of capital expenditure, treatment of contingent liabilities including guarantees, computation of pension liabilities, *etc.* were

deliberated upon to arrive at a consensus. The Group benefited from the comments of the Finance Secretaries on an earlier version of the draft report as well as from the deliberations in the 14th Conference of the State Finance Secretaries. Views of the Special Category States were also sought in view of their special needs and requirements.

3. The Report consists of five Sections, six Annexes and two Appendices. *Section 1* provides the background and the broad approach of the Group. An analysis of the sustainability of finances of State Governments based on the study on the consolidated financial position of States as well as the financial situation of individual States in terms of the indicators of debt sustainability revealed a sharp deterioration in these indicators, particularly since the mid-1990s (*Section 2*). It is, however, a positive sign that some of the States with very high ratio of revenue deficit to fiscal deficit have enacted fiscal responsibility legislations.

4. The principles of fiscal responsibility legislation, such as transparency, stability, responsibility, fairness, efficiency and integrity in the context of State Finances as also the recommendations of the Committees constituted earlier have been discussed in *Section 3.* The Group felt that the model fiscal responsibility bill for the State Governments should be consistent with these internationally accepted fiscal management principles.

5. *Section* 4 explains the major features of the proposed legislation and the underlying issues. The Group's decisions on the various features of the proposed fiscal legislation included:

(i) *Envisaged path of fiscal consolidation*: The Group analysed the pros and cons of the three alternative paths - front loaded, back loaded and uniform – and felt that the actual path of fiscal correction could be left to the individual States depending upon their initial conditions and capability.

(ii) *Rules for fiscal responsibility:* The Group considered the three rules for fiscal responsibility - deficit, debt and borrowings - and deliberated on the choice, coverage and targets of the fiscal indicators. On the choice of the deficit indicator for laying down the deficit rule, the Group felt that primary deficit (PD) is derived from gross fiscal deficit (GFD) and is not easy to understand. The increases in GFD and PD are mostly attributable to the persistent growth in RD in recent times and therefore, elimination of RD has been identified as the focal area of fiscal reforms. However, elimination of RD can at best be used as a supplementary target to a fiscal deficit cap to prevent crowding out of capital expenditure. Hence, the Group felt it appropriate to set the deficit rule in terms of RD and GFD rather than PD. As regards debt rule, the Group noted that different States adopt different definitions for the total liabilities in their budgets and felt that they would need to broaden their definition to capture the entire range of liabilities that should ideally emerge out of the budget. Accordingly, it was decided to extend the definition of liabilities to include not only the total liabilities under the Consolidated Fund of the State but also all the items under the Public Account of the State. Given the need to comply with budgetary targets in terms of the prescribed debt rule, State governments might have the tendency to go for off-budget borrowings. The Group felt that in order to bring such borrowings 'above board', fiscal rules should also cover off-budget borrowings. Accordingly, it was felt that borrowings by the Public Sector Undertakings and Special Purpose Vehicles and other equivalent instruments including guarantees where the liability for repayment of principal and/or interest is on the State Government would also be treated as borrowings of the Government for the purpose of computation of total liabilities. Under the borrowing rule, the Group felt that devolvements arising out of State guarantees should be included. Noting that a number of States have yet to enact the legislation for a ceiling on outstanding guarantees, the Group decided to incorporate a provision of placing a limit on annual incremental risk-weighted State Government guarantees in the model Fiscal Responsibility Bill (FRB). On the issue of the level of the target variables for the above rules, the Group felt that States may fix specific targets, depending upon their underlying fiscal situation and capability to undertake fiscal reforms as judged by individual States.

(iii) *Denominator for the fiscal deficit:* The members of the Group debated on the pros and cons of GSDP (which is the conventional approach) *vis-à-vis* revenue receipts and finally agreed to adopt total revenue receipts (TRR) as the denominator for revenue deficit and gross State domestic product (GSDP) as the denominator for gross fiscal deficit. This would also be consistent with the approach adopted by most States that have enacted fiscal responsibility legislations. In case of those States whose GSDP are subject to wide fluctuations, it was suggested that they could opt for trend GSDP.

(iv) *Transparency and reporting arrangements*: The Group noted that in general in respect of many States the existing disclosure practices through the State Budgets are not at the level required for monitoring the implementation of fiscal rules, and hence need to be improved upon. The disclosure formats were discussed and it was agreed that model formats could be notified under the rules to be framed under the Act.

(v) *Review and corrective measures*: With regard to the review mechanism for the fiscal performance *vis-à-vis* various targets, the Group deliberated upon whether to recommend a quarterly or a half-yearly review. It was recognised that it may not be immediately possible for all States to prepare a quarterly review and initiate corrective action. The consensus view of the Group was that while State Governments should have quarterly reviews, corrective measures if required, should, however, be taken only after taking into account the outcome of the trends in receipts and expenditure at the end of the second quarter. This would also be in line with the approach adopted in the fiscal rules framed by the Central Government.

(vi) *Independent evaluation of performance of the prescribed fiscal indicators*: The critical issue is whether performance evaluation is to be done internally or by an independent external body set up for the purpose. There were views of constituting a panel of external fiscal experts and also of the Comptroller and Auditor General (C&AG), an independent Constitutional authority to review the performance. Members broadly agreed on appointment of a person of eminence to head the Committee on the basis of a consensus arrived between the Chief Minister and the Leader of the Opposition. For the purpose of the model legislation, it was decided not to spell out the exact composition of the Review Committee, but only to lay down that the State Government may set up an appropriate agency independent of the Government to carry out the periodic review for the compliance of the provision of this Act in the manner as may be prescribed under the rules framed under the Act.

(vii) *Exclusion clauses:* The Group decided to include internal disturbances and natural calamities and other exceptional grounds to be specified by the State under the exclusion clause.

(viii) *Special category States*: In case of special category States, the exclusion clause may also cover the shortfall in the current transfers from Centre in excess of certain percentage, say 10, of the trend growth rate of such transfer for the last three years.

(ix) *Fiscal Rules:* The Group held detailed discussions before deciding upon the various features of the model FRB. In addition to the Fiscal Responsibility Act, the Group suggested that States could frame rules which would provide greater flexibility in regard to the targets. The States which may not be in a position to incorporate all the annual targets in respect of the fiscal indicators in the Act may include them in the rules to be framed under the Act.

6. In its concluding observations set out in *Section 5,* the Group noted that the fiscal performance of the State Governments has been an area of concern in recent years. The fiscal stress has seriously constrained the States' ability to discharge their primary responsibility of developing social and economic infrastructure. Several State Governments have, therefore, made efforts to correct the fiscal imbalances through the medium-term fiscal reform programme / Memorandum of Understandings with the Central Government. Such measures are somewhat discretionary and lack statutory backing. On the contrary, adoption of fiscal policy rules built under fiscal responsibility legislation commits the government to a deficit or debt reduction path. The institutional framework of the fiscal legislation facilitates effective monitoring of fiscal performance of the government and encourages pursuit of fiscal management policies aimed at transparency, responsibility, efficiency, fairness and stability. While such legislations can not be panacea for all fiscal ills and have their own drawbacks, they provide a basis for political consensus to accomplish complex economic tasks and thereby enhance the credibility of the Government. If a fiscal rule is to be useful for the subnational levels of government, it needs to be well designed, combining simplicity and flexibility. Furthermore, the rules must be implemented in a transparent manner, with the

support of an appropriate institutional structure especially as regards the budget processes and monitoring mechanism. While this is beyond the scope of this Report, the objective of fiscal responsibly legislation would need to be broadened to include the third tier of the government, viz., the local bodies. Unless there is a strong political commitment to adhere to a sustainable fiscal adjustment process enshrined in the spirit of fiscal legislation, the rules, howsoever well designed and elegantly framed, could be bypassed and policies reversed to the detriment of the long term financial health of the State.

7. The annexes provide the international experience with respect to fiscal legislation in respect of select developed and emerging market economies (*Annex 1),* discussion of the current status of fiscal responsibility legislation in India giving the salient features of fiscal legislation of the Government of India and of the State Governments *(Annex 2)*, transparency in budgetary practices, covering *inter alia*, the recommendations of the Core Group on Voluntary Disclosure of Norms for the State Governments and the Advisory Group on Fiscal Transparency (*Annex 3)*, model fiscal responsibility legislation bill for the States (*Annex 4),* model fiscal responsibility rules (*Annex 5)* and explanatory notes (*Annex 6)* explaining the various terms and concepts used in the report.

8. The model legislation in Annex 4 provides for a broader definition of total liabilities to include off-budget borrowings by State level public sector undertakings and Special Purpose Vehicles, etc. where the liability for repayment is on the State Government and the principal and/or interest are to be serviced out of the State budgets. The legislation provides for fiscal management objectives (elimination of revenue deficit and containment of fiscal deficit, pursuit of policies to raise non-tax revenue and laying down of norms for prioritisation of capital expenditure) and fiscal management principles (such as, transparency, stability and predictability, responsibility including integrity, fairness and efficiency). The legislation provides for laying before the Legislature the following statements (which may be combined into one or two statements): (a) the Macroeconomic Framework Statement; (b) the Medium Term Fiscal Policy Statement; and (c) the Fiscal Policy Strategy Statement. These Statements shall be in such form as may be prescribed (by the rules made under this Act). The model bill provides for fiscal targets relating to elimination of revenue deficit and containment of fiscal deficit, outstanding liabilities and annual incremental risk weighted guarantees and also lays down the provisos under which revenue and fiscal deficits may exceed the limits. The model bill provides for the measures that the State Government shall take to ensure greater transparency in its fiscal operations in the public interest and minimise as far as practicable, secrecy in the preparation of the budget. The bill spells out the measures that the State Government will take to enforce compliance, including quarterly review of the trends in receipts and expenditure, the outcome of which would be placed before the Legislature. No deviation in meeting the obligations shall be permitted without approval of Legislature except as provided under this Act. If there is any deviation from the target owing to unforeseen circumstances, the Minister of Finance shall make a statement in the House or Houses of Legislature explaining whether such deviation is substantial and relates to the actual or the potential budgetary outcomes; and the remedial

measures the State Government proposes to take. The State Government may set up an agency independent of the State Government to review periodically the compliance of the provisions of this Act and table such reviews in the House or Houses of the State Legislature. The model bill also empowers the State Government to make rules on the forms of the statements and disclosure, measures to enforce compliance, manner of review of compliance of the provisions of this Act by the independent agency, etc. The model bill also stipulates the procedure of framing rules and modifying them subject to the approval of the House.

9. The fiscal responsibility rules in Annex 5 provide for the forms of Macroeconomic Framework, Medium Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and the various forms of disclosure. On the measures to enforce compliance, the rules stipulate the circumstances under which the State Government shall take appropriate measures. Accordingly, the Minister-in-charge of the Ministry of Finance shall make a statement in the Legislature during the session immediately following the end of the second quarter detailing the corrective measures taken and the prospects for the fiscal deficit of that financial year.

10. Finally, Appendices I & II contain the Fiscal Responsibility and Budget Management Act, 2003 and the Rules framed thereunder by the Government of India as a ready reference for the readers.

REPORT OF THE GROUP ON MODEL FISCAL RESPONSIBILITY LEGISLATION AT STATE LEVEL

Section1

Introduction

Constitution of the Group

1.1 In the twelfth conference of the State Finance Secretaries held on August 1, 2003, it was decided that the Reserve Bank of India (RBI) would provide technical assistance in the preparation of a model fiscal responsibility bill for State Governments. Accordingly, a Group was constituted in October 2003 with the State Finance Secretaries of Kerala, Karnataka, Maharashtra, Punjab and Tamil Nadu and a representative from the Government of India, Ministry of Finance, as members. The Government of India nominated Shri Madhusudan Prasad, Joint Secretary (FRBM), Ministry of Finance, Department of Economic Affairs as their representative. Shri H.R. Khan, Chief General Manager-in-Charge, Internal Debt Management Department (IDMD) of the Reserve Bank of India (RBI), was the Convenor of the Group. Members shared their rich experience on State finances during the deliberations. This is a technical report of the Group intended to guide the States in enacting their fiscal responsibility legislations. Technical inputs were provided by the Department of Economic Analysis and Policy (Division of State and Local Finances) and the Legal Department of RBI.

Rationale and Objectives of Fiscal Responsibility Legislation for State Governments

1.2 Fiscal imbalances have grown sharply across the States since the late 1980s. Although there was some evidence of fiscal consolidation on part of most States during the early 1990s, this improvement could not be sustained thereafter. The fiscal consolidation efforts attempted under discretionary fiscal policy framework have not been durable, with a tendency to slip back into deficits and debt-cycles. The ineffectiveness of the discretionary policy is not unique to the Indian States and is corroborated by international experiences at the national and sub-national levels.

1.3 Internationally, rule-based fiscal policy has progressively gained in importance over discretionary fiscal policy so as to achieve the objectives of fiscal sustainability, credibility, accountability and transparency within a time frame. Fiscal responsibility legislation by providing an institutional framework for effective and objective evaluation of fiscal policy facilitates the achievement of these objectives by making fiscal policy makers more responsible and accountable. Such legislations bind the governments to follow a prudent and transparent fiscal policy and limit the scope for populist policies, such as, unbridled expansion in expenditure, free/highly subsidised services provided by public sector utilities in power, irrigation, higher education, public transport, etc., and a sharp reduction in tax rates and tax base. Such tendencies are not uncommon in democracies dependent on electoral politics. It is probable that deterioration in the fiscal situation, if not arrested, may constrain the ability of the States to raise resources from the market, more so if the investors feel that it is imprudent to rollover their loans to the fiscally unsound governments. Fiscal deterioration leading to accumulation of debt and associated debt service obligations also curtail the ability of the Government to undertake basic developmental activities such as provision of public health, elementary education, nutrition, and sanitation, and constrain public investment in physical infrastructure projects. The adverse consequences of current fiscal indiscretions would thus have to be faced by the future generations.

1.4 With prudence in fiscal policy based on established consensus and backed by institutional arrangements finding increasing support over pursuit of populist policies, several economies have moved towards adopting fiscal rules. Rules enable the governments to look beyond the short term gains to pursue improved governance in the medium to long term leading to fiscal sustainability. They also help build up public expectations and facilitate investment decisions by the creditors to invest in government papers. The rule-based system may, however, suffer from rigidity and lack of inventiveness. Nonetheless, the credibility of fiscal policy is considerably enhanced if the goals of government are specified in some detail in the form of a law besides the usual annual budget announcements (Premchand, 2003).

1.5 The fiscal consolidation efforts through legislative enactment of the fiscal rules would commit the government to pursue a medium/long-term deficit or debt reduction path and strengthen its fiscal position through the elimination of revenue deficit and reduction of fiscal deficit. Fiscal responsibility legislations bring transparency to fiscal operations/targets which facilitates investment for growth and development as also monetary and financial stability. Notwithstanding the downside risks of missing the pre-announced fiscal targets under fiscal responsibility legislation, transparency in policy-making not only provides the potential for disciplined decisions but also can assist in securing broad public acceptance for what can be ambitious policy agendas for reforms.

1.6 Under a federal set-up, the application of fiscal rules at the sub-national level of government becomes a key issue to be addressed. This is because it is the performance of the entire public sector, which is crucial for macroeconomic performance. Often it has been noticed that even when the Central Government takes steps for effective fiscal consolidation, the overall fiscal deficit may not improve due to the poor fiscal performance of the provincial Governments. Coordinated efforts towards fiscal correction is also important as the sovereign ratings are based on a comprehensive assessment of financial performance of all the tiers of the government.

1.7 Recognising the urgency of the need for fiscal consolidation at the State level and making their financial position sustainable, recently - beginning with Karnataka in 2002, and followed by Kerala, Tamil Nadu and Punjab in 2003 and Uttar Pradesh in 2004 - a few State Governments have enacted legislations on fiscal responsibility and budget management. These legislations, by and large, place responsibility on the State Governments to ensure fiscal stability, inter-generational equity and financial stability by achieving revenue surplus, containing fiscal deficit and maintaining a sustainable debt level. These objectives are to be achieved by charting out fiscal rules aimed at time-bound limits on the State Governments' borrowings, other liabilities, deficits and guarantees and ensuring greater transparency and public disclosure in fiscal operations. The examples set by these States and the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 and the rules framed thereunder by the Central Government, effective from July 5, 2004, are expected to generate further momentum towards adoption of fiscal responsibility legislations by the remaining States in the near future.

Approach of the Group

1.8 At a theoretical level, sub-national governments could adopt either a coordinated approach or an autonomous approach in enacting fiscal legislation (Kopits, 2001). Under the coordinated approach (i.e., top-down approach), all sub-national governments are subject to uniform rules under the surveillance of a central authority, and each sub-national government seeks to establish collective credibility for overall macro-economic policy. Under the autonomous approach[1] (a bottom-up approach), the initiative for adopting fiscal rules arises from individual sub-national governments.

1.9 In the Indian federal system, a coordinated approach might be preferable in the context of a high volume of fiscal activity handled by the State Governments and the likely repercussions of imprudent fiscal management by individual States. In pursuance of the recommendations of the Eleventh Finance Commission (EFC), several States have drawn up Medium Term Fiscal Reforms Programmes (MTFRP) in active collaboration with the Central Government. A coordinated approach has thus been adopted which takes into consideration the initial fiscal situation of the individual States. However, the States have not adopted a coordinated approach *vis-à-vis* fiscal legislation. While the medium term fiscal plan forms a core component of the fiscal legislations enacted by the States so far, other features tend to vary. Thus, the Indian States have adopted a unique blend of coordination and autonomy in providing statutory backing to their fiscal reform process (Pattnaik *et al*, 2004). The Group, in the framing of the model fiscal responsibility legislation, also decided to adopt the autonomous-cum-coordinated approach, with States having powers to modify the model, so as to enhance its flexibility subject to State-specific conditions.

1.10 The Group held eight meetings. The first, second, third, fifth, sixth, seventh and eighth meetings of the Group were held on October 21, November 28, December 24, 2003, August 5, 2004, September 16, 2004, November 20,2004 and January 19, 2005, respectively, at Mumbai. The fourth meeting was held at New Delhi on March 10, 2004. In its third meeting, the Group had the benefit of the views of Dr. C. Rangarajan, Chairman, The Twelfth Finance

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[1] For instance, in Canada, Switzerland and the US, the autonomous approach has been adopted wherein the fiscal rules have been adopted at the sub-national level with varying degrees of stringency.

Commission, on the subject. The Secretariat also held one meeting with Shri M. Prasad, JS (FRBM), on February 17, 2004 at Mumbai.

1.11 The Group decided that the model legislation would generally follow the Central FRBM Act, and build upon the State fiscal responsibility legislations enacted so far. The Group also took into account the international best practices available in the area as well the recommendations of the Committees on issues related to voluntary disclosure of information by the State Governments and fiscal transparency. The Group felt that the model bill would provide guidance to the States for enacting their fiscal responsibility legislations with reference to certain benchmarks. The objective was to design a template for the fiscal responsibility legislation for States on the basis of "workability" and enforceability taking into account the diverse requirements of various States. It was considered desirable to allow individual States to take a view on sequencing the adoption of the various provisions, fix the schedule of their implementation and allocate the provisions between the Act and the Rules depending on their fiscal capabilities and further refine the provisions given in the model bill within the overall framework of fiscal prudence and sustainability. Various dimensions of the fiscal legislative framework, such as, the choice of targets, the road map for achievement of the targets, provisions to take care of cyclical movements in revenues so as to smoothen budget trajectories, the course of salary payments and subsidies, need for a detailed set of illustrative rules, independent evaluation criteria, prioritisation of capital expenditure, treatment of contingent liabilities and guarantees, computation of pension liabilities, *etc.* were deliberated upon to arrive at a consensus. It was also considered important to ascertain the views of Special Category States in view of their special needs and requirements. Different points of view which emerged during the deliberations have been incorporated in *Section 3* of the report, while discussing the features of the proposed legislation.

Structure of the Report

1.12 The organisation of the report is as follows: *Section* 2 analyses the sustainability of finances of State Governments. The principles of fiscal responsibility legislation for the State Governments are discussed in *Section 3. Section* 4 enumerates the major features of the proposed legislation. This is followed by the conclusions set out in *Section* 5. The international experience with respect to fiscal legislation is summarised in *Annex 1. Annex 2* presents a discussion of the current status of fiscal responsibility legislation in India. Transparency in budgetary practices has been discussed in *Annex 3*. The model fiscal legislation bill for the States is presented in *Annex 4.* An illustrative model rules mainly based on the rules framed so far[2] are given in *Annex 5. Annex 6* presents explanatory notes for the terms and concepts used in the model legislation and other related terms/concepts. Appendices I & II *contain* the Fiscal Responsibility and Budget Management Act, 2003 and the Rules framed thereunder by the Government of India separately.

2 At the State level, passed by the Government of Karnataka

Section 2

Analysis of Sustainability of Finances of State Governments

2.1 The discretionary polices pursued by the States have resulted in a sharp deterioration in the indicators of debt sustainability, particularly since the mid-1990s. This Section describes both the consolidated financial position of States as well as the financial situation of individual States in terms of such indicators.

Key Fiscal Indicators of Debt Sustainability: An Aggregative View

Deficit Position

2.2 The overall borrowing requirements (*i.e.*, gross fiscal deficit) of the States, which reflect the extent of resource gap in the State finances, increased from 3.3 per cent of gross domestic product (GDP) (Rs.18,787 crore) in 1990-91 to 5.1 per cent of GDP (Rs.1,41,010 crore) in 2003-04 (RE) (**Table 1**). The high revenue deficit (RD) component in the gross fiscal deficit (GFD) implies recourse to borrowed resources to meet the revenue or non-asset creating expenditure including interest payments on past borrowings. As shown in the Table 1, primary deficit (PD), a factor having critical bearing on debt sustainability, showed only a marginal increase during the same period although it continued to remain at a high level.

Table 1: Indicators of States' Fiscal Sustainability

(per cent)

Year	Debt*/ GDP	GFD/ GDP	PD/ GDP	RD/ GFD	IP/ RR	Guarantees/ GDP	SOR/ AD
1990-91	19.4	3.3	1.8	28.3	13.0	6.5	43.5
1995-96	17.9	2.6	0.8	26.1	16.0	4.4	48.9
1996-97	17.8	2.7	0.9	43.3	16.7	4.6	46.7
1997-98	18.5	2.9	0.9	37.0	17.7	4.8	46.3
1998-99	19.6	4.2	2.2	58.8	20.3	5.6	42.1
1999-00	21.7	4.7	2.4	58.8	21.8	6.8	42.2
2000-01	23.7	4.3	1.8	59.8	21.7	8.1	43.1
2001-02	25.7	4.2	1.5	61.7	24.4	7.2	42.5
2002-03	27.8	4.1	1.3	54.0	25.0	7.5	42.3
2003-04 (RE)	29.1	5.1	2.1	51.1	25.5		36.8

PD = Primary Deficit RD = Revenue Deficit GFD = Gross Fiscal Deficit IP = Interest Payments RR = Revenue Receipts SOR = States' own resources AD = Aggregate Disbursements GDP = Gross Domestic Product RE = Revised Estimates

* Debt refers to outstanding liabilities comprising (i) internal debt (viz., open market loans, loans from banks/ financial institutions, special securities issued to the NSSF, WMA/OD from RBI), (ii) loans and advances from the Centre and (iii) small savings, State Provident Funds, etc. (excluding reserves funds and deposits).

2.1.2. Revenue Receipts

2.3 Revenue receipts of the State Governments comprising of both States' own revenue receipts (*i.e.*, tax and non tax revenue receipts) as well as current transfers from the Centre have not exhibited the required buoyancy. This is manifest in the stagnation in the tax-GDP ratio around the level of 7 to 8 per cent of GDP since 1990-91. States' own revenue receipts accounted for 61.8 per cent of total revenue receipts in 2003-04 (RE), while the balance 38.2 per cent was contributed by current transfers from the Centre. In recent years, within current transfers from Centre, there has been a switch from taxes to grants.

2.1.3 Expenditure Indicators

2.4 There has been a steady deterioration in the quality of expenditure pattern of State Governments. The share of developmental expenditure in total expenditure declined from 69.5 per cent in 1990-91 to 54.5 per cent in 2003-04 (RE), while that of non-developmental expenditure rose from 24.8 per cent to 32.1 per cent over the same period. The rise in the share of non-developmental expenditure is mainly on account of committed items, such as, interest payments and pensions. This is a matter of concern as in the existing federal fiscal arrangement, States have been entrusted with the basic responsibilities of providing social infrastructure like health, education, sanitation, etc. In view of preemption of revenues to fund such committed expenditures, the aggregate social sector expenditure of State Governments declined from 6.6 per cent of GDP in the latter half of the 1980s to 5.9 per cent of GDP in 2003-04 (RE). Capital outlay, which reflects the portion of borrowing going for productive purposes, showed a secular uptrend during the immediate post-reform years and rose from 49.1 per cent in 1990-91 to 62.6 per cent of GFD in 1994-95. The trend, however, reversed thereafter as capital outlays declined to 43.6 per cent in 2003-04 (RE).

2.1.4 Outstanding Liabilities

2.5 The cumulative impact of the steadily rising level of GFD is reflected in the growing outstanding liabilities[3] of the State Governments which increased from 19.4 per cent of GDP (Rs.1,10,289 crore) in 1990-91 to 29.1 per cent of GDP (Rs.8,07,131 crore) in 2003-04 (RE). Such high level of outstanding liabilities has, in turn, resulted in large interest payments, preempting about a quarter of revenue receipts of the States (**Table 1**).

2.1.5 Guarantees

3 To the extent captured in State Budgets

2.6 With restrictions on borrowings by the States, the State Governments have taken recourse to off-budget borrowings in the nature of contingent liabilities, which include guarantees, indemnities, etc. Although contingent liabilities *prima facie* do not form a part of the debt burden of States, in the event of default by the borrowing agency, the debt service obligations will devolve on the State Governments. The outstanding guarantees of State Governments have shown a rising trend during the 1990s[4]. The outstanding guarantees rose from Rs 40,159 crore (6.1 per cent of GDP) as at end-March 1992 to about Rs.1,84,294 crore (7.5 per cent of GDP) as at end-March 2003. Apart from the magnitude of contingent liabilities, an important dimension, which has implications for the stability of fiscal operations of the State governments, is the quality of guarantees extended and the element of risk embedded in such guarantees arising from a lack of, or poor risk assessment of guaranteed advances and bonds.

2.1.6 Ways and Means Advances and Overdraft

2.7 Although the Ways and Means Advances (WMA) facility of the RBI to the State Governments is meant to enable States to meet temporary liquidity mismatches, a number of States were prone to resort to overdraft (i.e. borrowings over and above their WMA limits) on a near permanent basis to fund their strcutural deficits. While, of late, there has been some improvement in this regard, frequent resort to WMA and utilisation of higher amounts under overdraft (OD) is a continuing phenomenon in respect of quite a few States.

2.1.7 Indicators of Debt Sustainability

2.8 Two key factors, viz., (i) the primary deficit (PD) and (ii) the effect of the difference between the growth rate and interest rate have a critical bearing on sustainability of the debt. Public debt would be technically sustainable (*i.e.* not following an explosive growth path) if the rate of growth of income exceeds the cost of public borrowings. Sustainability also depends on the extent of the development of the financial markets, which determines the absorptive capacity of the markets. Unusually high level of debt or skewed maturity profile of debt may induce the market participants to demand a higher risk premium leading to a higher cost of borrowing for the Government. Thus, even without any increase in the primary deficit, high debt ratios can lead to instability. Since 1998-99, while there has been a significant deceleration in nominal GDP growth due to both lower real GDP growth (except 2003-04) and inflation, the overall cost of borrowings of States has not declined commensurately. The downward rigidity in the average cost of borrowings essentially reflected the overhang of high cost borrowings of the past, in particular, the amount borrowed during the first half of the 1990s. The benefits of a sharp fall in market interest rates in recent years has accrued to only a small part of States' overall borrowings and that too only in respect of fresh borrowings (Prasad *et al*, 2003). Hence, the average interest rate on States' debt has not only been higher than the current market interest rate, but has also exceeded the GDP growth rate

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4 Average data received from 15 major States

(except 2003-04). Further, there has been a rise in the primary deficit from a range of 0.6-0.9 per cent in 1993-94 to 1997-98 to a range of 1.3-2.4 per cent in 1998-99 to 2003-04 (RE). Reflecting the trend in these variables, there has been a sharp rise in the debt–GDP ratio since 1996-97 as indicated in **Table 2**.

Table 2: Trends in Indicators of Debt Sustainability of States

(per cent)

Year	Average interest rate	Nominal GDP growth rate	PD - GDP ratio	Debt-GDP ratio
1990-91	9.2	17.0	1.8	19.4
1991-92	9.9	14.8	1.2	19.3
1992-93	10.5	14.6	1.0	19.0
1993-94	11.1	14.8	0.6	18.6
1994-95	12.1	17.9	0.8	18.2
1995-96	11.9	17.3	0.8	17.9
1996-97	12.1	15.2	0.9	17.8
1997-98	12.4	11.3	0.9	18.5
1998-99	12.8	14.3	2.2	19.6
1999-00	13.2	11.2	2.4	21.7
2000-01	12.3	7.9	1.8	23.8
2001-02	12.5	9.2	1.5	25.7
2002-03	12.0	8.2	1.3	27.8
2003-04 (RE)	12.2	12.3	2.1	29.1

2.2 State-wise Analysis

2.2.1 Liabilities

2.9 While at the aggregate level, there has been a steady increase in the outstanding level of debt in relation to GDP, there has been a considerable variation in the growth in the debt to gross State domestic product (GSDP) ratio across the States. States like Orissa, West Bengal, Rajasthan and Uttar Pradesh have added more than 20 percentage points to their respective debt to GSDP ratio during end-March 1996 to end-March 2004 (**Table 3)**. As at end-March 2004, six of the 14 major States (Bihar, Orissa, Punjab, West Bengal, Rajasthan and Uttar Pradesh) had debt GSDP ratio higher than 40 per cent level, while at end-March 1996, there was no State which was having debt-GSDP ratio higher than 40 per cent. As far as fiscal deficit is concerned, five States (viz. Gujarat, Maharashtra, Tamil Nadu, Uttar Pradesh and West Bengal) together accounted for about half of the gross fiscal deficit of States in 2003-04 (RE).

Table 3: Debt to GSDP ratio of States (14 Major States)

(per cent)

States	End-March 1996	End-March 2004	Difference
Orissa	34.6	70.8	36.2
Rajasthan	25.8	54.0	28.2
West Bengal	20.8	45.4	24.6
Uttar Pradesh	*26.3*	*46.7*	*20.4*
Gujarat	15.5	35.3	19.8
Madhya Pradesh	18.9	37.2	18.3
Bihar	37.5	54.4	16.9
Punjab	*35.3*	*49.4*	*14.1*
Andhra Pradesh	19.0	32.3	13.3
Tamil Nadu	*16.1*	*28.4*	*12.3*
Kerala	*26.1*	*38.1*	*12.0*
Maharashtra	11.6	23.3	11.7
Karnataka	*17.6*	*29.0*	*11.4*
Haryana	19.4	27.3	7.9

Note: (a) States which have since enacted the FRBM Act are shown in italics.
(b) Data on debt and GSDP in respect of Bihar, Madhya Pradesh and Uttar Pradesh include those of newly formed States *viz.,* Jharkhand, Chhattisgarh and Uttaranchal, respectively.

2.2.2 Revenue Deficit

2.10 States differ not only in terms of the quantum of fiscal deficit, but also in terms of the quality of fiscal deficit which can be best measured in terms of the ratio of revenue deficit to fiscal deficit (**Table 4**). Lower the ratio, higher the proportion of fiscal deficit deployed to fund capital expenditure. A one-size fits all approach is not applicable in respect of States, and accordingly, the States have been first grouped into special and non-special category States. Within these two categories, the data, however, reveal a widely divergent performance for the various States. For example, within special category States, two groups could be identified, depending on whether they have revenue surplus/balance (but with fiscal deficit) (**Group A**) or revenue deficit (**Group B**). The non-special category States could also divided into two groups – those States with RD/GFD ratio up to 50 per cent (**Group C**) and those exceeding 50 per cent (**Group D).** The poor quality of deficit of Group D States reflects, in part, the lower current level of transfers from the Centre as compared with the States belonging to the other categories.

2.11 The above analysis shows a steady deterioration of the fiscal situation of States, measured in terms of most indicators of fiscal prudence. It is, however, a positive sign that some of the States with very high ratio of revenue deficit to fiscal deficit have enacted fiscal responsibility legislations that, *inter alia,* include a time frame for eliminating revenue deficits. Thus, all the five States that have committed to bind themselves to the rigours of fiscal discipline through enactment of fiscal responsibility legislations belonged to Group D in 2002-03. While two of these States (Karnataka and Tamil Nadu) migrated to Group C in 2003-04, another two States (Punjab and Kerala) showed some improvement in the ratio.

Table 4: Group-wise Analysis of Revenues of States (2003-04, RE)

(per cent)

	States	RD/GFD	States' Own Revenue/ Revenue/ Expenditure	Current Transfers from Centre/ Revenue Expenditure	Total Revenue Receipts/ Revenue Expenditure	Current Transfers from Centre/Total Revenue Receipts
	Group D					
1	Uttar Pradesh	97.7	29.5	32.7	62.2	52.6
2	West Bengal	70.4	37.0	28.0	65.0	43.1
3	Haryana	67.1	78.9	12.6	91.5	13.8
4	Kerala	65.0	57.9	19.4	77.3	25.1
5	Madhya Pradesh	61.3	41.0	32.9	73.9	44.5
6	Punjab	61.3	65.8	13.7	79.4	17.2
7	Orissa	53.9	32.3	44.3	76.6	57.8
	Group C					
1	Tamil Nadu	48.1	66.9	19.2	86.1	22.3
2	Maharashtra	46.4	64.6	15.9	80.4	19.7
3	Rajasthan	46.3	49.1	32.0	81.1	39.4
4	Andhra Pradesh	39.1	60.2	30.2	90.4	33.4
5	Gujarat	35.0	70.8	14.6	85.3	17.1
6	Chhattisgarh	30.2	52.9	38.9	91.8	42.3
7	Bihar	27.0	26.0	66.4	92.4	71.9
8	Karnataka	23.7	71.1	23.2	94.3	24.6
9	Goa	20.2	83.8	11.3	95.1	11.9
10	Jharkhand	-8.5	47.0	55.0	101.9	53.9
11	NCT Delhi	-55.0	124.2	9.6	133.8	7.1
	Group B					
1	Himachal Pradesh	66.4	23.2	48.9	72.1	67.9
2	Uttaranchal	58.5	29.2	44.7	73.9	60.5
3	Assam	53.0	27.8	58.1	85.9	67.6
4	Manipur	34.0	7.0	78.1	85.1	91.8
5	Mizoram	7.6	6.3	91.3	97.5	93.6
6	Arunachal Pradesh	7.0	11.5	85.8	97.3	88.2
	Group A					
1	Tripura	-14.7	15.7	88.5	104.2	85.0
2	Nagaland	-23.0	7.2	98.4	105.6	93.2

3	Meghalaya	-38.1	20.0	87.0	106.9	81.3
4	Sikkim	-147.2	44.6	70.6	115.3	61.3
5	Jammu and Kashmir	*	22.8	106.1	129.0	82.3

***** Revenue balance and fiscal balance are in surplus.

Section 3

Principles of Fiscal Legislation at the State level

3.1 Keeping in view the poor financial position of the State governments, it is argued that there is an urgent need for putting in place fiscal policy rules at the subnational level. While designing any fiscal rule, it is important to keep in mind the internationally accepted principles of fiscal legislation. In view of the above, the Group felt that the model fiscal responsibility bill for the State Governments should be consistent with the following internationally accepted fiscal management principles meant primarily for national governments, but which could also be applied to sub-national governments with appropriate modifications.

3.2 **Transparency** is an important aspect in the setting of fiscal policy objectives, implementation of fiscal policy and publication of the public accounts (please see **Annex 3** for details). Operationally, this would imply disclosure of sufficient information to allow the public to scrutinise the conduct of fiscal policy and the state of the public finances, and not withholding information except where publication of that information would harm (i) the national security, defence or international relations of the nation; (ii) the investigation, prosecution, or prevention of crime, or the conduct of civil proceedings; (iii) the right to privacy; (iv) the right of other parties to undertake confidential communications with the Government; (v) the ability of the Government to undertake commercial activities; and (vi) the integrity of the decision-making and policy formulation processes in Government. In the context of Indian States, two Groups have already examined the issues of disclosure and transparency at the State level. First, *the Core Group* on *Voluntary Disclosure Norms for the State Governments (2001)* suggested benchmarking of certain disclosure standards to be followed by the State Governments with regard to the budgetary exercises. Second, the *Advisory Group on Fiscal Transparency (Chairman: Shri Montek Singh Ahluwalia, 2001)* examined the extent to which fiscal practices in India comply with the International Monetary Fund's Code of Good Practices on Fiscal Transparency. The Advisory Group felt that the fiscal transparency at the State level was generally behind the standards achieved by the Central Government. It recommended that the Finance Secretaries forum could take a note of their Report and determine a set of minimum standards on transparency which all State Governments should achieve within a three-year period. About 20 States have, since then, started publishing the '*Budget at a Glance'* as recommended by the Core Group. In order to meet the reporting requirements under fiscal policy rules, the States would be required to bring out an annual report in which outcomes are presented against the targets. In addition, they may require monthly or quarterly reporting of outcomes. States would also need to enhance their capability of fiscal analysis, develop models of intra-year fiscal forecasting and bring out medium term fiscal forecasts covering 3-5 years.

3.3 **Stability** in the fiscal policy-making process and in the way fiscal policy impacts on the economy is a very crucial element of fiscal management. Accordingly, the Government should operate fiscal policy in a manner that is predictable and consistent with the objective of high and stable levels of growth and employment.

3.4 **Responsibility** in the management of the public finances requires the Government to operate fiscal policy in a prudent way, and manage public assets, liabilities and fiscal risks with a view to ensuring that the fiscal position is sustainable over the long term. Integrity in budget formulation has also to be ensured. This will require a high degree of fiscal marksmanship leading to minimal divergence between budget estimates and actuals.

3.5 **Fairness** requires that fiscal policy should be operated in a way that takes into account the financial effects on future generations, as well as its distributional impact on the current population.

3.6 **Efficiency** should be the key objective in the design and implementation of fiscal policy and in managing the assets and liabilities of the public sector balance sheet. The Government should ensure that available resources are deployed optimally and public assets are put to the best possible use. The Government should also take into account economic efficiency and compliance costs when forming taxation policy. The objective here should be to enable fiscal policy to play its due role as an automatic stabilizer. Accordingly, at times of strong economic growth, there should be fiscal surplus through higher revenue and lower expenditure. This would provide the elbow room to fiscal policy to stimulate the economy though reduction in taxes and higher social/capital expenditure at times of recession or natural calamities. When the fiscal situation is unsustainable, the degree of manouevrability over the economic cycle is reduced and hence, the objective of the legislation should be to make adjustments as early as possible. Resources freed by quicker fiscal adjustment could be used for greater public investment in physical and social infrastructure leading to higher growth with all its beneficial effects.

Section 4
Features of the Proposed Fiscal Legislation

4.1 The analysis of fiscal indicators in **Section 2** has underlined the urgent need of the States to follow the fiscal rules relating to deficit, debt or borrowing. Keeping in view the principles of fiscal legislation enumerated in **Section 3**, States would need to adopt a multi-pronged approach of revenue augmentation, expenditure containment, etc. An immediate focus of fiscal reforms should be on achieving revenue balance within a time frame while placing a cap over fiscal deficit. Such reforms could be rule-based with the help of uniform, transparent and monitorable indicators of debt, deficit (fiscal, revenue and primary) and borrowings. The choice of these indicators would be such that any policy change or progress in respect of expenditure reduction and/or revenue enhancement would get transparently reflected in the movements of those indicators.

4.2 An important aspect of the fiscal consolidation process is the envisaged path. With a view to bringing about fiscal correction in the medium term period (say, five years), three alternative adjustment paths --- front loaded, back loaded and uniform – could be adopted. Under uniform adjustment path, the intensity of fiscal correction process remains uniform in each of the five years. Under front loaded adjustment, the required adjustments in the deficit are progressively reduced over the forecast period, with large corrections envisaged during the initial years. The front loaded adjustment path is better-suited if the fiscal correction process has already set in. If large envisaged corrections in the formative years are not achieved under the front loaded adjustment, it would place greater pressure on correction in the subsequent years, apart from impacting upon the credibility of fiscal policy. The back loaded adjustment, on the other hand, places higher burden of fiscal correction towards the later years, and hopes to gain as fiscal (tax) reforms progresses over time. If the institutional mechanism is not in place, the back loaded adjustment process would provide time to enhance the preparedness for fiscal consolidation. It is, however, a moot point whether the perceived gains from the relatively gradual initial correction could really facilitate higher correction in subsequent years considering the attendant risks of tendency to delay and procrastinate. It was felt that the actual path of fiscal correction could be left to the individual States depending upon their initial conditions and capability. In addition to the choice of these indicators and the pace in sequencing of fiscal reforms, any model fiscal responsibility legislation for States has to capture the other critical aspects of legislative framework for fiscal policy, budget management and supporting institutional arrangements drawing from cross-country experiences (**Annex 1**), fiscal responsibility legislations already enacted by the State Governments (**Annex 2**), the best practices of fiscal transparency (**Annex 3**) and the Central Government's FRBM Act 2003 (**Appendix I**) and Fiscal Responsibility Rules, 2004 (**Appendix II**).

4.3 The above aspects were intensively deliberated within the Group and also in the meetings with the State Finance Secretaries and other experts. The views that emerged on various features of the model bill are summarised below.

4.4 **Deficit Rule**

The choice of the deficit indicator for laying down the deficit rule is not an easy one. The Group assessed the pros and cons of adopting one or more among the three major deficit indicators, *viz*., gross fiscal deficit (GFD), revenue deficit (RD) and primary deficit (PD). Among GFD, PD and RD, RD is preferable as it is easy to understand and monitor. There is a view that in the context of a fiscal policy rule aiming at a gradual reduction in the debt to, or maintaining it at, a prudent level in relation to GDP, the operational rule needs to be expressed in terms of reduction in PD. As interest and debt-service levels reflect past fiscal policies, PD, which excludes interest payments, could serve as a better target for current fiscal policy. PD, as a concept is, however, a by-product, derived from GFD, and it is not easy to understand. In the absence of a RD target, the PD target may be achieved at the cost of capital expenditure. The Group, therefore, felt that in a developing economy like India where governments have to play an active role in developmental activities, it would be desirable to curtail the RD. Moreover, in India, the increases in GFD and PD during the recent times have been mostly attributable to the persistent growth in RD, and therefore, elimination of RD has been identified as the focal area of fiscal reforms. World over, the deficit targets are often set according to the golden rule[4], requiring elimination of RD. There was a view that while elimination of the RD is a popular goal, it can at best be used as a supplementary target to a fiscal deficit cap, to prevent crowding out of capital expenditure. Hence, the Group felt it appropriate to set the deficit rule in terms of RD and GFD rather than PD. It was decided that the elimination of the RD and the annual target for reduction of the GFD to a sustainable level over a specified time frame would be indicated in the model bill on similar lines as followed in the FRBM Act 2003 of the Central Government. Having decided the target variables for deficit rule, another point of debate was regarding the level of quantitative targets. It was felt that the sustainable deficit levels depend on a variety of factors, such as, growth rate of the State's economy, interest rate, level of dependence of the State on Central transfers and debt stock, and these vary greatly across States. In view of this, it was felt that States may fix specific targets, depending upon their underlying fiscal situation and capability to undertake fiscal reforms as judged by individual States.

4.5 **Debt Rule**: The Group noted that the accumulated stock of liabilities depends on the past deficits and hence, if the deficit target is introduced, it automatically defines the path for debt-reduction. Taking this into account, it was thought proper to decide on a proper definition of debt. The Group had a detailed discussion on the issues relating to the definition of debt and other liabilities of the State Governments. The Group noted that different States adopt different definitions for the total liabilities in their budgets and felt that they would need to broaden their definition to capture the entire range of liabilities that should ideally emerge out of the budget. Accordingly, it was decided to extend the definition of liabilities to include not only the total liabilities under the Consolidated Fund of the State but also all the items under the Public Account of the State. Given the need to comply with budgetary targets in terms of the prescribed debt rule, State Governments might have the tendency to go for off-budget borrowings. The Group felt that in order to bring such borrowings 'above board', fiscal rules should also cover off-budget borrowings. Accordingly, it was felt that borrowings by the Public Sector Undertakings and the Special Purpose Vehicles and other equivalent instruments including guarantees where the liability for repayment of principal and/or interest is on the State Government should also be treated as borrowings of the Government for the purpose of computation of total liabilities.

4.6 **Borrowing Rule**: The borrowing sources for the State Governments are the Government of India, National Small Savings Fund (NSSF), open market borrowings, loans from financial institutions and banks, compensation bonds / securitisation bonds, provident fund and public accounts, apart from the Ways and Means Advances (WMA) and Overdrafts (OD) from the RBI and the Central Government. The Group felt that the devolvements arising out of State guarantees should be included under the borrowing rule. Noting that a number of States have yet to enact the legislation for a ceiling on outstanding guarantees, the Group decided to incorporate a provision of placing a limit on annual incremental risk-weighted State Government guarantees in the model Fiscal Responsibility Bill. Wherever

[4] Borrowing should be undertaken for investment purposes and the rate of return on the investments should be sufficient to pay for debt service obligations.

such legislation exists, the same may be modified, if warranted, based on the experience so as to ensure that expansion of guarantees is subject to prudential limits. Such legislation should be referred to in the Fiscal Responsibility Bill. The Group also felt that mobilisation of high-cost funds through treasury and within the public accounts, a practice followed by a few States, and contracting high cost negotiated loans through Special Purpose Vehicles (SPVs) also should be closely monitored.

4.7 **Denominator for the Fiscal Target**: The Group noted that the fiscal targets could be expressed either as ratios of output (which is the conventional approach) or ratios of total revenue receipts (TRR). One view was that expressing the targets as ratios of GSDP could be problematic on account of the poor quality of State-level output data, and long lags associated with the availability of these data. The GSDP data are also subject to frequent revisions and perforce have to be forecast based. On the other hand, in case of TRR, States having a large component of transfers from the Centre could find it difficult to exercise control. The Group felt that TRR is a better denominator for revenue deficit target on account of its inherent stability (*vis-à-vis* GSDP) despite the periodic revision of the Central transfer formula and the year to year volatility in mobilisation of transferable Central taxes. Timely, high frequency (monthly) data are available for TRR so that intra-year corrective measures (increase in revenue receipts or reduction in revenue expenditure or both) can be initiated to keep the revenue deficit in line with the envisaged trajectory. Hence, it would be appropriate to adopt revenue receipts as the denominator for revenue deficit. It was also noted that the States such as Tamil Nadu and Punjab that have enacted fiscal responsibility legislation have used revenue receipts as the denominator for the revenue deficit target whereas, except for Punjab, the other four States that have enacted the FRBs have taken GSDP as the denominator for the fiscal deficit. Karnataka, Kerala and UP have, however, not outlined the trajectory of revenue deficit and have simply aimed at eliminating RD within a specified period. As regards the denominator for GFD, it was felt that GSDP would be more appropriate since it indicates the potential debt repayment capacity of the State Government. The Group underlined the importance of removal of infirmity of GSDP data and stressed the importance of reliable, quarterly data, with a minimal lag and recognized the initiatives being taken by the Finance Commission and the Central Statistical Organisation (CSO) to address this issue. The Group felt that in the interim, the States whose GSDP are subject to wide fluctuations, could opt for trend GSDP.

4.8 **Transparency and reporting arrangements**: A number of State Governments publish at regular intervals, data on important fiscal variables of the State, such as GFD, RD, levels of outstanding debt and guarantees (both in absolute amounts and as ratios to GSDP) although coverage and methods used for complications of these data varies widely among the States. The Group noted that in general in respect of many States the existing disclosure practices through the State Budgets are not at the level required for monitoring the implementation of fiscal rules, and hence need to be improved upon. Finance Departments will need to embark on a major capacity building exercise as a part of introduction of fiscal rules to meet the disclosure norms. The disclosure formats were discussed and it was agreed that model formats could be notified under the rules to be notified under the Act.

4.9 **Review and Corrective Measures:** With regard to the review mechanism for the fiscal performance *vis-à-vis* various targets, the Group deliberated upon whether to recommend a quarterly or a half-yearly review. Since half-yearly review would be available after completion of 7 to 8 months of the fiscal year, the time available to undertake corrective measures may not be adequate. Hence, the Group felt that a quarterly review would be of greater use in view of the availability of time for correction on both revenue and expenditure side, which could be required in case quarterly results show a deviation from the expected outcomes. However, the members felt that keeping in view the capacity constraints of the State Governments, it may not be immediately possible for all States to prepare a quarterly review and initiate corrective measures. Among the States that have enacted the FRBs, only Punjab Act provides for a quarterly review of receipts and expenditure in relation to the budgeted estimates, while States such as Karnataka and Uttar Pradesh have provided for half-yearly reviews. The Group felt that for the time being the States that are not in a position to prepare a quarterly review may initially commit to a half-yearly review while taking necessary steps to graduate towards the preparation of the quarterly review and to take corrective measures based on such reviews. The consensus view of the Group was that while State Governments should have quarterly reviews, corrective measures if required, should, however, be taken only after taking into account the outcome of the trends in receipts and expenditure at the end of the second quarter. This would also be in line with the approach adopted in the fiscal rules framed by the Central Government.

4.10 **Independent evaluation of performance of the prescribed fiscal indicators**: The critical issue is whether performance evaluation is to be done internally or an independent external body set up for the purpose. The evaluation of the fiscal rules could be undertaken by an independent body to avoid conflict of interest and impart an element of impartiality to the exercise. One of the views was to constitute a panel of external fiscal experts, with a view to ensuring the quality and credibility of the assessment of fiscal performance under the fiscal rules. There was a view that the Comptroller and Auditor General (C&AG) which is an independent constitutional authority and has full access to finances of the States on an ongoing basis could also be requested to review the performance and compliance with the targets and their reports could be placed before the legislature. However, members broadly agreed on the appointment of a person (persons) of eminence to head the Review Committee, and such appointments could be made on the basis of a consensus arrived between the Chief Minister and the leader of the opposition. For the purpose of the model legislation, it was decided not to spell out the exact composition of the Review Committee, but only to lay down that the State Government may set up an appropriate agency independent of the Government to carry out the periodic review for the compliance of the provision of this Act in the manner as may be prescribed under the rules framed under the act.

4.11 **Exclusion clauses**: The fiscal responsibility legislation provides for specific targets to be achieved in a specific time-frame. However, despite the best intentions and efforts, it may not be possible to meet the targets due to certain factors beyond the Government's control. These could be on account of natural calamities, internal disturbance and other extraordinary situations. In order to address such situations, it is important that certain exclusion clauses are provided in the Act. An escape or exclusion clause, in a contract, allows nonperformance of the contract if a certain specified condition occurs. In the FRBM Act 2003 of Government of India, it is provided that the revenue deficit and fiscal deficit could exceed the target on grounds of national security or natural calamity or such other exceptional grounds as the Central Government may specify. In the case of State Governments, these could cover internal disturbance and natural disasters. In case of special category States, the exclusion clause may also cover the shortfall in the current transfers from Centre in excess of certain percentage, say 10, of the trend growth rate of such transfer for the last three years.

4.12 **Special Category States and Central Transfers**: An important factor that is likely to have a bearing on the ability of the States in general and special category States in particular to meet their legislated fiscal targets, is the amount of Central taxes and grants received by the States. The special category States have a very high dependency ratio and the current transfers from the Centre account for about 70 per cent of their revenue receipts. These States may find it difficult to adhere to the targets set out in the fiscal responsibility legislation in the event of large shortfall in the receipts from the Centre from the budgeted amounts. It is, therefore, expected that the special category States take into account the Central transfers factor while framing their fiscal responsibility legislations and this could be covered under the exclusion principle.

4.13 The Group held detailed discussions before deciding upon the various features of the model FRB. In addition to the Fiscal Responsibility Act, the Group suggested that States could frame rules which would provide greater flexibility in the regard to the targets. The States which may not be in a position to incorporate all the annual targets in respect of the fiscal indicators in the Act may include them in the rules to be framed under the Act.

Section 5
Conclusions

5.1 The fiscal performance of the State Governments has been an area of concern in recent years. A number of factors, such as, growing interest burden, increasing pension liabilities, large administrative expenditure, losses incurred by State Public Sector Undertakings, inadequate tax buoyancy, inappropriate user charges and deceleration in Central transfers have been attributed to large disparity in the growth of receipts and expenditure and the consequent widening of fiscal gap of the State Governments. Persistently, large revenue deficit has led to higher fiscal deficit and a build-up of large debt stock. Consequently, a vicious cycle of deficit, debt and debt service payments has emerged. In addition to the direct borrowings, the contingent liabilities of the State Governments have also increased. In the event of default by the borrowing agency, the debt service obligations devolve on the State Governments leading to further fiscal stress. The fiscal stress, in turn, has seriously constrained the States' ability to discharge their primary responsibility of developing social and economic infrastructure.

5.2 Several State Governments have, therefore, made efforts to correct the fiscal imbalances through the medium-term fiscal reform programme / Memorandum of Understandings with the Central Government. While such measures have no doubt served some useful purposes, they are somewhat discretionary and hence lack statutory backing. On the contrary, adoption of fiscal policy rules built under fiscal responsibility legislation commits the government to a deficit or debt reduction path. The institutional framework of the fiscal legislation facilitates effective monitoring of fiscal performance of the government and encourages pursuit of fiscal management policies aimed at transparency, responsibility, efficiency, fairness and stability. While such legislations can not be panacea for all fiscal ills and have their own drawbacks, they provide a basis for political consensus to accomplish complex economic tasks and thereby enhance the credibility of the Government.

5.3 If a fiscal rule is to be useful for the subnational levels of government, it needs to be well designed, combining simplicity and flexibility. Furthermore, the rules must be implemented in a transparent manner, with the support of an appropriate institutional structure especially as regards the budget processes and monitoring mechanism. The rules should be adequate to reach the desired goal. They should be internally consistent and not conflict with each other. They should be simple for the general public to follow. Rules should be flexible to adapt to exogenous shocks. Also, depending on the constitutional and legal statutes, the rules must be enforceable by the concerned authorities.

5.4 While this is beyond the scope of this Report, the objective of fiscal responsibly legislation would need to be broadened to include the third tier of the government, viz., the local bodies. Fiscal legislation at all levels would facilitate the process of fiscal consolidation. However, irrespective of the statutory requirements under the fiscal legislation, the government should have the commitment to deficit reduction and growth maximization. Policies aimed at reducing non-interest outlays, taking measures for raising revenue including improvement in tax compliance and levying of optimal user charges on public services, enhancing the credibility of the Government through actions which would indirectly result in reduction in interest rate on borrowings of the State Government and taking initiatives for growth in GSDP leading to decline in debt-GSDP ratio need to be pursued actively. It may, however, be noted that unless there is a strong political commitment to adhere to a sustainable fiscal adjustment process enshrined in the spirit of fiscal legislation, the rules, howsoever well designed and elegantly framed, could be bypassed and policies reversed to the detriment of the long term financial health of the State.

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Annex 1: International Experience of Fiscal Policy Rules

I.1 A cross-country survey reveals that most of the countries that faced widening fiscal imbalances during the mid-1980s introduced medium-term fiscal adjustment plans. The crucial element of the adjustment plans was commitment to fiscal discipline by means of a rule. Fiscal rules enacted by the developed countries having sub-national entities include, USA, Canada, and Germany. Encouraged by the improved fiscal performance in developed countries in the period following the adoption of fiscal rules, several emerging economies, such as, Argentina, Colombia and Brazil also started to adopt fiscal rules to address fiscal issues.

Developed Countries

USA

I.2 All but two states in the United States have provisions requiring a balanced budget. 40 states require the legislature to pass a balanced budget. Most states have constitutional requirements or a combination of constitutional and statutory requirements; only five rely solely on statutory requirements. In addition to balanced budget rules, 27 states have tax and expenditure limitations, which set limits on annual revenue or expenditure increases. Furthermore, most states have some form of constitutional or statutory limits on the issuance of general obligation debt (debt which is guaranteed by all government funds and the government's ability to raise taxes). Most limits are based on a formula involving states' revenues or appropriations, while some states impose maximum dollar limits. Fourteen states allow general obligation debt to be overridden by a referendum or supermajority vote, and a few states prohibit the issuance of general obligation debt altogether.

Canada

I.3 In Canada, nine provinces and territories have enacted or tabled fiscal rules. In all but one jurisdiction, fiscal rule requires balanced budgets. Fiscal rules cover the consolidated budget in all but two jurisdictions. Most provinces require a balanced budget on an annual basis. However, New Brunswick and Saskatchewan provinces are required to balance their budgets over a four-year period. Deficits are permitted in Nova Scotia, Quebec and Ontario as long as they are offset in the next fiscal year. Several provinces have also chosen to target debt reduction and elimination. States, such as, Ontario, Manitoba, Alberta and the Yukon have taxation-by-referendum approval rules. Ontario, Manitoba, British Columbia and the Yukon have legislated penalties for not achieving the fiscal targets. For example, Ontario's legislation applies to members of the Executive Council, whereby salaries are reduced by 25 per cent in the first year of a deficit and 50 per cent for each year thereafter. One of the main advantages of legislated fiscal restrictions in Canada is that they increase the Finance Ministers' bargaining power to promote unpopular fiscal measures within the cabinet. Essentially, policy makers can quote the rules as an external constraint in reference to internal allocations of limited funds.

Germany

I.4 In Germany, a Constitutional rule was introduced in 1969 which requires a balanced budget, but allows borrowing for investment expenditure (i.e., the golden rule). In addition, some States' constitutions include the golden rule.

Emerging Market Economies

Argentina

I.5 In Argentina, under the Law on Fiscal Solvency adopted in September 1999, the federal government is required (a) to maintain a position of overall balance from 2003 onwards, following a three-year convergence period, and (b) to limit the real growth of primary expenditure to the real growth of GDP, or to zero in the event of a fall in GDP. Although exempt from the Law, the provincial governments are invited to adopt similar fiscal rules. While some provinces have already implemented them, others are considering doing so.

Peru

I.6 In Peru, the Law on Fiscal Prudence and Transparency, enacted in December 1999, declares as a general principle that the government should adhere to a balanced or surplus position over the medium term. With a coverage that extends practically to the entire general government, the rules resemble closely those of Argentina. Specifically, the Law obliges the authorities (a) to maintain overall balance, subject to a ceiling equivalent to 1 per cent of GDP and (b) to limit the annual nominal growth of primary expenditure to 2 percentage points above the annual rate of inflation. The rules could be waived in the event of national emergency or international crisis; on evidence of a contraction of GDP, the deficit would be allowed to rise to 2 percent of GDP. Also, the Law provides for a stabilisation fund, constituted from a portion of excess revenues and privatisation receipts, to be drawn to compensate for a cyclical shortfall. Any net accumulation above 3 per cent of GDP would be used for retiring public debt.

Brazil

1.7 In Brazil, the Fiscal Responsibility Law of May 2000 requires the federal government, each state government, and each municipality to (a) maintain current balance, (b) limit all personnel expenditures, including pensions, under 60 per cent (50 percent for the federal government) of net current revenue (i.e. net of transfers and contributions), and (c) limit the ratio of its debt to net current revenue within the limits set for each year by the President. In addition, the Law prescribes detailed rules for offsetting any unanticipated increase in expenditures and any increase in tax preferences, for granting guarantees and for own financing of any increase in public pension benefits.

Annex 2

Status of Fiscal Responsibility Legislation in India

II.1 A noteworthy development in the fiscal area was the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 by the Government of India (GOI). Five State Governments, *viz*. Karnataka, Punjab, Kerala, Tamil Nadu and Uttar Pradesh have also enacted similar legislations. In addition, Maharashtra has introduced the fiscal legislation bill in its State Assembly. It is important to note that the structure and content of these legislations go beyond the conventional fiscal legislation, i.e., setting the ceiling on the fiscal indicators. The legislations included enforcement mechanism as well as the supporting institutional mechanism to enable the observance of fiscal prudence. Furthermore, the legislations have combined fiscal transparency and provisions of medium-term fiscal policy framework, which have significant implications for budget integrity and accountability.

Fiscal Legislation of the Government of India

II.2 The FRBM bill was passed by the Lok Sabha in May, 2003 and by the Rajya Sabha in August, 2003. The institutional arrangements are being envisaged to achieve sound fiscal management through elimination of revenue deficit, reduction in fiscal deficit and a phased decline in Centre's borrowings from the RBI. The Government of India legislation has been enacted in terms of the conventional golden principles of fiscal legislation, viz., deficit rule, debt rule and borrowing rule, budget management, medium-term fiscal plan, and evaluation of fiscal performance. Recognizing that there could be extraordinary circumstances caused by domestic and global factors, the Act provides for fiscal targets as part of the rules framed under the Act, in order to strike a balance between legislative intervention and the need for flexibility to deal with fiscal imperatives. The Rules under the Act have been notified on July 5, 2004. It may be noted that the terminal year for the elimination of the revenue deficit has been extended to the year 2008-09 through an amendment to the FRBM Act 2003 carried out in July 2004.

Fiscal Legislations of the State Governments

II.3 Broadly akin to the Centre's fiscal legislation, the main focus of State legislations is the deficit reduction targets in terms of key deficit indicators, particularly, elimination of revenue deficit in the medium term. In addition, fiscal targets aim at reducing GFD. The targets in respect of GFD–GSDP ratio varies from 2 per cent (Kerala) to 3 per cent (Karnataka and Uttar Pradesh).

II.4 The **Karnataka Fiscal Responsibility Act, 2002** aims at reducing GFD/GSDP to 3 per cent and revenue deficit to 'nil' by 2006. The Act has also set limit on total liabilities at 25 per cent of GSDP by 2015 and on guarantees within prescribed ceiling under the Karnataka Government Guarantees Act. The Act also specifies budget management through medium-term fiscal Plan, compliance through half-yearly review and enhancement of transparency.

II.5 The **Kerala Fiscal Responsibility (KFR) Act, 2003** has set GFD target of 2 per cent of GSDP and 'nil' revenue deficit by 2007. Since the Kerala Ceiling on Government Guarantees Act provides for a upper limit on outstanding guarantees at Rs.14,000 crore, no separate provision on guarantees has been made in the KFR Act. The KFR Act also provides for setting up of the Public Expenditure Review Committee which would submit a review report explaining, inter alia, the reasons for deviation from the fiscal target during the previous year.

II.6 The **Punjab Fiscal Responsibility and Budget Management Act, 2003** contains the rate of growth of GFD to 2 per cent per annum in nominal terms till GFD is below 3 per cent of GSDP and stipulates reduction in the ratio of revenue deficit to revenue receipts by at least 5 percentage points each year until revenue balance is achieved. The Act also limits debt to 40 per cent of GSDP by 2007 and caps outstanding guarantees on long-term debt to 80 per cent of revenue receipts of the previous year and limits guarantees on short-term debt to borrowings in respect of working capital or food credit. The Act provides for Medium-term Fiscal Plan and quarterly review of performance and measures for fiscal transparency.

II.7 The **Tamil Nadu Fiscal Responsibility Act, 2003** aimed at containing GFD at 2.5 per cent of GSDP and the ratio of revenue deficit to revenue receipts at 5 per cent by 2007. The Act also caps outstanding guarantees at 100 per cent of the total revenue receipts in the preceding year or at 10 per cent of GSDP, whichever is lower. In addition to Medium-term Fiscal Plan and measures for transparency, the Act also states that an independent external body would carry out periodic review for compliance. The Act has since been amended in 2004, wherein the terminal year for the target of reduction of revenue deficit to revenue receipts and fiscal deficit to GSDP has been deferred by a year to 2008. Further, the terminal target for fiscal deficit has been raised from 2.5 per cent to 3.0 per cent. The risk weighted guarantees have also been capped at 75 per cent of the total revenue receipts in the preceding year or at 7.5 per cent of GSDP, whichever is lower.

II.8 The **Uttar Pradesh Fiscal Responsibility Act, 2004** stipulates limiting GFD to a maximum of 3 per cent by 2009. Revenue deficit would decline to nil over the same period. Total liabilities would be capped at 25 per cent of GSDP by 2018.

II.9 The **Maharashtra Fiscal Responsibility and Budget Management Bill, 2002** specifies that the revenue expenditure shall not exceed revenue receipts after a period of five years from the appointed day. The expenditure would be adjusted as per the latest revenue estimates and the amount of risk due to guarantees would be contained within 1.5 per cent of the expected revenue receipts.

The important features of fiscal legislation of the above mentioned States are summarised in the table below.

Table II.1: Fiscal Responsibility Legislation of States

Item/ State	Karnataka (Act)	Kerala (Act)	Tamil Nadu (Amended Act)	Punjab (Act)	Uttar Pradesh (Act)	Maharashtra (Bill)
1.Gross Fiscal Deficit	Not more than 3 % of GSDP by 2006	GFD to decline to 2% of GSDP by 2007.	GFD not more than 3.0 % of GSDP by 2008.	Contain rate of growth of GFD to 2% per annum in nominal terms, till GFD is below 3% of GSDP.	Not more than 3% of GSDP by 2009.	Limiting the annual incremental borrowings to not more than half the trend growth rate of revenue receipts.
2.Revenue Deficit	Nil by 2006.	Nil by 2007.	Ratio of RD to RR not to exceed 5 % by 2008.	Reduce RD as per cent of RR by at least 5 percentage points each year until revenue balance is achieved.	Nil by 2009.	Ensuring that after a period of five years from the appointed day, the revenue expenditure shall not exceed RR.

Item/ State	Karnataka (Act)	Kerala (Act)	Tamil Nadu (Amended Act)	Punjab (Act)	Uttar Pradesh (Act)	Maharashtra (Bill)
3.Limiting Guarantees	Limit the guarantees within prescribed ceiling under the Government Guarantees Act.	-	(i) Cap total outstanding guarantees to 100 per cent of the total revenue receipts in the preceding year or at 10 per cent of GSDP, whichever is lower. (ii) Cap risk weighted guarantees to 75 per cent of the total revenue receipts in the preceding year or at 7.5 per cent of GSDP, whichever is lower.	Cap outstanding guarantees on long-term debt to 80% of revenue receipts of the previous year and guarantees on short-term debt to be given only for working capital or food credit.	Not to give guarantee for any amount exceeding the limit prescribed under any rule or law to be made by the Govt for the purpose.	Amount of risk weighted guarantees issued in a year shall not exceed 1.5 per cent of the expected revenue receipts and to classify the guarantee obligations according to risk of devolvement.

Item/ State	Karnataka (Act)	Kerala (Act)	Tamil Nadu (Amended Act)	Punjab (Act)	Uttar Pradesh (Act)	Maharashtra (Bill)
4.Total liabilities	Total liabilities not to exceed 25 % of GSDP by 2015.	-	-	Debt / GSDP ratio not to exceed 40% by 2007.	Debt / GSDP ratio not to exceed 25% by 2018.	Restriction on borrowing by regulating salary expenditure, ceiling on expenditure on grant-in-aid institutions and ceiling on subsidies.
5.Expenditure	-	-	-	-	-	Achieving non-salary development expenditure not less than 60 per cent of the total expenditure.
6.Meduim-Term Fiscal Plan (MTFP)	MTFP would include- **i)Four-year rolling target for prescribed target,** ii)assessment of the sustainability, and iii)evaluation of performance of prescribed fiscal indicators.	MTFP would review periodically the progress of public expenditure with reference to fiscal target, and evaluation of the current trend to budgetary allocations.	MTFP would include- i) objectives, ii)Evaluation of fiscal indicators, iii) Strategies priorities for ensuing year iv) Economic trends and future prospects.	MTFP would include i) three-year rolling target for prescribed target, ii) Assessment of the sustainability, and iii) recent economic trends and future prospects.	MTFP would include - i)Five year rolling targets for prescribed indicators, ii)Medium term fiscal objectives, iii) Strategic priorities, iv)Evaluation of performance of prescribed indicators.	Multi-year framework and presenting three years forward estimates of revenue and expenditure.

Item/ State	Karnataka (Act)	Kerala (Act)	Tamil Nadu (Amended Act)	Punjab (Act)	Uttar Pradesh (Act)	Maharashtra (Bill)
7.Compliance	Half yearly review of receipts and expenditure in relation to budget estimates along with remedial measures to achieve the budget target. GFD/ RD may exceed the limits on unforeseen grounds due to national security or natural calamity.	Public Expenditure Review Committee which would submit a review report giving full account of each item where the deviation from the fiscal target have occurred during the previous year.	Independent external body to carry out periodic review for compliance for the provision of the Act. Target GFD/ RD may exceed the limits on unforeseen grounds due to national security or natural calamity.	Quarterly review of receipts and expenditure in relation to budget estimates along with remedial measures to achieve the budget target. GFD/ RD may exceed the limits on unforeseen grounds due to national security or natural calamity.	Half yearly review of receipts and expenditure in relation to budget; the review report to reflect clearly on deviations from the budget targets and remedial measures.	Constitution of Fiscal Advisory Board to advise Government relating to implementation of the fiscal responsibility legislation.
8. Fiscal transparency	Certain fiscal management principles and measures for fiscal transparency.	Measures to ensure greater transparency in its fiscal operations.	Measures to ensure greater transparency in its fiscal operations.	Measures to ensure greater transparency in its fiscal operations.	Budget to be made more transparent by better disclosure statements to be included in the budget documents.	Bringing budget transparency by identifying all liabilities (past & present), constitution of a Doubtful Loans and Equity Fund.

Item/ State	Karnataka (Act)	Kerala (Act)	Tamil Nadu (Amended Act)	Punjab (Act)	Uttar Pradesh (Act)	Maharashtra (Bill)
9. Pension	-	-	-	-	-	Present to the legislature every year estimated yearly pension liabilities worked out on actuarial basis for the next ten years.

Annex 3: Fiscal Transparency

III.1 Fiscal transparency is a key aspect of good governance based on fiscal policy rules. The transparency relates to the clarity with which the fiscal policy rules are defined and the adequacy of reporting against these rules. The principle of fiscal transparency emphasizes on being open to the public about the structure and functions of government, fiscal policy intentions, public sector accounts and fiscal projections (Kopits and Craig, 1998). Fiscal transparency, however, is quite distinct from the other two ingredients of sound fiscal management viz., the soundness of public finances and the efficiency of fiscal policy instruments. The soundness of fiscal management relates to the macroeconomic issue of fiscal balance, an essential pre-condition for stability. The efficiency of fiscal policy instruments relates to the microeconomic issues of expenditure programmes in achieving their objectives and tax policies in raising revenues with minimum economic distortion. Fiscal transparency, on the other hand, mainly focuses on the issue of whether sufficient information on the fiscal situation is being provided in a timely fashion to enable observers make an accurate assessment of the underlying fiscal position. Transparency in fiscal operations strengthens accountability of the budgetary policies and highlights the risk associated with unsustainable policies.

III.2. Transparency in government's fiscal operations has several dimensions, such as,

- provision of reliable information on the government's fiscal policy intentions and forecasts, presupposing a high degree of fiscal marksmanship;
- detailed data and information on government operations, including the publication of comprehensive budget documents that contain properly classified accounts for the general government and quasi-fiscal activities conducted outside the government; and
- a transparent regulatory framework, open public procurement and employment practices, a code of conduct for tax officials and published performance audits.

Fiscal Transparency and the IMF

III.3. The IMF Manual on Fiscal Transparency provides four general principles of fiscal transparency, which form the basic structure of Code of Good Practices. The Code provides policy makers with benchmarks of good practice in key areas that the IMF encourages the member countries to implement. These principles relate to:

- clarity of roles and responsibilities within government, and between government and the rest of the economy;
- public availability of information on fiscal outcomes;
- open and transparent budget preparation, execution and reporting; and
- assurances of integrity, including those relating to the quality of fiscal data and the need for independent scrutiny of fiscal information.

The Indian Constitution

III.4. In the Indian context, the Constitution provides a clear statement of roles and responsibilities of the Central and State Governments. *Article 150* of the *Constitution* provides that the form of accounts of both the Union and the States shall be in such form as may be prescribed by the President on the advice of the Comptroller and Auditor General (C&AG) of India. Accordingly, the State Governments place before the State Legislature, the *Annual Financial Statement* (AFS) (the Budget) in respect of the financial year (April 1 to March 31).

Core Group on Voluntary Disclosure of Norms for the State Governments

III.5. The State Finance Secretaries in their Conference held on June 12, 1999 at the Reserve Bank of India, Mumbai decided to constitute a Committee of State Finance Secretaries to suggest various measures of disclosures which can be introduced in the budgetary exercise of State Governments. Accordingly, a Core Group on Voluntary Disclosure of Norms for the State Governments was formed with membership drawn from the Government of India, State Governments and the Reserve Bank of India. The Group, in its Report submitted in January 2001, suggested benchmarking of certain disclosure standards to be followed by the State Governments with regard to the budgetary exercise. The Group identified two categories of States depending on whether or not they have already implemented the *Budget at a Glance* and recommended the following:

(a) The States which have already started publishing *Budget at a Glance* may be persuaded to disseminate more information on a time series basis, especially data on major fiscal indicators *viz.*, revenue deficit, primary deficit, tax revenue, interest payments, subsidies, contingent liabilities including guarantees, etc.

(b) Other States may initiate necessary steps towards publishing *Budget at a Glance* and also some of the time series data on some of the above mentioned fiscal indicators.

(c) In the medium term, States should publish *Budget Summary*. States with necessary expertise may move towards publishing the suggested *Budget Summary* (**Table A3.1**) as early as possible for others to emulate.

(d) The State Finance Secretaries forum may assess the progress under this sphere after a period of 2 years so as to chalk out further programme of action.

(e) The suggested format (Budget Summary) could be considered as an ultimate goal of State Governments in the transparency practices with regard to budget exercise.

(f) State Governments are encouraged to develop their own website and progressively disseminate high frequency data - half yearly, quarterly and monthly. Publishing high frequency data would help the authorities in assessing the performance and to plan for the future.

Table A3.1 GOVERNMENT OF - ----: BUDGET SUMMARY CONSOLIDATED STATEMENT ON RECEIPTS AND EXPENDITURE

	RECEIPTS & EXPENDITURE	1999-2000 BE	1999-2000 Actual	2000-01 BE	2000-01 RE	2001-02 BE
	1.	2.	3.	4	5.	6.
1.	REVENUE RECEIPTS (1.1 TO 1.7)					
1.1	**State's own Tax Revenue**					
1.2	**Share in Central Taxes**					
1.3	**State's own non-tax revenue**					
	of which Lotteries (Gross Receipts)					
1.4	**Grants for State Plan Schemes (Central Assistance)**					
1.5	**Plan Grants from Finance Commission**					
1.6	**Non-Plan Grants**					
1.7	**Central Sponsored Scheme/Central Plan Scheme Others**					
2	REVENUE EXPENDITURE (2.1+2.2)					
2.1	**Plan Revenue Expenditure**					
	of which					
	Outlay on CSS/CPS					
	Support to State PSUs					
	Lotteries (Gross Expenditure)					
2.2	**Non-Plan Revenue Expenditure**					
	of which					
	Interest Payments					
	Support to State PSUs					
	Lotteries (Gross Expenditure)					
3.	CAPITAL RECEIPTS (3.1 TO 3.14)					
3.1						
3.2						

3.3						
3.4	**SLR based Market borrowings (Gross)**					
3.5	**Negotiated Loans (Budgeted)**					
3.6	**Loans for State Plan Schemes (Central**					
3.7	**Assistance)**					
3.8	**Loans against Net Small savings**					
3.9	**Central Plan Schemes**					
3.10	**Central Sponsored Schemes**					
3.11	**net Change in WMA from RBI**					
3.12	**W & M advances from Centre**					
3.13	**Recovery of Loans and Advances**					
3.14	**Disinvestment**					
	Contingency Fund (net)					
	Appropriation to Contingency Fund (Net)					
	Other capital receipts into Consolidated Fund					
	Public Account (Net)					
	of which					
	Inter-State Settlement(Net)					
	Provident Fund (Net)					
	Reserve Fund (Net)					
	Deposits & Advances (net)(Budgeted)					
	Suspense & Miscellaneous (Net)					
	Withdrawal from C.B. Investment Account (Net)					
	Remittances (Net)					
	Others (Net)					

The Advisory Group on Fiscal Transparency

III.6. The Advisory Group on Fiscal Transparency (Chairman: Shri Montek Singh Ahluwalia), appointed by the Standing Committee on International Financial Standards and Codes, submitted its report in June 2001. The Group examined the extent to which fiscal practices in India comply with the International Monetary Fund's Code of Good Practices on Fiscal Transparency. The overall assessment of the Group is that current fiscal practices at the Central Government level satisfy the minimum requirement of the Code in many areas, although there are deficiencies in some areas. Many of these deficiencies would be substantially addressed once the FRBMB is enacted. The Group, however, observed that the fiscal practices at the State level were generally behind the standards achieved at the Central Government level. The Group recommended the following:

(a) The Finance Secretaries Forum could review the report of the Core Group and determine a set of minimum standards on transparency which all State Governments should achieve within a three-year period.

(b) To meet the reporting requirements under fiscal policy rules, the States should bring out an annual report in which outcomes are presented against the targets. In addition, a monthly or quarterly reporting of outcomes may also be required.

(c) States will also need to develop models of intra-year fiscal forecasting, apart from a medium term fiscal forecasts covering 3-5 years.

Annex 4

The Model Bill The State---------Fiscal Responsibility Bill or Fiscal Responsibility and Budget Management Bill -------(year)

A Bill to provide for the responsibility of the State Government to ensure prudence in fiscal management and fiscal stability by progressive elimination of revenue deficit, reduction in fiscal deficit, prudent debt management consistent with fiscal sustainability, greater transparency in fiscal operations of the Government and conduct of fiscal policy in a medium term framework and for matters connected therewith or incidental thereto.

Be it enacted by the ----State Legislature in the year --- as follows: -

1. Short Title and Commencement

(1) This Bill may be called the------ Fiscal Responsibility/Fiscal Responsibility and Budget Management Bill, -----.

(2) It shall come into force on such date as the State Government may, by notification in the *Official Gazette*, appoint in this behalf.

2. Definitions

In this Bill, unless the context otherwise requires-

(a) " budget" means the annual financial statement laid before the House or Houses of the State Legislature under Article 202 of the Constitution;

(b) "current year" means the financial year preceding the ensuing year;

(c) “ensuing year” means the financial year for which the budget is being presented;

(d) “financial year” means the year beginning on the 1^{st} April and ending on 31^{st} March next following;

(e) GSDP means Gross State Domestic Product at current market prices.

(f) "fiscal deficit" is the excess of aggregate disbursements (net of debt repayments) over revenue receipts, recovery of loans and non-debt capital receipts;

(g) "fiscal indicators" are such indicators as may be prescribed for evaluation of the fiscal position of the State Government;

(h) "fiscal targets" are the numerical ceilings and proportions to total revenue receipts (TRR) or GSDP for the fiscal indicators;

(i) “prescribed” means prescribed by the rules made under this Act;

(j) “previous year” means the year preceding the current year;

(k) "revenue deficit" means the difference between revenue expenditure and total revenue receipts (TRR);

Explanation: 'Total revenue receipts' (TRR) includes State's own revenue receipts (both tax and non-tax) and current transfers from the Centre (comprising grants and State's share of Central taxes).

(l) "total liabilities" means the liabilities under the Consolidated Fund of the State and the Public Account of the State and shall also include borrowings by the public sector undertakings and the special purpose vehicles and other equivalent instruments including guarantees where the principal and/ or interest are to be serviced out of the State budgets.

3. Fiscal Management Objectives

The State Government shall:

(a) take appropriate measures to eliminate the revenue deficit and thereafter build up adequate revenue surplus and contain the fiscal deficit at a sustainable level, and utilize such surplus for discharging the liabilities in excess of the assets or for funding capital expenditure;

(b) pursue policies to raise non-tax revenue with due regard to cost recovery and equity; and

(c) lay down norms for prioritisation of capital expenditure, and pursue expenditure policies that would provide impetus for economic growth, poverty reduction and improvement in human welfare.

4. Fiscal Management Principles

The State Government shall be guided by the following fiscal management principles, namely :-

(a) transparency in setting the fiscal policy objectives, the implementation of public policy and the publication of fiscal information so as to enable the public to scrutinise the conduct of fiscal policy and the state of public finances;

(b) stability and *predictability* in fiscal policy making process and in the way fiscal policy impacts the economy;

(c) responsibility in the management of public finances, including *integrity* in budget formulation;

(d) fairness to ensure that policy decisions of the State Government have due regard to their financial implications on future generations; and

(e) efficiency in the design and implementation of the fiscal policy and in managing the assets and liabilities of the public sector balance sheet.

5. Fiscal Policy Statements to be laid before the Legislature

The State Government shall in each financial year lay before the House/Houses of the Legislature, the following statements[5] of fiscal policy along with the budget, namely:-

(a) the Macroeconomic Framework Statement;

(b) the Medium Term Fiscal Policy Statement; and

(c) the Fiscal Policy Strategy Statement.

6. Macroeconomic Framework Statement

The Macroeconomic Framework Statement, in such form as may be prescribed, shall contain an overview of the State economy, an analysis of growth and sectoral composition of GSDP, an assessment related to State Government finances and future prospects.

7. Medium Term Fiscal Policy Statement

(1) The Medium Term Fiscal Policy Statement shall set forth in such form as may be prescribed the fiscal management objectives of the State Government and three- year rolling targets for the prescribed fiscal indicators with clear enunciation of the underlying assumptions.

(2) In particular and without prejudice to the provisions contained in sub section (1), the Medium Term Fiscal Policy Statement shall include the various assumptions behind the fiscal indicators and an assessment of sustainability relating to:-

(i) the balance between revenue receipts and revenue expenditure;

(ii) the use of capital receipts including borrowings for generating productive assets;

(iii) the estimated yearly pension liabilities worked out on actuarial basis for the next ten years.

Provided that in case it is not possible to calculate the pension liabilities on actuarial basis during the period of first three years after the coming into force of this Act, the State Government may, during that period, estimate the pension liabilities by making forecasts on the basis of trend growth rates.

8. Fiscal Policy Strategy Statement

The Fiscal Policy Strategy Statement shall be in such form as may be prescribed and shall contain, *inter alia*,

(i) the fiscal policies of the State Government for the ensuing year relating to taxation, expenditure, borrowings and other liabilities (including borrowings by Public Sector Undertakings and Special Purpose Vehicle and other

---

[5] The three statements may be combined into one or two statements

equivalent instruments where liability for repayment is on the State Government), lending, investments, other contingent liabilities, user charges on public goods/utilities and description of other activities, such as guarantees and activities of Public Sector Undertakings which have potential budgetary implications;

(ii) the strategic priorities of the State Government in the fiscal area for the ensuing year;

(iii) the key fiscal measures and the rationale for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, borrowings and user charges on public goods/utilities; and

(iv) an evaluation of the current policies of the State Government *vis-à-vis* the fiscal management principles set out in Section 4, the fiscal objectives set out in the Medium-Term Fiscal Policy Statement in sub-section 1 of section 7 and fiscal targets set out in section 9.

9. Fiscal Targets

(1) The State Government may prescribe such targets as may be deemed necessary for giving effect to the fiscal management objectives.

(2) In particular, and without prejudice to the generality of the foregoing provisions, the State Government shall -

(a) reduce revenue deficit by an amount equivalent to at least --------- percentage point of TRR in each financial year, beginning from the 1st day of April---- , so as to eliminate it by 31st March ------and generate revenue surplus thereafter;

(b) reduce fiscal deficit by an amount equivalent to at least --------percentage point of GSDP in each financial year beginning from the 1st day of April, ---------, so as to bring it down to not more than ---- per cent by the year ending March ----

(c) ensure within a period of -------------- years, beginning from the initial financial year on the 1st day of April ----, and ending on the 31st day of March -----, that the outstanding total liabilities do not exceed ------- per cent of the estimated GSDP for that year;

(d) limit the amount of annual incremental risk weighted guarantees to -----per cent of the TRR in the year preceding the current year or at------ per cent of GSDP of the year preceding the current year, which ever is lower.

Provided that revenue deficit and fiscal deficit may exceed the limits specified under this section due to ground or grounds of unforeseen demands on the finances of the State Government arising out of internal disturbance or natural calamity or such other exceptional grounds as the State Government may specify, Provided however that a statement in respect of the ground or grounds specified in the first proviso shall be placed before the House or Houses of the Legislature, as soon as may be, after such deficit amount exceeds the aforesaid targets.

10. Measures for Fiscal Transparency

(1) The State Government shall take suitable measures to ensure greater transparency in its fiscal operations in the public interest and minimise as far as practicable, secrecy in the preparation of the budget.

(2) In particular, and without prejudice to the generality of the foregoing provisions, the State Government shall, at the time of presentation of the budget, make disclosures on the following, along with detailed information in such forms as may be prescribed:

(a) the significant changes in the accounting standards, policies and practices affecting or likely to affect the computation of fiscal indicators;

(b) details of borrowings by way of Ways and Means Advances/Overdraft availed of from the Reserve Bank of India.

(3) Whenever the State Government undertakes to unconditionally and substantially repay the principal amount and/or pay the interest of any separate legal entity, it has to reflect such liability as the borrowings of the State.

11. Measures to Enforce Compliance.

(1) The Minister-in-Charge of the Department of Finance (hereinafter referred to as Minister of Finance) shall review, every quarter, the trends in receipts and expenditure in relation to the budget estimates and place before the House or Houses of the Legislature, the outcome of such reviews.

(2) Whenever there is either shortfall in revenue or excess of expenditure over the intra-year targets mentioned in the Fiscal Policy Strategy Statement or the rules made under this Act, the State Government shall take appropriate measures for increasing revenue and/or for reducing the expenditure, including curtailment of the sums authorised to be paid and applied from out of the Consolidated Fund of the State.

Provided that nothing in this sub-section shall apply to the expenditure charged on the Consolidated Fund of the State under clause (3) of Article 202 of the Constitution or any other expenditure, which is required to be incurred under any agreement or contract, which cannot be postponed or curtailed.

(3) (a) Except as provided under this Act, no deviation in meeting the obligations cast on the State Government under this Act shall be permissible without approval of Legislature.

(b) Where owing to unforeseen circumstances, any deviation is made in meeting the obligations cast on the State Government under this Act, the Minister of Finance shall make a statement in the House or Houses of Legislature explaining: --

(i) any deviation in meeting the obligations cast on the State Government under this Act;

(ii) whether such deviation is substantial and relates to the actual or the potential budgetary outcomes; and

(iii) the remedial measures the State Government proposes to take.

(4) Any measure proposed in the course of the financial year, which may lead to an increase in revenue deficit, either through increased expenditure or loss of revenue, shall be accompanied by a statement of remedial measures, proposed to neutralise such increase or loss and such statement shall be placed before the House/Houses of Legislature.

(5) The State Government may set up an agency independent of the State Government to review periodically the compliance of the provisions of this Act and table such reviews in the House or Houses of the State Legislature.

12. Power to Make Rules

(1) The State Government may, by notification in the Official Gazette, make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely

(a) the form of the Macroeconomic Framework Statement under section 6;

(b) the form of Medium-Term Fiscal Policy Statement, including the targets for the fiscal indicators, under section 7;

(c) the form of Fiscal Policy Strategy Statement under section 8;

(d) the forms for disclosure under sub-section (2) of section 10;

(e) measures to enforce compliance;

(f) the manner of review of compliance of the provisions of this Act by the independent agency under section 11; and

(g) any other matter which is required to be, or may be, prescribed.

13. Rules to be laid before Legislature

Every rule made under this Act shall be laid, as soon as may be after it is made, before the House or Houses of the Legislature, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, the House/Houses agree in making any modification in the rule or the House/Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

14. Protection of action taken in good faith

No suit, prosecution or other legal proceedings shall lie against the State Government or any officer of the State Government for anything which is in good faith done or intended to be done under this bill or the rules made there under.

15. Application of other laws not barred

The provisions of this bill shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

16. Power to remove difficulties

(1) If any difficulty arises in giving effect to the provisions of this bill, the State Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this bill as may appear to be necessary for removing the difficulty.

Provided that no order shall be made under this section after the expiry of two years from the commencement of this bill.

(2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of the State Legislature.

Annex 5 ----- (State) Fiscal Responsibility Rules, 200X NOTIFICATION

----- (State capital), the ------ (Date)

In exercise of the powers conferred by section 12 of the State Fiscal Responsibility Act, (Year) (-- of Year), the State Government hereby makes the following rules, namely :-

1. Short title and commencement

(1) These rules may be called the ------ (State) Fiscal Responsibility Rules, (Year).

(2) They shall come into force on the ----day of ----- (month), ------(year).

2. Definitions

In these rules, unless the context otherwise requires -

(a) "Act" means the ------- (State) Fiscal Responsibility Act, 200X (-- of 200X);

(b) "form" means a form appended to these rules;

(c) "section" means a section of the Act;

(d) words and expressions used herein but not defined and defined in the Act shall have the meanings respectively assigned to them in the Act.

(*Note: Those States that may not be in a position to incorporate all the annual targets in the Act itself, may provide for a separate Rule on annual targets under the Rules. Since the annual targets are indicated in the Model Bill, no annual target has been indicated in the Rules.*)

3. Macroeconomic Framework Statement

The Macroeconomic Framework Statement as required under Section 6, shall be in **Form F-1.**

4. Medium Term Fiscal Policy Statement

(1) The Medium Term Fiscal Policy Statement, as required under sub-section (1) of section 7, shall include in **Form F-2** three year rolling targets in respect of the following fiscal indicators:

(a) revenue deficit as a percentage of TRR;

(b) fiscal deficit as a percentage of GSDP;

(c) outstanding total liabilities as a percentage of GSDP;

(d) (any additional target(s) that the State may like to prescribe).

(2) The Medium Term Fiscal Policy Statement shall also explain the assumptions underlying the above mentioned targets for fiscal indicators and an assessment of sustainability relating to the items indicated in sub-section 2 of section 7.

5. Fiscal Policy Strategy Statement

(1) The Fiscal Policy Strategy Statement as required under Section 8 shall be in **Form F-3**.

6. Disclosures

(1) The State Government shall, at the time of presenting the budget, make disclosures as required under section 10 together with the following statements:

(a) a statement of select indicators of fiscal situation in **Form D-1;**

(b) a statement on components of State Government liabilities and interest cost of borrowings/mobilisation of deposits in **Form D-2**;

(c) a statement on the Consolidated Sinking Fund in **Form D-3**;

(d) a statement on guarantees given by the Government in **Form D-4;**

(e) a statement on outstanding risk-weighted guarantees in **Form D-5;**

(f) a statement on the Guarantee Redemption Fund in **Form D-6**;

(g) a statement of assets in **Form D-7**;

(h) A statement on claims and commitments made by the State Government on revenue demands raised but not realised in **Form D-8**; and

(i) a statement on liability in respect of major works and contracts, committed liabilities in respect of land acquisition charges and claims on the State Government in respect of unpaid bills on works and supplies in **Form D-9.**

(2) The provisions of sub-rule (1) shall be complied with not later than three years after the coming into force of this Act.

7. Measures to enforce compliance

In case the outcome of the quarterly reviews of trends in receipts and expenditure, at the end of the second quarter of any financial year shows that -

(i) the total non-debt receipts are less than -- per cent of Budget Estimates for that year; or

(ii) the fiscal deficit is higher than -- per cent of the Budget Estimates for that year; or

(iii) the revenue deficit is higher than -- per cent of the Budget Estimates for that year;

then –

(a) as required under sub-section (2) of section 11, the State Government shall take appropriate measures and (b) as required under sub-section 3(b) of section 11, the Minister-in-charge of the Ministry of Finance shall make a statement in the Legislature during the session immediately following the end of the second quarter detailing the corrective measures taken and the prospects for the fiscal deficit of that financial year.

Form F - 1

(See rules 3 and 4)

MACRO ECONOMIC FRAMEWORK STATEMENT

1. **Overview of the State Economy**: [This paragraph shall contain a synoptic analysis of trend in the rate of growth of output. Information on key macroeconomic indicators shall be presented in the table at the end of this form.]

2. **GSDP Growth:** [This paragraph shall contain an analysis of trends in overall GSDP growth and its sectoral composition.]

3**. Overview of State Government Finances:** [This paragraph shall detail the developments in State Finances including an analysis of trends in revenue collections and expenditure, and the important fiscal deficit and debt indicators and the measures taken to improve the financial position of the State Government. Trends in State Government finances shall be presented in the format appended. This will, *inter alia*, indicate the developments related to the Consolidated Sinking Fund, Guarantee Redemption Fund, and issuances of risk-weighted guarantees and Ways and Means Advances availed from the RBI. This paragraph may also cover analysis of finances of local bodies and State-level public sector undertakings including the progress made by them for compilation/finalisation of annual statements of accounts and Central transfers.]

4. **Prospects:** [Based on the trends in major sectors presented in the previous sections, an assessment shall be made regarding the growth prospects, along with the underlying assumptions. An assessment of fiscal prospects shall also be made.]

F-1 (Contd.)

Macro Economic Framework Statement

Economic Performance at a Glance

Table 1: Trends in Select Macroeconomic and Fiscal Indicators					
		Absolute Value (Rs. Crore)		**Percentage Changes**	
		April-Reporting period*		**April-Reporting period***	
		Previous Year	Current Year	Previous Year	Current Year
	Real Sector				
1	GSDP at factor cost				
(a)	at current price				
(b)	at 1993-94 price				
2	Agriculture Production				
3	Industrial Production				
4.	Tertiary Sector Production				
	Government Finances				
1	Revenue Receipts (2 +3)				
2	Tax Revenue (2.1+2.2)				
2.1	Own Tax Revenue				
2.2	State's Share in Central Taxes				
3	Non-Tax Revenue (3.1 + 3.2)				
3.1	State's Own Non Tax revenue				
3.2	Central Transfers				
4	Capital Receipts (5+6+7)				
5	Recovery of loans				
6	Other Receipts				
7	Borrowing and other liabilities				
8	Total Receipts (1+ 4)				

9	Non-Plan Expenditure					
10	Revenue Account					
	Of which:					
11	(a) Interest payments					
	(b) Subsidies					
	(c) Wages & Salaries					
	(d) Pension Payments					
12	Capital Account					
13	Plan Expenditure					
14	Revenue Account					
15	Capital Account					
16	Total Expenditure (9+13)					
17	Revenue Expenditure (10+14)					
18	Capital Expenditure (12+15)					
19	Revenue Deficit (17-1)					
20	Fiscal Deficit {16-(1+5+6)}					
21	Primary Deficit (20-11a)					
	Memo:					
	Average amount of WMA from RBI ^					
	Average amount of OD from RBI ^					
	Number of days of OD					
	Number of occasions of OD					

* Date will relate to the period up to which information for the current year is available. To facilitate comparison, date of previous year corresponds to the same period of current year. Accordingly, reporting period may vary for different items.

^ The average amount of WMA/OD is calculated by summing up the outstanding amount of WMA as on each day (including holidays) and dividing by the total number of days during April-Reporting period.

Form F-2

(See rules 3 and 5)

MEDIUM TERM FISCAL POLICY STATEMENT

A. Fiscal Indicators - Rolling Targets

	Previous Year (Y-2) Actuals	Current Year (Y-1) Budget Estimates (BE)	Current Year (Y-1) Revised Estimates (RE)	Ensuing Year (Y); Budget Estimates (BE)	Targets for next Two Years	
					Y + 1	Y + 2
1. Revenue Deficit as percentage of Total Revenue Receipts (TRR)						
2. Fiscal Deficit as percentage of GSDP						
3. Total outstanding Liabilities as percentage of GSDP						
4. [Any additional target(s)]						

B. Assumptions underlying the Fiscal Indicators -

1. Revenue receipts
   (a) Tax-revenue -Sectoral and GSDP growth rates
   (b) Non-tax-revenue - Policy stance
   (c) Devolution to Local Bodies
   (d) Share of own tax revenue to total tax revenue
   (e) Share of own non-tax revenue to total non-tax revenue

2. Capital receipts - Debt stock, repayment, fresh loans and policy stance
   (a) Loans and advances from the Centre
   (b) Special securities issued to the NSSF
   (c) Recovery of loans and advances
   (d) Borrowings from financial institutions
   (e) Other receipts (net) – small savings, provident funds, etc.
   (f) Outstanding Liabilities - Internal Debt and Other Liabilities

3. Total expenditure - Policy Stance

   (a) Revenue account

(i) Interest payments – (a) on borrowings during the year (aggregate and category-wise); (b) on outstanding liabilities – (i) (aggregate and category-wise)

(ii) Major subsidies

(iii) Salaries

(iv) Pensions

(v) Others.

(b) Capital account

(i) Loans and advances

(ii) Capital Outlay

4. GSDP Growth

C. Assessment of sustainability relating to -

(i) <u>The balance between receipts and expenditure in general and revenue receipts and revenue expenditure in particular</u>. The Medium Term Fiscal Policy Statement may specify the tax-GSDP ratio, own tax-GSDP ratio and State's share in Central tax – GSDP ratio for the current year and subsequent two years with an assessment of the changes required for achieving it. It may discuss the non-tax revenues and the policies concerning the same. Expenditure on revenue account, both plan and non-plan, may be also discussed with particular emphasis on the measures proposed to meet the overall objectives. It may discuss policies to contain expenditure on salaries, pension, subsidies and interest payments. An assessment of the capital receipts shall be made, including the borrowings and other liabilities, as per policies spelt out. The statement shall also give projections for GSDP and discuss it on the basis of assumptions underlying the indicators in achieving the sustainability objective.

(ii) <u>The use of capital receipts including market borrowings for generating productive assets.</u> The Medium Term Fiscal Policy Statement may specify the proposed use of capital receipts for generating productive assets in different categories. It may also spell out the proposed changes among these categories and discuss them in terms of the overall policy of the Government.

(iii) <u>The estimated yearly pension liabilities worked out on actuarial basis for the next ten years.</u> In case it is not possible to calculate the pension liabilities on actuarial basis during the period of first three years after the coming into force of this Act, the State Government may, during that period, estimate the pension liabilities by making forecasts on the basis of trend growth rates (i.e. average rate of growth of actual pension payments during the last three years for which data are available).

Form F - 3

(See rules 3 and 6)

FISCAL POLICY STRATEGY STATEMENT

A: Fiscal Policy Overview: [This paragraph will present an overview of the fiscal policy currently in vogue.]

B: Fiscal policy for the ensuing year: [This paragraph shall have, *inter alia*, six sub-paragraphs dealing with -

(1) Tax Policy

In the sub-paragraph on tax policy, major changes proposed to be introduced in direct and indirect taxes in the ensuing financial year will be presented. It shall contain an assessment of exemption in various taxes and how far it relates to principles regarding tax exemptions.

(2) Expenditure Policy

Under expenditure policy, major changes proposed in the allocation for expenditure shall be indicated. It shall also contain an assessment of principles regarding the benefits and target group of beneficiaries.

(3) Borrowings and Other Liabilities, Lending and Investments

In this sub-paragraph on borrowings, the policy relating to internal debt, including the access to WMA/OD facility from the Reserve Bank of India, Government lending, investments and other activities; including principles regarding average maturity structure, bunching of repayments, etc., shall be indicated. The borrowings by Public Sector Undertakings and Special Purpose Vehicle, lending, investments, pricing of user charges on public goods and utilities and description of other activities, and activities of Public Sector Undertakings which have potential budgetary implications; and the key fiscal measures and targets pertaining to each of these shall be indicated.

(4) Consolidated Sinking Fund

In this sub-paragraph, the policy related to the Consolidated Sinking Fund (CSF) shall be indicated.

(5) Contingent and other Liabilities

Any change in the policy on contingent and other liabilities, in particular guarantees, which have potential budgetary implications shall be indicated. Any change in the policy related to borrowings by special purpose vehicle (SPV) and other equivalent instruments where liability for repayment is on the State Government shall be indicated. The policy on building up of the Guarantee Redemption Fund (GRF) and commission charges/collected for guarantees issued shall also be indicated.

(6) Levy of User Charges

Any change proposed in the levy of user charges of public services shall be spelt out.

C. Strategic priorities for the ensuing year:

[(1) Resource mobilization for the ensuing financial year through tax, non-tax and other receipts shall be spelt out.

(2) The broad principles underlying the expenditure management during the ensuing year shall be spelt out.

(3) Priorities relating to management of public debt proposed during the ensuing year shall be indicated.]

D: Rationale for Policy changes:

[(1) The rationale for policy changes consistent with the Medium Term Fiscal Policy Statement, in respect of taxes proposed in the ensuing Budget shall be spelt out.

(2) The rationale for major policy changes in respect of budgeted expenditure including expenditure on subsidies and pensions shall be indicated.

(3) Rationale for changes, if any, proposed in the management of the public debt shall be indicated.

(4) The need for changes, if any, proposed in respect of the charges for public utilities shall be spelt out.]

E. Policy Evaluation:

[The paragraph shall contain an evaluation of the changes proposed in the fiscal policy for the ensuing year with reference to fiscal deficit reduction and objectives set out in the Medium Term Fiscal Policy Statement.]

FORM D-1

[See rule 7]

SELECT FISCAL INDICATORS

	Item	Previous Year (Actuals)	Current Year (RE)
1.	Gross Fiscal Deficit as Percentage of GSDP		
2	Revenue Deficit as Percentage of Gross Fiscal Deficit		
3.	Revenue Deficit as Percentage of GSDP		
4.	Revenue Deficit as Percentage of TRR		
5.	Total Liabilities -GSDP Ratio (%)		
6.	Total Liabilities - Total Revenue Receipts (%)		
7.	Total Liabilities –State's Own Revenue Receipts (%)		
8.	State's Own Revenue Receipts to Revenue Expenditure (%)		
9.	Capital Outlay as Percentage of Gross Fiscal Deficit		
10.	Interest Payment as Percentage of Revenue Receipts		
11.	Salary Expenditure as Percentage of Revenue Receipts		
12.	Pension Expenditure as Percentage of Revenue Receipts		
13.	Non-developmental Expenditure as Percentage of aggregate disbursements		
14.	Gross Transfers from the Centre as Percentage of Aggregate Disbursements		
15.	Non-tax Revenue as Percentage of TRR		

FORM D-2

[See rule 7]

A. Components of State Government Liabilities

(Rs. crore)

Category	Raised during the Fiscal Year		Repayment/Redemption during the Fiscal Year		Outstanding Amount (End-March)	
	Previous Year (Actuals)	Current Year (RE)	Previous year (Actuals)	Current year (RE)	Previous year (Actuals)	Current year (RE)
Market Borrowings						
Loans from Centre						
Special Securities issued to the NSSF						
Borrowings from Financial Institutions/ Banks						
WMA/OD from RBI						
Small Savings, Provident Funds, etc						
Reserve Funds/ Deposits						
Other Liabilities						
Total						

FORM D-2

[See rule 7]

B. Weighted Average Interest Rates on State Government Liabilities

(per cent)

	Raised during the Fiscal Year^		Outstanding Amount (End-March)	
Category	Previous Year (Actuals)	Current Year (RE)	Previous year (Actuals)	Current year (RE)
Market Borrowings				
Loans from Centre				
Special Securities issued to the NSSF				
Borrowings from Financial Institutions/ Banks				
WMA/OD from RBI				
Small Savings, Provident Funds, etc				
Reserve Funds/ Deposits				
Other Liabilities				
Total *				

^ Weighted average interest rate where the respective weight is the amount borrowed. This is calculated on contractual basis and then annualized.

* Weighted average interest rate where the weights are the amount of the respective components of State Government liabilities.

<u>Example 1</u>

Suppose the State Government raised resources from the market on three occasions during a fiscal year for an aggregate amount of Rs.6,000 crore. The annual rates of interest were 10 per cent, 12 per cent and 14 per cent, for Rs.1,000 crore, Rs.2,000 crore and Rs.3,000 crore, respectively. The weighted average interest rate in respect of the resources raised during the year would, therefore, be

[Rs.1000*(10/100) + 2000*(12/100) + 3000 * (14/100)}/(1000+2000+3000)] *100

= [100 +240 + 420]/6000*100

= (760/6000)*100

=12.67%

Example 2

Suppose the previous and current years pertain to 2002-03 and 2003-04. Suppose the total outstanding amount of special securities issued by the State Government to the NSSF was Rs.1,000 crore as at end-March 2002 and Rs.1,500 crore as at end-March 2003. Suppose the total interest cost incurred by the State Government on this account during 2002-03 and 2003-04 amount to Rs.100 crore and Rs.120 crore, respectively. Then the weighted average interest cost on the outstanding amount of special securities issued to the NSSF during the previous year (i.e. 2002-03) is equal to 100/1000 = 10 per cent. Similarly, the weighted average interest cost on the outstanding amount of special securities issued to the NSSF during the current year (i.e. 2003-04) is equal to 120/1500 = 8 per cent.

FORM D-3

[See rule 7]

Consolidated Sinking Fund (CSF)

(Amount in Rs. Crore)

Outstanding balance in CSF at the beginning of the previous year	Additions to CSF during the previous year	Withdrawals from CSF during the previous year	Outstanding balance in CSF at the end of the previous year/ beginning of current year	(4)/ Outstanding Stock of SLR Borrowings (%)	Additions to CSF during the current year	Withdraw-als from CSFduring the current year	Outstanding at the end of current year/ beginning of ensuing year	(8)/ Stock of SLR Borrowings (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

FORM D - 4

[See rule 7]

Guarantees given by the Government

Category (No. of Guarantees within bracket)	Maximum Amount Guaranteed during the year (Rs. crore)	Outstanding at the beginning of the year (Rs. crore)	Additions during the year (Rs. crore)	Reductions during the year (other than invoked during the year) (Rs. crore)
1	2	3	4	5

Invoked during the year (Rs. crore)		Outstanding at the end of the year (Rs. crore)	Guarantee Commission or Fee (Rs. crore)		Remarks
Discharged	Not discharged		Receivable	Received	
6	7	8	9	10	11

Note : Reporting year refers to the second year preceding the year for which the Budget is presented.

FORM D-5

[See rule 7]

Outstanding Risk –weighted Guarantees

(Amount in Rs. Crore)

Default Probability	Risk weights (per cent)	Amount outstanding as in the Previous Year and the Current Year	Risk weighted outstanding guarantee in the previous year and the current year
Direct Liabilities	100		
High Risk	75		
Medium Risk	50		
Low Risk	25		
Very Low Risk	5		
Total Outstanding			

Note: The risk-weights have been pre-specified for various risk categories.

FORM D-6

[See rule 7]

Guarantee Redemption Fund (GRF)

(Amount in Rs. Crore)

Outstanding invoked guarantees at the end of the previous year	Outstanding Amount in GRF at the end of the previous year	Amount of Guarantees Likely to be Invoked during the current year	Addition to GRF during the current year	Withdrawal from the GRF during the current year	Outstanding Amount in GRF at the end of the current year
(1)	(2)	(3)	(4)	(5)	(6)

Notes:

(i) As per the terms of the GRF, during each year, the Government is required to contribute an amount equivalent at least to $1/5^{th}$ of the outstanding invoked guarantees plus an amount likely to be invoked as a result of the incremental guarantees issued during the year.

(ii) Previous year refers to the year preceding the current year.

FORM D - 7

[See rule 7]

STATEMENT OF ASSETS

	Assets at the beginning of the reporting year	Assets acquired during the reporting year	Cumulative total of assets at the end of the reporting year
	Book Value (Rs. cr.)	Book Value (Rs. cr.)	Book Value (Rs. cr.)
Financial assets:			
Loans and advances			
Loans to Local Bodies			
Loans to companies			
Loans to others			
Equity Investment			
Shares			
Bonus shares			
Investments in GoI dated securities/Treasury Bills			
Investments in 14-day Intermediate Treasury Bills			
Other financial investments (please specify)			
Total			
Physical assets:			
Land			
Building – Office/Residential			
Roads			
Bridges			
Irrigation Projects			
Power projects			
Other capital projects			
Machinery & Equipment			
Office Equipment			
Vehicles			
Total			

Notes:

1. Assets above the threshold value of Rupees two lakh only to be recorded.
2. Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.
3. The Statement in respect of physical assets is to be prepared based on asset register maintained by the Government. The value to be indicated would be book-value, i.e. acquisition cost netted for depreciation/impairment.
4. **States that are not in a position to provide information in respect of physical assets may, to begin with, provide information only in respect of financial assets. They may disclose their physical assets within --- years from the date of publication of the Notification of the Rules in the State Gazette.**

Form D - 8

[See rule 7]

TAX REVENUES RAISED BUT NOT REALISED

(principal taxes)

(As at the end of the reporting year)

		Amount under disputes (Rs. crore)					**Amount not under disputes** (Rs. crore)					Grand Total
Major Head	Description	Over 1 year but less than two years	Over 2 years but less than 5 years	Over 5 years but less than 10 years	Over 10 years	Total	Over 1 year but less than two years	Over 2 years but less than 5 years	Over 5 years but less than 10 years	Over 10 years	Total	
	Taxes on Income & Expenditure											
	Agricultural Income Tax											
	Taxes on Professions, Trades, callings and employment											
	Taxes on Property and capital Services											
	Land Revenue											
	Stamps and Registration fees											
	Urban immovable property tax											
	Taxes on Commodities and Services											
	Sales Tax											

	Central Sales Tax											
	Sales Tax on Motor Spirit and Lubricants											
	Surcharge on Sales Tax											
	State Excise											
	Taxes on Vehicles											
	Other Taxes											
	TOTAL											

Note : Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.

Form D - 9

[See rule 7]

Statement of Miscellaneous Liabilities: Outstandings

(Rs. crore)

	Outstanding Amount$
Major Works and Contracts	
Committed liabilities in respect of land acquisition charges	
Claims in respect of unpaid bills on works and supplies	

$ The outstanding amount pertains to the end-March position for the year before the current year.

ANNEX 6

EXPLANATORY NOTES

Clause (3) of Article 202 of the Constitution

The Article 202 of the Constitution reads as follows:

Annual financial statement - (1) The Governor shall in respect of every financial year cause to be laid before the House or Houses of the Legislature of the State a statement of the estimated receipts and expenditure of the State for that year, in this Part referred to as the "annual financial statement".

The Clause (3) of Article 202 reads as follows:

"*The following expenditure shall be expenditure charged on the Consolidated Fund of each State -*

(a) the emoluments and allowances of the Governor and other expenditure relating to his office;

(b) the salaries and allowances of the Speaker and the Deputy Speaker of the Legislative Assembly and, in the case of State having a Legislative Council, also of the Chairman and the Deputy Chairman of the Legislative Council;

(c) debt charges for which the State is liable including interest, sinking fund charges and redemption charges, and other expenditure relating to the raising of loans and the service and redemption of debt;

(d) expenditure in respect of the salaries and allowances of Judges of any High Court;

(e) any sums required to satisfy and judgment, decree or award of any court or arbitral tribunal;

(f) any other expenditure declared by this Constitution, or by the Legislature of the State by law, to be so charged."

Borrowing Rule

The borrowing rule is one of the three rules of fiscal prudence – the other two being debt rule and deficit rule. Apart from on-budget borrowings, the devolvements arising out of State guarantees have been included under the borrowings rule.

Budget

Annual Financial Statement laid before the House/Houses of the State Legislature under Article 202 of the Constitution.

Capital Expenditure

Capital expenditure consists of payments for acquisition of assets like land, buildings, machinery, equipment, as also investments in shares etc., loans and advances granted by the

State government to local bodies, government companies, corporations and other parties, repayment of loans to the Centre, discharge of internal debt and other liabilities in the Public Account.

Capital Receipts

The main items of capital receipts are loans raised by the State government from the public, which are called market loans, borrowings by the State government from financial institutions/banks usually by way of negotiated loans, receipts from special securities issued to the National Small Savings Fund (NSSF), and recoveries of loans granted by the State government. It also includes proceeds from the disinvestments of government equity in public enterprises, receipts on account of reserve assets, deposits, etc.

Consolidated Fund

All receipts of the State Government from revenues, loans and recoveries of loans go into the Consolidated Fund of the State, constituted under Article 266(1) of the Constitution of India. All expenditure of the Government is incurred from this Fund from which no amount can be withdrawn without authorisation from the State Legislature. This part consists of two main divisions, namely, Revenue Account (Revenue Receipts and Revenue Expenditure) and Capital Account (Capital Receipts, Capital Expenditure, Public Debt and Loans, etc.).

Contingent Liabilities

Liabilities that are contingent on the occurrence of a certain event are called contingent liabilities. Such liabilities can either be explicit, such as guarantees or implicit, e.g. uncollateralised borrowings by a State Government owned undertaking.

Current Transfers from the Centre

Current transfers from the Centre includes share in Central taxes and grants from the Centre.

Debt Rule

Debt rule indicates the maximum amount of debt (generally in relation to GDP or GSDP) that is deemed to be sustainable. The fiscal management indicators under the Model Bill includes a debt rule on limiting the outstanding total liabilities of the State Government as a percentage of GSDP.

Default Probability

Assessment of probability of devolvement of a State Government guaranteed loan/bond on the State Government.

Deficit Rule

The deficit rule indicates the path for achieving sustainability in fiscal policies. The fiscal management indicators under the Model Bill includes two deficit rules, viz., one for eliminating revenue deficit in a time-bound manner and the other for fixing a ceiling

on fiscal deficit also to be met in a time bound manner. The elimination of revenue deficit and capping of fiscal deficit would together prevent crowding out of capital expenditure, in other words, non-availability of resources for developmental expenditure and investment by the private sector. While the rule relating to primary deficit is theoretically most appealing, the rules related to revenue and fiscal deficits are considered adequate to address the issue of sustainability for practical purposes, particularly as primary deficit is a byproduct of fiscal deficit.

Demands for grants

The demand for grants is a statement of estimates of expenditure from the Consolidated Fund and is required to be voted by the State Legislature. Generally, "demand for grant" is presented in respect of each ministry or department. It contains expenditure estimates made for a scheme or programme under both the revenue and capital heads. These estimates are brought together and shown on a net basis at one place by major heads.

Exclusion Clause

An escape or exclusion clause, in a contract provides for non-performance of the contract if a certain specified condition occurs. In the context of the Model Fiscal Responsibility Legislation for State Governments, the State Government can deviate from the pre-specified fiscal targets, such as revenue deficit and fiscal deficit if there are unforeseen demands on the finances of the State Government arising out of internal disturbance or natural calamity or such other exceptional grounds as the State Government may specify.

Financial Year

The year beginning on the 1st April and ending on 31st March.

Fiscal Policy Strategy Statement

The Fiscal Policy Strategy Statement, as enjoined by the Model Fiscal Responsibility Bill, contains the policies of the State Government for the ensuing financial year relating to taxation, expenditure, lending and investments, levy of user charges on public services, borrowings and guarantees. It outlines the strategic priorities of the State Government in the fiscal area, how the current policies are in conformity with sound fiscal management principles and rationale for any major deviation in key fiscal indicators.

Gross Fiscal Deficit (GFD)

Gross fiscal deficit (GFD) represents the gap between the government’s expenditures and its revenues (other than net borrowings). This gap is met by net borrowing. GFD is the difference between (i) aggregate disbursements net of debt repayments and (ii) revenue receipts, recovery of loans, and non-debt capital receipts. It also indicates the total net borrowing of the government, and the increment to its outstanding debt. The State Government finances its gross fiscal deficit by (i) loans from the Centre, (ii) market borrowings, (iii) loans from financial institutions/banks, (iv) provident funds, (v) reserve funds, (vi) deposits and advances, (vii) special securities issued to the NSSF, etc.

Gross Domestic Product (GDP)

GDP at current market prices is a measure of the total current market value of all final goods and services produced within the political boundaries of an economy during a given period of time, usually a year. GDP equals total consumer spending, business investment, and government spending and investment, plus the value of exports, minus the value of imports. *GDP at current factor cost* is a measure of the income of the various factors of production.[6] The addition of indirect taxes, net of subsidies to GDP at current factor cost, gives GDP at current market prices. Various fiscal variables, such as revenue, government expenditure, government liabilities, etc. are expressed in terms of GDP at current market prices.

Gross State domestic Product (GSDP)

GSDP at current market prices is the equivalent of GDP at current market prices at the State level. In India, the methodology of calculation of GSDP varies from State to State. The CSO publishes a series of GSDP by attempting to reconcile certain (but not all) differences in the methodology. Net State domestic product (NSDP) is equivalent to NDP at factor cost at the State level. Hence, deducting depreciation from GSDP at market prices gives NSDP at market prices. Deducting net indirect taxes (i.e. indirect taxes, net of subsidies) from NSDP at market prices gives NSDP at factor cost.

The Macroeconomic Framework Statement

The Macroeconomic Framework Statement, as enjoined by the Model Fiscal Responsibility Bill, would provide an overview of the State economy, an analysis of growth and sectoral composition of GSDP, an assessment related to State Government finances and their future prospects.

Medium Term Fiscal Policy Statement

The Medium Term Fiscal Policy Statement, as enjoined by the Model Fiscal Responsibility Bill, sets forth a three-year rolling target for specific fiscal indicators along with underlying assumptions. The statement includes an assessment of sustainability relating to: (i) balance between revenue receipts and revenue expenditure; (ii) the use of capital receipts including market borrowings for generation of productive assets and (iii) the estimated yearly pension liabilities worked out on actuarial basis for the next ten years.

Overdraft

The term 'Overdraft' as used in the Report refers to the borrowing by the State Governments from the Reserve Bank over and above the normal Ways and Means Advances (WMA) limits permitted as under section 17(5) of the Reserve Bank of India

[6] The factors of production are the resources that are necessary for production. They are usually classified into four different groups: (i) Land - all natural resources (minerals and other raw materials), (ii) Labour - all human resources, (iii) Capital - all man-made aids to production (machinery, equipment, etc.) and (iv) Enterprise - entrepreneurial ability.

Act. At present, the interest rates on overdraft up to 100 per cent of the normal WMA limit has been fixed at Bank Rate (currently at 6 per cent) plus 3 percentage points. For overdraft beyond this amount, a penal rate of interest of Bank Rate plus 6 percentage points is charged. The penal interest rate is levied on overdraft to discourage the States from using WMA/OD facility for limiting the usage of scheme only for short-term liquidity mismatches (which arises from the differences of timing of revenue receipts and expenditure) and to prompt them to improve cash discipline and not for funding their structural liquidity mismatches (which arises from the inability to match the aggregate revenue and expenditure over an extended period of time, more than a year).

Primary balance

It is the difference between the gross fiscal deficit and interest payments. Since the current outstanding stock of liabilities of a government reflects the effects of the past fiscal policies, interest payments on the outstanding stock of debt is subtracted from the gross fiscal deficit to delineate the impact of the current fiscal policies of the government. Thus, even when there is a fiscal deficit, if the primary balance is in surplus, it means that the current fiscal policies for revenue generation and expenditure management are generating a surplus and hence, are not leading to fresh borrowings. Thus, if there is a primary surplus (accompanied by fiscal deficit), the surplus is used to repay a part of the interest obligations (arising only from fiscal policies pursued earlier), while fresh borrowings would have to be resorted to repay only the balance part of the interest obligations. Hence, having a primary surplus is important for the reduction of the stock of debt. One of the criticisms levied against the concept of primary balance is that it does not distinguish as to whether the surplus arises from the revenue account or from the capital account. Such distinction is important for an emerging market economy like India where the government plays a significant role in infrastructural development and in providing social services and hence, the quality of fiscal deficit also matters.

Public Accounts

Receipts and disbursements in respect of small savings, provident funds, deposits, reserve funds, suspense, remittances, etc., which do not form part of the Consolidated Fund, are accounted for in Public Account. These relate to such receipts where the State Government acts as a banker. Such liabilities are not subject to vote by the State Legislature. By definition, these liabilities are not part of the internal debt of the State Government.

Resources transferred to States

The State Governments are provided grants and loans by the Central Government for various Plan and Non-Plan purposes. The formula for devising the aggregate pool and the proportional allocation of grants and loans is based on certain objective criteria (such as, per capital income, population, tax effort, etc.) fixed by the Finance Commissions. The share of the loan and grant component depends on whether the State belongs to the ‘special category’ (90:10) or otherwise (30:70). Besides, sizeable

amounts of tax revenues collected by the Central Government are also transferred to the State Governments. As per the formula of devolution of resources fixed by the Eleventh Finance Commission, 29.5 per cent of all shareable taxes collected by the Centre are transferred to the States. Some of the States also get grants to cover the gap in their revenue resources, as recommended by the Finance Commission.

Revenue Deficit

Revenue deficit refers to the excess of revenue expenditure over revenue receipts. Revenue expenditure, unlike capital expenditure, does not yield financial return. [7] Therefore, one of the golden rules of fiscal policy is to eliminate revenue deficit, if any. On the other hand, surplus in the revenue account can be used to fund capital expenditure and reduce the government's dependence on borrowed funds.

Revenue Expenditure

Revenue expenditure is meant for the normal running of government departments and various services, interest charges on debt incurred by the government and subsidies. Broadly speaking, expenditure that does not result in creation of assets is treated as revenue expenditure. All grants given by State governments to local bodies and other parties are also treated as revenue expenditure even though some of the grants may be for creation of assets. While the objective of a prudent fiscal policy is to minimise revenue expenditure, in practice, most of the revenue expenditure is of a committed nature, such as, interest payments, pension costs, salaries, etc.

Revenue receipts

Revenue receipts include proceeds of taxes and other duties levied by the State, State's share of Central taxes, interest and dividend on investments made by the government, and fees and other non-tax receipts for services rendered by the government, as well as profits of State Government undertakings.

Risk weighted Outstanding Guarantees

Guarantees are contingent liabilities since the risk of devolvement on the guarantor is contingent on the occurrence of a future event. In case of a State Government giving guarantee, it should ideally take into account the risk of devolvement while extending each guarantee and provide for in its Budget. The State Government should also make provision each year on the outstanding amount of guarantees since the risk perception of devolvement can change since guarantees were first issued. It is, therefore, important that States classify their outstanding stock of guarantees into various risk categories, such as 'direct liabilities' (where it is certain that the entire guaranteed amount would devolve on the State Government), 'high risk', 'medium risk', 'low risk' and 'very low risk' where the risk of devolvement is indicated probabilistically in the following table. Illustratively, as shown in the following table the weights that may be assigned to a guaranteed bond/ loan based on default probability are 100 per cent in respect of 'direct liabilities', 75 per cent in respect of 'high risk', 50 per cent in respect of 'medium risk', 25 per cent in respect of 'low risk' and 5 per cent in respect of 'very low risk'. Accordingly, as shown in the following table, while the outstanding amount of guarantees is Rs.500 crore, the total outstanding amount of risk weighted guarantees works out to Rs.255 crore.

Default Probability	Risk weights (per cent)	Amount outstanding as on March 31, 2004 (Rs. crore)	Risk weighted outstanding guarantee (Rs. crore)
Direct Liabilities	100	100	100
High Risk	75	100	75
Medium Risk	50	100	50
Low Risk	25	100	25
Very Low Risk	5	100	5
Total Outstanding		**500**	**255**

As per the provisions of the Model Fiscal Responsibility Bill, States are required to limit the outstanding amount of risk weighted guarantees. The guarantees have been included under the borrowing rule but not on the debt rule or the deficit rule.

Special Purpose Vehicle

It is an organization constructed with a limited purpose or life. Frequently, it serves as a conduit or pass through organisation or corporation. In relation to securitisation, it means the entity, which would hold the legal rights over the assets transferred by the originator.

Sustainability (of Fiscal Policies)

Fiscal policies are considered to be sustainable if the government is able to service the stock of public debt over the foreseeable future. In the theoretical literature, fiscal policy sustainability has been defined in terms of the projected future course of the ratio of debt-to-GDP. However, in practice, no unique ceiling can be identified since fiscal sustainability depends, *inter alia*, on the depth of the domestic financial markets and expectations of market participants regarding the government's continued ability to service the loans. Hence, a prudent fiscal policy involves maintaining a surplus in the primary balance so that the market participants expect that at least the current fiscal policy is on the right trajectory.

Total Liabilities

[7] Expenditure on health and education, although classified as revenue expenditure, is an exception as it yields a social return over a period of time since it facilitates human capital formation

Total liabilities in the context of the Model Fiscal Responsibility Legislation for State Governments have been defined to include all the liabilities of the State Government that are under the Consolidated Fund of the State and the Public Account of the State. In addition, total liabilities of the State Government would also include borrowings by the public sector undertakings and the special purpose vehicles and other equivalent instruments including guarantees where the principal and/ or interest are to be serviced out of the State budgets.

Total Revenue Receipts (TRR)

'Total revenue receipts' includes State's own revenue receipts (both tax and non-tax) and current transfers from the Centre (comprising grants and State's share of Central taxes).

Ways and Means Advances

Both the Reserve Bank and the Central Government provide ways and means advances (WMA), i.e. a loan for a temporary period, to the State Governments to help them to tide over their temporary liquidity mismatches (i.e. temporary shortfall in receipts vis-à-vis expenditure). The transparent and incentive driven formula for the limit of normal WMA provided by the RBI to the different States under section 17(5) of the Reserve Bank of India Act 1935 has been fixed as per the recommendation of the Advisory Committee on Ways and Means Advances to State Governments (Chairman: Shri C.Ramachandran) (2003) by linking normal WMA to the revenue receipts of the previous three years. As such, the limit of normal WMA is revised annually. Apart from normal WMA which is provided at the Bank Rate (currently at 6 per cent) and has to be vacated after 90 days, the Reserve Bank also provides 'special' WMA to the States at Bank Rate minus one per cent and the amount is proportional to the amount of investment in GoI securities by the States. There is also a provision for overdrafts to the States by the Reserve Bank at penal rates of interest.

Appendix I

THE FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT ACT, 2003
NO. 39 OF 2003

(26th August, 2003)

An Act to provide for the responsibility of the Central Government to ensure inter-generational equity in fiscal management and long-term macro-economic 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.

Be it enacted by Parliament in the Fifty-fourth Year of the Republic of India as follows :-

Short title, extent and commencement

1. (1) This Act may be called the Fiscal Responsibility and Budget Management Act, 2003.

(2) It extends to the whole of India

(3) It shall come into force on such date as the Central Government may by notification in the Official Gazette, appoint in this behalf.

Definitions

2. In this Act, unless the context otherwise requires :-

(a) "fiscal deficit" means the excess of total disbursements from the Consolidated Fund of India, excluding repayment of debt, over total receipts into the Fund (excluding the debt receipts), during a financial year.

(b) "fiscal indicators" means the measures such as numerical ceilings and proportions to gross domestic product, as may be prescribed, for evaluation of the fiscal position of the Central Government:

(c) "prescribed" means prescribed by rules made under this Act.

(d) "Reserve Bank" means the Reserve Bank of India constituted under sub-section (l) of section 3 of the Reserve Bank of India Act, 1934.

(e) "revenue deficit" means the difference between revenue expenditure and revenue receipts which indicates increase in liabilities of the Central Government without corresponding increase in assets of that Government.

(f) "total liabilities" means the liabilities under the Consolidated Fund of the India and the public account of India.

Fiscal policy statements to be laid before Parliament

3. (1) The Central Government shall lay in each financial year before both Houses of Parliament the following statements of fiscal policy along with the annual financial statement and demands for grants, namely :-

(a) the Medium-term Fiscal Policy Statement;
(b) the Fiscal Policy Strategy Statement;
(c) the Macro-economic Framework Statement.

(2) The Medium-term Fiscal Policy Statement shall set forth a three-year rolling target for prescribed fiscal indicators with specification of underlying assumptions.

(3) In particular, and without prejudice to the provisions contained in sub-section (2) the Medium-term Fiscal Policy Statement shall include an assessment of sustainability relating to -

(i) the balance between revenue receipts and revenue expenditures;
(ii) the use of capital receipts including market borrowings for generating productive assets.

(4) The Fiscal Policy Strategy Statement shall, *inter alia*, contain -

(a) the policies of the Central Government for the ensuing financial year relating to taxation, expenditure, market borrowings and other liabilities, lending and investments, pricing of administered goods and services, securities and description of other activities such as underwriting and guarantees which have potential budgetary implications;

(b) the strategic priorities of the Central Government for the ensuing financial year in the fiscal area;

(c) the key fiscal measures and rationale for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administered pricing and borrowings;

(d) an evaluation as to how the current policies of the Central Government are in conformity with the fiscal management principles set out in section 4 and the objectives set out in the Medium-term Fiscal Policy Statement.

(5) The Macro-economic Framework Statement shall contain an assessment of the growth prospects of the economy with specification of underlying assumptions.

(6) In particular, and without prejudice to the generality of the foregoing provisions, the Macro-economic Framework Statement shall contain an assessment relating to -

(a) the growth in the gross domestic product;

(b) the fiscal balance of the Union Government as related in the revenue balance and gross fiscal balance;

(c) the external sector balance of the economy as reflected in the current account balance of the balance of payments.

(7) The Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macro-economic Framework Statement referred to in sub-section (1) shall be in such form as may be prescribed.

Fiscal Management Principles

4. (1) The Central Government shall take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by the 31^{st} March, 2008 and thereafter build up adequate revenue surplus.

(2) The Central Government shall, by rules made by it, specify -

(a) the annual targets for reduction of fiscal deficit and revenue deficit during the period beginning with the commencement of this Act and ending on the 31^{st} March, 2008.

(b) the annual targets of assuming contingent liabilities in the form of guarantees and the total liabilities as a percentage of gross domestic product;

Provided that the revenue deficit and fiscal deficit may exceed such targets due to ground or grounds of national security or national calamity or such other exceptional grounds as the Central government may specify;

Provided further that the ground or grounds specified in the first proviso shall be placed before both Houses of Parliament, as soon as may be, after such deficit amount exceed the aforesaid targets.

Borrowing from Reserve Bank

5. (1) The Central Government shall not borrow from the Reserve Bank.

(2) Notwithstanding anything contained in sub-section (1), the Central Government may borrow from the Reserve Bank by way of advances to meet temporary excess of cash disbursement over cash receipts during any financial year in accordance with the agreements which may be entered into by that Government with the Reserve Bank:

Provided that any advances made by the Reserve Bank to meet temporary excess cash disbursement over cash receipts in any financial year shall be repayable in accordance with the provisions contained in sub-section (5) of section 17 of the Reserve Bank of India Act, 1934.

(3) Notwithstanding anything contained in sub-section (1), the Reserve Bank may subscribe to the primary issues of the Central Government securities during the financial year beginning on the 1st day of April, 2003 and subsequent two financial years:

Provided that the Reserve Bank may subscribe, on or after the period specified in this sub-section, to the primary issues of the Central Government securities due to ground or grounds specified in the first proviso to sub-section (2) of section 4.

(4) Notwithstanding anything contained in sub-section (1), the Reserve Bank may buy and sell the Central Government securities in the secondary market.

Measures for fiscal transparency

6. (1) The Central Government shall take suitable measures to ensure greater transparency in its fiscal operations in the public interest and minimize as far as practicable, secrecy in the preparation of the annual financial statement and demands for grants.

(2) In particular, and without prejudice to the generality of the foregoing provision, the Central government shall, at the time of presentation of annual financial statement and demands for grants, make such disclosures and in such form as may be prescribed.

Measures to enforce compliance

7. (1) The Minister-in-Charge of the Ministry of Finance shall review, every quarter the trends in receipts and expenditure in relation to the budget and place before both Houses of Parliament the outcome of such reviews.

(2) Whenever there is either shortfall in revenue or excess of expenditure over the pre-specified levels mentioned in the Fiscal Policy Strategy Statement and the rules made under this Act during any period in a financial year, the Central Government shall take appropriate measures for increasing revenue or for reducing the expenditure (including curtailing of the sums authorized to be paid and applied from and out of the Consolidated Fund of India under any Act so as to provide for the appropriation of such sums);

Provided that nothing in this sub-section shall apply to the expenditure charged on the Consolidated Fund of India under clause (3) of article 112 of the Constitution or to any other expenditure which is required to be incurred under any agreement or contract or such other expenditure which cannot be postponed or curtailed.

(3) (a) Except as provided under this Act, no deviation in meeting the obligations cast on the Central Government under this Act, shall be permissible without approval of Parliament.

(b) Where owing to unforeseen circumstances, any deviation is made in meeting the obligations cast on the Central Government under this Act, the Minister-in-Charge of the Ministry of Finance shall make a statement in both Houses of Parliament explaining -

(i) any deviation in meeting the obligations cast on the Central Government under this Act;

(ii) whether such deviation is substantial and relates to the actual or the potential budgetary outcomes; and

(iii) the remedial measures the Central Government proposes to take.

Power to make rules

8. (1) The Central Government may, by notification in the Official Gazette make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely :-

(a) the annual targets to be specified under sub-section (2) of section 4;

(b) the fiscal indicators to be prescribed for the purpose of sub-section (2) of section 3;

(c) the forms of the Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-economic Framework Statement referred to in sub-section (7) of section 3;

(d) the disclosures and form in which such disclosures shall be made under sub-section (2) of section 6;

(e) any other matter which is required to be, or may be, prescribed.

Rules to be laid before each House of Parliament

9. Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty

days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

Protection of action taken in good faith

10. No suit, prosecution or other legal proceedings shall lie against the Central Government or any officer of the Central Government for anything which is in good faith done or intended to be done under this Act or the rules made thereunder.

Jurisdiction of civil courts barred

11. No civil court shall have jurisdiction to question the legality of any action taken by, or any decision of, the Central Government, under this Act.

Application of other laws not barred

12. The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

Power to remove difficulties

13. (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:

Provided that no order shall be made under this section after the expiry of two years from the commencement of this Act.

(2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Appendix II

FISCAL RULES OF THE CENTRAL GOVERNMENT

NOTIFICATION

New Delhi, the 2nd July 2004

G.S.R. 396 (E). - In exercise of the powers conferred by section 8 of the Fiscal Responsibility and Budget Management Act, 2003 (39 of 2003), the Central Government hereby makes the following rules, namely :-

1. Short title and commencement :-

(1) These rules may be called the Fiscal Responsibility and Budget Management Rules, 2004.

(2) They shall come into force on the 5th day of July, 2004.

2. Definitions :- In these rules, unless the context otherwise requires,

(a) "Act" means the Fiscal Responsibility and Budget Management Act, 2003 (39 of 2003);

(b) "Form" means a form appended to these rules:

(c) "GDP" means gross domestic product at current prices;

(d) "section" means a section of the Act;

(e) words and expressions used herein but not defined and defined in the Act shall have the meanings respectively assigned to them in the Act.

3. Annual targets :-

(1) In order to achieve the target of revenue deficit as set out in sub-section (1) of section 4, by the 31st day of March, 2008, the Central Government shall reduce such deficit by an amount equivalent to 0.5 per cent or more of the GDP at the end of each financial year, beginning with the financial year 2004-05.

(2) The Central Government shall reduce the fiscal deficit by an amount equivalent to 0.3 per cent or more of the GDP at the end of each financial year beginning with the financial year 2004-2005, so that fiscal deficit is brought down to not more than 3 per cent of GDP at the end of 31st day of March, 2008.

(3) The Central Government shall not give guarantees aggregating to an amount exceeding 0.5 per cent of the GDP in any financial year beginning with the financial year 2004-2005.

(4) The Central Government shall not assume additional liabilities (including external debt at current exchange rate) in excess of 9 per cent of GDP for the financial year 2004-05 and in each subsequent financial year, the limit of 9 per cent of GDP shall be progressively reduced by at least one percentage point of GDP.

4. Medium Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro Economic Framework Statement :-

The Medium Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-Economic Framework Statement required to be laid before both Houses of Parliament by the

Central Government along with the annual financial statement and demands for grants shall be in Forms F-1, F-2 and F-3 respectively.

5. Fiscal Indicators :- (1) In the Medium Term Fiscal Policy Statement, three year rolling targets in respect of the following fiscal indicators shall be as given in Form F-1, namely :-

(i) revenue deficit as a percentage of GDP;

(ii) fiscal deficit as a percentage of GDP;

(iii) tax revenue as a percentage of GDP; and

(iv) total outstanding liabilities of the Central Government as a percentage of GDP.

(2) The Fiscal Policy Strategy Statement in Form F-2 shall also contain the intra-year benchmarks for assessing the trends in receipts and expenditure relating to annul targets and Budget Estimates.

6. Disclosures :- (1) In order to ensure greater transparency in its fiscal operation in the public interest, the Central Government shall, at the time of presenting the annual financial statement and demands for grants, make disclosures of the following :-

(a) any significant change in accounting standards, policies and practices affecting or likely to affect the computation of prescribed fiscal indictors.

(b) statements of receivables and guarantees in Forms D-1 to D-3.

(c) a statement of assets in Form D-4.

(2) The provisions of sub-rule (1) shall be complied with not later than with the presentation of the annual financial statement and demands for grants for the financial year 2006-2007.

7. Measures to enforce compliance :-

In case the outcome for the quarterly review of trends in receipts and expenditure, made under sub-section (1) of section 7, at the end of second quarter of any financial year beginning with the financial year 2004-2005 shows that -

(i) the total non-debt receipts are less than 40 per cent of Budget Estimates for that year; **or**

(ii) the fiscal deficit is higher than 45 per cent of the Budget Estimates for that year; **or**

(iii) the revenue deficit is higher than 45 per cent of the Budget Estimates for that year,

then, -

(a) as required under sub-section (2) of that section, the Central Government shall take appropriate corrective measures; and

(b) as required under sub-section (3) of that section, the Minister-in-charge of the Ministry of Finance shall make a statement in both Houses of Parliament during the session immediately following the end of the second quarter detailing the corrective measures taken, the manner in which any supplementary demands for grants are proposed to be financed and the prospects for the fiscal deficit of that financial year.

Form F-1

(See rule 4)

MEDIUM TERM FISCAL POLICY STATEMENT

A. Fiscal Indicators - Rolling Targets

	Current Year Revised Estimates	Ensuing year Target; Budget Estimates Y	Targets for next Two years Y + 1	Y + 2
1. Revenue Deficit as percentage of GDP				
2. Fiscal Deficit as percentage of GDP				
3. Tax Revenue as percentage of GDP				
4. Total outstanding Liabilities as percentage of GDP				

B. Assumptions underlying the Fiscal Indicators -

1. Revenue receipts
   (f) Tax-revenue -Sectoral and GDP growth rates
   (g) Non-tax-revenue - Policy stance
   (h) Devolution to States - Finance Commission

2. Capital receipts - Debt stock, repayment, fresh loans and policy stance
   (g) Recovery of loans
   (h) Other receipts
   (i) Borrowings - Public Debt and Other Liabilities

3. Total expenditure - Policy Stance
   (c) Revenue account
      (i) Interest payments
      (ii) Major subsidies
      (iii) Others
   (d) Capital account
      (i) Loans and advances
      (ii) Capital outlay

4. GDP Growth

C. Assessment of sustainability relating to -

(i) The balance between revenue receipts and revenue expenditure. The Medium Term Fiscal Policy Statement may specify the tax-GDP ratio for the current year and subsequent two years with an assessment of the changes required for achieving it. It may discuss the non-tax revenues and the policies concerning the same. An assessment of the capital receipts may be made, including the borrowings and other liabilities, as per policies spelt out. The statement may also give projections for GDP and discuss it on the basis of assumptions underlying the indicators. Expenditure on revenue account, both plan and non-plan, may also be made with particular emphasis on the measures proposed to meet the overall objectives.

(ii) The use of capital receipts including market borrowings for generating productive assets. The Medium Term Policy Statement may specify the proposed use of capital receipts for generating productive assets in different categories. It may also spell out proposed changes among these categories and discuss it in terms of the overall policy of the Government in achieving the national objective.

Form F - 2

(See rule 4)

FISCAL POLICY STRATEGY STATEMENT

A: Fiscal Policy Overview : [This paragraph will present an overview of the fiscal policy currently in vogue.]

B: Fiscal policy for the ensuing financial year: [This paragraph shall have five sub-paragraphs dealing with -

(1) Tax Policy

In the sub-paragraph on tax policy, major changes proposed to be introduced in direct and indirect taxes in the ensuing financial year will be presented. It shall contain an assessment of income tax exemption limits and how far it relates to per capita income, principles regarding tax exemptions and target group for exemptions.

(2) Expenditure Policy

Under expenditure policy, major changes proposed in the allocation for expenditure shall be indicated. It shall also contain an assessment of principles regarding the benefits and target group of beneficiaries.

(3) Government Borrowings, Lending and Investments

In this sub-paragraph on Government borrowings, the policy relating to internal debt, external debt, Government lending, investments and other activities; including principles regarding average maturity structure, bunching of repayments, etc., shall be indicated.

(4) Contingent and other Liabilities

Any change in the policy on contingent and other liabilities and in particular guarantees which have potential budgetary implications shall be indicated.

(5) Pricing of Administered Goods

Any change proposed in the pricing of administered products, including the progress towards market-based principles shall be spelt out.]

C: Strategic priorities for the ensuing year:

[(1) Resource mobilization for the ensuing financial year through tax, non-tax and other receipts shall be spelt out.

(2) The broad principles underlying the expenditure management during the ensuing year shall be spelt out.

(3) Priorities relating to management of public debt proposed during the ensuing year shall be indicated.]

D: Rationale for Policy changes :

[(1) The rationale for policy changes consistent with the Medium Term Fiscal Policy Statement, in respect of direct and indirect taxes proposed in the ensuing Budget shall be spelt out.

(2) The rationale for major policy changes in respect of budgeted expenditure including expenditure on subsidies shall be indicated.

(3) Rationale for changes, if any, proposed in the management of the public debt shall be indicated.

(4) The need for changes, if any, proposed in respect of pricing of administered goods shall be spelt out.]

E: Targets for the ensuring year

[At the end of the second quarter, a mid-year assessment shall be made of the trends in receipts and expenditures and achievement of targets of deficit reduction in relation to Budget Estimates. In case the total non-debt receipts are less than 40 per cent of Budget Estimates for that year; **or** the fiscal deficit is higher than 45 per cent of the Budget Estimates for that year; **or** the revenue deficit is higher than 45 per cent of the Budget Estimates for that year, the Central Government shall take action as required under sub-sections (2) and (3) of section 7.]

F. Policy Evaluation:

[This paragraph shall contain and evaluation of the changes proposed in the fiscal policy for the ensuing year with reference to fiscal deficit reduction and objectives set out in the medium term fiscal policy statement.]

Form F - 3

(See rule 4)

MACRO ECONOMIC FRAMEWORK STATEMENT

1. **Overview of the Economy**: [This paragraph shall contain a synoptic analysis of trends in growth rates, prices, output, external sector, money and capital markets. Information on key macro-economic indicators will be presented in the format appended.]

2. **GDP Growth:** [This paragraph shall contain an analysis of trends in overall GDP growth and its sectoral composition.]

3. **External Sector:** [Under this paragraph, trends in exports, imports, foreign exchanges reserves, current account balance and balance of payments shall be presented.]

4. **Money, Banking and Capital Markets:** [This paragraph shall present an account of the trends in money supply, bank deposits and credit and developments in the capital market.]

5. **Central Government Finances:** [Under this paragraph an analysis of trends in revenue collections and expenditure shall be presented. Trends in important fiscal deficit and debt indicators shall also be presented. Trends in Central Government finances shall be presented in the format appended.]

6. **Prospects:** [Based on the trends in major sectors presented in the previous sections, an assessment shall be made regarding the growth prospects, along with the underlying assumptions.]

F-3 (Contd)

Macro Economic Framework Statement

Economic Performance at a Glance

		Absolute Value		Percentage Changes	
		April-Reporting period*		**April-Reporting period***	
		Previous Year	Current Year	Previous Year	Current Year
	Real Sector				
1	GDP at factor cost				
(a)	at current price				
(b)	at 1993-94 price				
2	Index of industrial Production				
3	Wholesale Price Index (point to point)				
4	Consumer Price Index				
5	Money Supply (M3)				
6	Imports at current prices				
(a)	In Rs. Crore				
(b)	In US $ million				
7	Exports at current prices				
(a)	In Rs. Crore				
(b)	In US $ million				
8	Trade Balance				
(a)	In Rs. Crore				
(b)	In US $ million				
9	Foreign Exchange Assets				
(a)	In Rs. Crore				
(b)	In US $ million				
10	Current Account Balance				
	Government Finances				
1	Revenue Receipts				
2	Tax Revenue (net)				
3	Non-Tax Revenue				

4	Capital Receipts (5+6+7)				
5	Recovery of loans				
6	Other Receipts				
7	Borrowing and other liabilities				
8	Total Receipts (1+ 4)				
9	Non-Plan Expenditure				
10	Revenue Account				
	Of which:				
11	Interest payments				
12	Capital Account				
13	Plan Expenditure				
14	Revenue Account				
15	Capital Account				
16	Total Expenditure (9+13)				
17	Revenue Expenditure (10+14)				
18	Capital Expenditure (12+15)				
19	Revenue Deficit (17-1)				
20	Fiscal Deficit {16-(1+5+6)}				
21	Primary Deficit (20-11)				

* Data will relate to the period up to which information for the current year is available. To facilitate comparison, data of previous year corresponds to the same period of current year. Accordingly, reporting period may vary for different items.

Form D - 1

[See rule 6]

TAX REVENUES RAISED BUT NOT REALISED

(principal taxes)

(As at the end of the reporting year)

		Amount under disputes (Rs. crore)					**Amount not under disputes** (Rs. crore)					
Major Head	Description	Over 1 year but less than two years	Over 2 years but less than 5 years	Over 5 years but less than 10 years	Over 10 years	Total	Over 1 year but less than two years	Over 2 years but less than 5 years	Over 5 years but less than 10 years	Over 10 years	Total	Grand Total
	Taxes on Income & Expenditure											
0020	Corporation Tax											
0021	Taxes on Income other than Corporation tax											
	Taxes on Commodities & Services											
0037	Customs											
0038	Union Excise											
0044	Service Tax											
	TOTAL											

Note: Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.

Form D - 2

[See rule 6]

ARREARS OF NON-TAX REVENUE

(As at the end of the reporting year)

Description	**Amount pending** (Rs. crore)				Total
	0-1 year	1-2 years	2-3 years	above 5 years	
Fiscal Services					
Interest receipts					
of which					
From State Government and Union Territory Governments					
From Railways					
From Departmental Commercial Undertakings					
From Public Sector & Other Undertakings					
Dividends and Profits					
General Services					
Police receipts					
Economic Services					
Petroleum Cess/Royalty					
Communications (License Fee) Receipts					
Other Receipts					
Total					

Note : Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.

Form D - 3

[See rule 6]

Guarantees given by the Government

Class (No. of Guarantees within bracket)	Maximum Amount Guaranteed during the year (Rs. crore)	Outstanding at the beginning of the year (Rs. crore)	Additions during the year (Rs. crore)	Deletions (other than invoked during the year (Rs. crore)
1	2	3	4	5

Invoked during the year (Rs. crore)		Outstanding at the end of the year (Rs. crore)	Guarantee Commission or Fee (Rs. crore)		Other Material Details
Discharged	Not discharged		Receivable	Received	
6	7	8	9	10	11

Note : The year in the above table refers to the second year preceding the year for which the annual financial statement and demands for grants are prescribed.

Form D - 4

[See rule 6]

ASSET REGISTER

	Assets at the beginning of the reporting year	Assets acquired during the reporting year	Cumulative total of assets at the end of the reporting year
	Cost (Rs. cr.)	Cost (Rs. cr.)	Cost (Rs. cr.)
Physical assets:			
Land			
Building			
Office			
Residential			
Roads			
Bridges			
Irrigation Projects			
Power projects			
Other capital projects			
Machinery & Equipment			
Office Equipment			
Vehicles			
Total			
Financial assets:			
Equity Investment			
Shares			
Bonus shares			
Loans and advances			
Loans to State & UT Govts.			
Loans to Foreign Govts.			
Loans to companies			
Loans to others			
Other financial investments			
Total			

Notes:

1. Assets above the threshold value of Rupees two lakh only to be recorded.
2. This disclosure statement does not include assets of Cabinet Secretariat, Central Police Organisations, Ministry of Defence, Departments of Space and Atomic Energy.
3. Reporting year refers to the second year preceding the year for which the annual financial statement and demands for grants are presented.