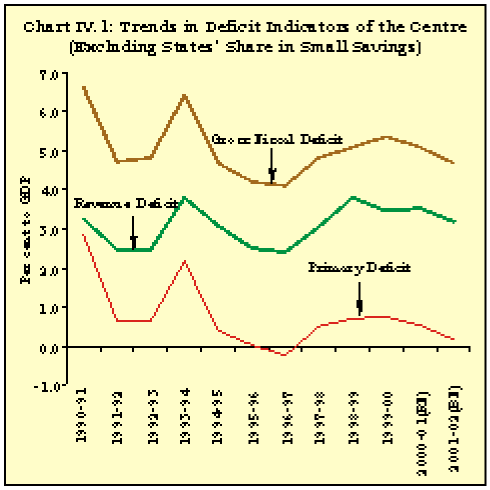
IV - Government Finances

4.1 As per revised estimates for 2000-01, the Central Government's gross fiscal deficit (GFD) is placed at 5.1 per cent of the GDP at current market prices and the revenue deficit at 3.5 per cent. The information available in respect of State finances indicates that the consolidated gross fiscal deficit of States in 2000-01 narrowed to 4.3 per cent of GDP in the revised estimates from 4.6 per cent in 1999-2000, due to relatively high growth in receipts than in expenditure. Accordingly, as per the revised estimates, the combined revenue and fiscal deficits of the Centre and States taken together narrowed to 5.9 per cent and 9.1 per cent, respectively, from 6.2 per cent and 9.4 per cent, respectively in 1999-2000. Market borrowings continued to be the most important source of financing for the Centre, accounting for 69.6 per cent of the gross fiscal deficit. For the States, market borrowings financed 13.3 per cent of the gross fiscal deficit. Although the recourse of States to Ways and Means Advances (WMA) from the Reserve Bank was generally higher in 2000-01 than in the preceding year, the outstanding WMA and overdrafts declined to Rs.6,811 crore at end-March 2001 from Rs.7,519 crore at end-March 2000. The combined debt of the Centre and States rose to 63.7 per cent of GDP at the end of March 2001 as against 61.5 per cent at the end of March 2000. Contingent liabilities of the Centre and States rose to 10.7 per cent of GDP at end-March 2000 from 9.8 per cent at end-March 1999.

4.2 For 2001-02, the gross fiscal deficit and the revenue deficit of the Centre are placed at 4.7 per cent and 3.2 per cent of GDP lower than 5.1 per cent and 3.5 per cent, respectively, in the revised estimates for 2000-01. The improvement in the fiscal outcome would be based on maintaining higher growth in revenue and continued focus on expenditure management. The finances of States are also expected to improve during 2001-02. The combined gross fiscal deficit of States is expected to decline to 3.8 per cent of GDP from 4.3 per cent in the revised estimates for 2000-01.

CENTRAL GOVERNMENT FINANCES : 2000-01

4.3 The fiscal consolidation programme envisaged in the Union Budget 2000-01 aimed at reduction in the Centre's gross fiscal deficit and revenue deficit to 5.1 per cent and 3.5 per cent of GDP, respectively. The revenue deficit in the revised estimates at Rs.77,369 crore was marginally lower than the budgeted level of Rs.77,425 crore. The gross fiscal deficit at Rs.1,11,972 crore exceeded the budget estimates (Rs.1,11,275 crore) marginally in absolute terms; however, in terms of GDP, it remained at the level of the budget estimates (BE). The gross primary deficit at Rs.11,305 crore (0.5 per cent of GDP) was higher by 12.9 per cent than the budget estimates of Rs.10,009 crore (Appendix Table IV.1). The process of fiscal consolidation, however, has been undergoing fluctuations in consonance with the cyclical influences on economic activity (Chart IV.1).

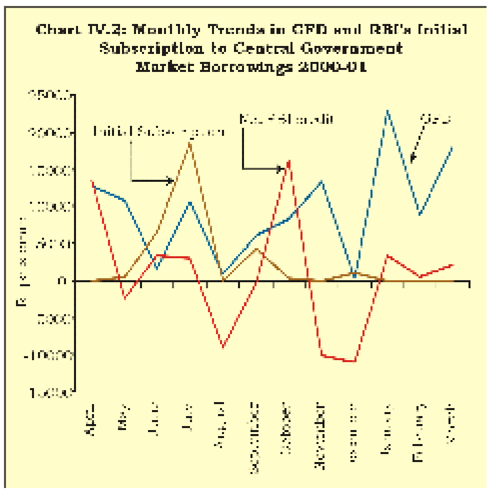


4.4 The aggregate expenditure in the revised estimates was lower by Rs.2,965 crore (0.9 per cent) than the budget estimates; in terms of GDP, the expenditure reduction was of the order of 0.2 percentage point *vis-a-vis* the budget estimates. The expenditure under both the non-Plan and Plan categories turned out to be lower than budget estimates. The expenditure compression impacted upon the annual Plan outlay, which declined to Rs.1,08,587 crore in the revised estimates, falling short by 7.5 per cent from the budget estimates of Rs.1,17,334 crore. This was mainly due to the shortfall in internal and extra budgetary resources (IEBR) of public enterprises (by Rs.5,740 crore) and reduced budgetary support to the Central Annual Plan (by Rs.3,007 crore).

4.5 Revenue receipts registered an increase of Rs.2,494 crore (1.2 per cent) or 0.1 percentage point in terms of GDP. While tax revenue suffered a decline of 1.2 per cent (Rs.1,806 crore), non-tax revenue recorded a growth of 7.5 per cent in the revised estimates, mainly on account of dividends and profits which surpassed the budget target by 26.4 per cent (Rs.2,955 crore). The shortfall in tax revenue was due to lower realisation from major taxes, *viz.*, customs and excise duties and corporation tax. Income tax collection, however, was higher by 11.7 per cent. The slackening of tax collections caused a decline in the tax-GDP ratio to 9.1 per cent in the revised estimates from 9.2 per cent projected in the budget estimates.

4.6 During 2000-01, disinvestment receipts fell short of the budget targets. The potential stress on the borrowing programme of the Centre was mitigated by efforts towards expenditure moderation. According to the Reserve Bank records, the net market borrowings during 2000-01 at Rs.73,787 crore were lower than the budget estimates of Rs.76,383 crore. The net receipts under other liabilities also declined in the revised estimates to Rs.30,845 crore (Rs.34,936 crore, BE). The Centre, however, resorted to drawing down cash balances to the extent of Rs.2,605 crore. Out of the borrowed funds, about 69.1 per cent was earmarked for meeting the revenue deficit, leaving the balance for investment outlays and net lending.

4.7 The monetary implication of the Centre's budgetary operations during 2000-01 is reflected in the level of net Reserve Bank credit to Centre, consisting of Ways and Means Advances (WMA) availed by the Centre, movements in cash balances and the Reserve Bank's participation in the Centre's market borrowings programme, which captures the extent of monetisation of the fiscal deficit. At end-March 2001, the net RBI credit to Centre amounted to Rs.6,705 crore as against a surplus of Rs.5,588 crore recorded in the previous year. Primary subscription of the Reserve Bank to the borrowing programme in the form of private placements/devolvement amounted to Rs.32,978 crore in 2000-01 as against Rs.29,267 crore in the previous year. The agreed limit for WMA for Centre for the first and second halves of 2000-01 remained the same as in the previous two years, *i.e.*, Rs.11,000 crore (April-September) and Rs.7,000 crore (October-March). The average utilisation of WMA exhibited a progressive decline from Rs.8,588 crore in the first quarter to Rs.5,198 crore in the second, Rs.4,273 crore in the third and further to Rs.1,650 crore in the last quarter. The year-end outstanding WMA was, however, placed higher at Rs.5,395 crore as against Rs.982 crore at end-March 2000 (Chart IV.2).



Central Government Budget : 2001-02

4.8 The fiscal consolidation envisaged in the Union Budget for 2001-02 focuses on expenditure management, mainly through control of non-productive expenditure, continued thrust on tax reforms and larger mobilisation of non-debt capital receipts. The Union Budget has projected all the major deficit indicators, in terms of GDP, at levels lower than the revised estimates for 2000-01. The gross fiscal deficit for 2001-02 is placed lower at 4.7 per cent of GDP and the revenue deficit at 3.2 per cent as against 5.1 per cent and 3.5 per cent, respectively, in the revised estimates for 2000-01. The primary deficit is estimated to decline to 0.2 per cent of GDP from 0.5 per cent in 2000-01.

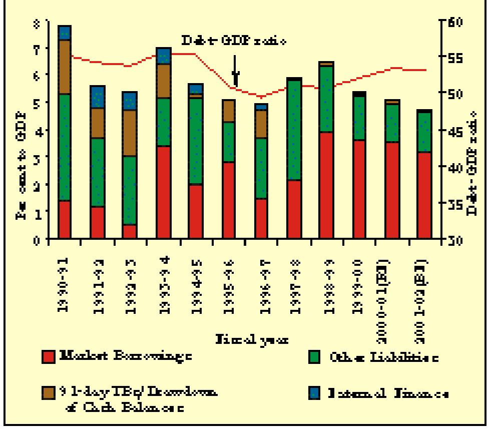
4.9 The Union Budget focuses on maintaining a higher growth in revenue (12.4 per cent) and containing the growth of aggregate expenditure (11.8 per cent). The expenditure management measures envisaged include downsizing the government as recommended by the Expenditure Reforms Commission, rationalisation of subsidies, pension reforms, restructuring of interest rates on contractual savings and restructuring and privatisation of public sector enterprises. All existing schemes, both at the Central and State levels, are proposed to be subjected to zero-based budgeting and all schemes that are similar in nature will be converged. Centrally Sponsored Schemes that can be transferred to States will be identified, resource flows will be linked to performance and importance will be given to decentralised planning. A new pension programme, based on defined contribution, is proposed to be implemented for those who enter Central Government service after October 1, 2001. The administered interest rates on small savings were reduced by 1.5 percentage points as of March 1, 2001 and the benefit of reduction in interest rates is fully passed on to States to reduce their borrowing cost from small savings by 100 to 150 basis points. The Union Budget has targeted a higher realisation of revenue at Rs.12,000 crore through disinvestment of equity holding of PSUs. Out of the receipts realised through disinvestments, Rs.7,000 crore are earmarked for providing restructuring assistance to PSUs, safety net to workers and reduction of the debt burden and the balance Rs.5,000 crore will be used to provide additional budgetary support for the Plan mainly in social and infrastructure sectors.

4.10 The budget projects the aggregate expenditure at Rs.3,75,223 crore, a lower growth of 11.8 per cent during 2001-02 as against 12.6 per cent in the revised estimates for 2000-01 and an average growth of 12.4 per cent during the last decade. The revenue expenditure is budgeted to grow by 9.5 per cent (Rs.27,031 crore) in 2001-02 as against 13.8 per cent (Rs.34,426 crore) in 2000-01, while capital expenditure would show a relatively high growth of 24.4 per cent (Rs.12,670 crore) than 6.2 per cent in the revised estimates for 2000-01. The moderation in the growth of revenue expenditure is envisaged through non-Plan components such as non-Plan grants to States and Union Territories, defence expenditure and major subsidies. The interest payments (Rs.1,12,300 crore) would show a growth of 11.6 per cent over Rs.1,00,667 crore in the previous year and would pre-empt 48.5 per cent of revenue receipts in 2001-02. Capital outlay (investment outlay) at Rs.40,647 crore is budgeted to increase by 53.2 per cent whereas loans and advances would be lower by 5.7 per cent. The enhancement in capital outlay would raise the Annual Plan outlay for 2001-02 to Rs.1,30,181 crore, higher by 19.9 per cent than the revised estimates of Rs.1,08,587 crore for 2000-01. Budgetary support at Rs.59,456 crore (higher by 23.2 per cent) would finance 45.7 per cent of the outlay (44.5 per cent in last year) and Internal and Extra Budgetary Resources (IEBR) of public sector enterprises budgeted at Rs.70,725 crore (17.3 per cent rise) would contribute 54.3 per cent of the Plan financing (55.5 per cent in 2000-01). The energy sector would continue to receive the major share (26.0 per cent) in the Plan outlay followed by the social services (20.7 per cent) and transport sector (17.3 per cent).

4.11 The tax measures proposed in the Union Budget are guided by the principles of revenue buoyancy, further simplification and rationalisation of rate structure, and enhancement of tax compliance. Under the Central Value Added Tax (CENVAT) system which has already been put to practice and contributes about 68 per cent of the total excise revenue, the Union Budget proposes to reduce the three rates of special excise duty to a single rate of 16 per cent. A regular surcharge of 15 per cent on cigarettes and increased duty on some other tobacco products has been introduced to replenish the National Calamity Contingency Fund (NCCF) as per the recommendations of the Eleventh Finance Commission. The rate schedule for custom duties would remain the same as in the previous year and with the abolition of the 10 per cent surcharge, the peak level custom duty is reduced from 38.5 per cent to 35 per cent. In order to widen the indirect tax base, more services have been brought under the tax regime. The major proposals in direct taxes, *inter alia,* include abolition of all surcharges payable by corporates and non-corporates, except the two per cent surcharge imposed for relief to the Earthquake hit areas of Gujarat. Other changes in direct taxes include extension of the one-by-six scheme to all urban areas to identify potential income tax assesses, reduction of tax on distribution of dividends by domestic companies and income in respect of units of mutual funds and Unit Trust of India (UTI) to 10 per cent from 20 per cent, and tax holiday for infrastructure and developers of Special Economic Zones (SEZs).

4.12 The Union Budget proposals are expected to cause a revenue loss of Rs.5,500 crore which is to be made up with tax buoyancy and increased voluntary compliance[1] . The Budget estimates place gross tax revenue at Rs.2,26,649 crore, which is higher by Rs.28,328 crore (14.3 per cent) over Rs.1,98,321 crore in 2000-01. The rise in tax revenue is expected to come from higher collection from the corporation tax (Rs.5,479 crore), income tax (Rs.5,329 crore), custom duties (Rs.5,041 crore) and Union excise duties (Rs.11,039 crore). The net tax revenue (net of States' share) at Rs.1,63,031 crore would record an increase of 12.9 per cent over the previous year (12.6 per cent). Non-tax receipts are estimated to increase by 11.3 per cent (Rs.6,951 crore) to Rs.68,714 crore during 2001-02.

Chart IV.3: Financing Pattern of Gross Fiscal Deficit and Debt-GDP ratio of Central Government



4.13 The Union Budget targets receipts of Rs.12,000 crore from disinvestment for 2001-02 as against Rs.2,500 crore in the revised estimates for 2000-01. The revenue receipts together with non-debt capital receipts (disinvestment and recoveries) are budgeted to finance 69.0 per cent of the total expenditure during 2001-02 as against 66.6 per cent in 2000-01. This implies that the borrowed funds (GFD) would finance 31.0 per cent of the total expenditure during 2001-02 as compared to 33.4 per cent in the previous year. The net market borrowings budgeted at Rs.77,353 crore would contribute 66.5 per cent of borrowed funds, marginally lower than 69.6 per cent in the revised estimates for 2000-01. The share of other liabilities would increase to 31.9 per cent (Rs.37,096 crore) from 27.5 per cent (Rs.30,845 crore) and that of external finance would be 1.6 per cent (Rs.1,865 crore) as against 0.5 per cent (Rs.575 crore) in the previous year (Chart IV.3).

Central Government Finances, 2001-02 (April-June)

4.14 Central Government finances came under stress during the first quarter of 2001-02 (April-June) with all the key deficit indicators increasing substantially over the corresponding period of 2000-01. The gross fiscal deficit (GFD) at Rs. 42,198 crore was higher by 68.3 per cent over April-June 2000 and constituted 36.3 per cent of the budget estimates. The revenue deficit at Rs. 32,431 crore (41.1 per cent of budget estimates) was almost double, while the primary deficit at Rs. 24,683 crore, was more than double the level of April-June 2000. Revenue receipts during April-June 2001 at Rs. 21,623 crore, were lower by 28.8 per cent, as against a growth of 26.6 per cent in April-June 2000. Revenue realisation during the first three months represented 9.3 per cent of the budget estimates, as compared with the realisation of 14.9 per cent in the same period of previous year. Gross tax collections during April-June 2001 declined by 13.4 per cent as against a growth of 16.5 per cent during April-June 2000. The aggregate expenditure during April-June 2001 amounted to Rs. 65,089 crore (17.3 per cent of the budget estimates), showing an increase of 14 per cent over April-June 2000. While the revenue expenditure increased by 15.6 per cent, capital expenditure registered a relatively low growth of 6.8 per cent.

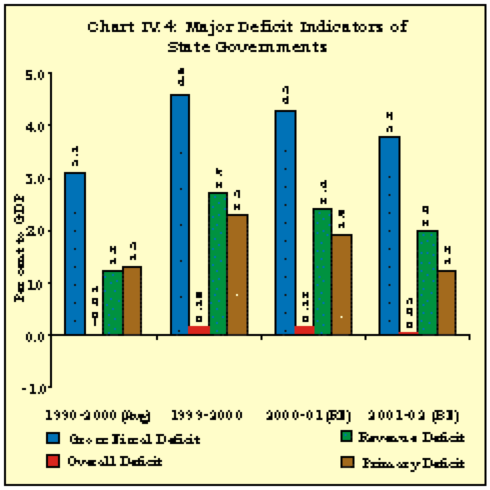
STATE GOVERNMENT FINANCES[2]

Budgetary Operations of the State Governments: 2000-01 and 2001-02

4.15 The fiscal outcome of States in the revised estimates for 2000-01 showed some improvement over the previous year. The consolidated gross fiscal deficit of States in the revised estimates for 2000-01 rose by 4.5 per cent from Rs.90,765 crore in 1999-2000 to Rs.94,821 crore in 2000-01. The GFD as percentage of GDP declined from 4.6 per cent in 1999-2000 to 4.3 per cent in the revised estimates for 2000-01. The improvement in the fiscal position during 2000-01 was due to relatively high growth in receipts than in expenditure, facilitated by a rise in current transfers from the Centre, particularly grants. Other fiscal indicators such as the revenue deficit and the primary deficit also showed some improvement in 2000-01. The revenue deficit declined from 2.7 per cent of GDP in 1999-2000 to 2.4 per cent of GDP in 2000-01 and the primary deficit declined from 2.3 per cent of GDP to 1.9 per cent of GDP during the same period.

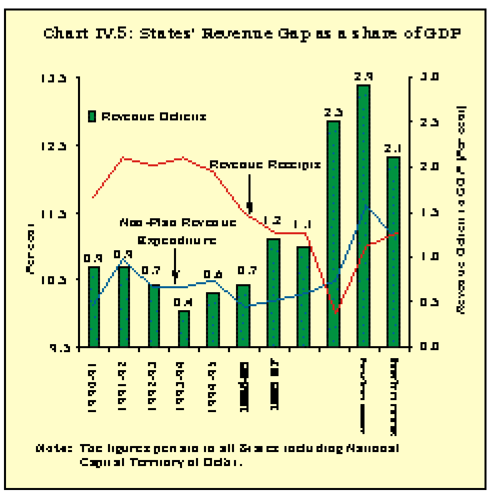
4.16 The high GFD characterising recent years has been mainly on account of the revenue deficit, which rose from Rs.8,201 crore in 1995-96 to Rs.53,709 crore in 1999-2000. This trend was reversed in 2000-01 with the revenue deficit declining even in absolute terms. As a result, the share of revenue deficit in the GFD declined from 59.2 per cent in 1999-2000 to 54.3 per cent in 2000-01.

4.17 While the revised estimates for 2000-01 showed an improvement in the GFD-GDP ratio over 1999-2000, it was 0.2 percentage point higher than the budget estimates. The rise in the gross fiscal deficit in revised estimates as compared with budget estimates was on account of a higher growth in expenditure (2.9 per cent) than growth in receipts (1.8 per cent). The revenue deficit in the revised estimates for 2000-01 overshot its projected level by 12.5 per cent to Rs.51,445 crore. In terms of GDP, the revenue deficit of the States is estimated at 2.4 per cent in 2000-01 in the revised estimates as against 2.1 per cent in the budget estimates for 2000-01. The primary deficit or the non-interest deficit as a percentage of GDP rose to 1.9 per cent as compared with the budgeted level of 1.6 per cent (Chart IV.4 and Appendix Table IV.5).



4.18 In the revised estimates for 2000-01, revenue receipts have shown a rise of 1.8 per cent mainly due to significant increase of 12.7 per cent in current transfers from the Centre comprising sharable taxes and grants.

4.19 Revenue expenditure exceeded its budgeted level by 3.5 per cent. The major component of revenue expenditure which has shown a very high growth in recent years is non-plan expenditure (mainly on account of interest payments, administrative services and pension outgo), which accounted for 83 per cent of revenue expenditure in 2000-01 (BE) (Chart IV.5). However, in the revised estimates for 2000-01, the expenditure on interest payment and administrative services declined by 0.5 per cent and 10.1 per cent, respectively, over the budget estimates.



4.20 An important development during 2000-01 was the shift in the composition of expenditure in favour of developmental expenditure. While the developmental expenditure is estimated to have risen by 7.4 per cent, non-developmental expenditure is anticipated to be lower by 1.3 per cent over the budget estimates. The decline in non-developmental expenditure was mainly on account of a fall in expenditure on administrative services and miscellaneous general services.

4.21 In the budget estimates for 2001-02, several States have proposed measures aimed at strengthening the revenue base and containing expenditure. The finances of States during 2001-02 are expected to record an improvement over the position in 2000-01. The gross fiscal deficit of these States at Rs.94,028 crore is budgeted to show a decline of 0.8 per cent over the revised estimates for 2000-01. In terms of GDP, the gross fiscal deficit of States has been budgeted at 3.8 per cent in 2001-02, as compared with 4.3 per cent in the revised estimates for 2000-01 and 4.6 per cent in 1999-2000. The fiscal consolidation process in 2001-02 has focused on improvement in the revenue account. Accordingly, the revenue deficit as a percentage of GDP is budgeted lower at 2.0 per cent in 2001-02 than 2.4 per cent in the revised estimates for 2000-01 and 2.7 per cent in 1999-2000. The revenue imbalances are sought to be addressed by Additional Resource Mobilisation (ARM) and improvement in States' own tax collection as also by expenditure management.

4.22 The consolidated revenue receipts during 2001-02, inclusive of ARM of Rs.1,997 crore, are budgeted to rise by 13.0 per cent over the revised estimates for 2000-01. A significantly high proportion of this rise (77.3 per cent) would be contributed by States' own revenue receipts comprising tax and non-tax receipts, while current transfers from the Centre comprising sharable taxes and grants would account for the rest.

4.23 Total tax receipts comprising States' own taxes and the States' share in Central taxes are estimated to show a lower rise of 17.4 per cent during 2001-02 as against 17.8 per cent in the revised estimates for 2000-01. The States' own taxes are, however, budgeted to show a higher rise of 18.8 per cent in 2001-02 as compared with 17.5 per cent in 2000-01 (RE). The States' share in Central taxes, on the other hand, is budgeted to rise by 14.3 per cent in 2001-02, as against 18.7 per cent in the revised estimates of 2000-01.

4.24 On the non-tax front, States' own non-tax receipts are estimated to show a rise of 7.3 per cent in 2001-02, higher than the growth of 0.3 per cent in 2000-01 (RE). In contrast, interest receipts of States are projected to show a decline of 13.3 per cent as against a rise of 8.9 per cent in 2000-01. The revenue expenditure during 2001-02, budgeted at Rs.3,27,642 crore is expected to show an increase of 9.7 per cent as against an increase of 15.4 per cent in the previous year. Thus, States' own revenue resources are expected to finance 53.4 per cent of revenue expenditure and 44.5 per cent of the aggregate expenditure in 2001-02 as compared with 50.3 per cent of revenue expenditure and 41.4 per cent of aggregate expenditure in the revised estimates of 2000-01 (Chart IV.6).

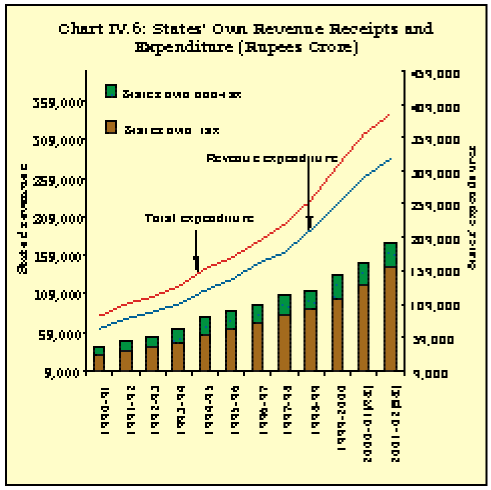


Chart IV.6: States' Own Revenue Receipts and Expenditure (Rupees Crore)

4.25 On the expenditure front, the non-developmental expenditure is estimated to rise by 16.1 per cent in 2001-02 as compared with 12.6 per cent in the previous year. The non-developmental expenditure is estimated to account for 36.3 per cent of the budgeted aggregate disbursements. The expenditure on pensions, interest payments and administrative services taken together are estimated to absorb 42.8 per cent of the revenuereceipts in 2001-02 marginally higher than that of 42.1 per cent in 2000-01.

4.26 The developmental expenditure is budgeted to show a lower rise of 3.6 per cent in 2001-02 than 19.7 per cent in 2000-01. The share of developmental expenditure in total expenditure has declined from 61.1 per cent in 2000-01(RE) to 58.4 per cent in the budget estimates for 2001-02. Component-wise, the expenditure on social services is budgeted to show a lower growth of 7.9 per cent in 2001-02 than 16.4 per cent in 2000-01 (RE). The expenditure on economic services is estimated to show a decline of 1.4 per cent in 2001-02 as against the growth of 23.8 per cent in the previous year.

4.27 While some improvement is expected in the revenue deficit and fiscal deficit of States during 2001-02, the high budgeted size of the overall resource gap, at Rs.94,028 crore, is a matter of concern. The revenue deficit, though budgeted lower than that in the previous year, still accounts for 51.5 per cent of the overall resource gap in 2001-02, which is much higher than the average level of 34.8 per cent in the 1990s.

4.28 The strain on State finances experienced in recent years is largely the outcome of the lower growth in revenue as against the sharp growth in committed expenditures such as wages and salaries, pensions and interest payments. These committed expenditures account for a major portion of the non-Plan expenditure and together absorb a sizeable part of the revenue receipts. During the 1990s, the average growth in revenue receipts is estimated at 13.8 per cent, while the growth in expenditure is estimated at 15.3 per cent.

4.29 On the financing front, the States depend to a large extent on loans from the Centre. The loans from the Centre (net) are projected to finance 35.8 per cent of the GFD during 2001-02 as compared with 33.8 per cent in the previous year (Chart IV.7). Besides loans from the Centre, the States have been taking recourse to provident funds, small savings and market borrowings to finance the growing expenditures. The net receipts from provident funds and small savings have been budgeted at Rs.13,443 crore in 2001-02, marginally lower than Rs.13,785 crore in 2000-01. The net market borrowings are estimated to decline from Rs.12,567 crore in 2000-01 to Rs.10,666 crore in 2001-02. (Appendix Table IV.8)

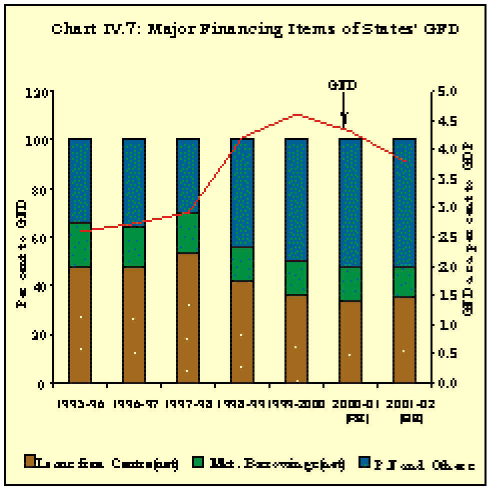


Chart IV.7: Major Financing Items of States' GFD

4.30 Keeping in view the need for institutional reforms including fiscal restructuring, several States have taken initiatives to improve their finances. The proposed fiscal restructuring measures are intended to address a number of long-term issues related to revenue mobilisation, expenditure management and PSUs reforms. The measures, *inter alia*, include the setting up of Consolidated Sinking Fund (CSF) for retiring public debt, setting up of an Expenditure Review/Reforms Committee to enforce budget discipline and improve expenditure management and establishment of Guarantee Redemption Fund (GRF) to take care of contingent liabilities. To illustrate, the States like Andhra Pradesh, Arunachal Pradesh, Assam, Bihar, Goa, Haryana, Maharashtra, Mizoram, Nagaland and West Bengal have taken initiatives to set up CSFs to help retire debt. The State of Goa has proposed the setting up of a GRF, while Assam has imposed a ceiling on government guarantees against loans and other forms of debt financing sought to be availed by PSUs. The Punjab State has constituted a Public Expenditure Reforms Commission and Public Sector Disinvestment Commission in order to improve the quality of public expenditure and channalise the resources towards productive purposes. The State of Himachal Pradesh aims to introduce a comprehensive rationalisation of posts and voluntary retirement scheme (VRS) for Government servants in the coming year.

4.31 As an important budgetary measure, many States have begun to focus on expenditure management and have identified performance indicators to assess the quality of expenditure restructuring. On the resource mobilisation front, many States have focused on efficient utilisation of existing resources through simplification / rationalisation of taxes, reviewing of user charges, *etc*. Further, the States have set the stage for introducing value added tax (VAT) through an agreement to impose uniform level of sales tax.

4.32 Several States are in the process of implementing the fiscal reforms in order to improve their financial health and consequently to meet the needs of the more potentially productive sectors, namely social and economic infrastructure. The State budgets have laid emphasis on infrastructure development by setting up Infrastructure Development Funds (IDFs) for providing necessary counterpart resources to attract private investment. Measures have also been initiated to restructure State-level public enterprises. Some States have signed Memorandum of Understanding (MoU) with the Central Government to undertake reforms in power sector and improve the financial viability of their electricity boards. Accordingly, many States have undertaken measures to set up State Electricity Regulatory Commissions (SERCs) for tariff rationalisation.

4.33 In order to enhance the transparency and uniformity of the information at State level, several States have started publishing *Budget at a Glance/Budget in Brief*, to facilitate a quick understanding of some of the critical fiscal indicators in their budgets.

Ways and Means Advances

4.34 The Reserve Bank announced a revised scheme called 'WMA Scheme 2001' effective from February 1, 2001. As per the revised scheme, the total normal WMA limits have been enhanced to Rs.5,283 crore. In the revised scheme, the Reserve Bank allows a State to run an overdraft for 12 consecutive working days instead of 10 days in the earlier scheme. Further, for facilitating cash flow management, time limit for bringing down the overdraft level, within the level of 100 per cent normal WMA limit, has been extended from 3 days to 5 days under the overdraft regulation scheme. The scheme is subject to review at the end of two years. The recourse to WMA by States has been generally higher during 2000-01 than in the previous year. However, as on March 31, 2001 State Governments' outstanding WMA and overdrafts from the Reserve Bank amounted to Rs.6,811 crore as against Rs.7,519 crore at the end of March 2000. The number of States resorting to overdrafts during 2000-01 remained at nineteen, the same as in the previous year. Three State Governments could not clear their overdrafts with the Reserve Bank within the stipulated time limit and consequently the Reserve Bank had to stop payments on their behalf.

COMBINED BUDGETARY POSITION OF THE CENTRE AND STATES[3]

4.35 The revised estimates for 2000-01 place combined gross fiscal deficit of the Centre and States at 9.1 per cent of GDP, marginally higher than the budget estimates of 8.8 per cent. The combined GFD during 2000-01 is, however, 0.3 percentage point lower than 9.4 per cent of GDP in 1999-2000 (Table 4.1). The revised estimates of combined revenue deficit and gross primary deficit for 2000-01 at 5.9 per cent and 3.4 per cent of GDP, respectively, are higher than the respective budget estimates of 5.6 per cent and 3.1 per cent. The rise in combined deficits was partly due to moderations in GDP growth and partly due to an increase in expenditure. The aggregate expenditure at Rs. 6,09,906 crore in the revised estimates witnessed a growth of Rs.13,675 crore. Revenue receipts at Rs.3,95,045 crore recorded relatively low growth of Rs.9,723 crore in the revised estimates. The increase in combined GFD was also contributed by non-realisation of targeted disinvestment receipts in the Centre's budget.

Table 4.1: Measures of Deficit of the Central and State Governments as proportion to GDP*

Year	Gross Fiscal Deficit	Revenue Deficit	Gross Primary Deficit
1	2	3	4
1990-91	9.4	4.2	5.0
1991-92	7.0	3.4	2.3
1992-93	7.0	3.2	2.1
1993-94	8.3	4.3	3.3
1994-95	7.1	3.7	1.9
1995-96	6.5	3.2	1.6
1996-97	6.4	3.6	1.3
1997-98	7.3	4.1	2.2
1998-99	8.9	6.3	3.7
1999-2000#	9.4	6.2	3.8
1990-2000 (Average)	7.7	4.2	2.7
2000-01(RE)#	9.1	5.9	3.4
2001-02(BE)#@	8.1	5.1	2.3

RE - Revised Estimates BE- Budget Estimates

* The combined deficit indicators have been worked out after netting out the inter- Governmental transactions between the Centre and States. As such, these figures will not be equal to the total deficits as worked out separately for the Centre and for the States. Details of the adjustments in respect of each deficit indicator are given in the Notes below.

\# Data for State Governments are provisional (See Notes to Appendix Table IV.5).

@ Worked out on the basis of the implicit nominal GDP underlying the budget estimates of the Central Government GFD/GDP ratio of 4.7 per cent for 2001-02.

Notes: 1. Combined GFD is the GFD of the Central Government plus GFD of the State Governments minus net lending from the Central Government to State. Governments expenditures of the Central and

2. Revenue deficit is the difference between revenue receipts and revenue State Governments adjusted for inter- Governmental transactions in the revenue account.

3. Gross primary deficit is defined as combined GFD minus combined interest payments.

4.36 During the fiscal year 2001-02, the budget estimates envisage reduction in all the major deficit indicators. The combined gross fiscal deficit for 2001-02 is placed at 8.1 per cent of GDP as compared with 9.1 per cent in the revised estimates for 2000-01. Revenue deficit and primary deficit for 2001-02 are placed at 5.1 per cent and 2.3 per cent of GDP, respectively, as against 5.9 per cent and 3.4 per cent in the revised estimates for 2000-01. The reduction in the deficits are envisaged through higher revenue mobilisation as well as moderation in the growth of expenditure. The combined revenue receipts are budgeted to grow at a higher rate of 13.4 per cent than 10.8 per cent in the combined expenditure. In the revenue receipts, almost 92 per cent of the incremental revenue is expected from tax receipts. The combined tax collection for 2001-02 is projected at Rs.3,66,927 crore, an increase of 15.4 per cent over the previous year. The combined tax to GDP ratio is budgeted to rise to 14.8 per cent in 2001-02 from 14.6 per cent in 2000-01 and 14.0 per cent in 1999-2000. (Appendix Table IV.3)

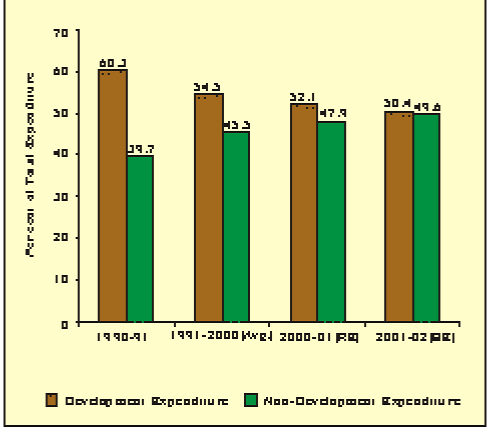


Chart IV.8: Expenditures of Central and State Governments

4.37 The budget estimates place combined expenditure growth in 2001-02 lower at 10.8 per cent than 12.4 per cent growth in 2000-01. The moderation in expenditure is envisaged through lower growth in revenue expenditure which is budgeted to rise by 9.8 per cent during 2001-02 as against 13.2 per cent in previous year. The capital expenditure would rise at a higher rate of 17.0 per cent as against 7.6 per cent in 2000-01. The pattern of expenditure indicates that developmental expenditure would increase at a lower rate of 7.3 per cent during 2001-02 as against 16.9 per cent in 2000-01. The non-developmental expenditure would increase by 13.8 per cent in 2001-02 as against 11.2 per cent during 2000-01. As a result, the share of non-developmental expenditure including others, in total expenditure is budgeted to increase from 47.9 per cent in 2000-01 to 49.6 per cent in 2001-02 with corresponding decline in the share of developmental expenditure from 52.1 per cent to 50.4 per cent (Chart IV.8). Expenditure on social sector is budgeted to increase at a lower rate of 7.4 per cent as compared with 15.1 per cent in 2000-01. Consequently, social sector expenditure as a proportion to GDP would decline to 7.3 per cent during 2001-02 from 7.8 per cent in 2000-01.

4.38 The financing pattern of the Government sector deficit indicates that almost the entire borrowing requirement is met by domestic sources. During 2001-02, domestic source is estimated to finance 99.0 per cent of the GFD and the balance through external assistance. Within the domestic sources, market borrowings would finance 43.9 per cent of the combined GFD in 2001-02 compared with 43.5 per cent in 2000-01 (RE). The other liabilities (comprising small savings, provident fund, deposits, reserve funds *etc.*) would finance 55.2 per cent in 2001-02 (BE) as against 56.2 per cent in 2000-01 (Chart IV.9)

Market Borrowings

Central Government

4.39 Market borrowings have emerged as an important source of financing Centre's fiscal deficit, accounting for 69.6 per cent of fiscal deficit during 2000-01 as against 67.1 per cent in 1999-00 and 17.9 per cent in 1990-91. The sharp deviations in the fiscal deficit from the budget targets during the 1990s led to an upward pressure on resources. During the latter half of the 1990s, on an average, deviations of the fiscal deficit of the Centre were absorbed to the extent of

19 to 65 per cent by enlargement of the market borrowing programme. For the year 2000-01, however, borrowings were within budget estimates (Chart IV.10). The net borrowings of the Centre were lower than the targeted borrowing programme for the fiscal year 2000-01 (Appendix Table IV.9).

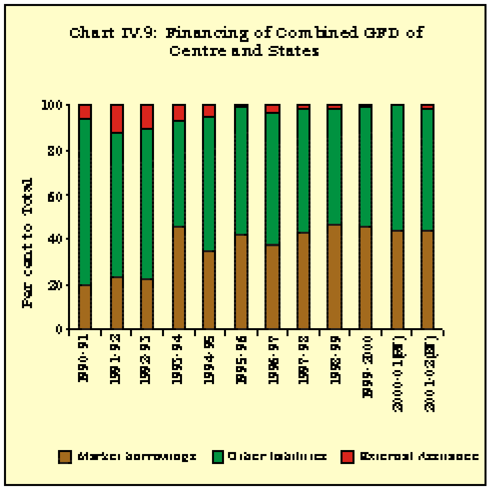


Chart IV.9: Financing of Combined GFD of Centre and States

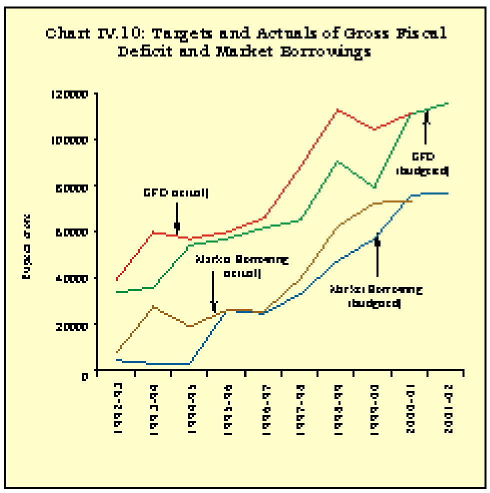


Chart IV.10: Targets and Actuals of Gross Fiscal Deficit and Market Borrowings

4.40 For the fiscal year 2001-02, the gross market borrowings of the Central Government are budgeted at Rs.1,18,852 crore and the net borrowings at Rs.77,353 crore. At this level, the net market borrowings would finance 66.5 per cent of GFD as against 69.6 per cent in the previous year.

State Governments

4.41 The net market borrowings originally allocated for all States for the fiscal year 2000-01 were Rs.11,230 crore (gross Rs.11,650 crore). As against this, the State Governments raised a net amount of Rs.12,880 crore (gross Rs.13,300 crore), including the additional allocation of Rs1,650 crore. The amount mobilised through pre-announced issues aggregated Rs.11,630 crore and through auction route Rs.1,670 crore. During 2000-01, with general moderation in interest rates in the economy, the weighted average cost of States' borrowings declined to 10.99 per cent as against 11.89 per cent in the previous year. Under the provisional allocation for the States for the year 2001-02, twenty-seven States, in the first tranche of the market borrowing programme, raised an amount of Rs.5,307 crore at the coupon rate of 10.35 per cent. Besides, the Government of Kerala had mobilised Rs.200 crore through auction method on April 17 and Gujarat Rs. 440 crore on July 20 and August 6, 2001.

DOMESTIC PUBLIC DEBT

Debt Position of Central Government

4.42 The outstanding debt-GDP ratio of the Central Government rose to 53.3 per cent as at end-March 2001 as against 52.2 per cent in the previous year. Although at this level, the debt-GDP ratio is lower than the level of 55.3 per cent at end-March 1991, the persistence of primary deficit and convergence of nominal GDP growth and interest rates impose a downward rigidity to the debt-GDP ratio. The gap between the GDP growth rate and the interest rate on Government borrowings has narrowed down, particularly since the latter half of the 1990s (Chart IV.11). The near stickiness of medium to long-term interest rates and moderation in GDP growth has direct implications for the stability of the debt-GDP ratio.

Debt Position of State Governments

4.43 The persistence of States' fiscal deficits at high levels, reaching 4.3 per cent of GDP in 2000-01 as against 2.9 per cent in 1991-92, led to a steady rise in their public debt-GDP ratio to 23.1 per cent by end-March 2001, from 19.3 per cent as at end-March 1992. The debt growth during the latter half of the 1990s, on an average, remained at 17.9 per cent, significantly above the growth rate of State revenues at 11.0 per cent, reflecting the incipient fiscal instability at the sub-national level. The interest payments pre-empted 21.7 per cent of the revenue receipts of States in 2000-01 as against 13.0 per cent in 1990-91.

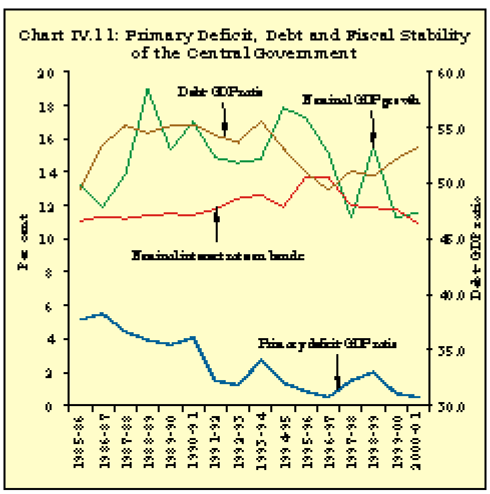


Chart IV.11: Primary Deficit, Debt and Fiscal Stability of the Central Government

4.44 Besides loans from the Centre and market borrowings, the other sources of growth in liabilities of States in recent years have been negotiated loans from banks and financial institutions and the public account liabilities mainly comprising provident funds, insurance and pension funds and endowments. While the share of public account liabilities in the total outstanding liabilities of States has risen from 15.4 per cent to 18.7 per cent during the 1990s, the share of loans from banks and financial institutions rose from 2.6 per cent to 6.2 per cent during the decade. These developments have implications for the fiscal stability of States, partly on account of the high interest cost element of such borrowings and partly due to the accumulation of repayment obligations of public account liabilities. The overall impact of the rising debt levels has been the reduced flexibility of States in exercising fiscal policy options to release funds for basic infrastructure and the social sector. While the demand for basic social services has risen significantly, particularly in terms of quality, the share of social service expenditure in aggregate expenditure has remained stagnant at about 32 per cent.

Combined Debt

4.45 The macroeconomic consequences of government debt and fiscal stability could be assessed in terms of the size and movement in the debt of the government sector in totality. The combined GFD of the Centre and States is placed at 9.1 per cent of GDP in 2000-01 (RE), up from 7.0 per cent in 1991-92 and the combined debt-GDP ratio at 63.7 per cent as at end-March 2001 as against 60.9 per cent as at end-March 1992. The shortening of maturity structure in the recent past with the underlying objective of minimising interest cost has given rise to the problem of bunching of repayment obligations of the Government as reflected in the repayment schedule of market debt. The high debt level also gives rise to adverse expectations and is, thus, an obstacle in the way of an easier interest rate environment. While the average nominal interest rate on Central Government market borrowings has come down to 10.95 per cent in 2000-01 from 11.77 per cent in 1999-2000 and 13.75 per cent in 1995-96, the sustained reduction and stability in long-term interest rates would be conditional upon the reduction in the size of Government borrowing. Also, given the stable domestic saving rate, sustaining higher output growth requires reduction in the public sector deficits.

4.46 The level and composition of domestic debt have assumed significance in the 1990s. The market loans, whose share in the domestic liabilities has risen from 27.0 per cent to 38.8 per cent between end-March 1991 and 2001, have been raised at considerably high cost. Similarly, another high cost component of debt, *viz.,* small savings and provident funds, constitutes a significant component of domestic liabilities, with its share in the outstanding debt increasing from 24.6 per cent to 29.5 per cent between 1991 and 2001. Since the relatively high administered interest rates on small savings provided rigidity to the interest rate structure on medium to long-term Government bonds, the overall borrowing cost of the public debt remained high, pushing up the interest burden of the Government sector to 5.7 per cent of GDP in 2000-01 from 4.4 per cent in 1990-91. The interest rate structure on small savings has since been revised, cutting back interest rates on various instruments by 0.5-2.0 percentage point in January 2000 and subsequently by 1.5 percentage point effective March 2001. Besides, the fiscal stability of the Government is also affected by existence of significant unfunded liabilities in the form of pension obligations, which are likely to grow in the future. Recognising these concerns, the Union Budget 2001-02 proposed a new pension programme based on defined contributions to those who enter Central government services after October 1, 2001.

4.47 The Central Government has introduced in Parliament the Fiscal Responsibility and Budget Management Bill, 2000, in December 2000. The Bill provides for the responsibility of the Central Government to ensure inter-generational equity in fiscal management and long-term macroeconomic stability by achieving sufficient revenue surplus, eliminating fiscal deficit and removing fiscal impediments in the effective conduct of monetary policy and prudential debt management consistent with fiscal sustainability. Under the Bill, the Government shall ensure that within a period of 10 financial years, beginning April 2001, the total liabilities (including external debt at current exchange rate) at the end of a financial year, do not exceed 50 per cent of GDP. The Bill provides for complete elimination of revenue deficit and reduction of the fiscal deficit-GDP ratio to 2 per cent by end-March 2006. The convergence conditions with regard to deficit and debt would, however, require adequate primary surplus so as to maintain debt-GDP ratio at the stipulated level.

Contingent Liabilities/Guarantees of Governments

4.48 While the outstanding public debt posed challenges for fiscal management, and its implications are clearly identified, the fiscal position of the Government may also be substantially influenced by the nature and levels of contingent liabilities, which include guarantees, counter guarantees and indemnities. Although these contingent liabilities are not treated as part of the liabilities in the existing accounting practices as their occurrence depends on certain future events, given the high debt level, these, however, are an important source of fiscal risk. Government guarantees, especially those extended to the financial institutions without risk assessment, have an in-built bias for moral hazard and adverse selection for the financial system. The outstanding guarantees extended by the Central and State Governments, which are mainly in the form of loan/credit guarantees amounted to Rs.2,08,767 crore as at end March 2000 - 21.3 per cent higher than in the previous year. In terms of GDP, the outstanding guarantees rose to 10.7 per cent as at end-March 2000 from 9.8 per cent as at end-March 1999 (Table 4.2). Besides the explicit guarantees, the implicit guarantees, *viz.,* letters of comfort/structured payment obligations, are also the potential source of fiscal risk. Since a major part of the outstanding loan/credit guarantees of governments is extended on behalf of the public enterprises, these are, in some sense, indicative of a component of the aggregate public sector debt.

Table 4.2 : Outstanding Government Guarantees

(Rupees crore)

Year(End-March)	Centre		States*		Total	
	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP
1	2	3	4	5	6	7
1992	50,575	7.7	40,159	6.1	90,734	13.9
1993	58,088	7.8	42,515	5.7	1,00,603	13.4
1994	62,834	7.3	48,866	5.7	1,11,700	13.0
1995	62,468	6.2	48,479	4.8	1,10,947	11.0
1996	65,573	5.5	52,631	4.4	1,18,204	9.9
1997	69,748	5.1	63,409	4.6	1,33,157	9.7
1998	73,877	4.9	73,751	4.8	1,47,628	9.7
1999	74,606	4.2	97,454	5.5	1,72,060	9.8

2000	83,954	4.3	1,24,813	6.4	2,08,767	10.7

* Data pertain to 17 major States.

Note : Ratios to GDP may not add up to the total due to rounding off.

Source: 1. Data on Centre's guarantees are sourced from finance accounts and budget documents of the Central Government.

2. Data on States' guarantees are based on the information received from State Governments.

4.49 Recognising the implications of guarantees for fiscal and financial sector stability, the Fiscal Responsibility and Budget Management Bill, 2000, prescribes that the Central Government shall not give guarantees for any amount exceeding one-half per cent of GDP during any financial year. In spite of these safeguards, it needs to be recognised that a proper reporting and disclosure of guarantees are internationally accepted as part of good practices of accounting and transparency in government operations.

4.50 It is widely recognised that the transparency with regard to the conduct of fiscal policy needs to be continuously improved (Box IV.1).

Box IV. 1
Fiscal Transparency and Code of Good Practices

Transparency in fiscal operations implies openness towards public about structure and functions of government, fiscal policy intentions, public sector accounts, and fiscal projections. 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, specially financial market participants to 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. It also enhances credibility with positive outcomes in the form of lower borrowing cost and stronger public support for sound macroeconomic policies.

The IMF has stressed the importance of good governance, with fiscal transparency forming a key aspect. The IMF Manual on Fiscal Transparency provides four general principles of fiscal transparency, which form the basic structure of Code of Good Practices. 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 Code of Good Practices on Fiscal Transparency provides policy makers with benchmarks of good practice in key areas that IMF encourages the member countries to implement.

Country experiences reveal that greater fiscal discipline is exhibited by countries with a relatively high degree of transparency, and in some cases the growth performance of such countries has been more robust as compared with the countries characterised by less transparent financial practices. The Fiscal Responsibility Act of New Zealand contains a set of principles for fiscal management and transparency, requiring the government to disclose all items involving fiscal costs and gains and to identify potential fiscal risks. In Chile, the budget process has been oriented to gain transparent control over the public finances consistent with macroeconomic stability. Chile's experience with transparency also reveals that the central bank's balance sheet contains data on quasi-fiscal activities and the state owned enterprises are operated in a transparent manner without hidden subsidies or preferential credits. In the UK, the combination of transparency and fiscal rules has supported the fiscal adjustment process.

In the Indian context, the Constitution provides a clear statement of roles and responsibilities of the Central and State governments. A reasonable standard of fiscal transparency has been achieved in the case of Central government regarding the amount of fiscal information that is made available to the public, whereas the disclosure practice in the budgetary operations of sub-national governments is not as sound as in the case of Central government. Further, the Fiscal Responsibility and Budget Management Bill (FRBMB) 2000, introduced in the Parliament in December 2000, provides for the Central government to take suitable measures to ensure greater transparency in fiscal operations in public interest and minimise as far as practicable secrecy in the preparation of the annual budget. The Bill requires laying before the Parliament the medium-term fiscal policy statement, fiscal policy strategy statement and the macroeconomic framework statement along with the annual budget. With regard to transparency at State level, 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 exercise.

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. Fiscal practices at the State level were felt to be generally behind the standards achieved at the Central Government level. The Group recommended that the Finance Secretaries Forum could review the Report of the Advisory Group on Fiscal Transparency and determine a set of minimum standards on transparency which all State Governments should achieve within a three-year period.

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6. Report of the Advisory Group on Fiscal Transparency (Chairman:Montek Singh Ahluwalia), June 2001 (http:\\www.rbi.org.in).

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[1] The Finance Minister announced some post-budget modifications under both direct taxes and indirect taxes on April 25, 2001. These modifications, *inter alia*, include: (i) increase in the limits of standard deduction to Rs.30,000 for income up to Rs.1,50,000 and Rs.25,000 for persons having income from Rs.1,50,000 to Rs.3,00,000; limit for tax deduction at source on interest receipts raised to Rs.5,000 from the budget proposal of Rs.2,500 and (ii) deduction of interest income under Section 80L raised to Rs.12,000 from the Budget proposal of Rs.9,000. Under indirect taxes, all garments, except clothing accessories, raincoats and undergarments would be subjected to excise duty at 16 per cent; 5 per cent customs duty imposed on indigenous shipping companies abolished; the concessional rate of duty of 55 per cent for the import of crude palm oil by sick vanaspati units abolished and the CVD of 16 per cent on 12 critical items of textile machinery including shuttleless looms abolished.

[2] Based on the provisional data relating to the budgets of 26 States including NCT Delhi (out of 29 States), of which four States are Vote-on-Account.

[3] Based on the budgets of twenty six State Governments.