IV GOVERNMENT FINANCES

4.1 The slowing of economic activity due to the drought impacted on public finances in 2002-03. In the revised estimates, the combined gross fiscal deficit of the Centre and States overshot its budgeted level by more than one per cent of GDP on account of the shortfall in tax revenue and disinvestment from budget estimates. Furthermore, the imperatives for food supply management in the context of the drought necessitated fiscal support in the form of higher food subsidies, which surged back almost to 1991-92 level as a proportion to GDP. Despite these setbacks, there were distinct gains in expenditure management. The Centre reined in its expenditure by pruning non-plan spending. On the other hand, the States' expenditure exceeded budget estimates, but this was mainly in the form of a spurt in capital expenditure towards debt consolidation. Importantly, States were able to contain the revenue expenditure around the budgeted level. Notwithstanding these modest successes in expenditure containment, the slippages from the budgetary projections underscore the deterioration in the quality of fiscal adjustment.

4.2 The tax-GDP ratio has been losing buoyancy over the 1990s, falling by more than two per cent of GDP by the year 2001-02 from the level attained in the late 1980s. This imparts urgency to reforms in the tax regime in the form of simplification of rules, widening the tax base, reviewing exemptions and improving compliance. The surge in interest payments following reforms in budgetary financing has continued unabated, and it is only in 2002-03 that some moderation in pace has set in. The steady improvement in the primary deficit coupled with fall in capital outlay during the 1990s indicates that the burden of the unrelenting expansion in interest outgoes has devolved on productive elements of fiscal spending. The overarching priority attached to reduction of expenditure to meet deficit targets has accentuated the erosion of capital outlays with serious implications for expanding the productive capacity of the economy in the future. Expenditure on subsidies has remained impervious to fiscal adjustment, while spending on social infrastructure continues to remain low. Large gaps in disinvestment have intensified the fiscal stress. Reflecting these adverse developments, the debt-GDP ratio has been climbing since the second half of the 1990s and is expected to touch 77 per cent of GDP by the end of March 2004. Moreover, the monotonic rise in public debt has eroded the Government sector's ability to generate savings and to service its internal debt. The "quality" of the fiscal deficit has worsened, with the revenue deficit having increased substantially indicating that a larger share of borrowed fund is pre-empted by consumption expenditure. (Table 4.1).

Table 4.1: Indicators of Fiscal Policy

Items	2003-04 (BE)	2002-03 (RE)	2001-02	1995-96	1990-91
1	2	3	4	5	6
(Per cent of GDP)					
Quantitative Indicators					
Gross Fiscal Deficit	9.2	10.1	9.9	6.5	9.4
Revenue Deficit	5.9	6.7	6.9	3.2	4.2
Primary Deficit	2.8	3.6	3.7	1.6	5.0
Qualitative Indicators					
Revenue Receipts	19.0	19.1	17.4	18.3	18.6
Tax Revenue	15.1	14.9	13.7	14.7	15.4
Direct Taxes	4.3	4.2	3.6	3.5	2.5
Indirect Taxes	10.8	10.7	10.1	11.2	12.9
Total Expenditure	29.6	30.4	28.5	25.6	28.8
Developmental Expenditure	14.6	15.4	14.3	13.9	17.4
Non-developmental Expenditure	15.0	15.1	14.1	11.6	11.4
Interest Payments	6.4	6.5	6.2	5.0	4.4
Debt	76.9	75.5	71.1	58.0	61.7
(Per cent)					
Capital Outlay/ Total Expenditure	11.2	9.6	9.0	10.7	13.1
Interest Payments/ Revenue Receipts	33.7	34.0	35.6	27.2	23.6
Revenue Deficit/ GFD	64.0	66.7	70.4	48.8	44.6

Note : All indicators are based on combined data of the Centre and States. For States, data are provisional for the years 2001-02 onwards.

CENTRAL GOVERNMENT FINANCES, 2002-03

Expenditure Management

4.3 Expenditure management strategies put in place by the Centre since the second half of the 1990s have begun to yield room for fiscal manoeuvre, notwithstanding the slippages in terms of deficit indicators in the recent years. Despite additional expenditure on account of drought relief and Plan allocations, cuts in non-Plan expenditure enabled a reduction in overall spending (as per revised estimates *vis-à-vis* budget estimates) by the Centre in 2002-03. The reduction in non-Plan expenditure was on account of lower defence spending, reduced interest payments due to softening in the interest rate on Government securities, lower outgo on pension as well as grants and loans to States and UTs due to non-utilisation of funds under the 'Fiscal Incentive Fund'. The expenditure on subsidies, however, increased significantly during 2002-03 reflecting the impact of dismantling of the Administered Price Mechanism (APM) for petroleum products as also the increase in food subsidy on account of drought conditions. Till the dismantling of the APM, subsidies on various petroleum products were absorbed in the oil pool account. With the discontinuance of the latter since 2002-03, the subsidies for domestic Liquefied Petroleum Gas (LPG), Public Distribution System (PDS) kerosene and freight for far flung areas now fall on the budget (Table 4.2).

4.4 The gains in expenditure restraint, *albeit* limited, have strengthened the commitment to fiscal consolidation. They have prepared the ground for adequate forecasting and financial planning so as to ensure that the overall gains of fiscal prudence are also reflected in efficient intra-year cash management. Effective cash management helps in conserving scarce cash resources and ultimately, in controlling aggregate spending and the budgetary gap. In the context of Central Government finances, it is observed that the intra-year divergence between revenue flows and expenditure is high. There is also a tendency of bunching of expenditure during the latter part of the fiscal year (Chart IV.1).

4.5 The initiative to introduce cash management on a pilot basis in major spending Ministries in the 2003-04 budget needs to be seen

Table 4.2 : Aggregate Expenditure of the Centre

(Rupees crore)

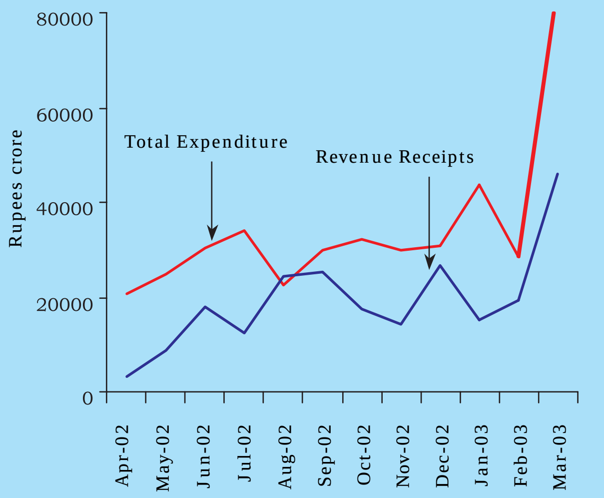
	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03) Amount	Per cent
1	2	3	4	5	6	7	8
Total Expenditure (1+2=3+4)	4,04,013 (16.3)	4,10,309 (16.0)	3,62,453 (15.8)	1,78,275 (15.0)	1,05,298 (18.5)	-6,296	-1.5
1. Non-Plan Expenditure *of which:*	2,89,924 (11.7)	2,96,809 (11.6)	2,61,259 (11.4)	1,31,901 (11.1)	76,933 (13.5)	-6,885	-2.3
Interest Payments	1,15,663 (4.7)	1,17,390 (4.6)	1,07,460 (4.7)	50,045 (4.2)	21,498 (3.8)	-1,727	-1.5
Defence	56,000 (2.3)	65,000 (2.5)	54,266 (2.4)	26,856 (2.3)	15,426 (2.7)	-9,000	-13.8
Subsidies	44,618 (1.8)	39,801 (1.6)	31,207 (1.4)	12,666 (1.1)	12,158 (2.1)	4,817	12.1
2. Plan Expenditure	1,14,089 (4.6)	1,13,500 (4.4)	1,01,194 (4.4)	46,374 (3.9)	28,365 (5.0)	589	0.5
3. Revenue Expenditure	3,41,648 (13.8)	3,40,482 (13.3)	3,01,611 (13.1)	1,39,861 (11.8)	73,516 (12.9)	1,166	0.3
4. Capital Expenditure@	62,365 (2.5)	69,827 (2.7)	60,842 (2.6)	38,414 (3.2)	31,782 (5.6)	-7,462	-10.7

RE : Revised Estimates. BE : Budget Estimates.

@ Includes capital outlays and loans and advances.

Note : Figures in brackets are per cent of GDP.

Chart IV.1 : Monthly Revenue Receipts and Total Expenditure of the Centre



as an important step forward towards effective expenditure management. The cross-country experience indicates that the time-sliced release of funds for spending and incentive-based cash management practices contribute to overall fiscal discipline (Box IV.1).

4.6 Subsidies have almost doubled in the last five years with a sharp increase in 2002-03. Food and fertiliser subsidies account for 87.4 per cent of the expansion in subsidy spending since 1990-91. Food subsidy, mainly financing the buffer carrying cost and producers' subsidy, has been rising *pari passu* with the accumulation of foodstocks. The fiscal impact of the increase in foodgrain stocks is visible in the unprecedented expansion in food subsidies since 2000-01. On the other hand, the rationalisation of the Retention Price Scheme and enhancement of the maximum retail price of fertilisers has had positive effects on fertiliser subsidies. The budget for 2001-02 announced a phased programme of

Box IV.1
Public Expenditure : Cash Management

Public expenditure management involves determination of the size of the budget, size of the outlays on different functions and the magnitude of outlays on various programmes within the resource constraints at various stages of government decision making. A core element of public expenditure management is cash management which involves conservation and optimisation of cash flow and a sensitivity to cash costs. Effective cash management involves (a) forecast of receipts, disbursements and the resulting cash balances within the governmental financial system on a high frequency basis; (b) strict control over cash inflows to minimise time lags between expected and actual receipts; (c) cash outflow control to prevent both late and premature payments; and (d) minimising operating cash balances.

Cross-country experience indicates that three types of practices for releasing funds are in existence. In countries where budgeted amounts are available soon after the budget is approved (few British Commonwealth countries and some economies in transition), a system of time-sliced releases is in existence. An alternative arrangement is one under which formal warrants are issued by the Ministry of Finance in response to requests from the spending agencies. Such requests have no defined periodicity and primarily reflect the changing seasonal requirements for outlays other than those on personnel. Under the third type of arrangement, fixed amounts are released for commitment and payment on either a monthly or a quarterly cycle.

All these arrangements regulate the release of cash rather than amounts of cash to be credited to spending agencies. Institutional arrangements for aggregate fiscal discipline can range from constitutional restraints on aggregate expenditure (*e.g.*, Indonesia) through formal laws (*e.g.*, Maastricht, New Zealand, Australia) to public commitments by the executives with or without the commitment of the legislature (*e.g.*, U.S.). Incentive-based practices are followed in some countries like Sweden where the annual budget appropriations are deposited into each agency's interest-bearing account. Slow spending agencies get some interest earnings and the fast spenders have to pay interest. Also, to avoid the end-of-year spending surges, the agencies are allowed to carry forward their unused appropriations.

In the Indian context, public expenditure management has received focused attention as part of fiscal consolidation. An important institutional arrangement in this direction was the creation of the Expenditure Reform Commission to suggest measures to strengthen expenditure management. Following the recommendations of the Commission, the Government has taken several measures to contain expenditure growth and ensure efficiency in the expenditure management. The weak link in expenditure management, however, is cash management.

The pattern of expenditure reveals that for the last three years on an average, about 19 per cent of the total expenditure is incurred during the last month of the fiscal

(Contd....)

(Concld....)

year. The pilot cash management system introduced in the Union Budget, 2003-04 adopts time-slicing of funds release to permit convergence of expenditure with the availability of resources within the year. Based on the actual requirement, monthly or quarterly cash limits for various ministries will be prescribed. The improved cash management is expected to avoid both mis-matches between receipts and expenditure and the rush of expenditure in the last quarter of the fiscal year.

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complete decontrol of the urea prices by April 1, 2006. The impact of these measures is reflected in the decline in fertiliser subsidies in recent years. Moreover, the emergence of petroleum subsidy since 2002-03 is the result of the dismantling of APM for petroleum products. The total subsidies are, however, high at 1.6 per cent of GDP in 2002-03, even after excluding the subsidy on the petroleum products (Table 4.3).

4.7 As mentioned before, earlier efforts at fiscal correction have resulted in a persistent decline in capital expenditure. In general, it is capital outlays which have provided the soft option for deficit-based fiscal correction. In the revised estimates for 2002-03, capital outlays fell short of the budgetary target by more than 25 per cent, implying the diversion of resources from productive investments to current expenditures. In the Indian context, there is

Table 4.3 : Expenditure on Subsidies by Major Heads

(Rupees crore)

Year	Food	Fertiliser	Interest	Petroleum	Other	Total Subsidies
1	2	3	4	5	6	7
1990-91	2,450	4,389	379	0	4,940	12,158
	(0.4)	(0.8)	(0.1)	–	(0.9)	(2.1)
1991-92	2,850	5,185	316	0	3,902	12,253
	(0.4)	(0.8)	(0.1)	–	(0.6)	(1.9)
1992-93	2,800	6,136	113	0	1,775	10,824
	(0.4)	(0.8)	–	–	(0.2)	(1.4)
1993-94	5,537	5,079	113	0	876	11,605
	(0.6)	(0.6)	–	–	(0.1)	(1.4)
1994-95	5,100	5,769	76	0	909	11,854
	(0.5)	(0.6)	–	–	(0.1)	(1.2)
1995-96	5,377	6,735	34	0	520	12,666
	(0.5)	(0.6)	–	–	–	(1.1)
1996-97	6,066	7,578	1,222	0	633	15,499
	(0.4)	(0.6)	(0.1)	–	–	(1.1)
1997-98	7,900	9,918	78	0	644	18,540
	(0.5)	(0.7)	–	–	–	(1.2)
1998-99	9,100	11,596	1,434	0	1,463	23,593
	(0.5)	(0.7)	(0.1)	–	(0.1)	(1.4)
1999-2000	9,434	13,244	1,371	0	438	24,487
	(0.5)	(0.7)	(0.1)	–	–	(1.3)
2000-01	12,060	13,800	111	0	867	26,838
	(0.6)	(0.7)	–	–	–	(1.3)
2001-02	17,499	12,595	210	0	903	31,207
	(0.8)	(0.5)	–	–	–	(1.4)
2002-03(RE)	24,200	11,009	765	6,265	2,379	44,618
	(1.0)	(0.4)	–	(0.3)	(0.1)	(1.8)
2003-04(BE)	27,800	12,720	179	8,116	1,092	49,907
	(1.0)	(0.5)	–	(0.3)	–	(1.8)

RE : Revised Estimates. BE : Budget Estimates.
Note: Figures in brackets are per cent of GDP.

Table 4.4 : Capital Expenditure of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Total Capital Expenditure (1+2)=(3+4)	62,365 (2.5)	69,827 (2.7)	60,842 (2.6)	38,414 (3.2)	31,782 (5.6)	-7,462	-10.7
1. Capital Outlay	30,345 (1.2)	40,691 (1.6)	26,558 (1.2)	14,099 ((1.2)	12,130 (2.1)	-10,346	-25.4
2. Loans and Advances	32,020 (1.3)	29,136 (1.1)	34,284 (1.5)	24,316 (2.0)	19,652 (3.5)	2,884	9.9
3. Non-Plan Capital Expenditure *of which*	20,945 (0.8)	26,640 (1.0)	21,305 (0.9)	21,062 (1.8)	15,348 (2.7)	-5,695	-21.4
Defence Capital	14,912 (0.6)	21,411 (0.8)	16,207 (0.7)	8,015 (0.7)	4,552 (0.8)	-6,499	-30.4
4. Plan Capital Expenditure (i+ii)	41,420 (1.7)	43,187 (1.7)	39,537 (1.7)	17,353 (1.5)	15,745 (2.8)	-1,767	-4.1
i) Central Plan Outlay	18,735 (0.8)	18,205 (0.7)	18,193 (0.8)	8,255 (0.7)	9,134 (1.6)	530	2.9
ii) Central Assistance for State and UT Plans	22,685 (0.9)	24,982 (1.0)	21,344 (0.9)	9,098 (0.8)	6,611 (1.2)	-2,297	-9.2

RE : Revised Estimates. BE : Budget Estimates.
Note: Figures in brackets are per cent of GDP.

considerable evidence that public investment has played a preponderant role in entrenching the conditions for higher growth. Moreover, expanding capital outlay in infrastructure has distinct salutary effects in terms of crowding in private investment. Under these circumstances, compression of capital outlay would inevitably affect asset creation and development of the physical infrastructure which holds the key to accelerated growth (Table 4.4).

Revenue Position

4.8 Various components of revenue receipts were impacted differentially by underlying macroeconomic conditions. The gap in revenue receipts *vis-a-vis* initial expectations was due to the fall in collections of direct taxes - individual income tax and corporation tax - as well as the Union excise duties. Both Union excise duties and corporation tax collections were, however, significantly higher than that in the preceding year, benefiting from the revival of industrial activity and the significant improvement in the financial performance of manufacturing companies. Customs duties benefited from the surge in import demand and posted a modest increase relative to budget estimates (Table 4.5).

4.9 The tax-GDP ratio of the Centre has suffered a steady deterioration from more than 10 per cent in the late 1980s to just about 9 per cent in 2002-03, reflecting a decline in tax buoyancy[1]. Over the Eighth and Ninth Plan periods, the buoyancy of Central taxes deteriorated from 0.9 to 0.8 mainly on account of indirect taxes; although the buoyancy in direct tax collection was maintained at 1.3, it has stagnated in recent years and has not compensated adequately for the fall in buoyancy of indirect taxes. The restructuring of both direct and indirect taxes effected since 1991-92, coupled with the structural shift in the composition of GDP towards the less-taxed services sector, appears to have affected the growth in tax revenue (Table 4.6).

4.10 Non-tax revenue remained broadly unchanged at 3 per cent of GDP in 2002-03, unresponsive to the impulses of fiscal reforms. However, the need for restructuring of public sector undertakings is critical, encompassing a thorough rationalisation of user charges and cost recoveries on the services rendered by the Government or its entities in areas such as transport, power and irrigation. The Prime Minister's Economic Advisory Council (2002) had identified establishment of rational user charges and credible regulatory

[1] Tax buoyancy is defined as proportionate change in tax collection as a ratio to proportionate change in tax base/GDP.

Table 4.5 : Total Receipts of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03) Amount	Per cent
1	2	3	4	5	6	7	8
Total Receipts	4,04,013 (16.3)	4,10,309 (16.0)	3,62,453 (15.8)	1,68,468 (14.2)	93,951 (16.5)	-6,296	-1.5
Revenue Receipts	2,36,936 (9.6)	2,45,105 (9.6)	2,01,449 (8.8)	1,10,130 (9.3)	54,954 (9.7)	-8,169	-3.3
Tax Revenue (Net)	1,64,177 (6.6)	1,72,965 (6.8)	1,33,662 (5.8)	81,939 (6.9)	42,978 (7.6)	-8,788	-5.1
Non-Tax Revenue	72,759 (2 .9)	72,140 (2.8)	67,787 (3.0)	28,191 (2.4)	11,976 (2.1)	619	0.9
Capital Receipts	1,67,077 (6.8)	1,65,204 (6.5)	1,61,004 (7.0)	58,338 (4.9)	38,997 (6.9)	1,873	1.1
Memo Items@							
Corporation Tax	44,700 (1.8)	48,616 (1.9)	36,609 (1.6)	16,487 (1.4)	5,335 (0.9)	-3,916	-8.1
Income Tax	37,300 (1.5)	42,524 (1.7)	32,004 (1.4)	15,592 (1.3)	5,371 (0.9)	-5,224	-12.3
Customs Duty	45,500 (1.8)	45,193 (1.8)	40,268 (1.8)	35,757 (3.0)	20,644 (3.6)	307	0.7
Union Excise Duty	87,383 (3.5)	91,433 (3.6)	72,555 (3.2)	40,187 (3.4)	24,514 (4.3)	-4,050	-4.4

RE : Revised Estimates. BE : Budget Estimates.
@ Memo items are on gross basis which include States' share.
Note : Figures in brackets are per cent of GDP.

Table 4.6 : Gross Tax Revenue of the Centre

(Per cent of GDP)

Years	Major Taxes: Income Tax	Corporation Tax	Excise Duties	Customs Duties	Gross Tax Revenue
1	2	3	4	5	6
1990-91	0.9	0.9	4.3	3.6	10.1
1991-92	1.0	1.2	4.3	3.4	10.3
1992-93	1.1	1.2	4.1	3.2	10.0
1993-94	1.1	1.2	3.7	2.6	8.8
1994-95	1.2	1.4	3.7	2.6	9.1
1995-96	1.3	1.4	3.4	3.0	9.4
1996-97	1.3	1.4	3.3	3.1	9.4
1997-98	1.1	1.3	3.2	2.6	9.1
1998-99	1.2	1.4	3.1	2.3	8.3
1999-00	1.3	1.6	3.2	2.5	8.9
2000-01	1.5	1.7	3.3	2.3	9.0
2001-02	1.4	1.6	3.2	1.8	8.1
2002-03(RE)	1.5	1.8	3.5	1.8	9.0
2003-04(BE)	1.6	1.9	3.5	1.8	9.2

RE : Revised Estimates. BE : Budget Estimates.

authorities as the two critical features on which the success of infrastructure development will depend. The rationalisation of user charges covers utilities such as power, water and transport. User charges could be index-linked to input cost and a process of periodic revision should be automatic (Box IV.2).

4.11 The disinvestment programme made some progress during 2001-02 with the strategic sale process of some public sector undertakings gaining momentum; nevertheless the actual proceeds were lower than the targeted amount. In 2002-03, the disinvestment process remained below expectations. A major challenge facing the programme of public sector restructuring has been the closing down of persistently loss making and non-viable public sector undertakings (PSUs) so that the profitability of the other public enterprises could be a major source of resource generation to provide budgetary support. The stage is set for reforms in the PSUs by restructuring of potentially viable PSUs and improving the profitability and efficiency of the viable units. Priorities in reforms include raising return on investments in PSUs and infusing professionalisation in management (Box IV.3).

Box IV.2

Pricing Policy for Public Services : The Dilemma of User Charges

The success of ensuring the critical physical infrastructure in the country depends on levying affordable and adequate user charges. In sectors like roads, telecommunications and ports where it has been possible to identify and levy proper user charges, overall growth has been noteworthy. Despite the well-known benefits of rationalising user charges to reflect true economic costs, progress in this direction has been impeded mainly by political economy considerations and the acute lack of the enabling legal architecture.

Taxation to cover the deficit is generally not favoured as an alternative to the raising of user charges. It is regarded as inequitable since everybody - not just the users of the public service - would be charged. Furthermore, while lump sum taxation to cover the deficit would not involve efficiency loss but it would be regressive. The Ramsey rule suggests that a mark-up (over the marginal cost) set in inverse proportion to the (compensated) price elasticity of demand for the product would minimise dead weight or efficiency loss.

Another solution to the policy dilemma is to charge a two-part tariff (a flat user fee which would be equivalent to a lump sum tax and hence would not involve any resource misallocation *plus* charge per unit of service) to those availing of the public service. Such techniques are used in the case of pricing of public utilities such as telephones, electricity and water supply.

Yet another technique is to apply price discrimination, wherein the consumer is charged a price equivalent to marginal cost at the last unit but higher prices for earlier units. Given the differences in the demand schedules of consumers, this would entail differential pricing as is evident in the case of electricity charges for residential and commercial groups.

In the case of public utility regulations, pricing is typically based on the principle of covering costs plus a fair return on capital, commensurate with that in respect of other industries. This is usually the case when public services are supplied in competition with private firms (which usually price the service above marginal cost). In accordance with the Theorem of the Second Best, setting price equivalent to marginal cost would be inefficient in other (public) sectors. In such cases, prices could be set equivalent to long-run average costs plus a normal return on capital. This would ensure fair competition and prevent high cost public producers from displacing more efficient low cost private producers.

Peak-load pricing involves charging higher user charges during periods of 'excess' demand and charging the marginal operating cost during off-peak periods (as was the case in respect of telephones in India). The same principle could be applied to address congestion on (toll) roads/bridges during peak hours. The pricing of negative externalities such as pollution is rendered much more difficult by the absence of adequate relevant information. Even so, efficient pricing involves adding the 'costs' of such externalities and setting the user charge equivalent to the marginal social cost.

In India, the need to raise user charges is underscored in the pricing of telecom services where it is seen as an essential ingredient of transition from a protected market to competition. As far as water pricing is concerned, a model based on capital, operation and maintenance costs has been attempted in some areas, although studies have shown that costs of water provision exceeded recovery in nearly 76 per cent of cities and towns in India. Cross-subsidisation of electricity charges in India has acted as a regressive tax on the commercial sector. Thus, electricity companies could recover only 68.6 per cent of their cost from the consumers. Proper pricing of power alone can reduce the financial burden of the state electricity boards and render them viable. As regards the railways, the fare freight ratio (earning per passenger Km. *vis-a-vis* earning per tonne Km.) continues to be one of the lowest in the world at 0.31 in 2001-02. Revenue losses of state road transport corporations were placed at around Rs.1,950 crore in 1999-2000.

Pricing and cost recovery policies have often not taken account of the fiscal effects and the cost of public funds. Setting user charges to economically efficient levels should, therefore, be the first priority for financing the economic infrastructure. Moreover, the user charges need to cover maintenance expenditures and control the level of services usage. Pricing policy should also address social concerns relating to public utilities and their long-term commercial viability.

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Box IV.3

Disinvestment Strategies and PSU Reform

The terms, 'disinvestment' and 'privatisation', are usually used interchangeably all over the world. In actuality, while 'disinvestment' represents sale of government share holding in PSUs, 'privatisation' is a more comprehensive concept and implies denationalisation including transfer of management and control to private entities. Widespread privatisation of PSUs has been a common phenomenon in both developing and developed countries in recent years, particularly as a response to their inefficient functioning and their adverse impact on State budgets. More than 100 countries across the globe have privatised some of their state-owned enterprises.

In India, initiatives have been taken over the years to enhance the efficiency and profitability of PSUs. Early PSU reforms focused on the creation of a buffer in the form of a holding company in line with the recommendations of the Committee to Review Policy for Public Enterprises (Chairman: Arjun Sengupta, 1984). Subsequently, a system of Memorandam of Understanding (MoU), imparting clarity to PSU objectives, was put in place.

The disinvestment process in India has evolved over more than a decade. The Government of India's Interim Budget for 1991-92 contained the first explicit statement on divestiture - the proposal to divest up to 20 per cent of the Government equity in select PSUs in favour of public sector institutional investors. A Disinvestment Commission was set up in 1996 and it recommended a shift from public offerings to strategic/trade sales with transfer of management in respect of a number of PSUs. The Union Budget of 1999-2000 provided clear guidelines for the classification of PSUs as strategic (defence-related, atomic energy related, railway transport) or non-strategic. A Department of Disinvestment was constituted in 1999 as a nodal department to streamline and speed up the process of disinvestment. Since 2000-01, major policy statements on disinvestment included closing down of PSUs which could not be revived, disinvestment in all non-strategic PSUs up to 74 per cent or higher and protection of workers' interest through safety nets. The Union Budget 2002-03 announced the completion of strategic sales in seven PSUs and some government-owned hotels and indicated that the shift in approach to strategic sales of blocks of shares to strategic investors (instead of disinvestments of small lots of shares) had enhanced the price/earnings (P/E) ratios. The policy on disinvestment announced in December 2002 specifically focused, *inter-alia*, on the modernisation and upgradation of PSUs, creation of new assets, generation of employment, retiring of public debt, setting up a Disinvestment Proceeds Fund and avoiding the emergence of private monopolies consequent upon disinvestment. The Union Budget 2003-04 has viewed the disinvestment process as a means for unlocking the productive potential of the PSUs and for reorienting the Government away from business and towards the business of governance.

Reforms in PSUs have varied across industries in India. The reform process in the power sector has envisaged privatisation of distribution, segregation of concentrated zones of high load density, competitive market structure and multi-tier regulation. The process, however, remains far from complete. Liberalisation of the telecommunication sector is substantially complete with the enactment of the National Telecom Policy 1994, setting up of the Telecom Regulatory Authority of India (TRAI) in 1997 and the New Telecom Policy 1999 which has enabled the opening up of almost all telecom services to the private sector. The oil sector has also completed the first round of disinvestment but the major stake is still with the Government.

Out of 62 PSUs considered for disinvestment by the Disinvestment Commission, the Central Government has so far taken decisions to divest 49 PSUs. Out of 919 State PSUs, the process of disinvestments/winding up/ restructuring has been initiated for 221 units and the process of privatisation has been completed for 33 units. Realisation through disinvestment during 1991-2003 stood at Rs.29,488 crore for the Centre as against a target of Rs.78,300 crore, *i.e.,* an achievement of about 38 per cent of the target.

References

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Overall deficit

4.12 The revised estimates for 2002-03 posted moderate slippages in the key indicators of the budgetary gap as initial expectations of higher growth in revenue collections and enhanced realisation from disinvestments were belied (Table 4.7).

4.13 The persistence of fiscal stress limits the manoeuverability in revenue and expenditure policy and thereby restricts the scope of fiscal policy as a counter-cyclical tool. The committed nature of the expenditure and rigidities in the revenue side impede fiscal discretion in the context of the downturn phase of the business cycle (Box IV.4).

Table 4.7 : Deficit Indicators of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Gross Fiscal Deficit	1,45,466	1,35,524	1,40,955	60,243	44,632	9,942	7.3
	(5.9)	(5.3)	(6.1)	(5.1)	(7.8)		
Revenue Deficit	1,04,712	95,377	1,00,162	29,731	18,562	9,335	9.8
	(4.2)	(3.8)	(4.3)	(2.5)	(3.3)		
Gross Primary Deficit	29,803	18,134	33,495	10,198	23,134	11,669	64.3
	(1.2)	(0.7)	(1.5)	(0.9)	(4.1)		

RE : Revised Estimates. BE : Budget Estimates.

Note: Figures in brackets are per cent of GDP.

Box IV.4

Fiscal Stress and the Counter-Cyclical Policy

Fiscal policy influences economic activity through the operation of built-in or automatic stabilisers or through discretionary fiscal policy measures. In the short-run, automatic stabilisers, both on the revenue (progressive taxation) and expenditure side (unemployment insurance programme), would come into operation, ensuring efficiency in the system. Thus, in times of economic slowdown, the ideal policy stance is to accommodate a higher fiscal deficit since any effort to achieve a balanced budget target would turn out to be pro-cyclical. The problem with automatic stabilisers is, however, the persistence of 'deficit bias' as observed in several European countries. These countries adopted an expansionary fiscal stance in the times of slowdown but failed to restrict the expenditure in phase of recovery. It is also a fact that automatic stabilisers are more relevant only in industrialised economies with respect to the response of revenues to cyclical fluctuation in output. In developing countries, discretionary fiscal policy embodied in expenditure policies ensures effective counter cyclical response in times of slowdown. The basic theoretical underpinnings of the role of discretionary fiscal policy in stabilising the economy lie in the Keynesian framework where the government expenditure help the recovery of economic activity through revival of aggregate demand and multiplier effects.

The emergence of the European Monetary Union (EMU) represents a milestone in the historical evolution of fiscal policy. Its 'Stability and Growth Pact' seeks to strengthen the way for automatic stabilisers and balanced or surplus budgets as they would avoid structural deficits and consequent accumulation of the public debt. Countries like US, Japan and France reinforced the automatic stabilisers through an easy stance of fiscal policy in the 1990s recession. The tight stance of discretionary fiscal policy in some of the countries in the European Union, in fact, delayed the recovery from the 1993 recession. Countries like UK, Sweden and France have eased fiscal policy during the recession and tightened later. They achieved success in stabilising the economy but at the cost of fiscal positions that were weak in 1999 with substantially high debt-to-GDP ratios. In the US, on the other hand, fiscal policy acted as a powerful complement to automatic fiscal stabilisation and the desired result of stabilisation was achieved with a better debt position.

The fiscal position in India is marked by the persistence of the deficit. The structure of Government expenditure is skewed towards non-productive sectors. Committed expenditure like interest payments and wages and salaries has risen, leaving little scope for the Government to direct resources towards developmental and productive channels. The sluggish trend in revenues as also the committed nature of expenditure has constrained the use of fiscal policy to counter the slowdown in the economy. Empirical studies have shown that the fiscal deficit in India is mainly of a structural type and the cyclical component is negligible. The presence of a large structural deficit implies less scope for relying on automatic stabilisers.

References

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2. Noord, Paul van den (2002). Automatic Stabilisers in the 1990s and Beyond in Buti, Hagen and Matinez-Mongay (2002).
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STATE GOVERNMENT FINANCES, 2002-03[2]

4.14 In recent years, the focus of fiscal reform has turned sub-national. It is increasingly recognised that it is the State finances where the government sector's interface with the people is most significant. Issues in the reform of fiscal policy in the States have a direct bearing on the quality of life.

4.15 The growth of revenue receipts of States during 2002-03 over the previous year was facilitated mainly by a rise in States' own taxes and grants from the Centre. Tax revenues were, however, affected by the slowing of activity in the wake of the drought. There were shortfalls in the States' own revenue receipts (tax and non tax revenue) as well as in States' share in Central taxes in the revised estimates *vis-a-vis* budget estimates. In the States' own taxes, the decline was mainly on account of sales tax collection; both States' property taxes and income taxes exceeded the budget estimates. Under States' non-tax revenue, receipts from State lotteries and interest receipts were lower in the revised estimates, while dividend and profits exceeded the budget estimates. Capital receipts of the States were higher on account of a rise in market borrowings and special securities issued to the National Small Saving Fund (Table 4.8).

4.16 Total expenditure in the revised estimates exceeded budget projections in 2002-03 on account of higher capital expenditure which rose to constitute one fifth of total expenditure of States. The increase in capital expenditure was mainly due to increases in the repayment of loans to the Centre and financial institutions reflecting the retirement of high cost debt owed to the Centre under the debt-swap scheme. Capital outlay in the revised estimates for 2002-03, however, fell short of budget estimates (Table 4.9).

4.17 The revised estimates for 2002-03 indicate deviations in all major deficit indicators of State finances, with significant slippages in the revenue deficit as well as the primary deficit. Gross fiscal deficit was also higher in the revised estimate as compared with the budget estimates (Table 4.10).

Table 4.8 : Total Receipts of States

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03) Amount	Per cent
1	2	3	4	5	6	7	8
Total Receipts (1+2)	4,37,292 (17.7)	4,25,655 (16.6)	3,80,106 (16.6)	1,80,433 (15.2)	91,160 (16.0)	11,637	2.7
1. Revenue Receipts (a+b)	2,93,873 (11.9)	3,06,844 (12.0)	2,55,599 (11.1)	1,36,803 (11.5)	66,467 (11.7)	-12,971	-4.2
a) Tax Revenue	2,02,518 (8.2)	2,15,049 (8.4)	1,80,275 (7.9)	92,913 (7.8)	44,586 (7.8)	-12,531	-5.8
States Taxes	1,49,358 (6.0)	1,52,590 (6.0)	1,31,710 (5.7)	63,865 (5.4)	30,344 (5.3)	-3,232	-2.1
Sharable Taxes	53,160 (2.2)	62,459 (2.4)	48,565 (2.1)	29,048 (2.4)	14,242 (2.5)	-9,299	-14.9
b) Non-Tax Revenue	91,355 (3.7)	91,795 (3.7)	75,324 (3.3)	43,891 (3.7)	21,881 (3.8)	-440	-0.5
Grants	55,401 (2.2)	54,008 (2.2)	43,048 (1.9)	20,996 (1.8)	12,643 (2.2)	1,393	2.6
States Own Non-Taxes	35,954 (1.5)	37,787 (1.5)	32,276 (1.4)	22,895 (1.9)	9,238 (1.6)	-1,833	-4.9
2. Capital Receipts	1,43,419 (5.8)	1,18,811 (4.6)	1,24,507 (5.4)	43,630 (3.7)	24,693 (4.3)	24,608	20.7

RE : Revised Estimates. BE : Budget Estimates.
Note : Figures in brackets are per cent of GDP.
Source : Budget Documents of State Governments.

[2] Provisional data based on the Budget Documents of 28 State Governments and the NCT Delhi, of which three are Vote-on-Account.

Table 4.9 : Total Expenditure of the States

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Total Expenditure (1+2)	4,42,609 (17.9)	4,30,842 (16.8)	3,77,555 (16.4)	1,77,584 (14.9)	91,088 (16.0)	11,767	2.7
1. Revenue Expenditure *of which*	3,55,175 (14.4)	3,55,159 (13.9)	3,14,833 (13.7)	1,45,004 (12.2)	71,776 (12.6)	16	0.0
Social Services	1,19,039 (4.8)	1,20,698 (4.7)	1,07,655 (4.7)	53,607 (4.5)	27,962 (4.9)	-1,659	-1.4
Economic Services	72,803 (2.9)	70,409 (2.8)	65,889 (2.9)	35,669 (3.0)	20,892 (3.7)	2,394	3.4
2. Capital Expenditure *of Which*	87,434 (3.5)	75,683 (3.0)	62,722 (2.7)	32,580 (2.7)	19,312 (3.4)	11,751	15.5
Capital Outlay	41,600 (1.7)	43,619 (1.7)	32,206 (1.4)	18,495 (1.6)	9,223 (1.6)	-2,019	-4.6

RE : Revised Estimates. BE : Budget Estimates.

Note : Figures in brackets are per cent of GDP.

Source : Budget Documents of State Governments.

4.18 A key issue in redrawing of boundaries between the public and the private sectors from the societal point of view is the physical and social infrastructure which provides the wherewithal for a durable improvement in standards of livelihood and significantly impacts the health of the State finances. In this regard, power sector reforms have assumed critical importance in recent years. The States of Andhra Pradesh, Delhi, Haryana, Karnataka, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh and Uttaranchal have enacted State Electricity Reform Acts providing, *inter alia*, for unbundling/ corporatisation of State Electricity Boards (SEBs). Twenty one States have either constituted or notified the constitution of State Electricity Regulatory Commission (SERC). Twenty five States have signed tripartite agreements envisaged under the scheme for one-time settlement of outstanding dues payable by the SEBs to the Central Public Sector Undertakings (Box IV.5)

Table 4.10 : Major Deficit Indicators of State Governments

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Gross Fiscal Deficit	1,16,730 (4.7)	1,02,882 (4.0)	95,986 (4.2)	31,426 (2.6)	18,787 (3.3)	13,848	13.5
Revenue Deficit	61,302 (2.5)	48,314 (1.9)	59,233 (2.6)	8,201 (0.7)	5,309 (0.9)	12,988	26.9
Primary Deficit	42,584 (1.7)	30,629 (1.2)	33,497 (1.5)	9,494 (0.8)	10,132 (1.8)	11,955	39.0

RE : Revised Estimates. BE : Budget Estimates.

Note : Figures in brackets are per cent of GDP.

Source: Budget Documents of State Governments.

Box IV.5

Issues in Sub-National Fiscal Reforms

Fiscal reform at the State level has assumed critical importance in recent years and there is a heightened sensitivity all around, displayed in conscious policy decisions. In this context, it is important to take note of certain constraints faced by the States in achieving their fiscal goals. A large proportion of expenditure is of a committed nature. Declining buoyancies in tax and non-tax receipts, competitive sales taxes and related concessions have affected their financial position. Internal resource mobilisation by the States has been further constrained by losses incurred by the State Public Sector Undertakings, especially electricity boards and transport undertakings.

Many States have initiated measures such as setting up of consolidated sinking fund, guarantee redemption fund, statutory and administrative limits on guarantees. Other important initiatives relate to the preparatory work for introduction of Value Added Tax (VAT) and rationalisation of user charges mainly relating to power, water and transport. On the expenditure front, a number of States have proposed containment of revenue expenditure through restrictions on fresh recruitment/creation of new posts and curbs on the increase in administrative expenditure. Some States have proposed introduction of a contributory pension scheme for newly recruited staff. Some States have initiated measures to provide statutory backing to fiscal reforms through enabling legislation.

In recent years, States have initiated measures pertaining to PSU reforms. Maharashtra has constituted a Board for restructuring State PSUs, while States such as Punjab and Tamil Nadu have initiated measures for constituting disinvestment commissions. In regard to power sector reforms, measures taken by the States relate to the constitution of State Electricity Regulatory Commissions (SERCs) for determining the tariff structure, unbundling of electricity boards into separate entities for power generation, transmission and distribution, increasing power tariffs, measures for reducing transmission and distribution losses.

The Centre has also initiated measures to encourage fiscal reforms at the State level. Guided by the recommendations of the Eleventh Finance Commission, the Central Government has set up an Incentive Fund for encouraging fiscal reforms in the States on the basis of a monitorable fiscal reform programme. Under this scheme, the States draw up a Medium-Term Fiscal Reforms Programme (MTFRP) aimed at bringing down the fiscal deficit to sustainable levels. The Union Budget, 2002-03 made provision for reform-linked assistance of Rs.12,300 crore for States under various schemes such as Accelerated Power Development and Reform Programme (APDRP), Accelerated Irrigation Benefit Programme (AIBP), Urban Reforms Incentive Fund (URIF), and Rural Infrastructure Development Fund (RIDF). In addition, a lump sum amount of Rs.2,500 crore was proposed for implementing policy reforms in sectors which are constraining growth and development.

COMBINED BUDGETARY POSITION OF THE CENTRE AND STATES

4.19 The combined revenue receipts of the Centre and States recorded a shortfall from the budgeted level. The rise in non-tax revenue, *albeit* marginal, was inadequate to compensate the shortfall in tax collections. The combined capital receipts increased in the revised estimates partly due to additional market borrowings by the States under the debt swap scheme to prepay the high cost debt to the Centre. The combined aggregate expenditure exceeded the budget estimates on account of higher than anticipated revenue expenditure and loans and advances, while capital outlay (capital expenditure net of loans and advances) registered a decline. Developmental expenditure rose mainly on account of increased spending in the social sector. On the other hand, non-development expenditure (excluding others) was lower than the budgeted level due to reduction in interest payments and non-developmental capital outlay. The revised estimates for 2002-03 place all the major deficit indicators of the combined Government sector (Centre and States) higher than their budgeted levels (Table 4.11).

FINANCING OF FISCAL DEFICITS

Financing of Deficit of Centre

4.20 Market borrowings have emerged as the major financing item of the gross fiscal deficit (GFD) of the Centre since the mid-1990s, with a corresponding decline in the share of other liabilities and external financing. There was net outgo under external assistance due to large repayments during 2002-03, including pre-payment of a part of external debt of the order of about Rs.13,000 crore. Another important development affecting the size of market borrowings was the transfer of the entire net proceeds collected under small saving schemes to State Governments with effect from 2002-03. The average utilisation of WMA at Rs.4,182 crore during 2002-03 was lower than that in the previous year (Table 4.12).

Table 4.11 : Indicators of Combined Finances of Centre and States*

(Rupees crore)

Items		2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03) Amount	Per cent
	Centre	1,45,466	1,35,524	1,40,955	60,243	44,632	9,942	7.3
		(5.9)	(5.3)	(6.1)	(5.1)	(7.8)		
Gross Fiscal Deficit	States	1,16,730	1,02,882	95,986	31,426	18,787	13,848	13.5
		(4.7)	(4.0)	(4.2)	(2.6)	(3.3)		
	Combined	2,48,979	2,26,864	2,26,418	77,671	53,580	22,115	9.7
		(10.1)	(8.9)	(9.9)	(6.5)	(9.4)		
	Centre	1,04,712	95,377	1,00,162	29,731	18,562	9,335	9.8
		(4.2)	(3.7)	(4.4)	(2.5)	(3.3)		
Revenue Deficit	States	61,302	48,314	59,233	8,201	5309	12,988	26.9
		(2.5)	(1.9)	(2.6)	(0.7)	(0.9)		
	Combined	1,66,014	1,43,691	1,59,395	37,932	23,871	22,323	15.5
		(6.7)	(5.6)	(6.9)	(3.2)	(4.2)		
	Centre	29,803	18,134	33,495	10,198	23,134	11,669	64.3
		(1.2)	(0.7)	(1.5)	(0.9)	(4.1)		
Primary Deficit	States	42,584	30,629	33,497	9,494	10,132	11,955	39.0
		(1.7)	(1.2)	(1.5)	(0.8)	(1.8)		
	Combined	88,492	64,442	84,048	18,598	28,585	24,050	37.3
		(3.6)	(2.5)	(3.7)	(1.6)	(5.0)		
Total Receipts (A+B)		7,46,601	7,36,538	6,55,907	2,96,629	1,52,398	10,063	1.4
A. Revenue Receipts (1+2)		4,71,600	4,90,665	4,00,229	2,17,527	1,05,757	-19,065	-3.9
1. Tax Receipts (a+b)		3,66,696	3,88,015	3,13,937	1,74,852	87,564	-21,319	-5.5
a) Direct Taxes		1,03,858	1,15,211	83,466	41,603	14,267	-11,353	-9.9
b) Indirect Taxes		2,62,838	2,72,804	2,30,471	1,33,248	73,297	-9,966	-3.7
2. Non-Tax Receipts		1,04,904	1,02,650	86,292	42,675	18,193	2,254	2.2
B. Capital Receipts (a+b)		2,75,001	2,45,873	2,55,678	79,102	46,641	29,128	11.8
a. Non-Debt Capital Receipts		14,657	19,726	18,158	6,968	3,233	-5,069	-25.7
b. Debt Capital Receipts		2,60,344	2,26,147	2,37,520	72,134	43,408	34,197	15.1
Aggregate Expenditure (4+5)		7,51,917	7,41,724	6,53,354	3,03,586	1,63,673	10,193	1.4
1. Revenue Expenditure		6,37,614	6,34,357	5,59,624	2,55,457	1,29,628	3,257	0.5
2. Capital Outlay		71,945	84,310	58,763	32,594	21,370	-12,365	-14.7
3. Loans and Advances		25,678	18,589	26,417	14,115	11,589	7,089	38.1
4. Development Expenditure		3,79,589	3,72,374	3,29,007	1,65,361	98,686	7,215	1.9
5. Non-Development Expenditure (Including others)		3,72,329	3,69,350	3,24,348	1,38,225	64,987	2,979	0.8

RE : Revised Estimates. BE : Budget Estimates.

* For States, data are provisional for the year 2001-02 onwards.

Notes :
1. Figures in brackets are per cent of GDP.
2. Combined GFD is the GFD of the Central Government plus GFD of the State Governments *minus* net lending from the Central Government to States.
3. Revenue deficit is the difference between revenue receipts and revenue expenditure adjusted for inter- Governmental transactions in the revenue account.
4. Gross primary deficit is defined as combined GFD *minus* combined interest payments.

Table 4.12 : Financing of Gross Fiscal Deficit of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Market Borrowings (Net)	1,12,865	95,859	87,724	33,087	8,001	17,006	17.7
	(77.6)	(70.7)	(62.2)	(54.9)	(17.9)		
Other Liabilities	40,799	38,895	49,126	17,031	22,103	1,904	4.9
	(28.0)	(28.7)	(34.9)	(28.3)	(49.5)		
of which							
Small Savings#	0	8,000	8,755	12,761	9,104	-8000	–
	(0.0)	(5.9)	(6.2)	(21.2)	(20.4)		
State Provident Funds	8,500	10,000	4,173	2,261	1,221	-1,500	-15.0
	(5.8)	(7.4)	(3.0)	(3.8)	(2.7)		
Special Deposits	10,280	9,898	8,070	5,295	7,716	382	3.9
	(7.1)	(7.3)	(5.7)	(8.8)	(17.3)		
External Finance @	-13,496	770	5,601	318	3,181	-14,266	–
	(-9.3)	(0.6)	(4.0)	(0.5)	(7.1)		
Draw Down of Cash Balances	5,298	–	-1,496	9,807	11,347	5,298	–
	(3.6)		(-1.1)	(16.3)	(25.4)		

RE : Revised Estimates. BE : Budget Estimates.

\# Since 2002-03 all the net amount collected through small savings is transferred to States/UTs.

@ As against net external assistance of Rs.770 crore budgeted in 2002-03, the revised estimates show that net external assistance would be negative at Rs.13,496 crore due to higher repayments/prepayment of Rs.25,210 crore than the budgeted amount of Rs.10,563 crore.

Note : Figures in brackets are per cent of GFD.

Source : Budget documents, Government of India.

4.21 Among domestic sources, amounts mobilised through small savings and provident funds have generally been at a higher cost than market borrowings through dated securities. Though interest rates have converged since the late 1990s, the cost of small savings continues to be higher than that of market borrowings considering the tax concession available on these funds. The average interest rate on overall public debt of the Centre shows a declining trend since 2000-01, reflecting the fall in the cost of raising funds in the gilt market (Table 4.13)

Financing of States' Deficit

4.22 The share of market borrowings in financing the GFD of the States has steadily increased. The share of small saving receipts (special securities issued to the NSSF) remained the major source of financing. The share of loans from the Centre was lower in the revised estimates reflecting repayments by States under the debt-swap scheme (Table 4.14).

DOMESTIC PUBLIC DEBT

Debt Position of the Central Government

4.23 The widening fiscal gap has led to a steep rise in the outstanding liabilities of the Government. Of the outstanding domestic debt of the Central Government, internal debt (including special securities issued *in lieu of* small savings outstanding as at end March 1999) alone accounted for 66.4 per cent and 'other liabilities', which comprise small savings and provident funds accounted for 29.9 per cent at the end of March, 2003. The sharp increase in the debt-GDP ratio since the mid-1990s is reflected in burgeoning interest payments, despite a decline in interest rates. This essentially represents the overhang of outstanding liabilities contracted at high interest cost in the past. This has created a vicious circle of high debt leading to higher interest payments, which in turns leads to higher deficit, higher borrowings and higher debt.

Table 4.13 : Average Interest Rate on various Components of Outstanding Liabilities of the Centre#

(Per cent)

Year	Internal Debt@	*of which* Market Loans	Small Savings, and PFs	Other Obligations	Reserve Funds	Domestic Liabilities	External Debt*	Public Debt
1	2	3	4	5	6	7	8	9
1991-92	7.35	10.43	10.94	0.78	0.63	8.44	8.58	8.46
1992-93	7.84	10.44	10.56	0.79	0.68	8.67	9.55	8.76
1993-94	7.83	11.33	12.96	0.54	0.72	9.18	8.81	9.14
1994-95	7.80	11.94	13.67	0.46	0.90	9.30	8.50	9.22
1995-96	8.32	11.76	12.12	0.78	0.87	9.36	8.67	9.29
1996-97	8.85	11.66	13.46	0.59	1.12	9.96	8.24	9.81
1997-98	9.08	12.04	12.78	0.58	1.34	9.90	7.58	9.71
1998-99	10.24	13.09	11.27	2.14 $	1.05	10.17	7.89	10.01
1999-00	10.72	13.35	12.60	0.68	0.80	10.79	7.87	10.61
2000-01	10.89	12.99	12.04	0.64	0.34	10.27	7.55	10.11
2001-02	10.82	11.32	11.25	0.44	0.19	9.97	6.55	9.18
2002-03 RE	9.93	10.69	11.08	0.73	0.25	8.61	6.31	8.49

Rates for each component are computed by dividing the interest payments in a year by the respective outstanding liabilities of the preceding year.

* External debt is at historical exchange rates.

@ Internal debt mainly comprises market loans, treasury bills, special securities issued to the Reserve Bank, compensation and other bonds, special securities converted to marketable securities, securities issued to international financial institutions and securities against small savings.

$ The jump is partly due to interest paid on special bonds issued to oil companies in 1998-99 in *lieu* of part of their outstanding claims under the APM for petroleum products.

4.24 Another disquieting feature has been the high debt discharge obligations of the Government. The servicing of debt of the Central Government rose significantly during 2002-03. Though the elongation of the average maturity of the dated securities in the recent years has helped in curtailing the rise in

Table 4.14 : Financing Pattern of Gross Fiscal Deficit of State Governments

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Loans from the Centre	8,138 (7.0)	18,731 (18.2)	9,098 (9.5)	14,801 (47.1)	9,978 (53.1)	-10,593	-56.6
Market Borrowings	23,264 (19.9)	11,823 (11.5)	17,017 (17.7)	5,888 (18.7)	2,556 (13.6)	11,441	96.8
Special Securities issued to NSSF	49,865 (42.7)	40,179 (39.1)	37,900 (39.5)	Nil	Nil	9,686	24.1
State Provident Fund	9,656 (8.3)	10,086 (9.8)	9,923 (10.3)	4,201 (13.4)	2,489 (13.2)	-430	-4.3
Others*	25,807 (22.1)	22,064 (21.4)	22,048 (23.0)	6,536 (20.8)	3,764 (20.0)	3,743	17.0

RE : Revised Estimates. BE : Budget Estimates.

NSSF : National Small Saving Fund of the Central Government.

* Includes loans from banks and financial institutions, reserve fund, deposits and advances, *etc.*

Notes : 1. Figures in brackets are per cent of gross fiscal deficit.

2. Under the revised accounting procedure effective from 1999-2000, the States' share in small savings, which was included under 'Loan from the Centre', are treated as receipts against special securities issued to NSSF which are included under internal debt of State Governments.

Source : Budget Documents of State Governments.

Table 4.15 : Combined Liabilities and Debt-GDP Ratio

Year (end-March)	Outstanding Liabilities (Rupees crore)			Debt - GDP Ratio (in per cent)		
	Centre	States	Combined	Centre	States	Combined
1	2	3	4	5	6	7
1990-91	3,14,558	1,10,289	3,50,957	55.3	19.4	61.7
1995-96	6,06,232	2,12,225	6,89,545	51.0	17.9	58.0
2001-02	13,66,408	5,89,797	16,32,084	59.5	25.7	71.1
2002-03 (RE)	15,61,875	6,94,289	18,66,626	63.2	28.1	75.5

RE : Revised Estimates.

Note : Data regarding States are provisional.

repayments, debt servicing, on an average, accounted for more than 70 per cent of the gross market borrowings of the Central Government during the period 1990-91 to 2002-03 (Chart IV.2).

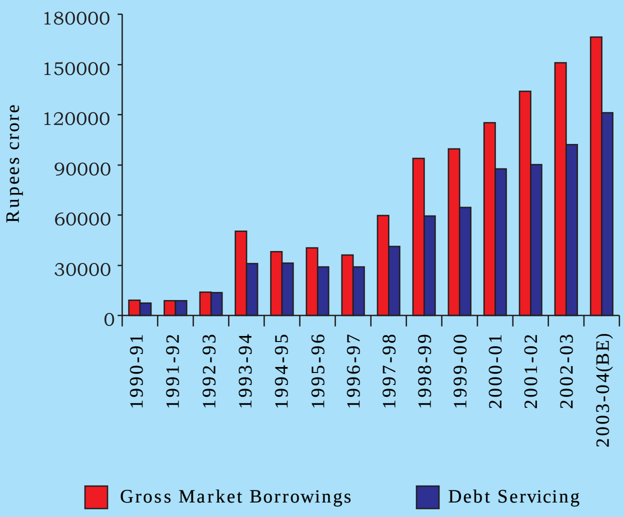
States' Debt

4.25 The high level of gross fiscal deficit have aggravated the debt position of States in recent years. The total outstanding debt of States rose by 17.7 per cent in 2002-03. The debt-GDP ratio of States rose to 28.1 per cent by end-March 2003.

Combined Debt

4.26 The combined outstanding liabilities of the Centre and the State Governments rose during 2002-03. Over the period between 1990-91 to 2002-03, outstanding liabilities of the Central and State Governments shot up by almost 15 per cent per annum (Table 4.15).

Chart IV.2 : Gross Market Borrowings and Debt Servicing of the Centre



Contingent Liabilities/Guarantees of the Government

4.27 The growing size of contingent liabilities has implications for the sustainability of Government finances. The volume of guarantees in the case of States has shown some signs of improvement in the year 2001-02. The contingent liabilities of State Governments also reflects the practice of setting up of special purpose vehicles (SPVs) to borrow from the market. Given the low user charges and inefficient operations of PSUs, these contingent liabilities are a potential threat to the stability and sustainability of the fiscal system (Table 4.16).

4.28 Many States have initiated measures to contain the growth of guarantees such as setting up of guarantee redemption funds and statutory and administrative limits on guarantees following the recommendation of the Technical Committee on State Government Guarantees (1999). Besides, some States have planned to charge guarantee commissions on outstanding guaranteed amounts. The recent Report of the 'Group to Assess the Fiscal Risk of State Government Guarantees' (2002) has made a number of recommendations to limit guarantees by the State Governments so as to contain the fiscal risk (Box IV.6)

Table 4.16 : Outstanding Government Guarantees

(Rupees crore)

Year (end March)	Centre		States		Total	
	Amount	Per cent of GDP	Amount	Per cent of GDP	Amount	Per cent of GDP
1	2	3	4	5	6	7
1992-93	58,088	7.8	42,515	5.7	1,00,603	13.4
1993-94	62,834	7.3	48,866	5.7	1,11,700	13.0
1994-95	62,468	6.2	48,479	4.8	1,10,947	11.0
1995-96	65,573	5.5	52,631	4.4	1,18,204	9.6
1996-97	69,748	5.1	63,409	4.6	1,33,157	9.7
1997-98	73,877	4.9	73,751	4.8	1,47,628	9.7
1998-99	74,606	4.3	97,454	5.6	1,72,060	9.9
1999-2000	83,954	4.3	1,32,029	6.8	2,15,983	11.2
2000-01	86,862	4.1	1,68,712	8.0	2,55,574	12.1
2001-02 (P)	95,859	4.2	1,66,116	7.2	2,62,975	11.5

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

Source : 1. Data on Centre's guarantees are sourced from Budget Documents of the Central Government.

2. Data on States' guarantees are based on the information received from State Governments and pertain to 17 major States.

Box IV.6
Fiscal Risk of State Government Guarantees

The contingent liabilities of governments have not been accorded due importance in conventional fiscal analysis. Central to fiscal stability and sustainability is the need for the fiscal risk of contingent liabilities to be recognised, identified, classified and provided for. In India, the hard budget constraint faced by State Governments has forced recourse to off-budget financing through State level undertakings or special purpose vehicles supported by guarantees, leading to their sharp rise in the second half of the 1990s. The Technical Committee on State Government Guarantees (February 1999) recommended that States fix a ceiling on guarantees; that there should be some selectivity in issuance of guarantees; and that information on guarantees should be comprehensive and disclosed in budget documents.

The Group to Assess the Fiscal Risk of State Government Guarantees was constituted to suggest, *inter alia,* a method for evaluation of the fiscal risk of State Government guarantees. The major recommendations of the Group are:

- Guarantees to be met out of budgetary resources should be identified and treated as equivalent to debt;
- For other guarantees, projects/activities need to be classified and assigned appropriate risk weights.
- Mapping of guarantees and future devolvement.
- Central financial institutions should amend their Acts/policies and do away with the practice of insisting on guarantees.
- Regular publication of data regarding guarantees in budget documents;
- State Level Tracking Unit for guarantees;
- At least one per cent of outstanding guarantees to be transferred to the Guarantee Redemption Fund (GRF) each year specifically to meet the additional fiscal risk.

THE FISCAL OUTLOOK

Union Budget, 2003-04

4.29 The Union Budget 2003-04 has accorded high priority to fiscal consolidation, with a commitment to eliminate budgetary drags and to strive for revenue enhancement under a modern tax regime. All major deficit indicators are expected to be lower than during 2002-03 (Table 4.17).

4.30 The budget envisages improvement in the buoyancy of tax receipts. The increase in tax revenue is expected to emanate from Union excise duties, corporation tax, income tax, customs duties and service tax. Of the gross tax collection, the share of States works out to 25.3 per cent. The measures envisaged to increase the tax collections are anchored on broadening the tax base and improving the compliance. This is sought to be achieved by integrating services into the tax net in a comprehensive manner through a constitutional amendment, improvements in tax administration by way of greater application of information technology, and further rationalisation of excise duties. Non-tax revenue in the form of interest receipts and dividends

Table 4.17 : Centre's Fiscal Position

(Rupees crore)

	2003-04 (BE)	2002-03 (RE)	Variation (BE over RE)	
			Amount	Per cent
1	2	3	4	5
Total Receipts/ Expenditure	4,38,795 (16.0)	4,04,013 (16.3)	34,782	8.6
Revenue Receipts	2,53,935 (9.3)	2,36,936 (9.6)	16,999	7.2
Capital Receipts	1,84,860 (6.7)	1,67,077 (6.8)	17,783	10.6
Revenue Expenditure	3,66,227 (13.3)	3,41,648 (13.8)	24,579	7.2
Capital Expenditure	72,568 (2.6)	62,365 (2.5)	10,203	16.4
Gross Fiscal Deficit	1,53,637 (5.6)	1,45,466 (5.9)	8,171	5.6
Revenue Deficit	1,12,292 (4.1)	1,04,712 (4.2)	7,580	7.2
Gross Primary Deficit	30,414 (1.1)	29,803 (1.2)	611	2.1

RE : Revised Estimates.
BE : Budget Estimates.
Note : Figures in brackets are per cent of GDP.

Table 4.18 : Receipts of the Centre

	2003-04 (BE)	2002-03 (RE)	Variation (BE over RE)	
			Amount	Per cent
1	2	3	4	5
Total Receipts	4,38,795 (16.0)	4,04,013 (16.3)	34,782	8.6
Revenue Receipts	2,53,935 (9.3)	2,36,936 (9.6)	16,999	7.2
Tax Revenue (Net)	1,84,169 (6.7)	1,64,177 (6.6)	19,992	12.2
Gross Tax Revenue	2,51,527 (9.2)	2,21,918 (9.0)	29,609	13.3
Of which:				
Corporation Tax	51,499 (1.9)	44,700 (1.8)	6,799	15.2
Income Tax	44,070 (1.6)	37,300 (1.5)	6,770	18.2
Customs Duty	49,350 (1.8)	45,500 (1.8)	3,850	8.5
Union Excise Duty	96,791 (3.5)	87,383 (3.5)	9,408	10.8
Capital Receipts	1,84,860 (6.7)	1,67,077 (6.8)	17,783	10.6
Of which				
Recoveries	18,023	18,251	-228	-1.2
Disinvestment	13,200	3,360	9,840	292.9
Market Borrowings	1,07,194	1,12,865	-5,671	-5.0
State Provident Funds	7,500	8,500	-1,000	-11.8
Special Deposits	9,970	10,280	-310	-3.0
External Finance	3,582	-13,496	17,078	–
Others	25,391	27,317	-1,926	-7.1

RE : Revised Estimates. BE : Budget Estimates.
Note: Figures in brackets are per cent of GDP.

and profits is expected to decline. Capital receipts are budgeted to show a rise mainly due to sharp increase in projected proceeds from disinvestment (Table 4.18).

4.31 The Union Budget has initiated fresh measures to contain the size of expenditure, improve cash management and accelerate the debt restructuring process. A major constraint in this endeavour is the downward inflexibility of revenue expenditure which accounts for over 70 per cent of the growth in overall expenditure anticipated in 2003-04. Non-Plan revenue expenditure comprising outflows such as interest payments, defence expenditure, and subsidies would form nearly 80 per cent of revenue expenditure. Interest payments alone would pre-empt 48.5 per cent of the revenue receipts during 2003-04. A noteworthy feature of the expenditure pattern for 2003-04 is that capital outlays are budgeted to increase, while loans and advances are expected to decline (Table 4.19).

State Budgets, 2003-04

4.32 The State Budgets for 2003-04 envisage continued efforts towards fiscal consolidation through revenue augmentation and containment of expenditure. The revenue deficit is budgeted to narrow from 2.5 per cent of GDP in 2002-03 to 1.8 per cent in 2003-04 and is expected to enable a decline in the gross fiscal deficit of the States from 4.7 per cent in 2002-03 to 4.0 per cent in 2003-04.

4.33 Revenue receipts of the States are budgeted to rise by 13.3 per cent over the previous year. A significantly high proportion of this rise (65 per cent) would be contributed by States' own revenue receipts comprising States' own tax and non-tax receipts. Thus, States' own revenue (SOR) resources are expected to finance the major portion of aggregate expenditure in 2003-04 (Table 4.20). The capital receipts of the States are budgeted to decline mainly on account of recovery of loans and advances, market borrowings and reserve funds.

Table 4.19 : Aggregate Expenditure of the Centre

(Rupees crore)

	2003-04 (BE)	2002-03 (RE)	Variation (2 over 3) Amount	Per cent
1	2	3	4	5
Total Expenditure	4,38,795	4,04,013	34,782	8.6
(1+2=3+4)	(16.0)	(16.3)		
1. Non-Plan	3,17,821	2,89,924	27,897	9.6
Expenditure	(11.6)	(11.7)		
of which:				
Interest Payments	1,23,223	1,15,663	7,560	6.5
	(4.5)	(4.7)		
Defence	65,300	56,000	9,300	16.6
	(2.4)	(2.3)		
Subsidies	49,907	44,618	5,289	11.9
	(1.8)	(1.8)		
2. Plan Expenditure	1,20,974	1,14,089	6,885	6.0
	(4.4)	(4.6)		
3. Revenue	3,66,227	3,41,648	24,579	7.2
Expenditure	(13.3)	(13.8)		
4. Capital Expenditure	72,568	62,365	10,203	16.4
	(2.6)	(2.5)		

RE : Revised Estimates BE : Budget Estimates.
Note: Figures in brackets are per cent of GDP.

4.34 The growth rate of total expenditure of States is budgeted to decelerate to 7.6 per cent from 17.2 per cent (in the revised estimates for 2002-03), reflecting the expenditure compression measures undertaken by the States. The share of developmental expenditure in total expenditure is budgeted to decline in 2003-04 mainly due to deceleration in expenditure on economic services (Table 4.21).

Table 4.20 : Revenue Receipts as a Percentage of Expenditure of States

Year	SOR as a per cent of Revenue Expenditure	SOR as a per cent of Total Expenditure	CTR as a percentage of Revenue Expenditure	CTR as a percentage of Total Expenditure
1	2	3	4	5
1990-91	55.1	43.4	37.5	29.5
1995-96	59.8	48.9	34.5	28.2
2000-01	51.3	43.0	30.4	25.5
2001-02	52.1	43.4	29.1	24.3
2002-03 (RE)	52.2	41.9	30.6	24.5
2003-04 (BE)	55.1	44.2	32.0	25.7

RE : Revised Estimates. BE : Budget Estimates.
SOR : States' Own Revenue Receipts.
CTR : Current Transfers from Centre, *i.e.,* sharable taxes and grants.
Source : Budget Documents of State Governments.

Table 4.21 : Expenditure Pattern of State Governments

(Per cent of Total Expenditure)

	2003-04 (BE)	2002-03 (RE)	2001-02	1995-96	1990-91
1	2	3	4	5	6
I. Development Expenditure (a+b)	54.8	56.0	57.4	64.7	69.5
a) Revenue	42.3	43.3	46.0	50.3	53.5
b) Capital	12.5	12.7	11.4	14.4	15.9
II. Non-Development Expenditure (c+d)	37.2	36.3	36.6	31.2	24.8
c) Revenue	36.4	35.5	36.2	30.5	24.3
d) Capital	0.8	0.8	0.4	0.7	0.5
III. Others (e+f)	8.0	7.7	6.1	4.2	5.8
e) Revenue @	1.5	1.4	1.2	0.9	1.0
f) Capital *	6.5	6.3	4.8	3.3	4.7

RE : Revised Estimates. BE : Budget Estimates.
@ Comprise compensation and assignments to local bodies, grants-in-aid contributions and reserves with finance departments.
* Comprise discharge of Internal debt and repayment of loans to the Centre.
Source: Budget Documents of State Governments.

4.35 Non-developmental expenditure of States mainly comprise three items, *viz.*, interest payments, administrative expenditure and pensions. The expenditure on these three items taken together as a percentage of revenue receipts is budgeted to show a marginal decline over the previous year (Table 4.22).

Table 4.22 : Selected Items under Non-Development Expenditure of States

(Rupees crore)

Year	Interest	Pensions	Administrative Services	Total (2+3+4)
1	2	3	4	5
1990-91	8,655	3,593	7,018	19,266
1995-96	21,932	7,813	13,391	43,136
2001-02	62,489	28,197	27,069	117,755
2002-03 (RE)	74,147	31,989	28,740	134,876
2003-04 (BE)	82,287	35,723	30,490	148,501
As a per cent of Revenue Receipts				
1990-91	13.0	5.4	10.6	29.0
1995-96	16.0	9.4	9.8	35.2
2001-02	24.4	11.0	10.6	46.1
2002-03 (RE)	25.2	10.9	9.8	45.9
2003-04 (BE)	24.7	10.7	9.2	44.6

RE : Revised Estimates. BE : Budget Estimates.
Source: Budget Document of State Governments.

Table 4.23 : Measures of Deficit of the Central and State Governments

	Rupees crore			Per cent of GDP		
Year	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit
1	2	3	4	5	6	7
1990-91	53,580	23,871	28,585	9.4	4.2	5.0
1995-96	77,671	37,932	18,598	6.5	3.2	1.6
1996-97	87,244	48,768	17,156	6.4	3.6	1.3
1997-98	1,10,743	62,782	32,466	7.3	4.1	2.1
1998-99	1,57,053	1,10,618	63,956	9.0	6.4	3.7
1999-2000	1,84,826	1,21,393	74,375	9.5	6.3	3.8
2000-01	1,99,852	1,38,803	77,885	9.5	6.6	3.7
2001-02	2,26,418	1,59,395	84,048	9.9	6.9	3.7
2002-03 (BE)	2,26,864	1,43,691	64,442	8.9	5.6	2.5
2002-03 (RE)	2,48,976	1,66,014	88,492	10.1	6.7	3.6
2003-04 (BE) @	2,51,951	1,61,300	76,463	9.2	5.9	2.8

RE : Revised Estimates. BE : Budget Estimates.

@ Per cent of GDP are worked out on the basis of the implicit nominal GDP underlying the budget estimates of the Central Government for the year 2003-04.

Combined Budgets for 2003-04

4.36 By the mid-1990s, the combined gross fiscal deficit was brought down significantly; by the end of the 1990s, however, it slipped back to pre-reform levels. The budgets for 2003-04 project all the major deficit indicators of the Government sector lower in terms of GDP. The reduction in deficit indicators in terms of GDP is envisaged through compressing the rise in expenditure and improvement in tax buoyancy (Table 4.23).

4.37 The combined revenue receipts of the Centre and States are budgeted to rise and lead to an improvement in the combined tax-GDP ratio. Developmental expenditure is estimated to register a lower expansion on account of reduction in the share of the social sector to 8.2 per cent of GDP (Table 4.24).

Financing

4.38 During 2003-04, the overall borrowing requirement (GFD) of the Centre is budgeted to rise by Rs.8,171 crore. Market borrowings would finance the major part of the GFD, 'other domestic liabilities' being the second important item of financing. On the utilisation of borrowed funds, the bulk of the GFD would continue to be used for financing the revenue deficit. (Table 4.25).

Table 4.24 : Combined Receipts and Disbursements of Central and State Governments

(Rupees Crore)

	2003-04 (BE)	2002-03 (RE)	Variations between BE and RE	
			Amount	Per cent
1	2	3	4	5
I. Total Receipts (A+B)	8,04,728	7,46,601	58,127	7.8
A. Revenue Receipts (1+2)	5,20,320	4,71,600	48,720	10.3
1. Tax Receipts	4,11,263	3,66,696	44,567	12.2
a) Direct Taxes	1,17,503	1,03,858	13,645	13.1
b) Indirect Taxes	2,93,760	2,62,838	30,922	11.8
2. Non-Tax Receipts	1,09,057	1,04,904	4,153	4.0
B. Capital Receipts	2,84,408	2,75,001	9,407	3.4
II. Total Disbursements (A+B)	8,11,321	7,51,917	59,404	7.9
A. Developmental Expenditure	3,99,926	3,79,589	20,337	5.4
B. Non-Developmental Expenditure (Including others)	4,11,395	3,72,329	39,066	10.5

RE : Revised Estimates. BE : Budget Estimates.

Table 4.25 : Financing and Decomposition of Centre's GFD

(Per cent)

Years	Financing of GFD				Decomposition of GFD		
	Market Borrowings	Other Liabilities	External Financing	91 day TB	Revenue Deficit	Capital Outlay @	Loans & Advances*
1	2	3	4	5	6	7	8
1990-91	17.9	49.5	7.1	25.4	41.6	27.2	31.2
1991-92	20.7	45.5	14.9	18.9	44.8	23.0	32.2
1992-93	9.2	47.0	13.2	30.6	46.2	29.0	24.7
1993-94	48.0	25.4	8.4	18.2	54.3	22.0	23.7
1994-95	35.2	56.9	6.2	1.7	53.8	16.1	30.1
1995-96	54.9	28.3	0.5	16.3	49.4	21.1	29.6
1996-97	30.0	45.8	4.5	19.8	48.9	20.6	30.5
1997-98	36.5	63.3	1.2	-1.0	52.2	18.7	29.1
1998-99	60.9	37.6	1.7	-0.2	59.1	11.4	29.5
1999-00	67.1	30.9	1.1	0.8	64.6	21.3	14.1
2000-01	61.4	33.3	6.3	-1.0	71.7	19.0	9.2
2001-02	62.2	34.9	4.0	-1.1	71.1	16.3	12.7
2002-03 (RE)	77.6	28.0	-9.3	3.6	72.0	18.6	9.5
2003-04 (BE)	69.8	27.9	2.3	0.0	73.1	18.9	8.0

@ Net of Disinvestment Receipts.
* Net of Recoveries of Loans.

4.39 Small savings receipts would continue to be a major source of financing the States' fiscal deficit, accounting for 58.0 per cent of GFD in 2003-04. Loans from the Centre and State provident fund are anticipated to finance 10.7 per cent and 7.0 per cent of GFD, respectively; however, the share of market borrowings is budgeted to decline to 12.4 per cent from 19.9 per cent in 2002-03. The balance is budgeted to be financed by loans from financial institutions, reserve funds, deposits and advances, *etc.*

4.40 The combined borrowings requirement (GFD) of the Centre and States has increased, on an average, by 15.3 per cent between 1990-91 and 2002-03. For 2003-04, however, the borrowings requirement is budgeted to increase moderately by 1.2 per cent (Table 4.26).

4.41 Major initiatives in fiscal consolidation are envisaged in the context of the State budgets for 2003-04. A few States have proposed to introduce a new contributory pension scheme for newly recruited employees. With regard to the value added tax, preparatory work towards its introduction is in progress. In view of the apprehensions expressed by a large number of States, the Union Budget 2003-04 envisages that the Central Government would compensate 100 per cent of the loss in the first year, 75 per cent of the loss in the second year and 50 per cent in the third year of the introduction of VAT.

4.42 The Twelfth Finance Commission which was constituted on November 1, 2002 is expected to make recommendations regarding improvement in distribution of net tax proceeds between the Union

Table 4.26 : Financing of Gross Fiscal Deficit of the Centre and States

(Rupees crore)

Year	Market Borrowings	State Provident Fund	Small Savings	External Borrowings	Others	Gross Fiscal Deficit
1	2	3	4	5	6	7
2001-02	1,04,741	14,096	43,773	5,601	58,206	2,26,417
	(46.3)	(6.2)	(19.3)	(2.5)	(25.7)	(100.0)
2002-03(BE)	1,07,682	20,086	40,000	770	58,327	2,26,865
	(47.5)	(8.9)	(17.6)	(0.3)	(25.7)	(100.0)
2002-03 (RE)	1,36,129	18,156	52,200	-13,496	55,990	2,48,979
	(54.7)	(7.3)	(21.0)	-(5.4)	(22.5)	(100.0)
2003-04 (BE)	1,20,683	16,063	60,000	3,582	51,622	2,51,950
	(47.9)	(6.4)	(23.8)	(1.4)	(20.5)	(100.0)

RE : Revised Estimates. BE : Budget Estimates.
Note : Figures in brackets are per cent of GFD.

and the States, and to review evolving principles governing grants-in-aid to the States. The Union Budget 2003-04 has proposed constitutional amendment which would enable levy of tax on services and empowerment to Central and State Governments to collect the proceeds.

4.43 Based on the recommendations of the Eleventh Finance Commission, an Incentive Fund has been instituted for the purpose of encouraging fiscal reforms in the States on the basis of a monitorable fiscal reform programme under the 'States Fiscal Reforms Facility' (2000-01 to 2004-05). Several States have drawn up Medium-Term Fiscal Reforms Programme (MTFRP) by setting targets for broad fiscal indicators in the medium term and by covering various aspects such as fiscal consolidation, public sector enterprises reform, power sector reforms and fiscal transparency. The Planning Commission is also extending support to the MTFRP by ensuring that the Annual Plan framework is consistent with it. The Twelfth Finance Commission would also review the fiscal reform facility introduced by the Central Government and suggest measures for effective achievement of its objectives.

4.44 With the passage of the revised Fiscal Responsibility and Budget Management (FRBM) Bill by the Parliament, institutional arrangements are being envisaged to achieve sound fiscal management through reduction in fiscal and revenue deficits and a phased decline in the Centre's borrowings. Recognising that there could be extraordinary circumstances caused by domestic and global factors, the revised Bill proposes fiscal targets as part of policy rules rather than enacted by legislation, in order to strike a balance between legislative intervention and the need for flexibility to deal with fiscal imperatives. At the State level, Karnataka, Punjab and Tamil Nadu have already enacted the Fiscal Responsibility legislation, while a fiscal responsibility bill has been passed by the State assembly in Kerala. A similar initiative has also been taken by Maharashtra.

Outlook

4.45 A downward inflexibility in the fiscal deficit and the corrosion of public sector outlays on the social and physical infrastructure are the dominant concerns weighing upon the fiscal stance for 2003-04. There is a gathering urgency to halt the dissaving of the public sector, embodied in the rising preemption of resources through the revenue deficit. Elimination of the revenue deficit of the Centre is now envisaged as a medium-term constitutional objective. Fiscal authorities in States which have already moved in the direction of enacting legislation for fiscal responsibility are required to take a hard option *i.e.,* attacking the earmarking of funds for current consumption expenditures. In the current phase of the business cycle, the priority attached to augmenting revenues in the context of the steady deterioration of the tax-GDP ratio has to be tempered with the need to stimulate investment demand and maintain consumption expenditures. Consequently, the thrust of efforts towards revenue mobilisation would have to be on improvements in tax administration, rationalisation of tax structures, rapidly putting in place the IT-enabled environment critical to the implementation of the VAT and widening the tax base by including services in a comprehensive manner in the tax net. Initial shortfalls observed in the cross-country experience in a VAT environment are likely to be more than counterbalanced by the lasting buoyancy gained from uniformity and stopping leakages, particularly in the context of the States.

4.46 While expenditure management would be carried forward with renewed vigour, improvements envisaged on the revenue side are expected to halt the retrenchment of capital outlays forced by the process of fiscal consolidation. The composition of public expenditure is expected to change in favour of public investment at the cost of subsidies and transfers. Public investment is envisaged in a twin role of raising the level of aggregate demand, and expanding the productive capacity of the economy, as there is compelling evidence that it is public investment which has made the predominant contribution to building human and capital stock in India and that it has been the major facilitator of private investment. 'Crowding in' properties of public investment are particularly strong in the social and physical infrastructure. Accordingly, health, housing, education, employment, agriculture and export promotion are the guiding themes of the Centre's budget for 2003-04, indicative of a shift in focus to the quality of fiscal policy. This is extended to all aspects of the ongoing consolidation, and in particular, towards ensuring the sustainability of public debt, including through pension reforms and limits on contingent liabilities - the two major risks to the progress of fiscal reforms. Pension reforms would assume priority in the coming years with the availability of a menu of schemes, diversification of risk and independent regulatory oversight. Steps are being taken to identify and provide for the fiscal risk embodied in State Government guarantees with limits imposed to restrain their growth. These structural changes are expected to impart sustainability to public debt over the medium-term.