

## **Finances of State Governments**

2.42 The deterioration in the finances of State Governments has been sharper than that of the Central Government. All the major fiscal indicators reveal a worsening of the fiscal situation as compared with the position obtaining in 1990-91. Fiscal deficit of States as a proportion of GDP increased from 3.3 per cent in 1990-91 to 4.7 per cent in the revised estimates for 2002-03. Revenue deficit witnessed a sharper deterioration from 0.9 per cent of GDP to 2.5 per cent of GDP in the same period. The factors responsible for such a deterioration include growing burden of interest payments, pension liabilities and administrative expenditure. Losses of state owned public enterprises, inappropriate user charges and deceleration in Central transfers compounded the problem. In recent years, the need for State level fiscal reforms has been well recognised. The problem of fiscal consolidation cannot be addressed unless reforms encompass both the Centre and States. With the worsening of the fiscal situation, particularly since 1998-99, a number of States have taken up fiscal reforms in right earnest.

2.43 The fiscal situation of States, which has been witnessing sharp worsening since 1998-99, improved somewhat in the years 2000-01 and 2001-02. Fiscal and revenue deficits as proportion of GDP in these years

were lower as compared with the levels obtaining in 1999-2000. Revised estimates for 2002-03, however, indicate a worsening of the fiscal deficit to 4.7 per cent of GDP from 4.2 per cent in the previous year. Despite an increase in the fiscal deficit, the revenue deficit marginally declined to 2.5 per cent in 2002-03 (RE) as compared with 2.6 per cent of GDP in 2001-02 indicating that the increase in fiscal deficit was driven by an increase in capital outlay and net lending. The capital expenditure (excluding loans and advances) of States increased from Rs.50,145 crore in 2001-02 to Rs.69,376 crore in 2002-03. The increase in fiscal deficit over the years, resulted in an increase in the outstanding liabilities-GDP ratio of States to 27.9 per cent in 2002-03 from 25.7 per cent in the previous year (Table 2.10). The growth in outstanding liabilities of State Governments is attributable to a build up of internal debt and loans from the Centre. As per the budget estimates for 2003-04, at the end of March, 2004, loans from the Centre and internal debt accounted for 31.8 per cent and 52.6 per cent of the outstanding liabilities of States, respectively. In recent years, there has been a build up of internal debt on account of higher small saving proceeds and higher market borrowings. The share of internal debt in total outstanding debt increased from 42.4 per cent at the end of March, 2002 to 52.6 per cent at the end of March, 2004.

2.44 In the State Budgets for 2003-04, fiscal and revenue deficits were placed at a lower level even in absolute terms as compared with the revised estimates for 2002-03. The budgeted reduction in fiscal deficit as proportion of GDP was from 4.7 per cent to 4.2 per cent and the reduction in revenue deficit was from 2.5 per cent to 1.8 per cent. The improvement was sought to be achieved through an increase in own tax revenue and containment of revenue expenditure (Table 2.9).

## State level reforms

2.45 A number of reform initiatives have been taken both by the Central Government and States to address the problem of fiscal consolidation at the sub national level. A few States have put in place fiscal responsibility legislations to strengthen the institutional backing for fiscal reforms. These States include Karnataka, Kerala, Punjab, Tamil Nadu and Uttar Pradesh. Based on the recommendations of the Eleventh Finance

**Table 2.9 : Receipts and disbursements of the State Governments**

|  | 1990-91 | 1998-99 | 1999-2000 | 2000-01 | 2001-02 | 2002-03<br>(RE) | 2003-04#<br>(BE) |
|--|---------|---------|-----------|---------|---------|-----------------|------------------|
| <b>(Rs. in Crore)</b>  |         |         |           |         |         |                 |                  |
| I. Total Receipts(A+B)   | 91160   | 262841  | 310775    | 349544  | 373886  | 437452          | 481225           |
| A. Revenue Receipts (1+2)  | 66467   | 176447  | 207201    | 237953  | 255675  | 294009          | 334290           |
| 1. Tax Receipts  | 44586   | 128416  | 146703    | 168715  | 180312  | 202503          | 229313           |
| of which:  |         |         |           |         |         |                 |                  |
| State's own tax revenue  | 30344   | 88995   | 102582    | 117981  | 128097  | 145141          | 166327           |
| 2. Non-Tax Receipts  | 21881   | 48031   | 60498     | 69238   | 75363   | 91506           | 104977           |
| of which:  |         |         |           |         |         |                 |                  |
| Interest receipts  | 2403    | 7478    | 9294      | 11438   | 9205    | 8869            | 9296             |
| B. Capital Receipts  | 24693   | 86394   | 103574    | 111591  | 118211  | 143443          | 146935           |
| of which:  |         |         |           |         |         |                 |                  |
| Recovery of loans & advances   | 1501    | 3302    | 3361      | 6898    | 7766    | 4186            | 3269             |
| II. Total disbursements(a+b+c)   | 91088   | 266361  | 313889    | 347199  | 377311  | 442641          | 488360           |
| a) Revenue   | 71776   | 220090  | 260998    | 291522  | 314863  | 355248          | 382616           |
| b) Capital   | 13556   | 34924   | 37359     | 43945   | 50145   | 69376           | 90344            |
| c) Loans and Advances  | 5756    | 11347   | 15532     | 11732   | 12303   | 18017           | 15400            |
| III. Revenue deficit   | 5309    | 43643   | 53797     | 53569   | 59188   | 61240           | 48326            |
| IV. Gross fiscal deficit   | 18787   | 74254   | 91480     | 89532   | 95994   | 116636          | 116175           |
| <b>(As per cent of GDP)</b>  |         |         |           |         |         |                 |                  |
| I. Total Receipts(A+B)   | 16.0    | 15.1    | 16.0      | 16.7    | 16.4    | 17.7            | 17.5             |
| A. Revenue Receipts (1+2)  | 11.7    | 10.1    | 10.7      | 11.4    | 11.2    | 11.9            | 12.1             |
| 1. Tax Receipts  | 7.8     | 7.4     | 7.6       | 8.1     | 7.9     | 8.2             | 8.3              |
| of which:  |         |         |           |         |         |                 |                  |
| State's own tax revenue  | 5.3     | 5.1     | 5.3       | 5.6     | 5.6     | 5.9             | 6.0              |
| 2. Non-Tax Receipts  | 3.8     | 2.8     | 3.1       | 3.3     | 3.3     | 3.7             | 3.8              |
| of which:  |         |         |           |         |         |                 |                  |
| Interest receipts  | 0.4     | 0.4     | 0.5       | 0.5     | 0.4     | 0.4             | 0.3              |
| B. Capital Receipts  | 4.3     | 5.0     | 5.3       | 5.3     | 5.2     | 5.8             | 5.3              |
| of which:  |         |         |           |         |         |                 |                  |
| Recovery of loans & advances   | 0.3     | 0.2     | 0.2       | 0.3     | 0.3     | 0.2             | 0.1              |
| II. Total disbursements(a+b+c)   | 16.0    | 15.3    | 16.2      | 16.6    | 16.5    | 17.9            | 17.7             |
| a) Revenue   | 12.6    | 12.6    | 13.5      | 14.0    | 13.8    | 14.4            | 13.9             |
| b) Capital   | 2.4     | 2.0     | 1.9       | 2.1     | 2.2     | 2.8             | 3.3              |
| c) Loans and Advances  | 1.0     | 0.7     | 0.8       | 0.6     | 0.5     | 0.7             | 0.6              |
| III. Revenue deficit   | 0.9     | 2.5     | 2.8       | 2.6     | 2.6     | 2.5             | 1.8              |
| IV. Gross fiscal deficit   | 3.3     | 4.3     | 4.7       | 4.3     | 4.2     | 4.7             | 4.2              |
| <p># The ratios to GDP at current market prices for 2003-04 (BE) are based on CSO's Advance Estimates released in February, 2004.</p> <p>Source : Reserve Bank of India.</p> |         |         |           |         |         |                 |                  |

| <b>Year</b> | <b>Total liabilities (Rs crore)</b> | <b>Col(2)as per cent of GDP</b> |
|-------------|-------------------------------------|---------------------------------|
| <b>1</b>    | <b>2</b>                            | <b>3</b>                        |
| 1993-94     | 160077                              | 18.6                            |
| 1994-95     | 184527                              | 18.2                            |
| 1995-96     | 212225                              | 17.9                            |
| 1996-97     | 243525                              | 17.8                            |
| 1997-98     | 281207                              | 18.5                            |
| 1998-99     | 341978                              | 19.6                            |
| 1999-2000   | 420132                              | 21.7                            |
| 2000-01     | 498092                              | 23.8                            |
| 2001-02     | 586687                              | 25.7                            |
| 2002-03(RE) | 688421                              | 27.9                            |
| 2003-04(BE) | 791400                              | 28.7                            |

**Source : Reserve Bank of India**

Commission, a monitorable fiscal reforms facility covering the years 2000-01 to 2004-05 was drawn up by the Central Government. An incentive fund of Rs.10,607 crore was earmarked to encourage States to implement fiscal reforms. Under the facility, release of incentive amount is linked to a minimum improvement of 5 percentage points in the revenue deficit-revenue receipts ratio every year with reference to the base year 1999-2000. So far, 23 States have drawn up medium term fiscal reforms programmes under the facility. Under the States' Fiscal Reforms Facility, there is also provision for additional market borrowings for meeting the structural adjustment burden.

2.46 To take advantage of the soft interest rate regime, a debt swap scheme is in operation since 2002-03. Under the scheme, mutually agreed between the States and the Centre, States are allowed to retire loans taken from the Central Government bearing a coupon rate in excess of 13 per cent. The

retirement of high cost loans will be funded through additional market borrowings and a specified percentage of small saving collections. High cost Central loans amounting to Rs.13,766 crore were retired in 2002-03, of which Rs. 10,000 crore was retired through additional market borrowings and the remaining through small saving collections. The amount retired in 2003-04 was Rs.46,211 crore. Of which, amount retired through additional market borrowings was Rs.26,623 crore and the rest through small saving proceeds. Over the three year period ending 2004-05, all the Central loans bearing coupon rate of 13 per cent and above are expected to be swapped, resulting in substantial saving in interest payments to States.

2.47 The Accelerated Power Development Programme (APDP) was redesigned as the Accelerated Power Development and Reform Programme (APDRP) in 2002-03. States can access the Fund on the basis of an agreed reform programme. The Fund has two main components, viz., an investment component for strengthening and upgrading the transmission and distribution system, and incentive component for encouraging utilities to reduce cash losses. Under the incentive component, States would be given incentive up to 50 per cent of the loss reduction by the State Electricity Boards/utilities.

2.48 Another programme linked to State level reforms was initiated by the Central Government in 2002-03 to encourage States to take up urban reforms. The Urban Reforms Fund has a corpus of Rs.500 crore per annum, to be given as additional Central assistance to States during the Tenth Plan period. The entire additional Central assistance under the Fund is being released as 100 per cent grant.