Chapter 3

Trends in Central and State Finances

3.1 In this Chapter, we have looked at some of the salient trends in central and state finances, particularly for the period since the initiation of economic reforms in the early nineties. Fiscal reforms, constituting a key element of the economic reforms, entailed significant changes in the regime of direct as well as indirect taxation during this period. The nineties also witnessed other momentous changes having a bearing on central and state finances. One critical development, following the recommendations of the Fifth Central Pay Commission, was the revision of the salaries of the central government employees. States, one after another, as if under a domino effect, agreed to implement comparable salary scales for their employees. Towards the latter half of the nineties, some of the highest nominal interest rates were witnessed, until inflation and interest rates began to fall. In the first few years of the new decade, as already discussed in the preceding chapter, the economy smarted under a severe recession, with some of the lowest nominal and real growth rates in recent years with the year 2002-03 also witnessing a severe drought. In 2000, the system of fiscal transfers also underwent a phase change when, the eightieth amendment to constitution, with the objective of facilitating tax reforms and broad-basing tax-sharing arrangements, provided for the sharing of all central taxes with limited exceptions, replacing the earlier arrangement of sharing only the income tax and the Union excise duties.

3.2 Arguably, the six years from 1997-98 to 2002-03, have had a debilitating impact on government finances. The first three years, put finances under pressure because of the salary revision and high interest rates, and the next three years, due to low growth and severe drought. With a view to providing a background to formulating our views on vertical and horizontal imbalances and the overall scheme of fiscal transfers, we have examined the salient trends in (a) central finances, (b) aggregate state finances, and (c) finances of individual states in a comparative perspective.

Trends in Central Finances

3.3 In analyzing the trends in central finances, we have focused on indicators of revenue receipts, particularly tax revenues, expenditure, in aggregate and in terms of broad categories, and debt. We examine first, however, the profile of fiscal imbalance, as it provides a summary view of the net outcome of the performance of various revenues and expenditures.

Centre: Profile of Fiscal Imbalance

3.4 We look at three indicators of fiscal imbalance: revenue deficit, fiscal deficit, and primary deficit. Revenue deficit indicates the extent to which current receipts are not able to cover revenue expenditures necessitating borrowing to finance current, not-asset building, expenditure. It represents government consumption expenditure that requires to be financed by capital receipts. These capital receipts, apart from a small portion of non-debt capital receipts, consist of net borrowing, which is called fiscal deficit. The primary deficit is equal to fiscal deficit, which represents net inflow of borrowed funds, minus interest payments, which represent outflows in the form of transfer payments. Primary deficits accumulate into debt, unless offset by an excess of GDP growth rate over interest rate. One related measure, namely, the ratio of revenue deficit to fiscal deficit, indicates the extent to which borrowing is used for current expenditures.

3.5 Table 3.1 provides the profile of different indicators of fiscal imbalance in respect of central finances from 1990-91. In comparing fiscal deficit since 1990-91, one adjustment requires to be made for figurer prior to 1999-00, when lending to the states on account of small savings was not channeled through the public account of National Small Savings Fund (NSSF) and constituted part of centre's fiscal deficit. After this adjustment, as given in Table 3.1, the fiscal deficit of the centre, first declined from 6.6 per cent in 1990-91 to 4.1 per cent in 1996-97. It started rising from 1997-98 to reach a level of 6.2 per cent of GDP in 2001-02. After that, there is a fall in centre's fiscal deficit relative to GDP. A similar profile is observed in the case of revenue deficit, which, after declining from 3.3 per cent of GDP in 1990-91 to 2.4 per cent in 1996-97, rose steadily to 4.4 per cent in 2001-02. The year 2002-03 witnessed an improvement in fiscal deficit to 5.9 per cent of the GDP due to a reduction in primary deficit, although the revenue deficit

Table 3.1
Centre:Profile of Fiscal Imbalance

(Per cent of GDP)

Year	Fiscal Deficit	Revenue Deficit	Primary Deficit	Ratio of Revenue to Fiscal Deficit(%)
1990-91	6.61	3.26	2.83	49.36
1991-92	4.72	2.49	0.65	52.72
1992-93	5.33	2.76	0.72	51.73
1993-94	6.43	3.81	2.15	59.21
1994-95	4.74	3.06	0.39	64.60
1995-96	4.23	2.50	0.02	59.16
1996-97	4.11	2.38	-0.24	58.01
1997-98	4.81	3.05	0.50	63.45
1998-99	5.14	3.85	0.67	74.78
1999-00	5.41	3.49	0.75	64.55
2000-01	5.69	4.08	0.93	71.74
2001-02	6.18	4.39	1.47	71.06
2002-03	5.87	4.37	1.10	74.36
2003-04 RE	4.77	3.60	0.27	75.59

Source: Central Budget Documents and Indian Public Finance Statistics, 2002-03
Figures for 2003-04 are revised estimates
Fiscal deficit figures exclude states' share against small savings.
Primary deficit is derived by netting interest payments from fiscal deficit.

continued almost at the same level as 2001-02. The situation seems to have improved in 2003-04 (RE), with the fiscal deficit and the revenue deficit declining to 4.8 and 3.6 per cent of GDP, respectively.

3.6 The most persistent deterioration is observed in the ratio of revenue deficit to fiscal deficit, which, by indicating the extent to which borrowed resources are used for current expenditures, shows the 'quality' of fiscal deficit. In 1990-91, this ratio was about 50 per cent. It increased steadily to 75 per cent in 1998-99. Thereafter, there was some improvement, but the ratio again increased back to the level of 75.6 per cent in 2003-04, indicating that three-fourth of borrowing has been used for current consumption in some years.

3.7 The outstanding liabilities of the centre, including the public account liabilities of the NSSF, after declining from 55.3 per cent of GDP in 1990-91 to 51.2 per cent in 1998-99, rose to 63.1 per cent in 2002-03. The liabilities as a percentage of GDP, however, declined marginally to 62.6 per cent in 2003-04 and are again expected to rise to 63.96 per cent of GDP at the end of 2004-05. However, in order to make changes in debt more consistent with fiscal deficit, it is useful to consider centre's debt after adjusting for lending to states through the NSSF against which the central government has equivalent assets in the form of securities issued by the state governments. If this is done, centre's debt from 51.2 per cent in 1998-99 would be shown to increase to 57.2 per cent in 2002-03, implying a rise of 6 percentage points. Thereafter, it is estimated to fall to about 53 per cent of GDP in 2004-05, when GDP growth rate once again became higher than the interest rate, and since the centre has been able to extinguish some of its own liabilities to the NSSF and others, on the basis of the repayments it obtained from the states under the debt swap programme. It may be noted that these estimates of debt include external debt that is evaluated at historical exchange rates. The adjustment required when external debt is evaluated at current exchange rates is discussed in Chapter IV.

Centre's Gross Tax Revenues

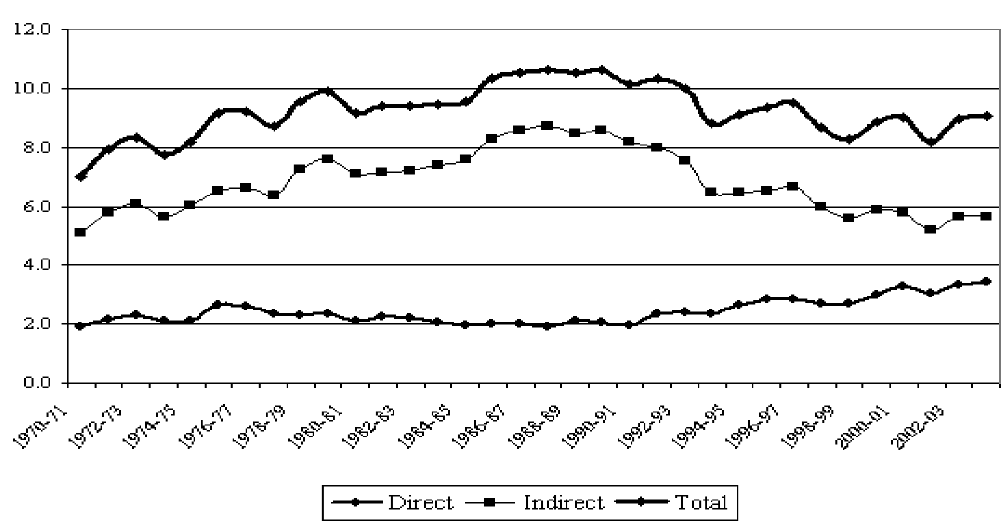
3.8 With fiscal consolidation, as one of the core objectives of economic reforms, the direct taxes, both personal and corporate income taxes, were rationalized. The number of rate categories as well as the marginal income tax rates were substantially reduced. The main central commodity taxes, i.e., Union excise duties and customs duties also underwent salient changes. In the case of customs duties, there were drastic reductions in the tariff rates across the rate categories including the peak rates. Reforms also entailed reduction in the rate categories and exemption regimes. In the case of Union excise duties, the principle of taxing the value added was adopted, first in the form of modified VAT (MODVAT) and later as central VAT (CENVAT). The impact of these reforms on direct and indirect taxes was diametrically opposite. While the direct taxes showed, even with the lower rates, a rising tax-GDP ratio, this ratio for the indirect taxes kept sliding down. The indirect taxes had a larger share in the total tax revenues of the centre and the fall in the indirect tax to GDP ratio could not be compensated by a rise in the direct taxes. As a result, the overall central tax-GDP ratio fell. Chart 3.1 shows the pattern of change in direct and indirect tax revenues of the centre relative to GDP from 1970-71, with a view to highlighting the reversal of the roles that these two types of taxes have played over the years. Prior to reforms, not only the indirect taxes contributed more, these steadily rose as percentage of GDP, while the direct taxes remained stagnant at about 2 per cent of GDP. After the nineties, the indirect taxes relative to GDP started falling, but in terms of their overall contribution, these are still higher than that of the centre's direct taxes.

3.9. Table 3.2 gives, relative to GDP, revenues from the four major central taxes, namely, corporation tax, income tax, customs duty, and Union excise duties. Considering the gross receipts from the central taxes, the tax-GDP ratio of the centre declined from 10.1 per cent in 1990-91 to 8.8 per cent in 2002-03. The major contributor to this decline was customs duty, which, relative to GDP, halved from 3.6 per cent in 1990-91 to 1.8 per cent in 2002-03. This, as already mentioned, has been on account of a phased reduction in import duty rates in the wake of WTO commitments and to become globally competitive. More serious was the decline in the ratio of excise duty collections to GDP by 1 percentage point during the same period from 4.3 per cent of GDP to 3.3 per cent. The direct tax revenues grew from 1.9 per cent of GDP in 1990-91 to 3.4 per cent in 2002-03, but the loss in the revenue from customs and excise duties did not get fully compensated, resulting in the lower tax-GDP ratio.

3.10 The main reason, among others, for the fall in the revenues from Union excise duties relative to GDP, is the reduction in the average tax rates without a compensatory rise in the tax base. With the rise in the share of service sector in GDP, it is neither feasible nor desirable to augment the ratio of domestic indirect taxes relative to GDP without fully incorporating services in the tax base. The service sector, which accounts for more than fifty per cent of GDP, has been subjected to taxation since 1994 and the scope of service tax has been

Chart 3.1

Centre's Tax-GDP Ratios: Direct to Indirect (1970-71 to 2002-03)



expanding, but the collection from service tax remains at levels below 0.5 per cent of GDP.

3.11 The composition of centre's gross tax revenues has changed in a fundamental way, as indicated in Table 3.2, in favor of corporation tax and income tax. The share of corporation tax increased from 9.3 per cent of centre's gross revenue receipts in 1990-91 to 24.7 per cent in 2003-04 RE, implying an increase of 15.4 percentage points. During the same period, the increase in income tax was 6.5 percentage points, which in 2003-04 RE accounted for 15.8 per cent of centre's gross revenue receipts. The fall during the period was 16.5 and 6.4 percentage points in customs duties and Union excise duties, respectively. It is almost point to point that the larger loss in customs duties was made up by the rise in corporation tax, and that in the Union excise duties was made up by a corresponding rise in revenues from the income tax.

Table 3.2

Major Taxes of the Centre: Performance since 1990-91

(Per cent of GDP)

Year	Corporation tax	Income Tax	Customs Duties	Union Excise Duties	Total Central Tax Revenues (Gross)
1990-91	0.94	0.95	3.63	4.31	10.12
1991-92	1.20	1.03	3.41	4.30	10.31
1992-93	1.19	1.06	3.18	4.12	9.97
1993-94	1.17	1.06	2.58	3.69	8.82
1994-95	1.36	1.19	2.65	3.69	9.11
1995-96	1.39	1.31	3.01	3.38	9.36
1996-97	1.36	1.33	3.13	3.29	9.41
1997-98	1.31	1.12	2.64	3.15	9.14
1998-99	1.41	1.16	2.34	3.06	8.26
1999-00	1.58	1.32	2.50	3.20	8.87
2000-01	1.71	1.52	2.28	3.28	9.03
2001-02	1.60	1.40	1.76	3.18	8.20
2002-03	1.87	1.49	1.82	3.33	8.76
2003-04r	2.27	1.45	1.78	3.33	9.20
Year	**As percentage of Centre's Gross Tax Revenues**				
1990-91	9.27	9.34	35.85	42.58	
1991-92	11.66	9.99	33.04	41.73	
1992-93	11.92	10.58	31.86	41.31	
1993-94	13.28	12.04	29.30	41.85	
1994-95	14.98	13.03	29.02	40.46	
1995-96	14.82	14.02	32.15	36.13	
1996-97	14.42	14.16	33.28	34.95	
1997-98	14.38	12.28	28.87	34.45	
1998-99	17.06	14.08	28.28	37.03	
1999-00	17.87	14.94	28.19	36.04	
2000-01	18.93	16.84	25.21	36.33	
2001-02	19.57	17.11	21.53	38.79	
2002-03	21.35	17.04	20.74	38.06	
2003-04r	24.71	15.80	19.36	36.24	

Source(Basic Data): Central Budget Documents and Indian Public Finance Statistics

Centre: Non Tax Revenues

3.12 The non tax revenues of the centre, which mainly comprise interest receipts, dividends from public sector undertakings (PSUs) and banks and receipts from economic services, rose from 2.11 per cent of GDP in 1990-91 to 2.98 per cent in 1992-93, but have not shown any significant increase after 1999-2000. The non tax receipts as a percentage of GDP have varied from 2.75 per cent in 1999-00 to 2.97 per cent in 2001-02, after which a declining trend is observed, mainly on account of a fall in interest receipts, as a result of the debt-swap scheme and a softening interest rate regime.

Centre: Trends in Expenditures

3.13 The total expenditure of the central government, comprising revenue and capital expenditure, after witnessing some fall relative to GDP in the first half of the nineties, started rising in 1997-98. It declined as a proportion of GDP from 18.5 per cent in 1990-91 to 14.7 per cent in 1996-97, rising thereafter to 16.8 per cent in 2002-03. The quality of expenditure has also witnessed deterioration over the years as the share of capital expenditure declined from 5.6 per cent of GDP in 1990-91 to 3.0 percent in 2002-03. The total expenditure was expected to increase to 17.1 per cent of GDP and capital expenditure to 4.02 per cent in the revised estimates for 2003-04. If, however, the prepayment of the centre's loans to NSSF from debt-swap receipts is excluded, the total expenditure would be 15.4 per cent and capital expenditure, 2.3 per cent. Revenue expenditure as a percentage of GDP declined from 12.9 per cent in 1990-91 to 11.6 per cent in 1996-97 and rose thereafter to 13.8 per cent in 2002-03.

3.14 Interest payments, subsidies, pensions and defence revenue expenditure account for 60 to 65 per cent of revenue expenditure. Interest payments form the single largest component of revenue expenditure, accounting for about 35 per cent of revenue expenditure. As a proportion of centre's revenue receipts, these accounted for about 51 per cent of centre's revenue receipts in 2002-03. Since then this ratio has come down to about 45 per cent in 2004-05 BE. With lower nominal interest rates in recent years, the average cost of market borrowings has witnessed a declining trend since 2000-01. Its effect on the total interest burden of the centre is not distinctly visible due to the growth of outstanding debt. However, in 2003-04 the debt-GDP ratio showed a fall as a result of prepayment based on repayments by the states under the debt swap arrangements.

3.15 Table 3.3 also gives details of some other major expenditures of the centre. Considering three year period averages over 1990-93 and 2000-03, Table 3.3 indicates that interest payments increased by about 0.6 percentage points of GDP, and pensions, by about 0.2 percentage points. Capital expenditure, on the other hand fell by a little less than 3 percentage points of GDP. Although subsidies show a decline, there is a need to prune these further. Table 3.4 gives more details on centre's explicit subsidies.

3.16 The main subsidies provided by the centre are food and fertilizer subsidies. More recently, the central government had also agreed, as part of the plan for dismantling the administered price regime (APR), to provide subsidies for kerosene and cooking

Table 3.3

Trends in Central Government Expenditures

(Per cent of GDP)

Year	Revenue Expenditure	Interest Payments	Pensions	Subsidies	Capital Expenditure	Total expenditure
1990-91	12.93	3.78	0.38	2.14	5.59	18.52
1991-92	12.60	4.07	0.37	1.88	4.46	17.06
1992-93	13.76	4.61	0.45	1.78	4.44	18.20
1993-94	12.59	4.28	0.39	1.35	3.92	16.51
1994-95	12.06	4.35	0.36	1.17	3.81	15.87
1995-96	11.77	4.21	0.36	1.07	3.23	15.01
1996-97	11.62	4.35	0.37	1.13	3.08	14.69
1997-98	11.84	4.31	0.45	1.22	3.40	15.24
1998-99	12.43	4.47	0.58	1.36	3.61	16.04
1999-00	12.86	4.66	0.74	1.26	2.53	15.39
2000-01	13.30	4.75	0.69	1.28	2.29	15.58
2001-02	13.21	4.71	0.63	1.37	2.67	15.88
2002-03	13.75	4.77	0.59	1.76	3.02	16.77
2003-04 (RE)	13.09	4.49	0.55	1.61	4.02	17.11
Average(1990-93)[A]	**13.09**	**4.15**	**0.40**	**1.93**	**4.83**	**17.92**
Average(2000-03)[B]	**13.42**	**4.74**	**0.64**	**1.47**	**2.66**	**16.08**
B-A	**0.32**	**0.59**	**0.24**	**-0.46**	**-2.17**	**-1.85**

Source (Basic Data): Central Budget Documents

gas for a limited period before phasing these out. Various studies have shown that many of these subsidies are ill-targeted and inefficiency promoting. In recent years, as shown by Table 3.4, the food subsidies have grown sharply rising from a level of 4.8 per cent of centre's revenue receipts in 1996-97 to 10.4 per cent in 2002-03. The volume of food subsidies depends, among other factors, on the difference between the procurement and carrying costs of food grains and the issue price for the public distribution system. While the procurement prices involve an income subsidy to the farmers, the carrying costs are dependent on the level of previous stocks as well as operational inefficiencies and wastages. The carrying costs have increased enormously since 1997-98, partly because of higher interest costs and partly due to higher salaries and wages in the FCI operations. Food subsidy has also become an indirect instrument of resource transfer to the states, depending on the location of the FCI procurements. Clearly, through this mechanism, the government is attempting to target multiple goals with a single instrument. Two changes, among other subsidy reforms, would help. First, the central government should develop a separate instrument for income support to farmers and make it more broad based in terms of coverage of crops than focusing it primarily on just producers of wheat and rice. Secondly, procurement policies should be more decentralized, with part of procurement being handled by the state governments. This would help reduce handling and operational costs and also make the indirect transfers more evenly distributed across states.

3.17 There has been a fall in the fertilizer subsidies relative to centre's gross revenue receipts, but ideally these should be reduced further. The fertilizer subsidies have undergone some reforms in recent years.

The fertilizer subsidies arose because of administered prices for purchase of fertilizers by the farmers and a retention price scheme in the case of indigenous urea fertilizer, which allowed a guaranteed return on net worth. The amount of subsidies depends on the difference between the consumer's and the retention price, and the level of production. There are subsidies also for imported urea fertilizers and sale of decontrolled fertilizers with concession to farmers. Fertilizer subsidies are input based and the benefits of the subsidy accrues more to farmers who use larger amounts of fertilizers and who also have more resources for the other complementary factors of production including water. As such, it is difficult to control and target the incidence of the benefit of the subsidy. Secondly, in so far as it relates to domestic production, it subsidizes inefficiencies of production. There is a clear need to develop an alternative instrument so that the volume of subsidy is small and its benefits better targeted. The present mechanism needs to be phased out as soon as possible.

Table 3.4

Explicit Subsidies Relative to Centre's Revenue Receipts

(per cent)

Year	Food	Fertilizer	Others	Total
1990-91	4.45	7.98	9.67	22.11
1991-92	4.32	7.85	6.39	18.56
1992-93	3.78	7.82	3.01	14.60
1993-94	7.31	6.02	1.99	15.31
1994-95	5.58	6.32	1.08	12.98
1995-96	4.88	6.12	0.50	11.50
1996-97	4.80	6.00	1.47	12.27
1997-98	5.90	7.41	0.54	13.85
1998-99	6.09	7.76	1.94	15.78
1999-00	5.20	7.30	1.00	13.49
2000-01	6.26	7.16	0.51	13.93
2001-02	8.69	6.26	0.55	15.50
2002-03	10.43	4.75	3.59	18.78
2003-04[RE]	9.58	4.48	2.93	17.00

Source (Basic Data) :Centre's Budget Documents

Centre: Some New Initiatives

3.18 Among others, three initiatives in recent years by the central government are quite important. These can play a significant role in reversing the fiscal deterioration witnessed since the late nineties. First, the central government enacted a Fiscal Responsibility and Budget Management Act, 2003 (FRBMA). The Act requires the central government to take appropriate measures to reduce the fiscal deficit and revenue deficit, so as to eliminate the latter by 2007-08 and thereafter build up an adequate revenue surplus. The target date for this has since been modified to 31st March, 2009 through the Finance Act, 2004. In terms of the Rules made under the Act, the fiscal deficit is required to be reduced to 3 per cent of GDP by 31st March, 2009. The enactment of the FRBMA provides an institutional framework and binds the government to prudent fiscal policies. For this reason, it is important that the targets set for the various fiscal parameters in the Act and the Rules are not relaxed. This will set an example for the states also. Secondly, the central government has brought about pension reforms by introducing a new pension scheme meant for new entrants to government service. Although this scheme may initially increase the expenditure on pensions, as the centre will have to make contributions to the pension fund, it will prove to be beneficial in the long run. Thirdly, the central government brought out a debt swap scheme, which has benefited the state governments and, in some way, also the central government. The states have been able to swap their high cost debt to the centre with low cost market borrowings. These additional recoveries have enabled the centre to repay some of its own high cost debt to the NSSF, among others.

3.19 In summary, the following are the main features in regard to the trends in the finances of the centre:

1. After declining in the mid-nineties, the fiscal deficit of the centre in 2001-02 was 6.2 per cent, only marginally lower than its level in 1990-91. In 2003-04 RE and 2004-05 BE, the fiscal deficit relative to GDP has shown a decline.
2. The revenue deficit relative to GDP shows a similar time profile. Having risen to a historical peak of 4.4 per cent, it is slated to come down to 2.5 per cent of GDP in 2004-05 RE. The ratio of revenue deficit to fiscal deficit has been progressively deteriorating until 2003-04 RE, when it amounted to 75.6 per cent.
3. Although centre's gross tax revenues fell from a level of 10.3 per cent of GDP in 1991-92 to 8.2 per cent in 2001-02, amounting to a fall of 2.1 percentage points, it has started improving since then.
4. The composition of central tax revenues has progressively tilted towards corporation tax and income tax. The Union excise duties still account for the single largest source of tax revenue, amounting to about 36 per cent of centre's gross tax revenues.
5. On the expenditure side interest payments and pensions relative to GDP increased during the period under review, and the burden of adjustment has mainly fallen on capital expenditure, which fell by about 2.2 percentage points during 2000-03 compared to average level during 1990-93.

The central government has taken an important step in enacting the FRBMA. It is vital that the revenue and fiscal deficit targets of the Act and the Rules are not modified and the centre sets an example for the states.

Trends in Aggregate State Finances

3.20 State finances, in their aggregate account, had only occasionally shown small revenue deficits until 1986-87. From 1987-88, state finances at the aggregate level have always been in revenue deficit. The magnitude of the deficit relative to GDP has also increased over the years since then, as state after state, rich and poor, small and large, special category and general category, increasingly slid into revenue deficit. Only a few special category states showed surplus on revenue account, but this arose from the composition of plan assistance, being ninety percent in the form of grants, adding to revenue receipts, although meant for capital expenditure, and did not signify any fiscal health.

3.21 As mentioned earlier, the six years from 1997-98 to 2002-03, have been the worst in the history of state finances. The first half of this period, saw one of the sharpest increases in the salary bill of state government employees, when as shown elsewhere in this Report, the average per employee salary increased by close to 60 per cent in a span of three years. This was also the period when central transfers, relative to GDP, fell and states were engaged in exemption-proliferating tax competition leading to a fall in the level of own tax revenue relative to GDP.

3.22 Unable to adjust their expenditure downwards, states depended more and more on borrowing to finance their revenue expenditures in a period when the nominal interest rates hit a peak. While the states finances smarted under these multiple pressures, the economy, as discussed in the preceding Chapter, went into a recession, showing some of the lowest real and nominal growth rates in the first three years of the new decade. The impact of these changes, being felt in a short span of six years, was swift and debilitating. In no other stretch of six years of the fiscal history of the states, has there been a rise of more than 10 percentage points in the debt-GDP ratio as the one, which occurred in this period where the ratio of outstanding debt to GDP increased from 21 per cent in 1996-97 to 31 per cent in 2002-03. We have analyzed below, focusing on the period 1993-03, the trends in state finances, in the aggregate as well as in a comparative perspective across states.

All-States: Contours of Fiscal Imbalance

3.23 We look at three indicators of fiscal imbalance: revenue deficit, fiscal deficit, primary deficit. Table 3.5 shows that for the states considered together the revenue deficit as percentage of GDP, comparing the averages over 2000-03 and 1993-96 was higher by a margin of 1.9 percentage points, and the fiscal deficit, by a margin of 1.5 percentage points. The primary deficit relative to GDP had reached a peak in 1999-00, but has since evinced a decline. In fact, in 1999-00, both revenue deficit and fiscal deficit had reached a peak at 4.64 and 2.82 per cent of GDP, respectively. As mentioned earlier, the outstanding debt to GDP ratio increased from 21 per cent in 1996-97 to 31 per cent in 2002-03. Comparing the average over 2000-03 with that of 1990-93, the increase amounted to about 9.4 percentage points.

Table 3.5

Aggregate State Finances: Alternative Deficit Indicators

(per cent of GDP)

Year	Revenue Deficit	Fiscal Deficit	Primary Deficit	Rev. Def. /Fisc Def.	Debt./GDP
1993-94	0.45	2.35	0.52	19.05	21.79
1994-95	0.69	2.72	0.79	25.55	21.40
1995-96	0.73	2.59	0.76	28.06	21.00
1996-97	1.31	2.77	0.90	47.37	21.00
1997-98	1.23	2.94	0.93	42.01	21.73
1998-99	2.61	4.31	2.24	60.48	23.02
1999-00	2.82	4.64	2.34	60.87	25.20
2000-01	2.61	4.16	1.69	62.60	27.42
2001-02	2.68	4.09	1.41	65.49	29.37
2002-03	2.29	3.94	1.14	58.09	31.15
Averages					
1993-96[A]	0.62	2.55	0.69	24.22	21.79
2000-03[B]	2.53	4.07	1.41	62.06	31.15
[B]-[A]	1.90	1.51	0.72	37.84	9.36

Source (Basic Data): State Finance Accounts

3.24 The ratio of own tax revenues to GDP for all states fell from 5.3 percent to 4.9 per cent in 1998-99 and was at 5.1 percent in1999-00. There was a substantial improvement in 2000-01 as most states agreed to the implementation of floor rates in sales tax and to reduce and rationalize various exemptions. In 2002-03, the states' own tax revenues as percentage of GDP had improved to 5.5 per cent. Comparing the 2000-03 average with that of 1993-96, there was an improvement of 0.17 percentage points. In the case of own non-tax revenues, there has been a downward slide. It fell from 1.6 per cent of GDP in 1993-94 to 1.2 per cent in 2001-02. Comparing the 2000-03 average to that of 1993-96 average, there is a fall of 0.3 percentage points in the own non tax revenues of the states.

3.25 In the period under review, the Finance Commission's transfers relative to GDP were the lowest in 1998-99 and 1999-2000 at 2.4 per cent and 2.5 per cent respectively. There has been an improvement since. In the case of non-Finance Commissions' transfers, the fall was even more significant. In 1993-94, non-Finance Commission transfers accounted for about 2 per cent of GDP. These fell to below 1.3 per cent in the period sine 1998-99. Together, the Finance Commission and non-Finance Commission transfers from the centre fell by about 0.44 percentage points comparing the 2000-03 average with that of 1993-96. Taking these revenue flows together, the aggregate revenue receipts of the states as percentage of GDP were the lowest in 1998-99 at 9.8 per cent. Comparing the two period averages of 1993-96 and 2000-03, there has been a fall of little less than 0.6 percentage points in the total revenue receipts of the states.

Table 3.6

Aggregate State Finances: Main Fiscal Indicators

(per cent of GDP)

Year	Own Tax Revenues	Own Non-Tax Revenues	Finance Commission Transfers	Non- Finance Commission TransfersReceipts	Total Revenue
1993-94	5.30	1.59	3.05	2.02	11.96
1994-95	5.31	1.55	2.86	1.55	11.27
1995-96	5.20	1.51	2.90	1.30	10.91
1996-97	5.01	1.47	2.94	1.29	10.71
1997-98	5.14	1.43	2.90	1.33	10.80
1998-99	4.93	1.26	2.44	1.17	9.81
1999-00	5.09	1.38	2.50	1.29	10.26
2000-01	5.46	1.37	3.02	1.20	11.04
2001-02	5.32	1.19	2.84	1.28	10.63
2002-03	5.52	1.23	2.80	1.22	10.77
Average					
1993-96[A]	5.27	1.55	2.94	1.62	11.38
2000-03[B]	5.44	1.26	2.88	1.23	10.81
[B]-[A]	0.17	-0.29	-0.05	-0.39	-0.57

Source (Basic Data): State Finance Accounts

Aggregate State Finances: Expenditure Trends

3.26 Table 3.6 shows the main trends in the all-state revenue expenditures focusing on interest payments and pensions as well as the aggregates of plan and non-plan revenue expenditures. In contrast to the trends in revenue receipts, almost all expenditure categories show perceptible increases during the period under review. These increases are particularly sharp in the case of interest payments and pensions. As far as interest payments are concerned, these rose from about 1.8 per cent in 1993-94 to 2.8 per cent in 2002-03 showing a rise of 1 percentage point in a span of 10 years. In the case of pensions also, there has been a sharp rise. In 1993-94, relative to GDP, pensions amounted to 0.6 per cent. These rose to 1.24 per cent in 2002-03, showing a rise of more than 100 per cent. Both these heads of expenditure account for transfer payments. With their claims rising in this manner, the required adjustments led to fall in plan revenue expenditure, which was at the level of 2.2 per cent of GDP in 1993-94. By 2002-03 it had fallen to a level of 1.8 per cent.

3.27 It is on account of interest payments and pensions that the total revenue expenditure increased from 12.4 per cent in 1993-94 to 13 per cent in 2002-03. Comparing the period averages of 1993-96 and 2000-03, there has been a rise of 1.34 percentage points of GDP. At the aggregate level, total revenue expenditure of all the states was at its lowest at 11.6 per cent of GDP in 1995-96. Thereafter, it increased steadily to reach a level of 13.7 per cent in 2000-01, after which it came down to 13.1 per cent in 2002-03. The increase during 1998-2001 can be attributed to the large increases in salaries and pensions due to their revision following the

Table 3.7

Aggregate State Finances: Expenditure Indicators

(per cent of GDP)

Year	Total Revenue Expenditure	Interest Payments	Pension	Plan Revenue Expenditure	Non-Plan Revenue Expenditure
1993-94	12.41	1.82	0.61	2.22	10.19
1994-95	11.96	1.92	0.63	2.06	9.91
1995-96	11.63	1.83	0.66	2.01	9.63
1996-97	12.02	1.87	0.72	2.10	9.93
1997-98	12.03	2.01	0.77	1.93	10.10
1998-99	12.41	2.07	0.93	1.99	10.43
1999-00	13.08	2.30	1.16	1.87	11.21
2000-01	13.65	2.48	1.24	1.91	11.74
2001-02	13.31	2.68	1.26	1.85	11.46
2002-03	13.06	2.80	1.24	1.81	11.24
Average					
1993-96[A]	12.00	1.86	0.63	2.09	9.91
2000-03[B]	13.34	2.65	1.25	1.86	11.48
[B]-[A]	1.34	0.79	0.62	-0.24	1.57

Source (Basic Data): State Finance Accounts

recommendations of the Fifth Central Pay Commission. Within the overall revenue expenditure, the non-plan component increased steadily from 9.6 per cent in 1995-96 to 11.7 per cent in 2000-01, after which it has been coming down.

3.28 Among the factors that have contributed to the deterioration of the state finances, a reference must be made to subsidies. Bulk of the subsidies provided by the states is implicit rather than explicit. Implicit subsidies arise when services are provided at prices that do not recover costs. Low user charges have been a universal phenomenon. Budgetary support to the power sector in particular has been an important source of drain in states where explicit subsidy for this purpose has been provided for in the budgets. However, several states do not provide subsidy, even though electricity boards may be suffering losses. Subventions received by the power sector from the state governments are estimated to be 32.8 per cent of commercial losses in 2003-04, according to the Tenth Plan document. A reform of the power sector aimed at reducing losses will be an important step in improving state finances.

3.29 The main trends relating to the aggregate state finances, comparing the average over 1993-96 with that of 2000-03 may be summarized as follows:

1. Revenue deficit of the states rose from 0.62 per cent of GDP in 1993-96 to 2.53 per cent in 2000-03, implying an increase of 1.9 percentage points.
2. Fiscal deficit of the states increased from 2.55 per cent during 1993-96 on average to about 4 per cent of GDP, implying a rise of about 1.5 percentage points.
3. Within the period from 1996-97 to 2002-03, the debt-GDP ratio of the states increased by a massive margin of 10 percentage points of GDP, rising from 21 per cent of GDP in 1996-97 to 31.2 per cent in 2002-03.
4. The own tax revenues of the states showed an increase from 5.3 per cent of GDP during 1993-96 on average to 5.5 per cent during 2000-03. But own non-tax revenues as also the central transfers relative to GDP fell during this period. The fall in transfers was mainly on account of non-Finance Comm-ission transfer.
5. On the expenditure side interest payments and pensions increased. In the case of interest payments, the rise amounted to 0.79 percentage points, rising from 1.86 during 1993-96 to 2.65 during 2000-03. In fact, if only end years 1993-94 and 2002-03 are compared, the increase is a clear one percentage point of GDP. Pensions rose by 0.62 percentage points comparing the averages for the two periods under review.

State Finances: A Comparative Perspective

3.30 In this section, we look at the relative performance of individual states in a comparative perspective. For this purpose, we have focused on the following variables: own tax revenue, revenue and capital expenditures, interest payments and pensions, revenue and fiscal deficits, and outstanding liabilities. Comparisons are made for two three-year period averages, 1993-96 and 2000-03. All variables are taken as percentages to the respective GSDPs of the states. States other than the eleven special category states (SCS) are referred to as the general category states (GCS). States of Uttar Pradesh, Madhya Pradesh, and Bihar are taken as undivided states for purposes of comparison for the entire period.

Contours of Fiscal Imbalance: Inter-State Comparison

3.31 As mentioned earlier, the aggregate revenue account of the states went into deficit in 1987-88. During the nineties, some of the individual states were still in revenue surplus. Among the general category states, Andhra Pradesh went into revenue deficit in 1994-95, Gujarat and Haryana in 1995-96, and Goa, at the top end of income scale, also went into revenue deficit in 1997-98. As shown in Table 3.8, the largest revenue deficit on average during 1993-96 was that of Orissa at 2.0 per cent of GSDP followed by Punjab, Uttar Pradesh, and West Bengal. The deficits of these states rose persistently. In the period 2000-03, there were no states of the general category showing a revenue surplus. The magnitudes of their revenue deficits were higher and their relative position had also changed. The highest revenue deficit relative to GSDP was now that of West Bengal at 5.5 per cent followed by Punjab, Orissa and Rajasthan. Among the special category states, Arunachal Pradesh, Meghalaya, and Sikkim continued to show a surplus. The deterioration in the case of general category states, comparing the 2000-03 average with that of 1993-96, was 2.33 percentage points of all-state GSDP of the general category states.

3.32 The difference between period averages of 1993-94 and 2000-03 shows that the largest deterioration in the revenue deficit to GSDP ratio was that for West Bengal followed by Orissa, Rajasthan, and Punjab. Thus, revenue deficit became high relative to GSDP for high income states like Punjab, middle income states like West Bengal, and low income states like Orissa. In fact, the states which did not show any perceptible deterioration during this period were Bihar with an increase in the revenue deficit to GSDP ratio of only 0.04 percentage point and Haryana with an increase of 0.56 percentage point.

3.33 Table 3.8 shows that the fiscal deficit among the general category states was the highest during 1993-96 in the case of Orissa, Rajasthan, Punjab, Uttar Pradesh, West Bengal, and Andhra Pradesh. During 2000-03, Orissa had become the highest fiscal deficit state among the general category states followed by West Bengal, Punjab, Rajasthan, Gujarat, and Uttar Pradesh. The average deterioration over these two periods was the largest in the case of West Bengal followed by Gujarat and Orissa.

Debt-GSDP Ratios: Comparative Position of States

3.34 Relative to all-State GSDP, as shown in Table 3.9, the outstanding liabilities had increased by nearly 12 percentage points from 1993-96 average of 24.86 per cent to the 2000-03 average of 36.7 per cent. Among the general category states, Orissa had the highest debt-GSDP ratio during 2000-03 at 63.7 per cent followed by 47 per cent for Uttar Pradesh, 46.7 per cent for Punjab, 44.9 per cent for Rajasthan, and 42.7 per cent for West

Table 3.8

Comparative Performance of States: Revenue and Fiscal Deficits

(Per cent of GSDP)

	Revenue Account [Deficit (-)]			Fiscal Account [Deficit(-)]		
States	**1993-96[A]**	**2000-03[B]**	**[B-A]**	**1993-96[C]**	**2000-03[D]**	**[D-A]**
Arunachal Pradesh	24.28	1.76	-22.51	1.48	-12.70	-14.18
Assam	-0.01	-1.90	-1.88	-2.38	-3.73	-1.34
Himachal Pradesh	-1.56	-7.28	-5.72	-6.70	-11.41	-4.71
Jammu & Kashmir	4.56	-1.82	-6.38	-3.85	-8.28	-4.44
Manipur	6.07	-2.46	-8.53	-3.02	-6.06	-3.04
Meghalaya	3.32	0.84	-2.48	-3.20	-5.28	-2.08
Mizoram	7.53	-9.07	-16.60	-5.82	-17.79	-11.96
Nagaland	-0.19	-2.12	-1.93	-5.26	-7.97	-2.71
Sikkim	8.10	11.30	3.20	-8.26	-3.42	4.84
Tripura	2.57	-0.61	-3.18	-4.04	-7.20	-3.15
Total: SCS	**1.96**	**-2.53**	**-4.49**	**-3.64**	**-7.04**	**-3.40**
Andhra Pradesh	-0.51	-2.03	-1.51	-3.16	-4.57	-1.41
Bihar	-1.83	-1.87	-0.04	-2.85	-4.52	-1.67
Goa	1.44	-2.44	-3.89	-2.30	-4.68	-2.38
Gujarat	0.10	-4.66	-4.75	-1.82	-5.74	-3.93
Haryana	-0.75	-1.32	-0.56	-2.50	-3.69	-1.19
Karnataka	-0.07	-2.21	-2.15	-2.71	-4.37	-1.65
Kerala	-1.18	-4.17	-2.99	-3.32	-5.13	-1.81
Madhya Pradesh	-0.61	-2.05	-1.44	-2.16	-3.94	-1.78
Maharashtra	-0.09	-3.09	-3.00	-2.16	-4.12	-1.96
Orissa	-2.00	-4.91	-2.91	-4.63	-7.84	-3.21
Punjab	-1.88	-4.53	-2.66	-4.37	-6.14	-1.77
Rajasthan	-1.09	-3.87	-2.78	-4.51	-6.05	-1.54
Tamil Nadu	-0.71	-2.50	-1.78	-1.99	-3.75	-1.77
Uttar Pradesh	-1.77	-2.98	-1.21	-4.04	-5.07	-1.03
West Bengal	-1.53	-5.47	-3.95	-3.18	-7.31	-4.13
Total: GCS	**-0.86**	**-3.19**	**-2.33**	**-2.93**	**-4.97**	**-2.04**
All States	**-0.72**	**-3.15**	**-2.43**	**-2.96**	**-5.08**	**-2.12**

Source (Basic Data): State Finance Accounts

Bengal. The highest deterioration during the period under review was that for Orissa at 27.5 percentage points followed by West Bengal at 19.5 percentage points, Gujarat at 16.9 percentage points, and Rajasthan at 16.6 percentage points.

3.35 The special category states had a high debt-GSDP ratio during 1993-96, the highest being that for J&K at 58 per cent, followed by 53.7 per cent for Sikkim. These ratios also increased sharply during the late 1990s. During 2000-03, the debt-GSDP ratio for Mizoram was as high as 85 per cent followed by 63.2 per cent for Sikkim, 61.8 per cent for Himachal Pradesh 56 per cent for J&K and 54.8 per cent for Arunachal Pradesh. The largest deterioration, comparing the period averages under review, was for Mizoram at 32.3 percentage points of its GSDP, followed by 19.8 percentage points, for Himachal Pradesh and 18.3 percentage points for Arunachal Pradesh, relative to their respective GSDPs.

Table 3.9

Outstanding Debt Relative to GSDP: State-wise Position

(Per cent)

States	1993-96[A]	2000-03[B]	Col.[B-A]
Arunachal Pradesh	36.48	54.82	18.34
Assam	31.40	34.75	3.35
Himachal Pradesh	41.95	61.79	19.84
Jammu & Kashmir	58.01	55.99	-2.02
Manipur	38.16	47.88	9.72
Meghalaya	24.12	38.68	14.56
Mizoram	53.05	85.29	32.25
Nagaland	42.71	49.91	7.20
Sikkim	53.65	63.24	9.59
Tripura	38.77	38.11	-0.67
Total:SCS	**39.68**	**47.17**	**7.48**
Andhra Pradesh	21.86	29.93	8.07
Bihar	36.80	44.35	7.55
Goa	41.64	33.54	-8.10
Gujarat	21.07	37.92	16.85
Haryana	19.85	28.02	8.17
Karnataka	19.62	27.27	7.65
Kerala	27.27	37.58	10.32
Madhya Pradesh	19.95	30.42	10.47
Maharashtra	15.63	27.11	11.48
Orissa	36.21	63.68	27.47
Punjab	34.55	46.66	12.10
Rajasthan	28.28	44.88	16.60
Tamil Nadu	18.87	26.16	7.29
Uttar Pradesh	33.94	46.94	13.00
West Bengal	23.26	42.73	19.47
Total: GCS	**24.12**	**36.06**	**11.94**
All States	**24.86**	**36.65**	**11.79**

Source (Basic Data): State Finance Accounts

Comparative Performance of States: Own Tax Revenues

3.36 The single positive feature in this otherwise depressing narrative of state finances was the performance of states in regard to their own tax effort. Table 3.10 shows that the tax-GDP ratio increased, considering the two period-averages over 1993-96 and 2000-03, for the groups of special category and general category states, and all the individual states except a few. The overall increase over the period-averages under review for the states as a whole was 0.67 percentage points for all states relative to the all-state GSDP, 0.66 for the SCS and 0.69 for the GCS group, relative to their respective group-GSDPs. The only exceptions in terms of individual states, where the tax-GDP ratio declined in terms of their 2000-03 averages are Goa, Karnataka, Kerala, and West Bengal, although while the first three went from high to less high, West Bengal had a somewhat lower tax-GSDP ratio even in the 1993-96 period. Among the SCS group, only Manipur has shown a decline in tax-GSDP ratio.

Table 3.10

Own Tax Revenues: Comparative Performance of States

	Average OTR/GSDP (%)			Buoyancy
States	**1993-96 [A]**	**2000-03 [B]**	**[B-A]**	**1993-03**
Arunachal Pradesh	0.55	1.47	0.91	2.543
Assam	3.69	4.58	0.90	1.326
Himachal Pradesh	4.87	5.08	0.21	1.043
Jammu & Kashmir	3.11	4.51	1.40	1.443
Manipur	1.44	1.21	-0.23	0.842
Meghalaya	3.02	3.26	0.23	1.089
Mizoram	0.59	0.97	0.38	1.608
Nagaland	1.18	1.19	0.01	0.980
Sikkim	3.44	4.58	1.15	1.303
Tripura	1.95	2.19	0.24	1.105
Total:SCS	**3.30**	**3.96**	**0.66**	**1.226**
Andhra Pradesh	5.90	7.30	1.40	1.271
Bihar	3.71	4.46	0.75	1.290
Goa	7.91	6.46	-1.45	0.806
Gujarat	7.51	7.71	0.20	1.010
Haryana	7.22	8.30	1.09	1.205
Karnataka	8.53	8.33	-0.19	0.969
Kerala	8.45	8.11	-0.34	0.946
Madhya Pradesh	4.91	6.45	1.53	1.452
Maharashtra	6.64	7.76	1.12	1.221
Orissa	3.93	5.81	1.87	1.639
Punjab	6.88	7.13	0.25	1.061
Rajasthan	5.50	6.48	0.98	1.231
Tamil Nadu	8.40	9.00	0.60	1.110
Uttar Pradesh	4.76	5.88	1.12	1.318
West Bengal	5.46	4.26	-1.20	0.690
Total: GCS	**6.26**	**6.95**	**0.69**	**1.143**
All States	**6.12**	**6.79**	**0.67**	**1.141**

Source: State Finance Accounts

3.37 During 2000-03, the highest tax-GSDP ratio was that for Tamil Nadu at 9.0 per cent of GSDP, and the lowest for West Bengal at 4.26 per cent, among the general category states. Chart 3.2 shows the tax-GSDP ratios of the general category states along with Assam. States are arranged in ascending order of per capita comparable GSDP (average over 1999-2002). A logarithmic trend line has also been shown. The pattern does show a positive relationship, and would have been even better, but for the exceptions of Punjab and Goa at the higher income end, West Bengal, in the middle range, and Assam and Bihar, at the lower per capita GSDP end. These states, in terms of the tax-GSDP ratio have performed below the par set by other states in their neighborhood in terms of the level of per capita GSDP.

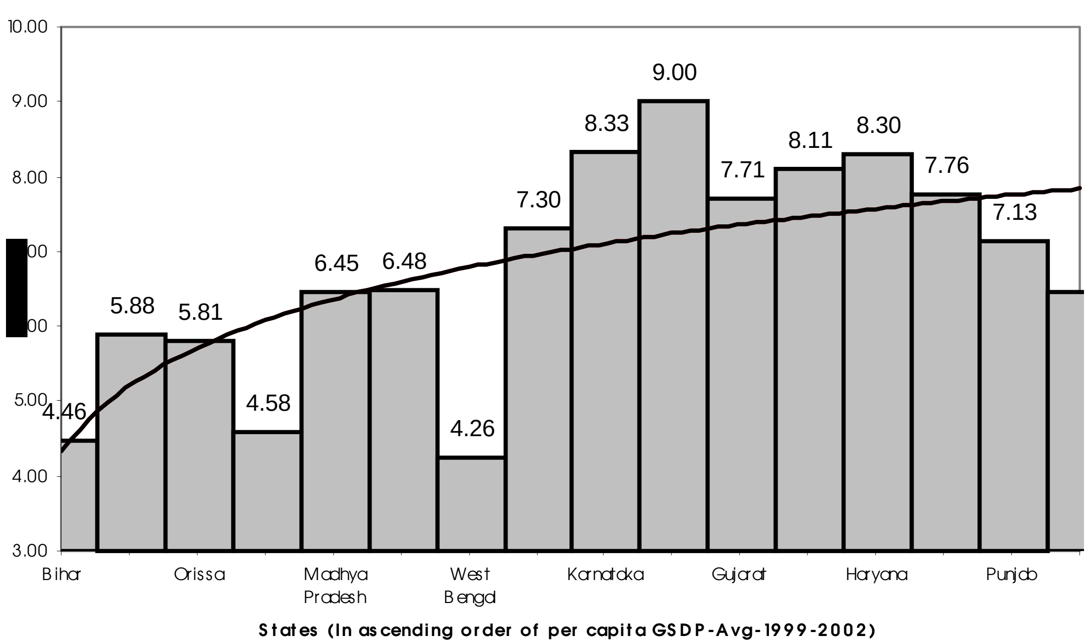
3.38 Table 3.10 shows the buoyancy of own tax revenues of the states with respect to their respective per capita GSDPs, which indicates the extent of increase in own tax revenues following a one per cent change in per capita comparable GSDP, taking the latter as a macro indicator of the tax base. The tax-buoyancy has been estimated over the period 1993-2003. If the states with a low tax-GSDP ratio have a high buoyancy, they would find improvement in their tax-GSDP ratios over time. If the tax-buoyancy is less than 1, the tax-GSDP ratio would fall over time. Subject to adjustment for levels of per capita GSDPs, it would be desirable if states at the lower end of the chart show higher buoyancy. In this sense, the states at the lower to middle income ranges, with the exception of West Bengal, do show an improving picture.

Comparative Performance of States: Expenditures

3.39 In respect of revenue expenditures relative to GSDP levels, comparing

Chart 3.2

State's Own Tax Revenues Relative to GSDP (2000-03)



averages over the two periods, viz., 1993-96 and 2000-03, Table 3.11 shows a general upward trend. The corresponding ratio for capital expenditure, however, shows a change in the reverse direction. For the SCS group, there is an increase of 1.4 percentage points between the two period averages. Among the general category states, the largest increase in the ratio of revenue expenditure to GSDP are in respect of Gujarat (5.9 per cent) and Orissa (5.7 per cent). The states where this increase is least are Goa (0.1 per cent) and Haryana (0.4 per cent). The main reason for the increase in revenue expenditure in relation to GSDP can be attributed to the increases in salaries and pensions during the period as well as on account of an increasing debt servicing burden.

3.40 Looking at the levels of revenue expenditures relative to GSDP, the average for 2000-03 indicates that for the SCS group the ratio is about 10 percentage points higher than that for the general category states. In this group, Orissa has an exceptionally high ratio at 22.2 per cent. At the lower end, we have Haryana at 13.5 per cent and Maharashtra at 14.1 per cent, which are the only states below 15 per cent.

3.41 Expectedly, the increase in revenue expenditure has led to a fall in capital expenditure with special category states displaying the larger reduction in capital expenditure to GSDP ratio between 1993-96 and 2000-03, comparing group to group. In the GCS group, Orissa has the highest level of capital expenditure at 3.2 per cent in 2000-03 while Kerala has the lowest at 1.1 per cent.

3.42 Table 3.12 shows comparisons over the two period-averages under review for two other important ratios, namely, interest

Table 3.11

States: Comparative Trends in Expenditure

(Per cent of GSDP)

	Revenue Expenditure			Capital Expenditure		
States	**1993-96[A]**	**2000-03[B]**	**[B-A]**	**1993-96[C]**	**2000-03[D]**	**[D-A]**
Andhra Pradesh	13.47	15.56	2.08	3.87	2.93	-0.94
Bihar	16.50	18.11	1.60	1.04	2.67	1.63
Goa	17.11	17.25	0.13	3.86	2.33	-1.54
Gujarat	12.52	18.37	5.85	2.37	2.43	0.06
Haryana	13.06	13.45	0.39	2.33	2.52	0.18
Karnataka	13.96	15.33	1.36	3.08	2.44	-0.64
Kerala	14.93	16.11	1.18	2.23	1.07	-1.16
Madhya Pradesh	13.29	16.74	3.45	1.90	2.37	0.47
Maharashtra	10.68	14.10	3.42	2.56	1.47	-1.09
Orissa	16.49	22.22	5.74	2.83	3.23	0.40
Punjab	12.75	15.33	2.59	2.65	2.11	-0.54
Rajasthan	15.43	18.06	2.63	3.89	2.30	-1.59
Tamil Nadu	13.95	15.60	1.66	1.85	1.51	-0.34
Uttar Pradesh	14.28	16.78	2.50	2.63	2.23	-0.40
West Bengal	11.80	15.02	3.23	1.78	1.94	0.16
General Category	**13.33**	**16.05**	**2.72**	**2.51**	**2.12**	**-0.38**
Special Category	**26.27**	**27.66**	**1.40**	**5.71**	**4.69**	**-1.03**
All States	**13.94**	**16.67**	**2.72**	**2.66**	**2.26**	**-0.40**

Source: State Finance Accounts

payments relative to total revenue receipts and pension expenditures relative to GSDP. In the absence of adequate availability of non-debt resources, many states relied on increased borrowing to finance the upward revision of salary scales and pensions during 1997-2000. Consequently, the debt servicing burden of states as typified by the interest payments to TRR ratio has increased to unsustainable levels. Among SCS group, IP-TRR ratio is the highest for Himachal Pradesh at 28.8 per cent during 2000-03. This state has registered the largest increase in this ratio at 12.9 percentage points over 1993-96. The increase in debt servicing burden has affected the GCS group more than the special category states. West Bengal has registered the largest increase in IP-TRR ratio in 2000-03 over 1993-96 at 24.0 percentage points. As a consequence, its IP-TRR ratio at 44.3 per cent during 2000-03 is the highest among all states. Punjab follows next at 38.5 per cent. A consistently high level of this ratio for this state during the nineties is reflected by the fact that its IP-TRR ratio was the highest at 32.1 per cent during 1993-96. Orissa and Rajasthan have also shown large increases in their IP-TRR ratios at 13.5 and 13.2 percentage points, respectively between the two periods. During 2000-03, Karnataka, undivided Madhya Pradesh, and Tamil Nadu have displayed lower levels of the IP-TRR ratios at about 18 per cent.

3.43 The phenomenal growth of pension liabilities consequent upon the revision of

Table 3.12

State Expenditure Trends: Comparative Profile

(Per cent of GSDP)

	Int. Payment/TRR			**Pension Exp./GSDP**		
States	**1993-96[A]**	**2000-03[B]**	**[B-A]**	**1993-96[C]**	**2000-03[D]**	**[D-A]**
Andhra Pradesh	14.07	22.37	8.30	1.01	1.49	0.48
Bihar	21.78	24.92	3.14	1.01	2.82	1.82
Goa	14.21	19.50	5.29	0.55	1.28	0.74
Gujarat	15.18	24.59	9.41	0.60	1.25	0.65
Haryana	15.26	23.35	8.09	0.54	1.10	0.56
Karnataka	12.08	18.07	6.00	0.92	1.42	0.50
Kerala	17.61	27.34	9.73	1.72	2.57	0.85
Madhya Pradesh	13.34	18.36	5.02	0.67	1.17	0.50
Maharashtra	11.93	20.75	8.82	0.36	0.88	0.52
Orissa	22.39	35.85	13.46	0.68	2.21	1.53
Punjab	32.13	38.51	6.38	0.64	1.62	0.98
Rajasthan	17.38	30.57	13.19	0.73	1.91	1.18
Tamil Nadu	11.98	18.61	6.63	0.93	2.11	1.19
Uttar Pradesh	22.30	28.27	5.97	0.54	1.21	0.67
West Bengal	20.34	44.33	23.98	0.61	1.44	0.83
General Category	**16.70**	**25.40**	**8.70**	**0.72**	**1.51**	**0.80**
Special Category	**13.41**	**16.98**	**3.57**	**1.11**	**2.39**	**1.28**
All States	**16.37**	**24.57**	**8.20**	**0.73**	**1.56**	**0.83**

Source: State Finance Accounts

pay scales, shows, as indicated by Table 3.12, that during 2000-03, pension liabilities as a percentage of GSDP were higher than the corresponding average over 1993-96 by 1.28 percentage point for the general category states and by 0.8 percentage points for the special category states. During 2000-03, pension expenditures relative to GSDP varied from 1 per cent to 3 per cent across all states. Among the general category states, the increase in terms of percentage points, in the ratio of pension expenditures to GSDP, was the highest for undivided Bihar (1.82), Orissa (1.53), Rajasthan (1.18) and Tamil Nadu (1.19).

3.44 In summary, in the context of evaluating the comparative performance of states in a period when they had to face the impact of the salary and pension revisions and other macroeconomic developments, some major features, comparing 1993-96 to 2000-03 averages, may be highlighted as below:

1. The revenue deficit to GSDP ratio, over the period, showed the largest increase for West Bengal, followed by Orissa, Rajasthan and Punjab. Bihar showed the least deterioration. In the case of fiscal deficit also, the largest deterioration was for West Bengal, Punjab, Rajasthan, Gujarat, and Uttar Pradesh. This list of states does indicate that the level of GSDP alone was not responsible for the deterioration and other aspects of fiscal management may have been important.

2. During 2000-03, among the general category states, Orissa had the highest debt-GSDP ratio at 63.7 per cent, followed by Uttar Pradesh at 47 per cent, Punjab at 46.7 per cent, Rajasthan at 44.9 per cent, and West Bengal at 42.7 per cent.

3. During 2000-03, the highest tax-GSDP ratio was for Tamil Nadu at 9 per cent of GSDP, and the lowest for West Bengal at 4.26 per cent. The level of GSDP does show a positive impact on the tax-GSDP ratio, but Goa and Punjab at the higher income end, West Bengal in the middle income range, and Assam and Bihar at the low income end show lower performance than what might be expected if the per capita GSDP was taken as a determinant.

4. In terms of revenue expenditure relative to GSDP, comparing the two period averages, the largest increases are those for Gujarat and Orissa, and the lowest increases are for Goa and Haryana.

5. In terms of pension expenditures, the largest increase relative to GSDP, comparing the two period-averages, are for Bihar, Orissa, Rajasthan, and Tamil Nadu.

The presence of several high and middle income states in several indicators of performance, which have shown deterioration, does indicate that while robust resource bases are important for fiscal health, the quality of fiscal management is also equally important.

Concluding Observations

3.45 We have seen that the period during 1997-98 to 2002-03 , the finances both of the central and the state governments suffered serious adverse effects due to one time events like the increase in salaries and pensions and macroeconomic factors that affected interest rates and growth rates. In a way, the states finances suffered a larger shock because they had by far a large base of government employees, faced higher interest rates including those charged by the central government, and also partook in sharing the impact of a fall in centre's tax-GDP ratio, which had resulted in a noticeable fall in the level of transfers. In fact, the lower than expected growth during 2000-03 resulted in less than anticipated tax devolution in the first three years of the award period of the Eleventh Finance Commission.

3.46 It is worth taking note of the fact that government finances and macroeconomic performance should not be viewed in isolation but rather as interdependent and integrally linked. In a way, by nursing large revenue deficits, the centre and the states contributed to a fall in the aggregate government savings to GDP ratio which, although partially compensated by a rise in the households savings relative to GDP set in motion a vicious cycle of falling growth rates, decreasing transfers, increasing borrowings, rising interest payments, and worsening revenue deficit. We have examined these issues in the next Chapter, in the context of macroeconomic stability and the need for restructuring government finances.

❏❏