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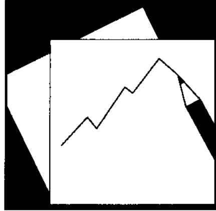

IMF Working Paper

Indian Subnational Finances: Recent Performance

Adarsh Kishore and A. Prasad

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Indian Subnational Finances: Recent Performance

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Abstract

This Working Paper should not be reported as representing the views of the IMF.
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The fiscal performance of the States in India has been an area of concern for quite some time. The Twelfth Finance Commission (TFC) recommended a three-pronged strategy to alleviate States' fiscal distress, built around greater orientation toward market discipline, incentives for fiscal consolidation targets, and commitment to fiscal correction. We find that States have created fiscal space through raising revenues and reducing and reprioritizing expenditures. Looking ahead, expansion of fiscal space is essential to meet the States' large infrastructure and social needs in order to alleviate bottlenecks to growth. This needs to be accomplished without undermining fiscal sustainability.

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I. Introduction

Understanding and analyzing the factors associated with strong fiscal effort can offer interesting policy lessons. The fiscal performance of the States[2] in India has been an area of concern for quite some time. A number of factors, such as, a growing interest burden, increasing pension liabilities, unrestrained administrative expenditure, losses incurred by State Public Sector Undertakings (PSUs), inadequate tax buoyancy, and inappropriate user charges, have been attributed to the large disparity in the growth of receipts and expenditure and the consequent widening of fiscal gap of the State governments. Deceleration in central transfers relative to GDP exacerbated this trend. Persistently large revenue deficits[3] had led to higher fiscal deficit and the build-up of a large debt stock. Consequently, a vicious cycle of deficit, debt and debt-service payments had emerged. The poorer States saw the most severe fiscal deterioration.[4] In addition to the direct borrowings, the contingent liabilities of the States had also increased. The fiscal stress, in turn, had seriously constrained the States' ability to discharge their primary responsibility of developing social and economic infrastructure.

Formative steps toward fiscal consolidation were seen with the introduction of the Fiscal Reforms Facility (FRF) in 2000–01 following the recommendation of the Eleventh Finance Commission.[5, 6] States in general were able to arrest the increasing trend in revenue deficit after 2001–02, although on average during 2000–04 all the headline indicators of deficit showed a worsened position as compared with the previous five-year average.[7] The gross fiscal deficit/GDP ratio remained stubbornly high and consequently the outstanding liabilities / GDP ratio of States reached 33.5 percent of GDP at the end of March 2004. Notwithstanding that, the FRF resulted in two unambiguous gains. First, it forced the States to accept the imperatives of reforms and, second, it provided a robust and credible framework for further fiscal consolidation in States.

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[2] India is subdivided into 28 States and seven Union Territories. The terms Subnationals and States are used interchangeably in this paper. India is a federation comprising a number of self-governing States or regions united by a central (federal) government.

[3] The term "revenue balance" corresponds to the term "current balance" used in the international literature.

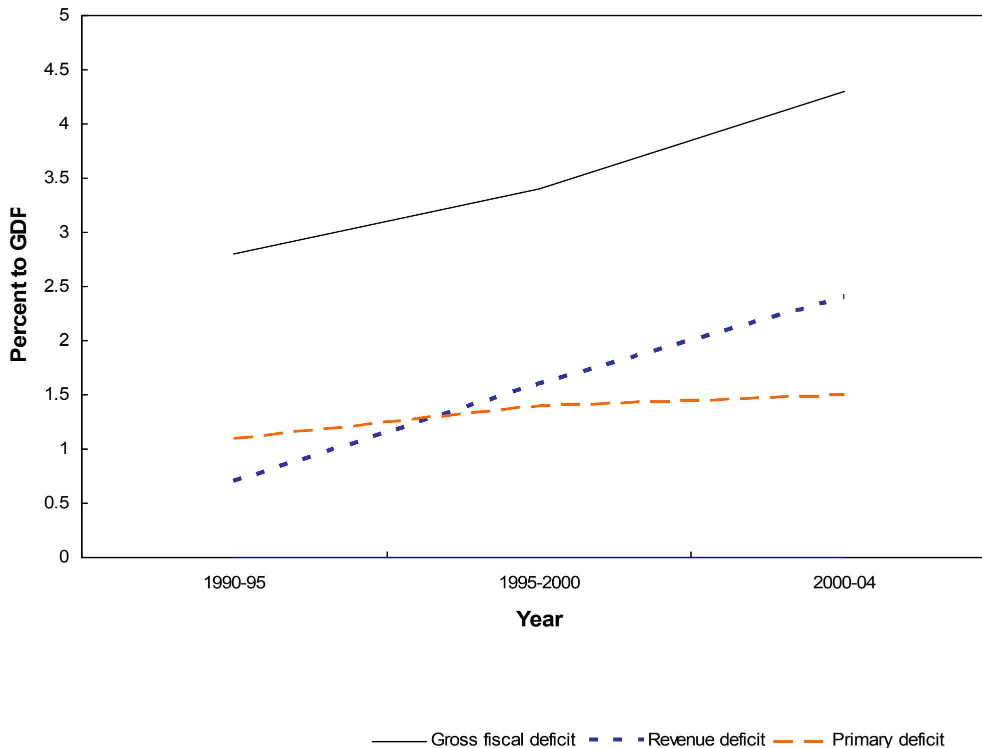
[4] World Bank (2004).

[5] The Constitution of India requires the appointment of a Finance Commission at least every five years to mediate the sharing of resources between the Center and the States.

[6] Under the FRF, Medium-Term Fiscal Reform Programmes (MTFRPs) were drawn up by States encompassing fiscal reforms, public sector restructuring, and budgetary reforms.

[7] The improvements in the revenue deficit reflected a combination of States' own fiscal efforts and a steady stepping up of transfers from the Center.

Figure 1. Major Deficit Indicators of State Governments



Against this background, the Twelfth Finance Commission (TFC) recommended a three-pronged strategy to alleviate States' fiscal distress—subjecting States to greater market discipline, rewarding States for fiscal consolidation targets achieved by providing debt and interest rate relief, and making statutory commitments to fiscal correction by passing of fiscal responsibility legislation (Box 1).[8] The TFC, with a view to restructuring public finances, recommended that States achieve a revenue balance by 2008–09 and reduce their fiscal deficit to 3 percent by 2009–10 (Box 2). The main objective of this paper is to assess the performance based on the Revised Estimates for 2006–07 and Budget Estimates for 2007–08, against the targets set by the TFC.[9]

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[8] Fitch Ratings (2006).

[9] For the purpose of analysis, this study includes NCT Delhi to the list of States to take the total number of States to 29. Data are available for 2006-07 and 2007-08 for 27 out of the 29 States, of which 2 State budgets—Uttar Pradesh and Orissa are votes-on-account.

The remainder of the paper is structured as follows. Section II provides a brief literature review of cross-country experiences on the impact of fiscal responsibility legislations (FRLs) on fiscal performance. Section III presents some trends in States' finances leading up to the beginning of the TFC period. Section IV assesses the fiscal performance of the States so far against the targets set by the TFC. Section V discusses the future challenges faced by States. Section VI presents the concluding observations.

Box 1. Summary of Recommendations of the Twelfth Finance Commission

Restructuring public finances

- Improve the combined tax-GDP ratio of Center and States to 17.6 percent, and capital expenditure to nearly 7 percent of GDP, by 2009–10.
- Bring down the combined debt-GDP ratio (with external debt measured at historical exchange rates) to 75 percent by 2009–10.
- Reduce the fiscal deficit to GDP targets for the Center and States to 3 percent.
- Eliminate the revenue deficit of the Center and States by 2008–09.
- Bring down interest payments relative to revenue receipts to 28 percent and 15 percent for the Center and States, respectively.
- Follow a recruitment policy for States such that the total salary bill, relative to revenue expenditure, net of interest payments, does not exceed 35 percent.
- Enact fiscal responsibility legislation at State level, providing for elimination of the revenue deficit by 2008–09 and reducing the fiscal deficit to 3 percent of State domestic product.
- Bring to an end over time the system of on-lending. The long-term goal is to bring down the debt-GDP ratio to 28 percent each for the Center and the States.

II. Fiscal Responsibility: Cross-Country Experience

Recent history provides evidence that policymakers do not always pursue time-consistent and sustainable fiscal policies. The tendency to conduct procyclical fiscal policies and the recent increase of debt ratios in a number of developed and emerging economies point to the existence of a deficit bias exacerbated by electoral cycles and voters' fiscal illusion.[10] An unsustainable fiscal policy can jeopardize macroeconomic stability. Fiscal deterioration leading to accumulation of debt and associated debt-service obligations also curtail the ability of the government to undertake basic developmental activities and disrupt delivery of government services. Concern about these trends has prompted policymakers in many countries to adopt medium-term programs of fiscal adjustment. The speed and composition

[10] Kaminsky, Reinhart and Vegh (2004) find, based on a sample of 103 countries, that fiscal policy, and in particular expenditure, is procyclical in most developing countries.

of fiscal adjustment impinges on growth. A fiscal adjustment that relies unduly on cuts in investment or excessive revenue enhancements may lower an economy's growth trajectory. Fiscal policy design therefore needs to ensure that fiscal adjustment minimizes the adverse consequences for growth.[11]

The debate on the ways to favor sound fiscal policies has focused on the need to rebalance the incentives to policymakers to impose constraints on the conduct of fiscal policy via the introduction of adequate fiscal rules and institutions. These proposals usually take three forms: procedural rules laid down in law or the constitution, numerical fiscal rules, and independent national institutions other than the government and the parliament. In many countries, this adjustment is being carried out, in an environment of growing decentralization of expenditure and revenue-raising responsibility, by imposing budget constraints on subnational governments.

Internationally, rules-based fiscal policy has progressively gained in importance over discretionary fiscal policy as countries work to achieve the objectives of fiscal sustainability, credibility, accountability, and transparency within a fixed time frame. Many countries have introduced fiscal rules over the past two decades.[12] These fiscal rules have taken the form of deficit rules, expenditure rules, revenue rules, and debt rules. Fiscal rules directly contribute to fiscal discipline by imposing binding constraints on fiscal policy and help address expenditure bias and thereby fiscal illusion. Fiscal rules are attractive, since they are generally transparent and relatively easy to monitor, and hence they confer predictability and credibility on fiscal policy. Fiscal rules also contribute to policy coordination between different levels of government. Rules enable the governments to look beyond short-term gains to pursue improved governance in the medium-to-long term leading to fiscal sustainability.

Fiscal rules may, however, be ineffective if they are not backed by political commitment and clear rules of enforceability. The mandate to abide by rules may lead to low-quality measures or may encourage circumvention of rules through creative accounting. Nonetheless, the credibility of fiscal policy is considerably enhanced if the goals of government are specified in some detail in the form of a law in addition to the usual annual budget announcements (Premchand, 2003).

A. Impact of Fiscal Responsibility Legislations (FRLs) on Fiscal Performance

Empirical studies have frequently found fiscal rules to be associated with positive fiscal outcomes. Von Hagen and Harden (1995) have found tighter budget rules to be associated with lower deficits and borrowing in Member Countries of the Organization for Economic

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[11] It is often argued that stabilization has been achieved by cutting productive expenditures, thereby sacrificing growth.

[12] The definition of fiscal rules follows that proposed by Kopits and Symanski (1988) — that is, a permanent constraint on fiscal policy, expressed in terms of a summary indicator of fiscal performance, such as the government budget deficit, borrowing, debt, or a major component thereof.

Cooperation and Development (OECD). Alesina, Hausmann and Stein (1999) and Stein, Talvi, and Grisanti (1999) also found fiscal rules to be associated with greater fiscal discipline in Latin America. [13] An IMF Working Paper reports several studies that have looked at the effectiveness of subnational government rules in the context of the U.S. states (Bohn and Inman, 1996; Inman, 1996; and Poterba, 1997).[14] The general results were that rules did enforce some budget discipline on U.S. states, in terms of lower deficits and quicker reaction to negative shocks.[15] A recent study, European Commission (2006), confirms the influence of fiscal rules in determining budgetary outcomes in the euro area. This study found that the primary current account balance on average improved in the year following the introduction of fiscal rules, while it remained broadly stable over 1990–2005. Also, primary government expenditure tended to grow more slowly in the years following the introduction of numerical expenditure rules.

III. Trends in State Finances in India

Fiscal imbalances were not just an aggregate phenomenon but had grown sharply across the States since the late 1980s, and the deterioration was reflected in all major fiscal indicators. Although there was some evidence of fiscal consolidation on the part of most States during the early 1990s, this improvement could not be sustained thereafter. The fiscal consolidation efforts attempted under a discretionary fiscal policy framework have not been durable, with a tendency to slip back into deficits and debt cycles.[16] The situation started worsening after 1987–88, when the surplus on the revenue account turned negative, and this continues until 2006–07. State finances at the aggregate level have always been in revenue deficit.

The six years from 1997–98 through 2002–03 have been described as the worst in the history of India's subnational finances.[17] The adjustment efforts of States, especially after the FRF, were somewhat negated by the adverse impact of the cyclical slowdown in the economy. This period witnessed falls in the central transfers and the ratio of own tax revenue to GDP, reflecting exemption-proliferating tax competition among States, sharp increases in the salary bill, and an increase in interest payments. As a result, the debt-to-GDP ratio of the States increased to 31 percent by 2002–03. The situation led one study to conclude that all of the States were in need of fiscal correction, with differences only in the degree and urgency of the corrective action called for.[18]

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[13] Steven Webb (2004) finds evidence, using a sample of five Latin American countries, that fiscal responsibility laws are neither necessary nor sufficient for achieving fiscal prudence at multiple levels of government, but they can be useful as mechanisms to coordinate and sustain commitments to fiscal prudence.

[14] Ahmad, Albino-War and Singh (2005).

[15] The nature and scope of fiscal rules vary widely across U.S. states.

[16] The ineffectiveness of the discretionary policy is not unique to the Indian States and is corroborated by international experience at the national and subnational levels— for instance, in Latin American countries.

[17] Government of India, Twelfth Finance Commission (2004).

[18] Rajaraman, Bhide, and Pattnaik (January 2005)

Based on the recommendations of the Eleventh Finance Commission, the government of India created a Fiscal Reform Facility (2000–01 to 2004–05) to incentivize the States to undertake medium-term fiscal reforms program that would result in about 25 percent reductions/ improvements in their revenue deficits/surpluses.[19] Recognizing the urgency of the need for fiscal consolidation at the State level and making their financial positions sustainable over the medium-term, a few State Governments enacted legislations on fiscal responsibility and budget management, beginning with Karnataka in 2002, and followed by Kerala, Tamil Nadu and Punjab in 2003

The examples set by these States and the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 and the rules framed thereunder by the central government, effective July 5, 2004, generated further momentum towards adoption of fiscal responsibility legislations by the remaining States. Although the FRF sensitized the States to the need for fiscal consolidation, it did not adequately address the problem of how to achieve steady convergence to a stable, sustainable debt path.[20] Given the unsustainable debt burden in many States, it became difficult to imagine how State reforms program could succeed without a debt-restructuring package.[21]

IV. Fiscal Consolidation in States During TFC Period

A. Restructuring Plan

Against this backdrop, in late 2004, the TFC submitted its report and recommendations to the government. The TFC's framework provided three channels through which States could improve their fiscal circumstances.[22] States would benefit from a higher revenue share and higher grants, debt restructuring, and debt relief. The broad restructuring indicators and the required annual adjustments envisaged by the TFC are given in Table 1. States would also confront a stricter borrowing regime, with the Center setting global ceilings on borrowings and henceforth only lending to fiscally weak States.

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[19] The consolidated revenue deficit came down from 2.6 percent of GDP in 2001-02 to 2.2 percent of GDP in each of the next two years. By 2003-04, the economy had shifted into a buoyant phase.

[20] Government of India, Twelfth Finance Commission (2004).

[21] See, for instance, Purfield (2004).

[22] International Monetary Fund (2006 a).

Table 1. Restructuring Plan of Twelfth Finance Commission:
(percent of GDP)

	2004-05 (at time of TFC Report)	2004-05 Actuals	**2009-10 TFC Target**	Avg Annual Adjustment Required (Compared with 2004-05 Actuals	Avg Annual Adjustment Required (Compared with 2004-05 TFC Report	2006-07 RE	2007-08 BE
Revenue deficit	2.00	1.20	**0.00**	-0.24	-0.40	-0.01*	-0.38*
Fiscal deficit	4.50	3.50	**3.00**	-0.10	-0.30	2.60	2.10
Primary deficit	1.60	0.70	**1.00**		-0.12	0.35	-0.02
States own tax revenue	5.90	6.10	**6.80**	0.14	0.18	6.22	6.30
Own Non-tax revenue	1.20	1.50	**1.40**		0.04	1.23	1.11
Revenue receipts		11.90	**13.20**	0.26	2.64	12.61	12.54
Interest payments	2.90	2.80	**2.00**	-0.16	-0.18	2.26	2.16
Revenue expenditure	13.60	13.10	**13.20**		-0.08	12.60	12.16
Capital expenditure	2.60	2.00	**3.10**	0.22	0.10	3.82	3.65
Total expenditure	16.20	18.30	**16.30**	-0.40	0.02	16.42	15.81
Interest payments/ Revenue expenditure		23.60	**15.00**	-1.72	3.00	17.93	17.76
Debt (end-year)	30.30	33.40	**30.80**	-0.52	0.10	N.A	N.A

Sources : Twelfth Finance Commission, Reserve Bank of India, Ministry of Finance, and budget documents of State Governments.
Notes : BE denotes budget estimates; RE denotes revised estimates;
BE for 2007-08 are based on data for 27 States, including NCT Delhi and excluding Punjab and Uttarakhand; and * indicates surplus

Box 2. Debt Relief

A two-pronged approach has been recommended.

(a) A general scheme of debt relief applicable to all States, prospectively, from the year in which they enact fiscal responsibility legislation (FRL). This scheme gets into operation through a process of consolidation of all central loans contracted by States until the end of March 2004 and outstanding at the end of March 2005, for a fresh term of 20 years at an annual interest rate of 7.5 percent.

(b) Write off scheme, after consolidation of central loans, linked to fiscal performance and subject to the following conditions:
   - (i) enactment of FRL (required for consolidation, in any case);
   - (ii) reduction of revenue deficit each year starting from 2004–05, when compared to the average of the preceding 3 years. In the process, if the revenue deficit is eliminated completely by 2008–09, the State will get the full benefit of the waiver;
   - (iii) reduction in the revenue deficit should be at least equal to the interest relief owing to consolidation;
   - (iv) separate treatment for revenue surplus states, where the base-year surpluses should be maintained throughout the award period; and
   - (v) containment of the fiscal deficit at the 2004–05 level in succeeding years.

Twenty-six State governments have enacted FRL so far. While 4 States had already passed the legislation during 2002–03—that is, prior to the recommendations of the TFC—22 States enacted the laws following the recommendations of the TFC.[23] The FRLs of States have similar characteristics.[24] The targets set in the FRLs are similar to those set by the Center for itself and are in line with the TFC recommendations of eliminating the revenue deficit by 2008–09 and reducing the ratio of gross fiscal deficit to GDP to 3 percent by 2009–10. A number of States have placed limits on guarantees. None of the Acts, except the one in Assam, have sanctions. All States have incorporated corrective mechanisms into their Acts, in the form of triggers for cuts in expenditures or increases in revenues to get them back on target, or neutralizing measures for policy changes made during the year.

B. Macro Assumptions

The TFC had developed State Fiscal Adjustment Scenarios based on a set of macro assumptions (Table 2). It assumed that the gross fiscal deficit (GFD) would be reduced to 6 percent of GDP on the combined account and that the revenue deficit would be reduced to zero, which would enable an increase in the aggregate saving rate as well as in the government capital expenditure as a percentage of GDP. In consequence, the TFC assumed that as the aggregate investment rate increased, growth would stabilize at above 7 percent and nominal interest rates would remain at prevailing levels, which would imply a continuing fall in the average interest rates for the Center and the States. Since fiscal deficits were reduced and inflation was kept under control, there would be no pressure for interest rates to rise.[25]

Table 2. Macro Assumptions : Twelfth Finance Commission:
(percent)

	Assumtions of TFC		Actuals
	2004-05	2009-10	2006-07
GDP growth rate (percent)	6.5	7.0	9.2
Inflation	6.0	5.0	5.7
Saving rate	24.0	26.0	32.4
Investment rate	24.5	27.5	33.8
Current Account/GDP ratio	0.5	-1.5	-1.5

Sources : Twelfth Finance Commission and Reserve Bank of India

[23] The States that have not enacted FRLs are Sikkim and West Bengal.

[24] Reserve Bank of India (2006 a).

[25] Government of India Twelfth Finance Commission (2004).

C. Fiscal Consolidation

The macroeconomic environment has been on the ascendancy since the TFC recommendations were issued. GDP growth has been buoyant, far exceeding expectations. The interest rate environment, however, was considerably tighter during this period, reflecting the increase of 125 basis points in policy rates (reverse repo rates) since the end of March 2005. Also, States started the adjustment path from a stronger-than-expected initial position, since the actual fiscal positions of States in 2004–05 turned out to be much better than were suggested by the base-year data used by the TFC.[26] The performance of the States has to be viewed against this background.

The initial skepticism that FRLs would be adhered to only exceptionally has been partially belied by actual performance. Since the beginning of the TFC period, fiscal policy in States has been geared toward consolidation and reducing the high public debt ratio. States have embarked on a fiscal correction program, particularly on the revenue account. The improvement in finances of the State governments is evident from the reduction in alternate measures of deficit as well as liquidity management.[27] The overall fiscal correction by States is reflected in the declining deficit indicators (revenue, fiscal and primary) since 2004–05 against the backdrop of robust economic conditions. By 2006/07, the consolidated States revenue balance as a proportion of GDP had already turned into a surplus (Table 3), exceeding the TFC's 2008–09 targets. The consolidation in the gross fiscal deficit and primary deficit positions also shows similar over achievement. The budget estimates for 2007–08 reflect continued strong commitment by States to reduce the remaining imbalances or build on their consolidation efforts.

Table 3. State Governments:Major Deficit Indicators
(percent of GDP)

	1990-95 Average	1995-2000 Average	2000-04 Average	2004-05 Actual	2005-06 Actual	2006-07 RE	2007-08 * BE
Gross fiscal deficit	2.80	3.40	4.30	3.50	2.40	2.60	2.10
Revenue deficit	0.70	1.60	2.40	1.20	0.04	-0.01	-0.38
Primary deficit	1.10	1.40	1.50	0.70	0.12	0.35	-0.02

Sources : Reserve Bank of India, Ministry of Finance, and budget documents of state governments.
Notes : * Excluding Punjab and Uttarakhand;
RE denotes revised estimates; BE denotes budget estimates; and
"-" indicates surplus.

[26] It could be argued, in hindsight that the macro assumptions of the TFC were conservative and, hence, the fiscal targets were also conservative. If the TFC had been able to predict the upturn in the economy since 2004-05, it might have come out with a different set of proposals for debt relief and set different fiscal targets. In fact, Table 1 indicates that the fiscal position for 2004-05 turned out to be much better than had been envisaged by the TFC, which made the restructuring path easier for the States to follow.

[27] Reserve Bank of India, (2005).

The consolidation in the revenue account has been widespread, and generally all States except three—West Bengal, Jharkhand and Kerala—had already achieved the TFC targets by 2006–07 or are on course to meet the TFC targets (See Table A 1). In fact, 16 States have already recorded surpluses in the revenue account. The BE for 2007–08 indicate a continuation of consolidation in all States; and according to current estimates, only two States—Kerala and West Bengal—seem to have backloaded their adjustment—that is, left a large proportion of the deficit reduction for the latter part of the TFC period.[28]

The combined ratio of gross fiscal deficit to GDP of States for 2006–07 also reflects achievement of the TFC target three years in advance. A redeeming feature is the increase in capital outlay to 2.5 percent of GDP by 2006–07, a tremendous improvement over the 1990s and the 2000–04 average and more than had been anticipated by the TFC. The progress toward achieving the GFD targets seems to be uneven across States since many States have backloaded this adjustment on account of large investment needs, which are more observable in Special Category States.[29] However, the budget estimates for 2007–08 show greater commitment to achieving the TFC targets (SeeTable A 2).

Revenues

International experience has shown that revenue-based consolidation strategies can be successful but are more difficult to undertake. Successful revenue-based consolidations are less common than expenditure-based consolidations even at low revenue levels, which mainly reflect administrative constraints. Countries have also had more difficulties protecting revenue-based gains against new revenue erosions and expenditure incursions.[30] States recorded a correction of about 1.2 percent of GDP in the revenue account between 2004–05 and 2006–07, with the increase in receipts being 0.7 percent of GDP and the adjustment in expenditure being 0.5 percent of GDP. The bulk of the correction in the revenue account has been on account of increased transfers from the Center, especially the sharable taxes and grants and the impact of debt relief and consolidation. In contrast to the 0.7 percent of GDP improvement in revenue receipts between 2004–05 and 2006–07, States' own efforts were negative, as a marginal increase in own tax collections was offset by a decrease in own non tax collections (Table 4).[31] However, when compared with the average for 1995–00, States' own tax efforts contributed one-third of the improvement in the revenue receipts during 2000–06.

[28] The budget document for Kerala proposes to reduce the revenue deficit to less than 1 percent of GDP by 2010-11, implying it will not achieve the TFC target.

[29] Special Category States are some of the hilly terrain States, which are relatively more backward, and, therefore, attract a higher component (90 percent) of grants and 10 percent loan component from the Planning Commission.

[30] International Monetary Fund (2006 b).

[31] Between the 2000-04 average and 2006-07, about 41 percent of the improvement in revenue receipts was achieved by States' own tax efforts.

On the receipts side, implementation of the value added tax (VAT) has been the most significant tax reform measure undertaken at the State level.[32] The decision to implement State-level VAT was taken in the meeting of the Empowered Committee (EC) of State Finance Ministers in June 2004, at which a broad consensus was reached on introducing VAT from April 1, 2005. By April 2007, all States, barring Uttar Pradesh, implemented VAT in lieu of sales tax.[33] The initial tax collections through VAT have been encouraging recording 13 percent and 23 percent growth rates, respectively, during 2005–06 and 2006–07. Continuation of these trends points toward the achievement of the overall revenue receipts target set by the TFC, but the prospects for increasing own revenues remain uncertain. Further tax administration reform and institution of a good information system could enhance the buoyancy of revenues from States taxes.[34]

Table 4. States:Aggregate Receipts
(percent of GDP)

	1990-95	1995-2000	2000-04	2004-05	2005-06	2006-07	2007-08
	Average	Average	Average	Accounts	Accounts	RE	BE
Aggregate receipts	16.1	15.2	17.4	18.6	16.3	16.0	15.8
Total revenue receipts	12.1	10.9	11.4	11.9	11.8	12.6	12.5
- Own revenue	7.3	6.9	7.1	7.6	7.1	7.5	7.4
- Own tax	5.4	5.3	5.7	6.1	5.9	6.2	6.3
- Own Nontax	1.8	1.6	1.4	1.5	1.2	1.2	1.1

Sources:Reserve Bank of India, Ministry of Finance, and budget documents of State governments.
Notes: BE denotes budget estimates; RE denotes revised estimates.
BE for 2007-08 are based on data for 27 States, including NCT Delhi and excluding Punjab and Uttarakhand.

Expenditures

The trends in revenue expenditure seem to be on course to achieve the TFC targets set for 2009–10, mainly owing to a reduction in interest payments (Table 5 and Table A 3), reflecting debt rescheduling, notwithstanding higher market interest rates. As many as

[32] The State-level VAT presently being implemented is to replace the existing sales tax systems in States. Under Entry 54 of List II (State List) in the Seventh Schedule to the Constitution of India, “tax on sale or purchase of goods within a State” is a State subject.

[33] Reserve Bank of India (2007).

[34] India, Economic Advisory Council to the Prime Minister (2007).

19 States qualified for receiving write offs of central loans in 2006–07, owing to their improved fiscal performance in terms of the TFC recommendations.[35] The market borrowings for 2005–06 were lower reflecting the impact of the debt swap scheme in 2004–05 as well as a buildup of surplus cash balances.[36] Some of the advantages of lower borrowings were lost because of the increase in the weighted average interest rates by about 160 basis points in two years (118 basis points in 2005–06 compared with 2004–05 and a further 43 basis points in 2006–07). The effective interest cost of National Small Savings Fund (NSSF) debt of the States, (the ratio of total interest paid by States to NSSF to their total outstanding loans from the NSSF) had also come down from 10.5 percent in 2005–06 to about 10.2 percent in 2006–07.[37] The lower interest payments in revenue (current) expenditure was reflected in a slower adjustment in the consolidated primary deficit, although the performance in this category had surpassed the TFC target set for 2009–10.

Table 5. States:Expenditure Pattern
(percent of GDP)

	1990-95	1995-00	2000-04	2004-05	2005-06	2006-07	2007-08
	Average	Average	Average	Actual	Actual	RE	BE
Aggregate Expenditure	16.0	15.2	17.3	18.1	15.3	16.4	15.8
Revenue expenditure	12.8	12.6	13.8	13.1	11.8	12.6	12.2
Interest payments	1.7	2.0	2.8	2.8	2.3	2.3	2.2
Capital expenditure	3.2	2.7	3.6	5.1	3.5	3.8	3.7
Capital outlay	1.6	1.4	1.6	2.0	2.1	2.5	2.4
Developmental expenditure	10.8	9.6	9.7	9.4	9.1	10.0	9.7
Non-development expenditure	4.3	4.9	6	6	5.0	5.2	5.0
Others	0.9	0.7	1.6	2.7	1.1	1.2	1.1

Sources:Reserve Bank of India, Ministry of Finance, and budget documents of State governments.
Notes: BE denotes budget estimates; RE denotes revised estimates.
BE for 2007-08 is based on data for 27 States, including NCT Delhi and excluding Punjab and Uttarakhand

[35] India, Economic Advisory Council to the Prime Minister (2007).

[36]The debt swap scheme enabled States to prepay their high-cost debt to the Center by means of additional market borrowings and proceeds from small savings.

[37] The NSSF was created in the Public Account of India in April 1999 with the objective of delinking small savings transactions from the Consolidated Fund of India to ensure the operations of small savings in a transparent and self sustaining manner. All deposits made under the small savings schemes are credited to the NSSF, and all withdrawals by depositors are made out of the accumulations in that fund.

All the States have increased their capital outlays as percentages of their respective gross state domestic products (GSDP) during the last three years, but expenditures on the social sector were uneven among States (See Tables A 4 and A 5). The ratio of expenditure on the social sector to total capital outlays is still low, although it is improving. The ratio of social sector expenditure to total expenditure by States is also showing an upward trend (See Table A 6).

V. Issues and Challenges

Some clear trends are discernible from the performance of States during the post-TFC period.

(i) Higher revenues, lower interest payments and reallocation of expenditures contributed to increased fiscal space in States.[38]

(ii) The consolidated position of States' gross fiscal deficit (GFD), revenue deficit (RD) and primary deficit (PD) has improved. Already in 2006/07, the consolidated State headline deficit indicators show that the TFC's targets have been exceeded. The improvement has been widespread across States.

(iii) Revenue receipts have increased owing to higher central transfers and grants. A marginal increase in own taxes has been negated by a decline in non tax revenue.

(iv) Developmental expenditure has increased while non developmental expenditures have declined.

(v) The expenditure side has been characterized by lower interest payments and larger capital outlays.

(vi) Expenditures on economic and social services have increased but have been uneven across States.

(vii) In the aggregate, States are well placed to meet medium-term adjustment targets, but this task will be more difficult for a few States.

It is critical that States are able to sustain the marked correction achieved so far in key fiscal indicators. The speed with which fiscal responsibility legislations have been formulated and enacted reflects some eagerness by States to avail themselves of the debt relief recommended by the TFC, since the adjustment seen in the revenue account predominantly reflects central transfers and grants and lower interest payments and not States' own revenue raising efforts. However, by passing FRLs, States have benefited from a number of externalities resulting from other clauses relating to fiscal transparency, liabilities, guarantees, and medium-term fiscal plans.

Any fiscal correction path under FRL has to be realistic and should not adversely impact capital expenditure and spending on social services. In order to make the process of fiscal

[38] In its broadest sense, fiscal space has been defined in (Heller (2005), as the availability of room in the budget that allows a government to provide resources for priority purposes without undermining fiscal sustainability.

consolidation durable and sustainable, adequate investment in economic infrastructure and expenditure on social sectors is essential.[39] Given the need to step up investments, capital expenditure is bound to increase. Although increased investments will improve the revenue generation capacity of States, in the short term it will require them to maintain stronger discipline on the revenue front if the fiscal deficit is to be contained within the TFC targets. Revenue augmentation, rationalization of expenditure, and containment of debt within sustainable limits, therefore, need to be continuously addressed over the medium term.

A. Tax Reforms

States' own income is likely to expand with the continued buoyancy of taxes. The introduction of a goods and services tax (GST) remains a medium-term objective and seems achievable, since only one more State has to introduce the VAT. The central sales tax (CST), as an origin-based non rebatable tax, is inconsistent with the concept of VAT and needs to be phased out. One critical issue involved in phasing out the CST is compensating the States for resulting revenue losses.[40,41] By allowing full integration of the goods and services tax at the national level, a GST should be able to secure further gains in economic efficiency.[42]

B. Improving Nontax Revenues

States' nontax revenue arises from a mix of sources, such as interest receipts on loans made by governments, dividends on equity investments and user charges for services provided by the government. There are no signs of increases in this category since substantial reforms of public sector enterprises are yet to be undertaken. There are hundreds of State-level public enterprises with vast sums of public money invested in them. Given the improving state of State government finances, it is critical that the financial positions of many loss-making enterprises and the subsidies provided to some enterprises do not undermine the reforms that are taking place in other sectors of the economy. This underscores the need to find viable means to revive and sustain such enterprises.

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[39] Reserve Bank of India (2006 a).

[40] Although the CST is levied by the Center under the central legislation, it is wholly retained by States.

[41] The Empowered Committee has been deliberating on the issue. The matter was also discussed in the meetings of State Finance Ministers. The Committee had submitted a proposal to the Department of Revenue containing its recommendations on the modalities for phasing out the CST and for compensating States for resulting revenue losses. The Committee's proposal was examined and, thereafter, the views and suggestions of the government on this were communicated to the Committee. Further deliberations on the issue are going on in the Committee. (Ministry of Finance, Economic Survey, 2006-07).

[42] Poirson (2006).

C. Expenditure Reduction and Reprioritization

Fiscal adjustment based predominantly on expenditure reduction is likely to run the risk of triggering a downturn in economic activity and impacting social-welfare schemes. Meeting FRBM Act and TFC targets would speed up the medium-term decline in the debt/GDP ratio and be a favorable step toward longer-term debt reduction.[43] The interest bill would moderate in the medium term owing to a combination of good macroeconomic management, price stability, and the impact of debt consolidation, debt relief and debt swaps.

The ratios of States' expenditures on wages and salaries to GDP and to revenue expenditure have stabilized in recent years, helped by a stable work force. The Center has announced the setting up of the next pay commission. All the States, either through state-level pay commissions or by executive orders, shall be obliged to follow suit. This may lead to imbalances that would have to be accommodated in context of a rule-based fiscal policy. At the time of the last pay revision in 1997, the expenditures of states on administrative services (the bulk of these are for wages and salaries) had risen sharply by 80.0 percent.[44] The States have learned lessons from the pay hikes after the Fifth Pay Commission. However, the wage structure in the market and relative movement of labor across industries have changed since then. It would therefore not be surprising if the Sixth Pay Commission came out with an award that made the wage structure in government compatible with that of the private sector in order to enable government to attract and retain talent. The Sixth Pay Commission award would most certainly create a pull effect on States, encouraging them to raise wages. This is bound to create additional stress on the financial position of States.

D. Dealing with Cash Surpluses

The increase in central transfers to States, the availability of debt relief under the TFC, and the continued buoyancy of small savings collection have resulted in a surplus cash position of State governments and low or non-utilization of the Ways and Means Advances (WMA). The weekly average utilization of WMA and overdrafts by the State governments was Rs. 23.4 million and Rs. 48.2 million during 2006–07 and 2005–06 respectively. State governments had large cash balances, which were reflected in their weekly average investments in 14-day intermediate treasury bills of Rs. 430.75 billion during 2006–07.[45] The large cash surpluses imply that States have over-borrowed for funding the gross fiscal deficit, or have underestimated their gross fiscal deficits, or have breached their net borrowing ceilings on account of excess inflows from the NSSF. This has implications for the revenue balances of States, because although the cash balances are invested in Treasury bills, the fiscal deficit is financed predominantly by relatively higher-cost market borrowing and small savings deposits.

[43] IMF, 2007,

[44] The Fifth Pay Commission resulted in a 0.9 percent of GDP increase in state employee compensation and a 0.5 percent of GDP increase in central wage and pension payments.

[45] Reserve Bank of India, 2007.

E. Reform of National Small Savings Fund

The fiscal adjustment being envisaged by the States faces challenges because it does not put them in full control of their financing decisions. The financing pattern of the gross fiscal deficit has continued to reflect the predominance and buoyancy of small savings. Over one-half of the States' fiscal deficit is financed by small savings collections through the securities issued to NSSF. This is an exogenous source of financing for the States, since neither the quantum nor the cost of these borrowings are within their purview. The rates on these small savings instruments are decided by the central government and are usually higher than on market borrowings by the States.[46] The fiscally better managed States would thus prefer to borrow from the market to finance their deficits rather than access these small savings funds. They perceive that they would get finer spreads and full subscriptions in the auctions and be able to lower their costs of borrowing. The small savings collections, however, are by law passed on to the States. The NSSF has entailed a relatively high cost and further buildup of debt on States. Exclusion of NSSF loans by TFC from the scope of debt relief on the ground that the fund is maintained in the Public Account has meant that for States where NSSF loans form the dominant component of debt, the package recommended by the TFC cannot significantly reduce their debt burden.

To mitigate the impact of small savings collections, with effect from April 2007, these are being shared between the States and the Center in the ratio of 80:20 (vis-à-vis the previous arrangement of 100 percent transfer of collections to the State governments) with States having the option to take up to 100 percent of their collections. The interest rates on loans taken by State governments from NSSF from 1999–2000 to 2002–03 were also reset at 10.5 percent effective from April 2007. The NSSF invests in special securities that are nontradable and have a maturity of 25 years, including a moratorium of 5 years on the principal. The interest rates on special securities are 9.5 percent at present and their effective cost is 10.2 percent. Innovative mechanism needs to be evolved to either reduce the cost of, or retire, this debt. Using the surplus cash balances of State Governments or refinancing the outstanding debt through market borrowings are some ideas that could be explored. Unless interest rates on the current small savings instruments are linked to market rates, States will continue to bear the fiscal stress on account of higher interest rates they must pay to the Center.[47]

F. Impose Debt Cap

In view of the increasing debt sustainability of states, a global cap on all borrowings could be considered. Under Article 293 of the Constitution of India, States require permission from

[46] Small savings schemes are essentially a basket of diversified and heterogeneous products that include postal deposits; saving certificates; and social security schemes; such as public provident funds and retirement schemes.

[47] Reserve Bank of India (2001 and 2004).

the Center to raise loans if they are indebted to the central government or have taken guarantees from the Center in respect of loans raised by States.[48] This means that the Center has to assess the debt sustainability of the State and its ability to repay the loans, prior to giving States the permission to undertake fresh borrowings. Historically, States have financed their fiscal deficits through components such as market borrowings and loans from the Center—items that are monitored and within the ambit of Article 293 (Table 6). This has now changed, with bulk of States' financing coming from securities issued to the NSSF, an uncontrolled component.[49] Further, the borrowings under the public accounts[50] are also not subject to Article 293 jurisdiction, and States do not require permission to undertake such borrowings. Thus, the explicit and implicit restrictions under Article 293 with regard to borrowings by the States in certain cases and at times seem to have been bypassed.

Table 6. Control over Financing of States' Fiscal Deficit
(percent of total)

	1990-1995 (Average)	1995-2000 (Average)	2000-04 (Average)	2004-05 Actual	2005-06 RE	2006-07 BE
Market borrowings *(Article 293 permission)*	16.0	16.1	24.6	31.6	16.4	20.8
Loans from Center *(Controlled)*	49.0	40.6	7.8	-10.8	1.9	4.4
Loans from banks and financial institutions *(Uncontrolled)*	1.8	2.8	4.9	NA	4.9	6.9
Securities issued to NSSF *(Uncontrolled)*	-	28.9	35.4	62.2	65.4	53.1
Public accounts, reserve funds *(Uncontrolled)*	30.9	28.7	16.2	21.1	10.2	10.9
Others *(Not monitored)*	-5.0	9.5	1.1	9.6	4.9	3.6

Source: Reserve Bank of India.
Notes: RE denotes revised estimates; BE denotes budget estimates.

[48] Internal debt and external debt constitute public debt of India and are secured under the Consolidated Fund of India, as reported under the "*Consolidated Fund of India - Capital Account"* in the Annual Financial Statement of the Union Budget. The Constitution of India, under Article 292, provides for placing a limit on public debt secured under the Consolidated Fund of India but precludes "*other liabilities*" under the Public Account. There is also a similar provision under Article 293 with respect to borrowings by the States, wherein the State legislature has powers to fix limits on State borrowings upon the security of the Consolidated Fund of the State. However, a State's power to borrow is limited to internal debt (raised within the terriotory of India), and a State is required to obtain prior consent of the government of India, as long as the State has outstanding loans made by the government of India.

[49] Prasad Abha, Rajan Goyal and Anupam Prakash, 2004.

[50] Public accounts are outside the consolidated fund and the contingency fund. Under these accounts, States act like bankers by accepting deposits and may even pay interest on them.

There is a view that Article 293 restrictions should be extended to all borrowings that finance States' deficits to fix a global cap on the total borrowed resources rather than having separate caps for each instrument. This would possible require a constitutional amendment. Tighter borrowing ceilings could reinforce States' adjustment efforts. States' annual borrowing ceilings could be brought in line with adjustments targeted under their FRLs. This would require reducing the dependence of States on NSSF in favor of market borrowings subject to a borrowing cap. Such a strategy would, however, require comprehensive NSSF reform, including linking the rates on the small savings instruments to market rates and scaling back of tax exemptions on such instruments.

G. External Assistance

The Center is now passing on external assistance from the World Bank to States on the same terms and conditions as attached to the assistance, without transforming them to 70 percent loan and 30 percent grant components, thereby disintermediating and making the Government of India, a financial intermediary without gain or loss, as recommended by the TFC.[51] This implies that the States are taking on a larger debt as well as assuming the foreign exchange risk on these loans. Although these external funds are being used by States, they are guaranteed by the Center. In order to provide a cushion against a possible exchange rate risk, it would be appropriate for the Center to structure some sort of exchange fluctuation reserve that would be funded by States. The Center should evolve a scheme that would find consensus among States.

H. Market Borrowings

Market borrowings by States have been a successful experiment. This has forced the market to differentiate States according to their performance while bidding for State Government debt and motivated States to improve their performance in order reduce their cost of borrowings. The difference in spreads between market debt issued by the Central government and State Governments market borrowings through debt instruments has reduced over the last few years from 50 basis points to 25-20 basis points, on an average. All States resorted to auctions for borrowings in 2006–07. The general push to market and use of credit ratings would offer incentives for greater competitiveness among States. In this respect, greater transparency and dissemination of information on recent and prospective developments in the finances of States are highly desirable. States should be encouraged to make necessary changes in their legal and institutional frameworks to promote these objectives.

H. Towards a Balance-Sheet Approach

While accountability, transparency, and governance in corporate entities have evolved into sophisticated conventions, they are still narrowly focused on expenditures in governments. More striking is the absence of a convention for a balance sheet of assets and liabilities for

[51] Earlier, external assistance was being generally passed on to States in the form of 70 percent loans and 30 percent grants.

governments; and, hence, the assets of State governments are not systematically valued and tracked. The basic concept is that the balance sheet enables assessment of fiscal policies on the net worth of the government. Balance sheets would provide useful information about the form in which States hold their assets and liabilities. Even when analysts are looking at debt sustainability, balance sheets provide an indicator that is richer than the more usual data on borrowing and debt because the former take account of changes in assets and liabilities. Fiscal sustainability is often analyzed in terms of how well debt can be managed. Debt is only one of the relevant liabilities. Without balance sheets, it is difficult to see the so-called intertemporal liabilities including pension claims. In time, State governments should move toward providing balance sheets of assets and liabilities to enable monitoring. A public sector balance sheet can help analysts diagnose vulnerabilities that are not immediately visible in the Budget.[52] Eventually, States need to construct balance sheets that are comprehensive and forward looking to make them more relevant for fiscal policy.

VI. Conclusion

There has been improvement in the finances of States during the TFC period so far. States have created fiscal space through raising revenues and reducing and reprioritizing expenditures. Looking ahead, expansion of fiscal space is essential to meet the States' large infrastructure and social needs in order to alleviate bottlenecks to growth. This needs to be accomplished without undermining fiscal sustainability. On the revenue side, obtaining large increases in nontax revenues does not seem feasible unless States undertake an overhaul of public sector enterprises, which would require difficult political economy decisions. Further increases in tax revenues would depend on improvements in tax administration. On the expenditure side, the scope for large reductions in interest payments is limited. The gains from stabilization in salary payments could be jeopardized by making large pension payments and the impact of the Sixth Pay Commission. Given the difficult choices of the political economy and the impending implications of the Sixth Pay Commission recommendations, in all likelihood, there will be a fresh phase of fiscal stress unless timely and appropriate actions are undertaken. Expenditures on subsidies are also likely to continue following the same trend unless reforms are undertaken. A targeted system of subsidy that involves pass-through of prices accompanied by cash compensation would increase efficiency and decrease costs while not denying subsidies for the poor.

There is substantial room for improvement in the allocation of resources. Transfer of services to local bodies by giving them grants and making them accountable could enhance efficiency and reduce expenditures. Policies to be considered could include targeted grants linked to investment thresholds to be met by local bodies or improvement of performance in key sectors. Cofinancing schemes and fiscal incentives could be made conditional on local bodies' participation, which would require improvements in local bodies' capacities to plan future investments and in their financial management. All these changes underscore the importance of improving governance at the grass-roots level.

[52] Traa and Carare (2007)

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Appendix Tables

Table A 1. Ratio of State-Wise Revenue Deficit to GSDP
(percent)

	2002-03 to 2004-05	2005-06	2006-07	2007-08
	Average	Actual	RE	BE
Non-special category				
Andhra Pradesh	1.6	0.03	0.02	0.01
Bihar	1.6	-0.13	1.14	-4.64
Chattisgarh	0.6	-3.12	-3.09	-3.08
Goa	1.5	0.17	0.23	0.05
Gujarat	2.3	0.18	-0.72	-0.57
Haryana	0.6	-1.21	0.56	-0.84
Jharkhand	1.0	3.25	2.09	0.85
Karnataka	0.5	-1.35	-1.46	-0.74
Kerala	4.3	2.60	4.36	3.41
Madhya Pradesh	1.4	-0.03	-1.44	-1.44
Maharashtra	2.8	0.89	0.64	-0.09
Orissa	2.4	-0.76	-0.90	-1.01
Punjab	4.4	*	*	*
Rajasthan	3.3	0.54	-0.06	-0.13
Tamil Nadu	1.5	-0.92	0.10	0.04
Uttar Pradesh	4.7	0.49	-1.15	-1.81
West Bengal	4.7	3.24	3.20	2.43
NCT Delhi	-2.9	-4.11	-3.57	-3.91
Special Category				
Arunachal Pradesh	-3.6	-6.29	-13.58	-4.90
Assam	1.1	-3.20	1.24	-1.64
Himachal Pradesh	7.9	-0.41	0.19	0.75
Jammu and Kashmir	-7.1	-7.98	-7.64	-9.94
Manipur	0.5	-9.42	-16.85	-8.17
Megalaya	-0.9	-1.26	-5.43	-7.46
Mizoram	-0.7	-2.00	-4.69	-3.78
Nagaland	-3.1	-2.53	-4.16	-5.16
Sikkim	-12.9	-11.46	-23.42	-18.00
Tripura	-1.7	-6.91	-5.30	-2.55
Uttarakhand	4.0	*	*	*

Sources : Reserve Bank of India, Ministry of Finance, and budget documents.
of State governments

Notes: A "-" sign indicates surplus; RE denotes revised estimates;
BE denotes budget estimates; and "*" indicates that data are not available.

Gross State Domestc Product (GSDP) data are projected on three-year average annual growth rate, wherever both Central Statistical Organization (CSO) and budget speech data on GSDP are not available.

Table A 2. Ratio of State-Wise Gross Fiscal Deficit to GSDP
(percent)

	2002-03 to 2004-05	2005-06	2006-07	2007-08
	Average	Actual	RE	BE
Non-special category				
Andhra Pradesh	4.3	3.7	3.1	3.0
Bihar	6.4	6.1	10.4	4.2
Chattisgarh	4.0	1.0	2.6	2.7
Goa	4.7	4.6	4.7	4.3
Gujarat	4.9	2.9	2.5	2.1
Haryana	2.5	0.3	0.6	1.2
Jharkhand	6.2	10.3	10.1	7.5
Karnataka	3.4	2.2	2.8	2.9
Kerala	5.6	3.5	6.1	4.8
Madhya Pradesh	6.2	4.2	3.7	3.3
Maharashtra	5.1	4.1	3.1	2.0
Orissa	5.1	0.4	1.1	1.2
Punjab	5.5	*	*	*
Rajasthan	6.6	4.2	3.4	3.2
Tamil Nadu	3.5	1.1	2.7	2.9
Uttar Pradesh	6.0	3.9	3.8	2.8
West Bengal	6.1	4.2	4.5	3.9
NCT Delhi	2.7	-0.2	0.7	1.3
Special category				
Arunachal Pradesh	11.9	9.3	8.5	4.2
Assam	3.6	-0.8	7.2	3.8
Himachal Pradesh	12.2	3.2	3.9	4.1
Jammu and Kashmir	3.9	7.0	4.9	6.7
Manipur	8.7	6.3	4.9	2.1
Megalaya	4.6	3.1	1.4	1.2
Mizoram	11.5	12.1	7.7	2.6
Nagaland	3.3	3.8	4.0	2.0
Sikkim	5.5	8.7	10.5	11.8
Tripura	5.4	1.2	4.6	2.7
Uttarakhand	8.2	*	*	*

Sources : Reserve Bank of India, Ministry of Finance, and budget documents of State governments.

Notes : * Data not available; RE denotes revised estimates; BE denotes budget estimates; "-" sign indicates surplus; and GSDP data are projected on a three-year average annual growth rate, wherever both CSO and budget speech data on GSDP are not available.

Table A-3. Ratio of Interest Payments to Revenue Receipts

(percent)

	2002-03 to 2004-05	2005-06	2006-07	2007-08
	Average	Actual	RE	BE
Non-special category				
Andhra Pradesh	25.6	20.1	17.7	15.7
Bihar	24.8	20.5	16.9	14.2
Chattisgarh	16.2	10.6	8.9	8.9
Goa	17.8	18.5	17.0	14.7
Gujarat	29.8	24.5	22.9	23.5
Haryana	21.3	15.2	14.3	14.0
Jharkhand	12.2	8.8	7.7	15.5
Karnataka	17.5	12.4	11.1	11.8
Kerala	27.5	24.8	23.4	22.3
Madhya Pradesh	19.9	16.6	15.7	15.2
Maharashtra	23.0	19.3	19.5	17.7
Orissa	30.9	26.2	18.5	21.0
Punjab	30.1	*	*	*
Rajasthan	31.0	25.0	22.5	21.4
Tamil Nadu	18.8	13.4	13.6	12.5
Uttar Pradesh	29.6	20.1	17.7	17.3
West Bengal	52.2	41.1	40.2	37.5
NCT Delhi	17.9	15.4	18.0	17.5
Special Category				
Arunachal Pradesh	10.0	8.5	8.9	8.9
Assam	17.0	12.5	13.3	11.0
Himachal Pradesh	34.8	23.8	24.0	24.3
Jammu and Kashmir	13.8	11.3	10.0	9.3
Manipur	16.5	9.9	9.2	10.7
Megalaya	11.8	10.9	8.7	6.9
Mizoram	12.4	11.2	11.4	11.1
Nagaland	13.0	11.2	9.9	10.1
Sikkim	5.5	5.2	4.8	4.7
Tripura	14.9	12.3	12.6	10.6
Uttarakhand	17.9	*	*	*

Sources: Reserve Bank of India, Ministry of Finance, and budget documents of State Governments

Notes : RE denotes revised expenditure; BE denotes budget expenditure;
"*" denotes that data are not available

Table A 4. Ratio of Capital Outlay to GSDP
(percent)

	2002-03 to 2004-05	2005-06	2006-07	2007-08
	Average	Actual	RE	BE
Non-special category				
Andhra Pradesh	2.4	3.4	4.1	4.5
Bihar	2.9	3.4	8.7	8.5
Chattisgarh	2.8	3.4	4.7	6.1
Goa	3.1	4.5	4.5	4.2
Gujarat	2.0	3.2	3.3	2.6
Haryana	0.8	1.6	1.7	2.0
Jharkhand	4.2	4.7	5.3	5.0
Karnataka	2.7	3.4	4.1	3.7
Kerala	0.8	0.7	1.2	0.9
Madhya Pradesh	3.5	6.1	4.2	4.2
Maharashtra	1.9	2.3	2.1	1.9
Orissa	1.9	1.6	2.0	2.0
Punjab	0.7	*	*	*
Rajasthan	2.9	3.5	3.6	3.2
Tamil Nadu	1.9	1.9	2.6	2.9
Uttar Pradesh	2.9	3.4	4.8	4.5
West Bengal	0.6	0.7	0.8	0.9
NCT Delhi	1.3	1.4	1.7	2.5
Special Category				
Arunachal Pradesh	15.4	15.6	22.0	9.0
Assam	2.6	2.3	5.7	5.2
Himachal Pradesh	4.3	3.7	3.8	3.3
Jammu and Kashmir	10.7	14.8	13.3	17.0
Manipur	8.0	14.3	20.4	10.1
Megalaya	4.6	4.5	6.4	8.5
Mizoram	11.5	13.7	12.8	6.7
Nagaland	6.4	6.3	8.2	7.1
Sikkim	18.4	20.1	34.0	29.8
Tripura	7.1	8.2	9.9	5.2
Uttarakhand	3.6	*	*	*

Sources : Reserve Bank of India, Ministry of Finance, and Budget Documents of State Governments

Notes : RE denotes revised estimates; BE denotes budget estimates;
* indicates data are not available.
GSDP data are projected on three-year average annual growth rate, wherever both CSO and budget speech data on GSDP are not available.

Table A-5. Ratio of Social Sector Expenditure to GSDP
(percent)

	2002-03 to 2004-05	2005-06	2006-07	2007-08
	Average		RE	BE
Non-special category				
Andhra Pradesh	7.0	6.6	8.4	9.8
Bihar	12.1	14.3	18.7	17.5
Chattisgarh	8.8	9.7	12.4	12.1
Goa	7.2	6.8	7.1	6.8
Gujarat	5.6	5.1	5.2	4.6
Haryana	4.1	4.7	4.8	5.0
Jharkhand	12.0	12.9	14.1	12.1
Karnataka	6.4	6.8	8.0	8.8
Kerala	7.2	6.2	7.2	6.8
Madhya Pradesh	7.6	8.6	9.3	9.3
Maharashtra	5.5	5.6	6.0	5.5
Orissa	8.5	8.5	8.1	8.2
Punjab	4.2	*	*	*
Rajasthan	9.1	8.9	8.7	8.2
Tamil Nadu	6.8	6.9	7.1	7.7
Uttar Pradesh	6.6	7.8	8.8	8.1
West Bengal	4.9	5.0	5.5	5.6
NCT Delhi	4.6	4.3	4.6	5.4
Special Category				
Arunachal Pradesh	23.7	26.7	29.1	15.4
Assam	9.6	9.5	15.6	14.6
Himachal Pradesh	12.2	12.5	10.7	9.6
Jammu and Kashmir	14.0	17.7	17.4	16.6
Manipur	18.1	21.9	23.1	17.6
Megalaya	13.4	13.3	15.5	19.2
Mizoram	24.6	22.0	21.7	16.9
Nagaland	10.7	9.8	10.1	7.9
Sikkim	29.6	29.2	34.8	34.0
Tripura	14.2	12.3	13.7	5.9
Uttarakhand	11.5	*	*	*

Sources : Reserve Bank of India, Ministry of Finance, and budget documents of State Governments.

Notes : RE denotes revised estimates; BE denotes budget estimates;
"*" denotes data are not available.
GSDP data are projected on three-year average annual growth rate, wherever both CSO and budget speech data on GSDP are not available.

Table A-6. Ratio of Social Sector Expenditure to Total Expenditure
(percent)

	2004-05	2005-06	2006-07	2007-08
	Accounts	Accounts	RE	BE
Non-special category				
Andhra Pradesh	29.3	30.8	34.8	36.1
Bihar	30.5	38.4	40.1	40.8
Chattisgarh	37.7	44.2	48.6	44.5
Goa	31.4	30.9	31.9	27.7
Gujarat	29.0	32.1	33.6	32.1
Haryana	24.2	32.0	29.1	33.5
Jharkhand	44.1	45.9	47.0	43.7
Karnataka	28.5	33.4	34.9	39.1
Kerala	36.2	35.6	33.9	34.0
Madhya Pradesh	24.7	32.5	37.1	37.8
Maharashtra	28.1	35.3	38.2	37.9
Orissa	28.9	34.1	33.1	32.9
Punjab	17.8	*	*	*
Rajasthan	34.1	40.1	40.0	38.2
Tamil Nadu	32.6	36.9	35.3	37.9
Uttar Pradesh	28.6	33.6	34.8	34.0
West Bengal	29.1	28.2	33.5	35.1
NCT Delhi	33.1	41.0	26.3	39.3
Special category				
Arunachal Pradesh	31.2	30.6	31.5	19.0
Assam	32.4	36.8	38.7	40.3
Himachal Pradesh	29.0	32.7	33.2	33.7
Jammu and Kashmir	27.9	29.9	30.7	28.4
Manipur	33.6	34.2	30.5	27.5
Megalaya	35.8	38.1	36.8	38.1
Mizoram	35.6	33.3	34.2	33.2
Nagaland	27.6	28.6	29.9	26.6
Sikkim	22.2	23.3	25.1	23.7
Tripura	37.6	33.9	37.9	33.5
Uttarakhand	28.6	*	*	*

Sources : Reserve Bank of India, Ministry of Finance, and Budget Documents of State Governments.

Notes : RE denotes revised estimates and BE denotes budget estimates;
"*" denotes data are not available.