UTTAR PRADESH
MEDIUM TERM EXPENDITURE POLICY

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November 2005

National Institute of Public Finance and Policy
New Delhi

Preface

This study has been undertaken by the National Institute of Public Finance and Policy at the instance of the Resource and Expenditure Commission of Uttar Pradesh, Lucknow.

The study team consists of D. K. Srivastava, C. Bhujanga Rao, and Manish Gupta. Opinions and analyses here are those of the authors. The members of the Governing Body of the National Institute of Public Finance and Policy are in no way responsible for these.

November 2005 M. Govinda Rao
New Delhi Director

Acknowledgements

The study was undertaken at the instance of the Resource and Expenditure Commission of Uttar Pradesh. The study team has benefited from extensive discussions with B. N. Tiwari, Chairman, Resource and Expenditure Commission. In the interactions with the government officials in Uttar Pradesh, O. P. Agarwal and R. K. Verma has been of immense help as coordinators.

The study team had occasion to discuss various dimensions of expenditure and budgetary reforms with officials of different departments. We would particularly like to acknowledge the help of Shekhar Agarwal, Principal Secretary, Finance Department and B. M. Joshi, Secretary, Finance Department. We had useful discussions with V. Venkatachalam, Principal Secretary, Planning Department, Mahesh Kumar Gupta, Secretary, Department of Energy, Amal Kumar Verma, Principal Secretary, Irrigation Department, N. C. Bajpai, Additional Chief Secretary, Agricultural Production Commission, Siddharth Behura, Principal Secretary, Medical and Public Health Department, Rajeev Kumar, Secretary, Higher Education Department, S. K. Agarwal, Principal Secretary, Public Works Department, and Anil Sant, Principal Secretary, Social Welfare Department.

At the NIPFP, we would like to thank M. Govinda Rao, Director and Amaresh Bagchi, Emeritus Professor for their constant guidance and encouragement.

Our Project Associate Shrabani Mukherjee has worked with diligence and resourcefullness.

R. S. Tyagi provided adept secretarial assistance. We thank them all.

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November 2005
New Delhi

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Executive Summary

Medium Term Expenditure Policy

1. There are three reasons for which a medium term expenditure policy is highly relevant in Uttar Pradesh.

    a. *Fiscal Correction*: The finances of UP show marked deterioration in revenue and fiscal balance relative to GSDP towards the end of the nineties. The profile of fiscal imbalance after bifurcation, after a brief period of improvement has started deteriorating again. The quality of fiscal deficit has worsened considerably over the years. Relative to other states, fiscal imbalance in UP is among the largest.

    b. The Twelfth Finance Commission has recommended a programme for structuring state finances and provided a set of incentives. The state government should take full benefit of the provisions in accordance with the Debt Consolidation and Relief Facility (2005-10) [DCRF] notified by the Central government.

    c. The state government has enacted a Fiscal Responsibility and Budget Management Act. Achieving targets specified in the Act would require a suitable medium term expenditure policy.

State Finances: Overview

2. Relative to GSDP, every major component of revenue receipts, i.e., own tax revenues, central transfers, and own non-tax revenues fell during 1987-88 to 1999-00. This was accompanied by an unhealthy structural shift in expenditure. While interest payments, pensions and salary expenditures rose sharply, capital expenditure fell. There has been an improvement in revenue receipts in 2004-05 and 2005-06. These exhibit the highest level of revenue effort since 1987-88. On the expenditure side, major concerns remain. Compared to 1990-91, the emergent picture with respect to GSDP in 2005-06 indicated that:

    i. own tax revenues declined over the years but reached the same level as in 1990-91. Throughout the period 2000-01 to 2005-06 BE (except 2001-02), the tax-GSDP ratio has remained above 6 percent of GSDP. This represents a significant improvement in UP's tax-GSDP ratio;

    ii. own non-tax revenues increased by 0.30 percentage point (although compared to 1987-88, this shows a fall of 0.10 percentage point); own non-tax revenue fell as percentage of GSDP in recent years after reaching a peak in 2003-04;

    iii. central transfers after falling towards the end of the nineties, have improved in 2004-05 and 2005-06;

iv. interest payment increased by 1.63 percentage points during 1990-91 and 1999-00; these have continued to rise reaching a level of 4.7 percent in 2003-04 but showed improvement in the subsequent years;

v. pensions increased by 0.80 percentage point during 1990-91 to 1999-00, and have continued to rise as percentage of GSDP;

vi. capital expenditure fell by 1.22 percentage points between 1990-91 and 1999-00. In 2005-06 BE, these are estimated at 2.86 percent of GSDP;

vii. revenue deficit increased by 2.14 percentage points (by 4.78 percentage points as compared to 1987-88);

viii. fiscal deficit increased by 1.37 percentage points (3.67 with respect to 1987-88); it has come down in recent years (except 2003-04) and estimated at 4.9 percent of GSDP in 2005-06 BE; and

ix. outstanding debt rose by 14.41 percentage points between 1990-91 to 1999-00. It has continued to rise till 2003-04 and since then it is estimated to decline by 2 percentage points reaching a level of 53.2 percent in 2005-06 BE.

Expenditure: Disturbing Trends

3. Interest payments and pensions have grown much faster than GSDP and revenues. The share of economic services in total revenue expenditure has fallen by more than 10 percentage points during the nineties; and that of social services, by a little more than 2 percentage points. There is a sharp increase in the ratio of interest payment to total revenue expenditure in the post-division years. It is estimated at about 23 percent in 2005-06. This together with pension payment of 8.7 percent, account for about 32 percent of revenue expenditure.

4. The burden of adjustment of declining revenue receipts fell significantly on capital expenditures, which have steadily fallen relative to GSDP. Most of this decline was in capital outlay.

5. High revenue intensity in plan expenditures of over 65 percent indicates that plan schemes have relatively large salary expenditure. At the same time, the share of plan revenue expenditure has been falling in total revenue expenditure. In the years after the bifurcation of the state, plan revenue intensity has improved. It is estimated to be about 49 percent in 2005-06.

6. Control on growth in number of government employees will provide necessary reduction in growth of committed expenditure that is needed for carrying fiscal correction required in the FRBMA and the DCRF.

Fiscal Responsibility Act: Medium Term Targets

7. The fiscal situation of the state calls for multi-dimensional reforms, augmenting tax revenues with distortion-minimising tax reforms, reducing interest payments, curbing growth of government employment, introducing a new strategy for handling pension

liabilities, revamping state level public enterprises, curbing contingent liabilities and bringing debt within sustainable limits. To achieve a greater control and more effective intervention, the FRBMA provides for reducing revenue deficit to zero by 2008-09 among other targets. This would help the state take benefit of the debt consolidation and relief facility based on the recommendations of the Twelfth Finance Commission.

8. Given the FRBMA, a seven-point strategy of expenditure reforms is suggested.

    i. Pension reforms.
    ii. Salary and employment related reforms.
    iii. Subsidy reforms.
    iv. Capital expenditure augmentation.
    v. New plan strategy.
    vi. Improving efficacy of government expenditure.
    vii. Rationalisation of support to public sector.

Expenditure Reforms

9. Pensions constitute an ever-increasing fiscal liability. Pension reforms should be initiated to bring its budgetary costs under control. Salary related reforms, including reform in government employment strategy, should constitute the core of fiscal reform.

10. Subsidy reforms should lead to reduction in volumes, lower costs, greater transparency and better targeting. The planning strategy should emphasise not the plan size but its productivity. Projects should be selected on the basis of cost-benefit analysis; and potential contribution to output and non-government employment opportunities.

11. Capital expenditure relative to GSDP should be augmented, focusing on infrastructure, especially roads and bridges, power, and information technology. It would be efficient to rationalise the departmental organisation of government's responsibilities. Once reforms are decided upon and undertaken, a monitoring mechanism should be in place to review the progress of reforms.

12. Expenditures in sectors like health and education, and maintenance of buildings and roads must be augmented in line with the recommendations of the TFC, to not only take full advantage of the conditional grants earmarked for these sectors, but also to improve the quality and effectiveness of government services.

13. A medium term strategy of expenditure restructuring and reforms should aim at improving the outcomes of government's provision of crucial public services like general administration and law and order and merit services like health and education.

14. In this study, a medium term expenditure restructuring plan has been drawn up for the period upto 2009-10. It shows how medium term restructuring of expenditure should be taken up while achieving and benefiting from the FRBMA and DCRF provisions.

Abbreviations

BE	Budget Estimates
EFC	Eleventh Finance Commission
FRBMA	Fiscal Responsibility and Budget Management Act
DA	Dearness Allowance
GCS	General Category States
GDP	Gross Domestic Product
GoUP	Government of Uttar Pradesh
GSDP	Gross State Domestic Product
IMR	Infant Mortality Rate
LPG	Local Public Good
MTFRP	Medium Term Fiscal Restructuring Policy
NSC	Non-Special Category
NSSF	National Small Savings Fund
O&M	Operation and Maintenance
OTR	Own-Tax Revenue
PRI	*Panchayati Raj* Institutions
RE	Revised Estimates
SCS	Special Category States
TFC	Twelfth Finance Commission
TGR	Trend Growth Rate
TRR	Total Revenue Receipts
UUP	Undivided Uttar Pradesh

Chapter 1: Medium Term Expenditure Policy: Objectives and Prerequisites

Government expenditures are made primarily for providing public goods like general administration and law and order and merit goods like education and health. Government also has a role in building infrastructure, which requires large and lumpy investments. Expenditures incurred by the state governments are meant to serve the citizens in respect of the responsibilities constitutionally assigned to the states. The state government has a key role to play not only in supporting economic growth and facilitating private investment, but also evolving an expenditure policy with the objective of combating poverty and providing social security.

A robust expenditure policy should not only be equitable and efficient, it should keep in mind the relevant resource constraint, and take into account not only the immediate impact of expenditures but also the longer-term outcomes. In practice, government expenditures often get pre-determined by past commitments like interest payments and pensions. Inefficiencies are generated when only an incremental approach and ad hoc considerations determine current expenditure allocations. Clearly, a medium term perspective to determining state level expenditures is essential for improving the efficiency and quality of government's participation in providing public and merit goods to its citizens and strengthening the growth and poverty alleviating processes in the state.

At present, most state governments show a structure of expenditure that has a pre-emptively large share of interest payments and inadequate capital expenditures including that on infrastructure, human and physical. This structural imbalance is due to inordinate growth of debt relative to GDP and inadequate economic growth. Corrections in fiscal imbalance that are structural in nature require a medium term framework that avoids sudden shocks but is persistent enough to yield results in a period of four to five years. Such a policy would slowly but steadily nurse government finances in Uttar Pradesh to productive and growth-augmenting fiscal balance. A medium term expenditure policy should be designed with a focus on the following:

i. The state government is able to provide adequately public goods like general administration and law and order, and merit goods like education and health since these are its primary responsibilities;

ii. The medium term expenditure policy should be consistent with the resource constraint and duly take into account fiscal deficit and revenue deficit targets prescribed under the State Level Fiscal Responsibility Act and DCRF (discussed in the following sections);

iii. The government is able to restructure expenditure towards building up infrastructure, with a view to strengthening the growth pulse of the state economy;

iv. The state government is able to provide only desirable levels of well targeted subsidies in limited cases like education and health, and undertake extensive reforms to make subsidies smaller in volume, transparent, and well targeted; and

v. The expenditure policy should aim at not only the immediate impact but also the longer-term outcomes.

1.1 Fiscal Responsibility and Budget Management Act

The Government of Uttar Pradesh (GoUP) enacted a Fiscal Responsibility and Budget Management Act (FRBMA) in 2004. This Act aims at ensuring fiscal stability and sustainability for Uttar Pradesh while enhancing the scope of improving social and physical infrastructure as well human development. It emphasizes, for this purpose, the need for achieving revenue surplus, reduction in fiscal deficit, and prudent management of debt. It envisages limits on fiscal and revenue deficits as well as government guarantees. It also places emphasis on the need for greater transparency and provides for a medium term fiscal framework. It specifically provides that the state government shall:

i. reduce revenue deficit to zero by the end of 2008-09;

ii. reduce revenue deficit as percentage of GSDP in each financial year beginning April 1, 2004 in a manner consistent with eliminating revenue deficit by 2008-09;

iii. reduce fiscal deficit as percentage of GSDP in each year beginning April 1, 2004 so as to achieve the target of reducing fiscal deficit to no more than 3 percent of GSDP by 2008-09; and

iv. ensure that within a period of 14 financial years beginning from 2004-05, that is by 2017-18, the total liabilities of the state government do not exceed 25 percent of GSDP of that year.

The guarantees are also to be limited as provided by appropriate Rules framed under the Act or any other suitable law or rule.

The medium term expenditure policy in Uttar Pradesh has to be consistent with the UP's FRBMA. The deficit reduction targets have to go hand in hand with expenditure restructuring so as to achieve the objectives of the Act while augmenting the quality of services provided by the government.

Following the recommendations of the Twelfth Finance Commission (TFC), the Ministry of Finance, Government of India has notified the States' Debt Consolidation and Relief Facility (2005-10)[DCRF]. The DCRF provides that the state would be entitled to the rescheduling of its debt to the central government till March 31, 2004 as outstanding on March 31, 2005 for a period of 20 years at an interest rate of 7.5 percent. This facility is incumbent upon the state legislating a Fiscal Responsibility Act that provides for eliminating the revenue deficit by 2008-09 and reducing fiscal deficit to GSDP ratio to 3 percent.

The deficit defined in DCRF is inclusive of the power sector deficit. The exact definitions are given below:

Revenue Deficit	Budgetary Revenue Receipts - Budgetary Revenue Expenditure
Fiscal Deficit	Revenue Deficit + [Budgetary Capital Expenditure, including net loans advanced - Other non-debt Capital Receipts]
Power Sector Revenue Deficit	Power Sector loss/profit net of actual subsidy transfer + increase in debtors during the year in power utility accounts.
Consolidated Revenue Deficit	Budgetary Revenue Deficit + Power Sector Deficit + Interest on SPV borrowings made by PSUs outside budget.

Any revenue expenditure classified as capital expenditure would be added back as revenue expenditure.

The state government's FRBMA and Central government's DCRF are given as Annexures 1 and 2.

1.2 Dimensions of a Medium Term Expenditure Policy

Recent trends in the structure of expenditure in Uttar Pradesh show a rising share of interest payments and a falling share of capital expenditures. According to available information, interest payments in 1993-94 accounted for about 16 percent of total expenditure in Uttar Pradesh. In the 2004-05 budget estimates, these are shown to account for more than 26 percent of the total expenditure. Similarly, during this period, pension payments have increased from 3.4 to 9.7 percent of total expenditure. Expenditure reforms should lead to a reversal of this pattern. A medium term expenditure policy should indicate:

i. areas where expenditures should be reduced;

ii. areas where expenditure should be increased;

iii. steps for improving the quality and efficacy of expenditures relating these to short term and long term goals;

iv. improvement in monitoring and tracking systems for approved expenditures; and

v. comprehensive restructuring of state level subsidies, which necessitate examination not only of levels of expenditures but also methods of financing these.

The medium term expenditure policy should also examine (i) the scope of reducing pension liabilities in relation to total revenue expenditures, and (ii) the scope of limiting the growth of salary expenditures. Areas where expenditures should increase are non-salary expenditure on education and health and capital expenditure. The scope for giving more responsibilities to the local bodies should also be examined. Often, excessive intervention in economic sectors leads to an under-emphasis in respect of general services that include administration and law and order, which are the main responsibilities of the state governments.

Expenditure policy cannot be formulated without properly taking into account the link between expenditure and its financing. In particular, economic theory suggests that the best method of financing expenditure on public goods is through taxation. Merit goods may be financed through a mix of user charges supplemented by desirable level of subsidies financed by taxation. Expenditure on private goods and services provided by the state government should be financed by suitable user charges and tariffs. This nexus between expenditure and its mode of financing is critical for efficient fiscal intervention.

1.3 Impact of Expenditure on Outputs and Outcomes

Most expenditure priorities are determined without an adequate consideration of their impact. Expenditures translate into outputs in the short run and outcomes in the final analysis. Thus, expenditure on education translates into changes in the literacy rate and other educational attainments. Similarly, expenditure on health makes an impact on lowering of IMR, MMR, and increasing life expectancy. In the case of capital expenditures also, there is need to focus on the quality and form of capital expenditure. In particular, emphasis has to be on building physical infrastructure in roads, schools, and hospitals and away from loans or equity investment in unproductive public sector enterprises.

1.4 Intra-State Inequalities

After the bifurcation of the state and creation of Uttaranchal, Uttar Pradesh can pay greater attention to the two main regions with low economic base and high incidence of poverty, *viz*., Bundelkhand and Eastern Uttar Pradesh. In view of the poverty alleviation objective, an inter-regional dimension should also characterise the medium term expenditure policy.

1.5 Need for Decentralisation

Decentralization is generally considered efficiency augmenting. The provisions of local public goods (LPGs) is best handled in a decentralised way. The efficiency advantages of decentralisation of LPGs are varied and quite significant. The first advantage of decentralisation is the possibility of having regional variety in the mix and level of LPGs, which can greatly enhance social welfare. Research has indicated that preference revelation problems encountered in public finance are greatly diminished as the size and heterogeneity of the population decreases. With decentralisation, competition, proximity, and transparency provide a strong motivation for local governments to be more responsive to the desires of the public.

1.6 Aggregate Fiscal Discipline

Institutional arrangements for aggregate fiscal discipline can take many forms including formal constitutional restraints on aggregate expenditure, formal responsibility legislations, and public commitments by the executive with or without the commitment of the legislature. When decision-makers formally set the aggregate expenditure ceiling at the appropriation stage, there is need to monitor actual expenditure during budget execution, and identify as far in advance as possible, pressure points in relation to the aggregate expenditure. An important restraint on decision-makers is the requirement that actual expenditure be reconciled with budget estimates during budget execution.

1.7 Strategic Priorities

Given aggregate fiscal discipline, the second key challenge is how to prioritize competing claims on scarce resources. It is best to build up institutional arrangements to provide the incentives for desired strategic allocation of resources and improve the quality of information needed to do this effectively. Institutional arrangements that support sound strategic policy making would require a cohesive document describing the vision in the medium and long-term for the state.

1.8 Operational Performance

The predictability of funding to approved policies, both within the budget year and from one year to the next, increases efficiency. The increased delegation to line managers of the authority to make financial decisions commensurate with the responsibility for producing outputs and achieving outcomes. Further, a genuine “hard” budget constraint, during budget execution, for the state as a whole and for the individual departments, produces better allocations of resources and administrative energies.

This study is divided into five Chapters. In Chapter 2, we look at the salient fiscal trends highlighting growing imbalances and areas that require correction. In Chapter 3, the implications of the Fiscal Responsibility and Budget Management Act and Centre’s Debt Consolidation and Relief Facility are examined. A medium term expenditure policy for Uttar Pradesh is suggested in Chapter 4. The final Chapter summarises the suggested medium term expenditure reforms.

Chapter 2: Fiscal Trends in Uttar Pradesh: A Review

In November 2000, Uttaranchal was carved out from the erstwhile Uttar Pradesh as a separate state. This has affected the two new States asymmetrically. In this chapter, we look at the salient fiscal trends in Uttar Pradesh for the undivided UP (UUP) until November 8, 2000, and reorganised UP after that date.

2.1 Fiscal Imbalance: Structural Deterioration

The outstanding feature of the finances of Uttar Pradesh was the mounting fiscal imbalance where the revenue surplus of 0.66 percent of GSDP in 1987-88 transformed into a deficit in 1988-89 reaching a peak of 5.31 percent in 1998-99. Upto 1998-99, the deteriorating fiscal situation can clearly be divided into three phases: the first from 1987-88 to 1990-91, the second from 1991-92 to 1995-96, and the last from 1996-97 to 1998-99. The year 1999-00 could be seen as the beginning of another phase of improvement. In 1999-00, it improved to 4.12 percent of GSDP. The fiscal deficit increased from 2.64 percent of GSDP in 1987-88 to a peak of 7.11 percent in 1998-99. It marginally improved to 6.31 percent in 1999-00. In fact, after the reorganisation of UP, the trend towards improvement was strengthened until 2003-04, when a sharp deterioration occurred due to the power sector adjustments. Thereafter there is some improvement. The three phases mentioned above and the position after that as shown by the profiles of revenue, fiscal, and primary deficits are shown in Chart 2.1.

Further, the share of revenue deficit in fiscal deficit, which is indicative of the quality of fiscal deficit, had also sharply deteriorated. In 1990-91, nearly 40 percent of fiscal deficit was claimed by revenue deficit. This share rose to nearly 75 percent in 1998-99. After that, it has started to fall showing improvement in the utilisation of fiscal deficit, with 2003-04 being an exception, due to one-time adjustment in the electricity sector, as already mentioned. The dimensions of fiscal imbalance, based on some key fiscal indicators, are summarised in Table 2.1. It is notable that in both the earlier phases, fiscal deterioration started with salary revisions in tandem with the Fourth and Fifth Central Pay Commissions. In the late nineties, the deterioration is sharper, combining the influence both of salary revision and increasing debt combined with the rising cost of borrowing in the nineties.

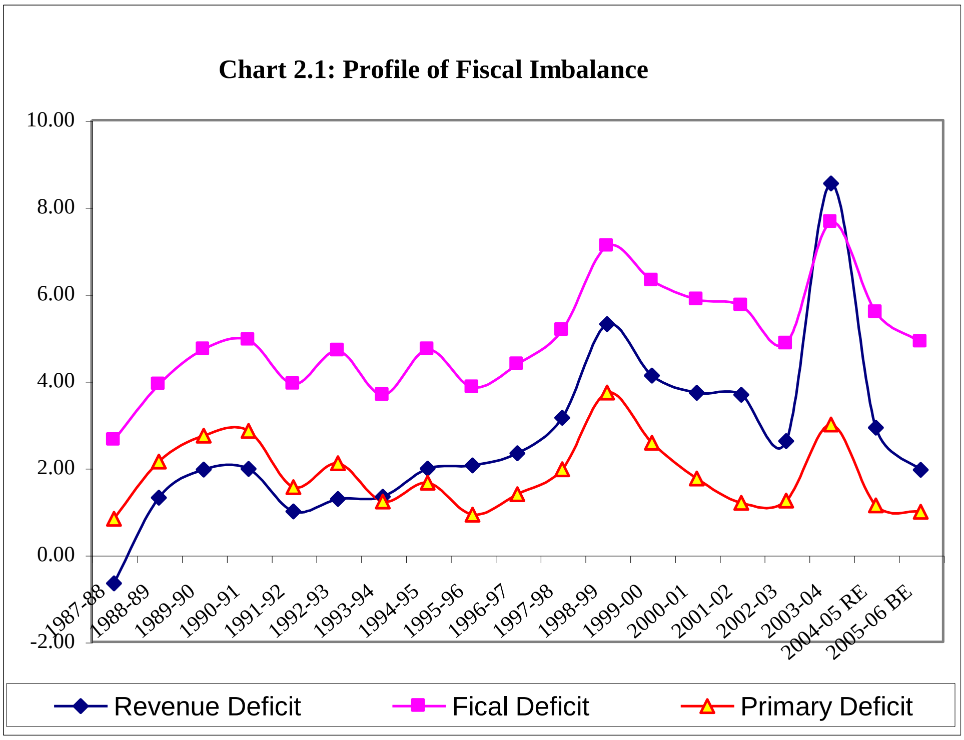


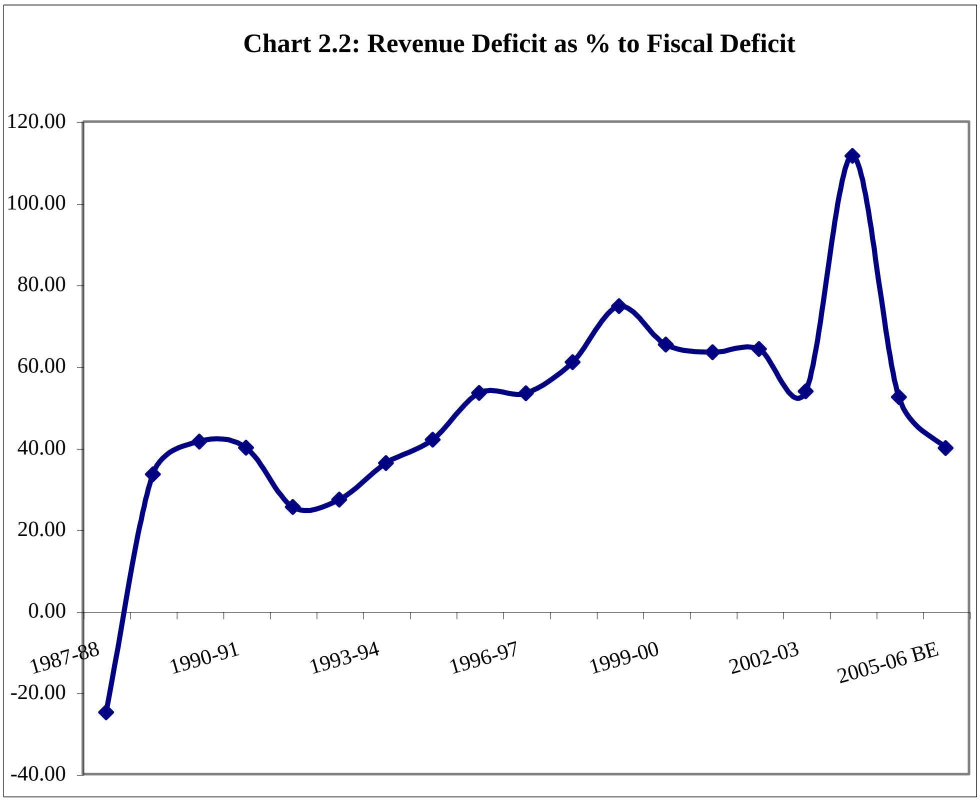
Table 2.1: Fiscal Imbalance: The Key Indicators

(Percent to GSDP)

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Revenue Deficit	-0.66	1.32	1.97	1.98	1.00	1.28	1.34	1.99	2.06	2.34
Fiscal Deficit	2.64	3.92	4.73	4.94	3.92	4.69	3.68	4.73	3.85	4.38
Primary Deficit	0.83	2.15	2.75	2.85	1.56	2.11	1.23	1.66	0.93	1.39
Revenue Deficit/Fiscal Deficit	-24.86	33.55	41.53	40.04	25.54	27.34	36.29	42.02	53.43	53.38
Outstanding Debt*	29.53	29.02	30.59	31.26	31.41	33.15	33.96	34.20	34.54	33.75

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05RE	2005-06BE
Revenue Deficit	3.16	5.31	4.12	3.73	3.68	2.62	8.54	2.93	1.96
Fiscal Deficit	5.17	7.11	6.31	5.87	5.73	4.86	7.65	5.58	4.90
Primary Deficit	1.97	3.74	2.58	1.76	1.20	1.25	3.00	1.14	0.99
Revenue Deficit/Fiscal Deficit	61.03	74.76	65.35	63.42	64.25	53.88	111.62	52.44	39.93
Outstanding Debt*	36.05	38.31	45.68	43.85	50.76	51.94	55.27	54.01	53.24

Sources (Basic Data): Finance Accounts of Uttar Pradesh & Budget Document (2005-06) of Uttar Pradesh.
Note: * Includes Reserve Fund and Deposits.



In the late nineties, almost all states went through a difficult phase in respect of state finances. In a comparative perspective, however, the position of fiscal imbalance in Uttar Pradesh has been one of the worst. As already mentioned, the ratio of revenue to fiscal deficit in UUP was 74.76 percent in 1998-99, which was the highest among the NSC states in that year. Thus, while the experience of growing fiscal imbalance during the nineties is shared by all states, UP's finances proved to be particularly vulnerable to the impact of rise in revenue expenditure claims on salaries, pensions and interest payments. The outstanding liabilities of the state government show an explosive growth since 1999-00. It rose from a level of 38.31 percent of GSDP in 1998-99 to 55.27 percent in 2003-04 and there is a decline since then.

2.2 State Finances: Overview

Fiscal imbalance is the outcome of changes in revenue and expenditure profiles. We now look at these in terms of relevant revenue and expenditure aggregates. During the period from 1987-88 to 1998-99, the revenues of the state relative to GSDP declined by about 3 percentage points from 13.3 to 10.4 percent. There has been an improvement since then. The revenue receipts in 2004-05 RE and 2005-06 BE are estimated at 15.5 and 15.2 percent of

GSDP. If actually realised, these would be the highest levels of revenue effort seen since 1987-88. The relevant magnitudes are given in Table 2.2. This improvement has been mainly due a rise in own tax revenues and also due to the marginal increase in transfers from the centre.

Table 2.2: State Finance of Uttar Pradesh: An Overview

(Percent to GSDP)

	1987-88	**1988-89**	**1989-90**	**1990-91**	**1991-92**	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**
Revenues	13.25	11.69	11.93	12.76	12.49	13.85	12.87	12.20	12.78	11.55
Own Tax Revenues	5.18	4.50	4.67	5.10	4.84	4.92	4.80	4.84	4.81	4.64
Own Non-Tax Revenues	1.02	0.93	0.87	0.62	0.61	0.88	0.77	0.79	1.51	0.73
Share in Central Taxes	4.70	3.88	4.41	3.75	3.81	4.33	4.16	3.95	4.48	4.51
Grants	2.36	2.39	1.97	3.29	3.24	3.73	3.15	2.62	1.98	1.67
Contra Entries	0.63	0.61	0.69	0.63	0.89	0.92	1.23	1.08	0.60	0.24
Expenditures	16.16	16.00	16.73	18.29	16.67	18.63	16.69	17.76	16.76	16.10
Revenue Expenditure *of which*	12.60	13.01	13.90	14.74	13.49	15.14	14.21	14.19	14.84	13.89
Interest Payment	1.81	1.77	1.99	2.09	2.37	2.58	2.45	3.06	2.92	2.99
Pension	0.31	0.33	0.33	0.37	0.41	0.60	0.49	0.49	0.64	0.66
Capital Expenditure (net) *of which*	3.56	2.99	2.84	3.55	3.18	3.50	2.48	3.57	1.93	2.21
Capital Outlay	2.76	2.03	1.85	1.90	0.99	1.61	1.10	1.11	0.99	1.06
Net Lending	0.53	0.57	0.91	1.07	1.93	1.80	1.24	1.63	0.80	0.99

	1997-98	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05RE**	**2005-06BE**
Revenues	11.76	10.39	11.99	13.41	13.85	14.03	14.33	15.47	15.23
Own Tax Revenues	4.78	4.83	5.34	6.78	5.70	6.53	6.25	6.39	6.62
Own Non-Tax Revenues	0.64	0.67	0.92	0.82	0.72	0.78	0.84	0.66	0.60
Share in Central Taxes	4.90	3.56	4.25	4.28	5.62	5.54	6.10	6.42	6.17
Grants	1.44	1.32	1.48	1.53	1.82	1.18	1.14	1.99	1.84
Contra Entries	0.24	0.23	0.22	0.25	0.27	0.20	0.21	0.21	0.22
Expenditures	17.15	17.96	18.45	19.45	19.79	19.00	27.73	21.32	20.26
Revenue Expenditure *of which*	14.91	15.70	16.12	17.14	17.54	16.65	22.87	18.40	17.19
Interest Payment	3.20	3.37	3.72	4.12	4.53	3.61	4.65	4.44	3.91
Pension	0.72	1.09	1.17	1.19	1.32	1.41	1.33	1.62	1.50
Capital Expenditure (net) *of which*	2.24	2.26	2.34	2.31	2.25	2.35	4.85	2.93	3.07
Capital Outlay	1.14	1.28	1.44	1.80	1.96	1.94	4.28	2.58	2.86
Net Lending	0.88	0.51	0.75	0.34	0.09	0.30	-5.17	0.08	0.08

Source (Basic Data): Finance Accounts of Uttar Pradesh and Budget Document (2005-06) of Uttar Pradesh.

During 1987-88 to 1998-99, the general fall in revenue receipts was accompanied by a rise in expenditure from 16.16 percent of GSDP in 1987-88 to 18.45 percent in 1999-00. Within this margin of increase in the ratio of aggregate expenditure to GSDP, a large structural change needs to be highlighted. This relates to the committed expenditures like interest payments, pensions and salaries, which increased, and capital expenditure, and non-interest and non-pension revenue expenditures, which fell. Most of the increase was due to only two components of expenditure, namely, interest payments and pensions, which went up respectively by margins of 1.81 and 0.86 percentage points of GSDP between 1987-88 to

1999-00. On the other hand, capital expenditure became a casualty of the adjustment process, falling from 3.56 to 2.34 percent of GSDP over 1987-88 to 1999-00, a decline of 1.22 percentage points. In 2003-04, the revenue expenditure increased sharply from 16.1 percent of GSDP to 27.7 percent and has declined thereafter. This was due partially to a rise in interest payments from 3.6 percent of GSDP in 2002-03 to 4.7 percent in 2003-04. Pension payments also increased from 1.4 percent to 1.6 percent of GSDP between these years.

The structural changes in the fiscal profile of UP are summarised in Table 2.3 where a comparison is made in respect of selected fiscal aggregates, considered relative to GSDP, in 2003-04 and three benchmark years, *viz*., 1987-88, 1990-91 and 1999-00. Except for non-tax revenues, the resultant structural changes are the same in the two comparisons. Compared to 1990-91, the emergent picture indicates that:

i. own tax revenues declined over the years but reached the same level as in 1990-91. Throughout the period 2000-01 to 2005-06 BE (except 2001-02), the tax-GSDP ratio has remained above 6 percent of GSDP. This represents a significant improvement in UP’s tax-GSDP ratio;

ii. own non-tax revenues increased by 0.30 percentage point (although compared to 1987-88, this shows a fall of 0.10 percentage point); own non-tax revenue fell as percentage of GSDP in recent years after reaching a peak in 2003-04;

iii. central transfers after falling towards the end of the nineties, have improved in 2004-05 and 2005-06;

iv. interest payment increased by 1.63 percentage points during 1990-91 and 1999-00. They have continued to rise reaching a level of 4.7 percent in 2003-04 but showed improvement in the subsequent years;

v. pensions increased by 0.80 percentage point during 1990-91 to 1999-00, and have continued to rise as percentage of GSDP;

vi. capital expenditure fell by 1.22 percentage points between 1990-91 and 1999-00. In 2005-06 BE these are estimated at 2.86 percent of GSDP;

vii. revenue deficit increased by 2.14 percentage points (by 4.78 percentage points as compared to 1987-88);

viii. fiscal deficit increased by 1.37 percentage points (3.67 with respect to 1987-88); it has come down in recent years (except 2003-04) and estimated at 4.9 percent of GSDP in 2005-06 BE; and

ix. outstanding debt rose by 14.41 percentage points between 1990-91 to 1999-00. It has continued to rise till 2003-04 and since then it is estimated to decline by 2 percentage points.

Table 2.3: Fiscal Profile of Uttar Pradesh: Summary of Structural Changes (During 1999-00 to 2003-04)

(Percentage Points With Respect to GSDP)

	1987-88	1990-91	1999-00	1999-00 Minus		2003-04	2003-04 Minus
				1987-88	1990-91		1999-00
Own Tax Revenues	5.18	5.10	5.34	0.17	0.25	6.25	0.91
Own Non-Tax Revenues	1.02	0.62	0.92	-0.10	0.30	0.84	-0.08
Central Transfers	7.06	7.04	5.73	-1.33	-1.31	7.24	1.51
Interest Payment	1.81	2.09	3.72	1.92	1.63	4.65	0.93
Capital Expenditure	3.56	3.55	2.34	-1.23	-1.22	4.85	2.52
Revenue Deficit	-0.66	1.98	4.12	4.78	2.14	8.54	4.42
Fiscal Deficit	2.64	4.94	6.31	3.67	1.37	7.65	1.34
Outstanding Debt*	29.53	31.26	45.68	16.15	14.41	55.27	9.60

Source (Basic Data): Finance Accounts of Uttar Pradesh and Budget Document (2005-06) of Uttar Pradesh.
Note: * Includes Reserve Fund and Deposits.

Since 1999-00 and upto 2002-03, one notable change is the improvement in own tax revenues at 6.3 percent of GSDP. On the side of expenditure, in total expenditures, no significant change is noticeable. Revenue expenditures are examined in the following section.

Thus, the profile of the major fiscal aggregates over 1987-88/1990-91 to 1998-99 reveals *falling* (i) own tax revenues; (ii) non-tax revenues; (iii) capital expenditures relative to GSDP, accompanied by *rising;* (iv) interest payments; (v) pensions; (vi) revenue deficit; (vii) fiscal deficit; and (viii) outstanding debt. The picture since 1999-00 show improvement in own revenues, but the expenditures still show a rising trend. As a result, there is no tangible improvement in fiscal imbalance. The superimposition of cyclical phases on long-term deterioration path may be attributed to one-time shocks of salary revisions that occurred twice (connected with Fourth and Fifth Central Pay Commission Reports).

2.3 Revenue Expenditure: Trends

The structure of revenue expenditures has undergone a significant change during 1987-88 to 2003-04. In considering the expenditure trends, it is appropriate to consider the period upto 1999-00, while UP was undivided as distinct from the period afterwards. As per the TGR estimated over the period 1987-88 to 1999-00 (Table 2.4), interest payments grew by about 21 percent per annum, while pension payments grew by about 26 percent per annum on an average. Revenue expenditure on education grew by 14 percent, while that on medical and public health grew by about 12 percent per annum. Expenditure on economic services grew at a TGR of about 11 percent. The growth in expenditure was thus dominated by the growth in interest payments and pensions. There was a fall in the growth of interest payments after the bifurcation, because of a fall in the nominal interest rates. The pre-emptive claim of committed expenditures of interest payments and pensions is also clearly brought out by the changes in the structure of revenue expenditure indicated in Table 2.5. The share of interest payment in total revenue expenditure increased from about 14.2 percent in 1990-91 to more than 23 percent in 1999-00, and that of pensions increased from 2.52 percent to more than 7 percent, during the same period. Correspondingly, the shares of social services and economic services have both gone down, the latter by a much larger margin of about 10 percentage points.

Table 2.4: Growth Profile of Revenue Expenditure: A Disaggregated Analysis

(Percent Per Annum)

	Trend Growth Rates			
	1987--2000	**1987-2004**	**1987-1995**	**1995-2004**
General Services	**18.64**	**16.53**	**19.49**	**12.09**
Interest Payment	20.68	18.11	23.17	13.38
Pension	26.27	23.70	24.34	19.63
Others	14.98	13.14	15.37	8.28
Social Services	**13.66**	**11.54**	**13.84**	**7.70**
Education	14.41	12.06	14.83	7.97
Medical & Public Health	11.70	9.84	13.12	6.17
Family Welfare	8.17	6.69	12.36	2.77
Other Social Services	13.85	12.52	12.07	8.66
Economic Services	**10.65**	**11.32**	**14.49**	**15.18**
Irrigation	10.98	7.41	17.25	-0.62
Roads and Bridges	10.54	11.42	15.12	13.98
Others	10.39	11.91	13.43	18.85
C. & A. to Local Bodies	**29.34**	**25.35**	**34.14**	**21.17**
Total Expenditure	**15.19**	**13.95**	**16.34**	**12.10**

Source (Basic Data): Finance Accounts of Uttar Pradesh and Budget Document (2005-06) of Uttar Pradesh.

There is sharp increase in the ratio of interest payment to total revenue expenditure in post-division years. By 2001-02, it had increased to about 26 percent. After some decline, it is estimated at about 23 percent in 2005-06BE. This together with pension payment of 8.7 percent, claim about 32 percent of revenue expenditure.

However, as shown in Chart 2.3, the ratio of interest payment to revenue deficit in UP is lower than that of a number of the NSC states (as per actual figures for the year 2002-03). Chart 2.4 shows plan expenditure as percentage of plan outlay for UP relative to other NSC states. UP's performance is shown to be worse than states like Andhra Pradesh, Tamil Nadu, West Bengal and Kerala but better than most of the other NSC states (Rajasthan, Madhya Pradesh, Haryana and Bihar).

Table 2.5: Changing Structure of Revenue Expenditure of Uttar Pradesh

(Percent)

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
General Services	**34.94**	**34.19**	**35.81**	**34.22**	**37.80**	**37.42**	**38.53**	**42.76**	**46.06**	**44.07**
Interest Payment	14.34	13.63	14.29	14.20	17.53	17.06	17.27	21.59	19.71	21.51
Pension	2.48	2.57	2.39	2.52	3.00	3.96	3.48	3.48	4.29	4.74
Others	18.12	18.00	19.13	17.50	17.26	16.40	17.78	17.69	22.07	17.82
Social Services	**36.51**	**36.81**	**39.86**	**37.09**	**35.28**	**33.83**	**33.16**	**32.72**	**32.60**	**33.76**
Education	19.78	21.26	25.57	22.99	20.62	20.95	19.29	20.04	20.05	20.52
Medical & Public Health	5.85	5.81	5.59	5.16	4.90	4.97	5.59	4.54	4.67	4.57
Family Welfare	2.16	1.98	1.80	1.63	1.49	1.20	1.96	1.73	1.29	1.55
Water Supply & Sanitation	2.22	2.31	1.98	2.22	1.73	1.48	1.58	1.58	1.52	1.59
Other Social Services	6.50	5.44	4.91	5.08	6.52	5.23	4.74	4.83	5.06	5.54
Economic Services	**27.35**	**28.33**	**23.83**	**27.52**	**25.12**	**26.72**	**26.45**	**22.85**	**19.71**	**20.59**
Irrigation	6.05	5.95	5.93	4.78	5.69	6.28	5.81	6.43	5.96	5.86
Roads and Bridges	2.10	2.46	1.71	2.14	2.09	1.66	2.43	1.89	1.57	1.56
Others	19.21	19.92	16.19	20.60	17.34	18.78	18.21	14.54	12.18	13.18
C. & A. to Local Bodies	**1.20**	**0.67**	**0.51**	**1.16**	**1.80**	**2.03**	**1.85**	**1.66**	**1.62**	**1.58**
Total Expenditure	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05RE	2005-06BE
General Services	**44.86**	**44.73**	**47.46**	**49.57**	**51.67**	**47.86**	**39.26**	**48.86**	**50.55**
Interest Payment	21.47	21.46	23.11	24.38	26.26	21.68	20.42	24.15	22.73
Pension	4.82	6.95	7.27	7.08	7.64	8.45	6.77	8.80	8.74
Others	18.57	16.32	17.08	18.12	17.78	17.73	12.07	15.91	19.07
Social Services	**34.34**	**34.56**	**30.60**	**30.15**	**29.82**	**31.66**	**22.38**	**31.72**	**32.05**
Education	19.21	22.30	20.15	20.02	19.30	18.64	12.62	3.87	18.09
Medical & Public Health	5.03	3.96	3.72	3.74	3.49	3.97	3.07	3.86	4.22
Family Welfare	1.48	0.84	0.76	0.87	0.84	0.84	0.98	1.21	0.92
Water Supply & Sanitation	2.42	1.54	1.10	0.98	1.55	0.83	1.33	1.25	1.03
Other Social Services	6.20	5.92	4.87	4.54	4.64	7.39	4.38	21.53	7.77
Economic Services	**17.97**	**17.31**	**18.90**	**16.73**	**15.54**	**16.90**	**35.29**	**15.34**	**13.05**
Irrigation	4.79	4.11	2.72	2.88	2.73	3.53	1.29	2.56	2.18
Roads and Bridges	1.41	1.23	1.53	1.73	1.71	2.07	1.03	1.42	0.88
Others	11.77	11.97	14.64	12.12	11.10	11.28	32.97	11.36	9.99
C. & A. to Local Bodies	**2.83**	**3.40**	**3.04**	**3.55**	**2.96**	**3.58**	**2.62**	**4.09**	**4.36**
Total Expenditure	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source (Basic Data): Finance Accounts of Uttar Pradesh and Budget Document (2005-06) of Uttar Pradesh.

Chart 2.3: Interest Payment as % of Revenue Deficit: UP in Comparison to NSC States

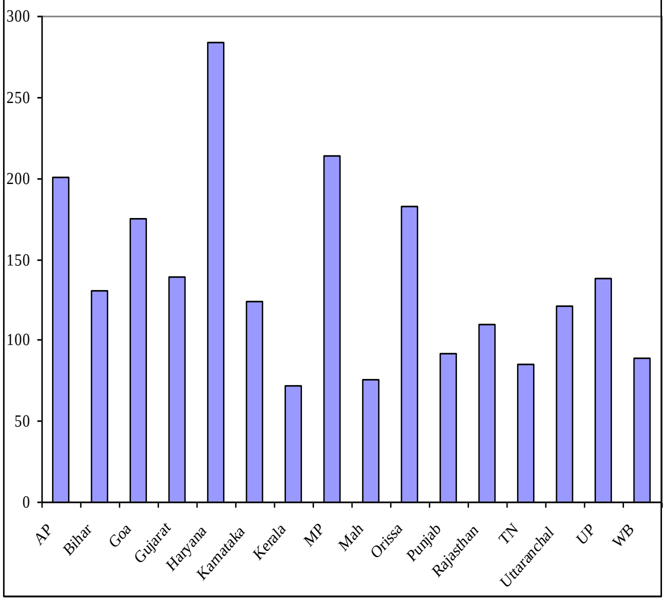
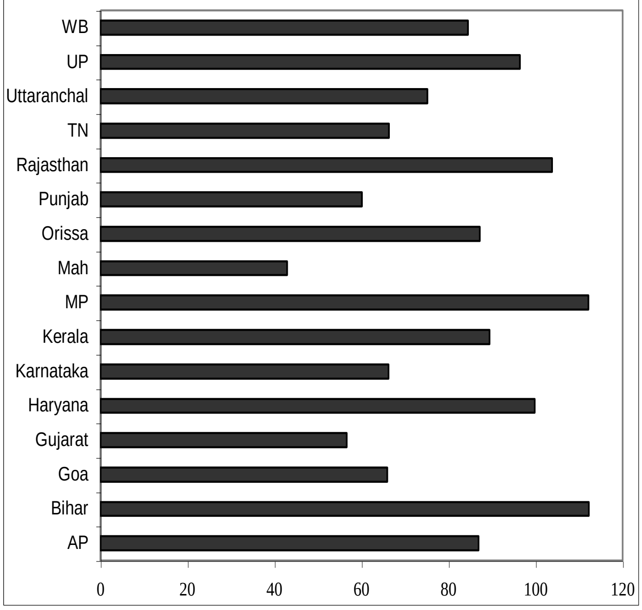


Chart 2.4: Plan Expenditure as % to Plan Outlay: NSC States



2.4 Capital Expenditures: Persistent Fall

In the pre-division years, capital expenditure as percent of GSDP declined from 3.56 to 2.34 over the period 1987-88 to 1999-00. Most of this decline was in capital outlay that fell from 2.76 percent of GSDP in 1987-88 to 1.44 percent in 1999-00. Table 2.6 shows year-wise growth rates for different components of capital expenditure indicating considerable volatility. The trend growth rates (TGRs) over 1987-88 to 1999-00 show that the capital outlays grew sluggishly as compared to the other components. In considering the growth rates, in the post-division years, growth rates in 2003-04 jumped up because of one time capital outlay as part of power sector restructuring. Even prior to that, capital expenditure shows volatile growth.

Table 2.7 shows changes in the composition of capital expenditure and highlights the fall in the share of capital outlay, which declined from about 51.62 percent of total capital expenditure in 1987-88 to 42.67 percent in 1999-00. On the other hand, the repayments continued to accelerate claiming an increasing share of total capital expenditures and peaking in 1998-99 with a share of 63 percent in capital expenditure. This trend has been further strengthened in the post-division years.

Table 2.6: Growth of Capital Expenditure: A Disaggregated Analysis

(Percent Per Annum)

	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Capital Outlay	-12.01	4.05	21.16	-39.39	77.98	-25.29	18.02	0.82	27.10
Loans and Advances	43.43	17.07	99.26	54.37	-5.72	-20.69	109.40	-57.20	47.56
Repayment of Loans & Advances	-21.33	45.89	104.56	18.33	-30.95	67.87	-21.26	-17.73	-31.33
Capital Expenditure (Net of Rep.)	0.43	8.22	48.22	4.29	20.27	-22.80	68.77	-39.16	37.02
Total Capital Expenditure	-6.85	18.86	67.76	10.23	-2.99	6.50	22.91	-32.17	9.97
	1998-99	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05 RE**	**2005-06 BE**	**TGR 1987-88 to 1999-00**
Capital Outlay	25.74	20.81	28.98	8.81	6.72	145.64	-32.19	24.96	7.29
Loans and Advances	-0.62	-1.63	-41.70	-42.70	52.81	54.46	-31.54	-30.31	12.73
Repayment of Loans & Advances	259.82	-70.80	11.50	44.29	85.20	64.94	-6.15	-67.59	11.30
Capital Expenditure (Net of Rep.)	12.79	11.09	1.88	-2.49	12.66	129.69	-32.11	18.41	9.07
Total Capital Expenditure	98.45	-40.40	4.84	12.83	43.05	94.57	-20.18	-28.08	10.31

Source (Basic Data): Finance Accounts of Uttar Pradesh and Budget Document (2005-06) of Uttar Pradesh.

Table 2.7: Composition of Capital Expenditure

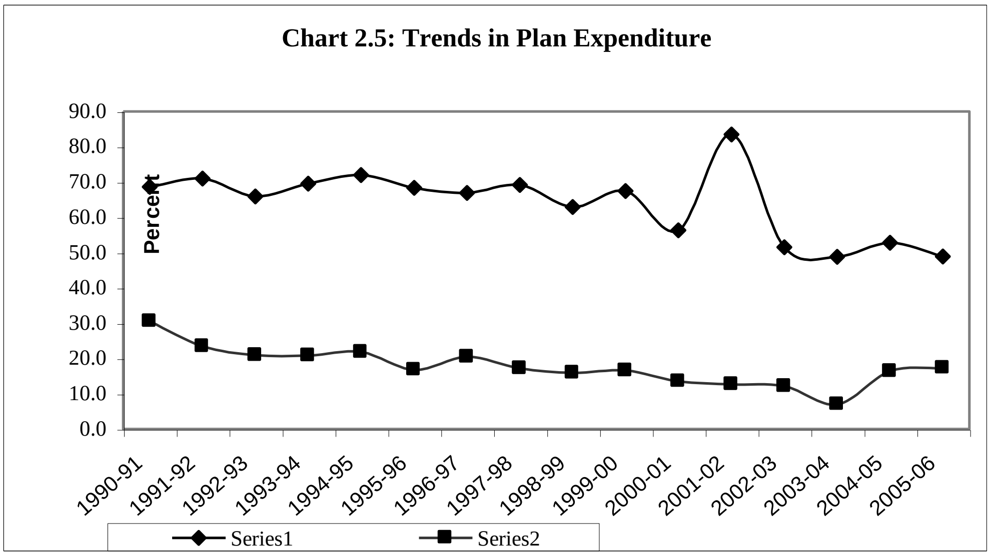
(Percent)

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Capital Outlay	51.62	48.76	42.68	30.82	16.95	31.10	21.82	20.95	31.14	35.99
Loans and Advances	14.92	22.98	22.63	26.88	37.65	36.59	27.25	46.42	29.29	39.30
Repayment of Loans & Advances	33.46	28.26	34.69	42.30	45.40	32.32	50.94	32.63	39.58	24.72
Of which										
Central Loans	17.95	20.17	18.93	11.74	10.99	11.96	12.72	11.11	17.73	18.81
Internal Debt	15.51	8.09	15.75	30.55	34.41	20.36	38.22	21.52	21.84	5.91
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**
		1997-98	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05 RE**	**2005-06 BE**
Capital Outlay		33.22	21.05	42.67	52.49	50.62	37.76	47.67	40.50	70.37
Loans and Advances		32.10	16.08	26.54	14.76	7.49	8.00	6.35	5.45	5.28
Repayment of Loans & Advances		34.68	62.87	30.80	32.75	41.89	54.23	45.97	54.05	24.35
Of which										
Central Loans		17.42	10.04	18.90	24.57	20.40	36.20	34.21	42.23	12.12
Internal Debt		17.26	52.84	11.90	8.18	21.49	18.03	11.76	11.82	12.23
Total		**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source (Basic Data): Finance Accounts of Uttar Pradesh and Budget Documents (2005-06) of Uttar Pradesh.

2.5 Plan Expenditure: High Revenue Intensity

Trends in plan expenditure point out to two disturbing features: (i) high revenue intensity, and (ii) falling plan revenue expenditure as proportion of non-plan revenue expenditure (Chart 2.5). In the post-division years, there has been a fall in the share of plan revenue expenditure to total plan expenditure. There has also been fall in the ratio of plan expenditure to non-plan revenue expenditure. Table 2.8 provides a profile of growth of plan and non-plan revenue expenditures, as also plan capital outlay. The ratio of plan revenue expenditure to total plan has also been indicated for the decade of the nineties and beyond. This ratio has been in the range of 62 to 72 percent upto 1999-00. It may be recalled that the desirable ratio is only 30 percent in relation to which the grant-loan proportion of plan assistance was determined in the Gadgil Formula. In the post-division years, plan revenue intensity improved. It is estimated to be 49 percent in 2005-06BE. The high revenue intensity only reflects the relatively large salary expenditures in the plan schemes. Table 2.8 also indicates that the TGR of plan revenue expenditure was 7.84 percent whereas that for non-plan revenue expenditure was 14.21 percent. It is because of the much higher growth of the latter, that the ratio of plan to non-plan revenue expenditure fell from 30.55 percent in 1990-91 to about 16 percent in 1998-99. In 1999-00, there was an improvement in this ratio, but it is still nearly 14 percentage points below that in 1990-91.



Series 1: Revenue Plan Expenditure as % of Total Plan Expenditure

Series 2: Plan Revenue Expenditure as % of Revenue Non-Plan Expenditure

Table 2.8: Trends in Plan Expenditure in Uttar Pradesh

(Rs. crore)

Year	Plan Revenue Expenditure	Non-Plan Revenue Expenditure	Plan Capital Outlay	Total Plan Col. (2+4)	Plan Revenue Expenditure as % of Total Plan	Plan Revenue Expenditure to Non-Plan Revenue (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1990-91	2267.03	7421.17	1035.65	3302.68	68.64	30.55
1991-92	1977.02	8422.18	809.67	2786.69	70.95	23.47
1992-93	2196.8	10493.94	1133.88	3330.68	65.96	20.93
1993-94	2285.72	10994.41	1000.44	3286.16	69.56	20.79
1994-95	2763.54	12660.12	1074.69	3838.23	72.00	21.83
1995-96	2524.44	15031.42	1168.39	3692.83	68.36	16.79
1996-97	3267.94	15939.76	1614.48	4882.42	66.93	20.50
1997-98	3262.62	18932.41	1455.64	4718.26	69.15	17.23
1998-99	3589.8	22485.05	2118.59	5708.39	62.89	15.97
1999-00	4090.39	24657.34	1976.44	6066.83	67.42	16.59
2000-01	3686.01	27346.60	2862.28	6548.29	56.29	13.48
2001-02	3564.66	28215.25	706.98	4271.64	83.45	12.63
2002-03	3574.82	29363.68	3361.38	6936.20	51.54	12.17
2003-04	3276.01	46945.11	3437.18	6713.19	48.80	6.98
2004-05 RE	6416.45	39205.71	5740.97	12157.42	52.78	16.37
2005-06 BE	7090.44	40980.64	7413.19	14503.63	48.89	17.30
TGR (1990-00)	**7.835**	**14.206**	**9.728**			

Source: Reserve Bank of India Bulletin on State Finances (various issues) and Government of Uttar Pradesh.

2.6 Structure of Government Employment

Immediately prior to the bifurcation of the state, according to a statement brought out by the UP Government, regarding approved posts and employees actually in position, as on 1.4.2000 there were 8,04,480 approved posts and 6,87,031 positions were actually occupied. Table 2.9 lists all departments where the number of approved position is more than 10,000.

Table 2.9 indicates that in terms of actual employees the highest percentage share is that of home department (police) followed by agriculture and allied activities, medical and public health, followed by the revenue department. Irrigation also has a large share of about 7 percent. There is considerable variation in the ratio of actual to approved employment across departments. The lowest of these ratios is for forestry and the highest is for the home department.

Table 2.9: Staff Strength in the Departments of State Government as on 1st April, 2000

Departments	Approved	Actuals	Actuals as Percent of Approved	Percent Share in Total Approved	Percent Share in Total Number of Employees Actual
Home (Police)	187447	175619	93.690	23.30	25.56
Law and Justice	22810	20042	87.865	2.84	2.92
Revenue	78600	68207	86.777	9.77	9.93
Public Works	40386	35734	88.481	5.02	5.20
Education	37667	30135	80.004	4.68	4.39
Medical and Public Health	106965	89237	83.426	13.30	12.99
Agriculture and Allied Activities	145478	117948	81.076	18.08	17.17
Forestry	11797	8209	69.585	1.47	1.19
Irrigation	52841	45650	86.391	6.57	6.64
All Others	132286	104459	78.965	16.44	15.20
Total	**804480**	**687031**	**85.401**	**100.00**	**100.00**

Source (Basic Data): Uttar Pradesh Budget 2000-01, Volume 6.

More recent data indicate that total number of approved posts, covering both gazetted and non-gazetted posts, as on 1.4.2004, in different departments is 8,25,483. While these figures relate to regular establishment both approved and in office, it may be noted that some departments such as irrigation will have a large complement of work charged establishment on the rosters who are not regular employees. These are generally construction labourers on daily wages. Their number is not known. The state government should consider whether such large contingent of supervisory personnel constituting the regular staff is actually needed.

2.7 Uttar Pradesh: Comparative Fiscal Position

A comparative evaluation of the state finances made by the Twelfth Finance Commission shows that states, considered together, went into revenue deficit in 1987-88. The largest revenue deficit on average during 1993-96 was that of Orissa at 2.0 percent of GSDP followed by Punjab, Uttar Pradesh, and West Bengal (Table 2.10). The deficits of these states rose persistently. In 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.

In the case of fiscal deficit, the largest deterioration was for West Bengal, followed by 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.

Table 2.10: Comparative Performance of States: Revenues and Fiscal Deficits

(Percent of GSDP)

States	Revenue Account [Deficit (-)]			Fiscal Account [Deficit (-)]		
	1993-96[A]	2000-03[B]	[B-A]	1993-96[C]	2000-03[D]	[D-A]
SCS	**1.96**	**-2.53**	**-4.49**	**-3.64**	**-7.04**	**-3.40**
Bihar	-1.83	-1.87	-0.04	-2.85	-4.52	-1.67
Madhya Pradesh	-0.61	-2.05	-1.44	-2.16	-3.94	-1.78
Orissa	-2.00	-4.91	-2.91	-4.63	-7.84	-3.21
Rajasthan	-1.09	-3.87	-2.78	-4.51	-6.05	-1.54
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
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: Report of the Twelfth Finance Commission (2004).

During 2000-03, among the general category states, Orissa had the highest debt-GSDP ratio at 63.7 percent, followed by Uttar Pradesh at 47 percent, Rajasthan at 44.9 percent, and west Bengal at 42.7 percent (Table 2.11).

Table 2.11: Outstanding Debt Relative to GSDP

(Percent)

States	1993-96[A]	2000-03[B]	[B-A]
SCS	**39.68**	**47.17**	**7.48**
Bihar	36.80	44.35	7.55
Madhya Pradesh	19.95	30.42	10.47
Orissa	36.21	63.68	27.47
Rajasthan	28.28	44.88	16.60
Uttar Pradesh	**33.94**	**46.94**	**13.00**
West Bengal	23.26	42.73	19.47
GCS	**24.12**	**36.06**	**11.94**
All States	**24.86**	**36.65**	**11.79**

Source: Report of the Twelfth Finance Commission (2004).

During 2002-03 the highest tax-GSDP ratio was for Tamil Nadu at 9 percent of GSDP, and the lowest for West Bengal at 4.26 percent. Table 2.12 shows the tax-GSDP ratios of the low income states within the general category states. Uttar Pradesh, during 2000-03 had an average ratio of 5.88 percent with two states within this group (Madhya Pradesh and Rajasthan) above it, and two states (Bihar and Orissa) below it.

Table 2.12: Own Tax Revenues: Comparative Performance of States

States	Average OTR/GSDP (%)			Buoyancy 1993-03
	1993-96[A]	2000-03[B]	[B-A]	
SCS	**3.30**	**3.96**	**0.66**	**1.226**
Bihar	3.71	4.46	0.75	1.290
Madhya Pradesh	4.91	6.45	1.53	1.452
Orissa	3.93	5.81	1.87	1.639
Rajasthan	5.50	6.48	0.98	1.231
Uttar Pradesh	**4.76**	**5.88**	**1.12**	**1.318**
GCS	**6.26**	**6.95**	**0.69**	**1.143**
All States	**6.12**	**6.79**	**0.67**	**1.141**

Source: Report of the Twelfth Finance Commission (2004).

In terms of revenue expenditure relative to GSDP most of the poor states are below the all-states ratio (Table 2.13). In the case of Orissa, revenue expenditure accounts for 22 percent of the GSDP while for Uttar Pradesh it is about 17 percent.

Table 2.13: Selected States: Comparative Trends in Expenditure

(Percent of GSDP)

States	Revenue Expenditure			Capital Expenditure		
	1993-96[A]	2000-03[B]	[B-A]	1993-96[C]	2000-03[D]	[D-A]
SCS	**26.27**	**27.66**	**1.40**	**5.71**	**4.69**	**-1.03**
Bihar	16.50	18.11	1.60	1.04	2.67	1.63
Madhya Pradesh	13.29	16.74	3.45	1.90	2.37	0.47
Orissa	16.49	22.22	5.74	2.83	3.23	0.40
Rajasthan	15.43	18.06	2.63	3.89	2.30	-1.59
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
GCS	**13.33**	**16.05**	**2.72**	**2.51**	**2.12**	**-0.38**
All States	**13.94**	**16.67**	**2.72**	**2.66**	**2.26**	**-0.40**

Source: Report of the Twelfth Finance Commission (2004).

In terms of pension expenditure, the largest increase relative to GSDP, comparing the two period’s averages, are for Bihar, Orissa, and Rajasthan (Table 2.14).

The finances of both the central and state Governments suffered due to one-time increases in salaries and pensions and macro economic factors that affected interest rates and growth. The state finances suffered a large shock due to a large base of government employees, higher interest rates including those charged by the central government and also had to be content with sharing the impact of a fall in center’s tax-GDP ratio. This resulted in lower transfers to the states.

Table 2.14: State Expenditure Trends: Comparative Profile

(Percent of GSDP)

States	Interest Payment/TRR			Pension Exp./GSDP		
	1993-96[A]	2000-03[B]	[B-A]	1993-96[C]	2000-03[D]	[D-A]
SCS	**13.41**	**16.98**	**3.57**	**1.11**	**2.39**	**1.28**
Bihar	21.78	24.92	3.14	1.01	2.82	1.82
Madhya Pradesh	13.34	18.36	5.02	0.67	1.17	0.50
Orissa	22.39	35.85	13.46	0.68	2.21	1.53
Rajasthan	17.38	30.57	13.19	0.73	1.91	1.18
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
GCS	**16.70**	**25.40**	**8.70**	**0.72**	**1.51**	**0.80**
All States	**16.37**	**24.57**	**8.20**	**0.73**	**1.56**	**0.83**

Source: Report of the Twelfth Finance Commission (2004).

There has been considerable slippage in achieving the targets set by the Eleventh Finance Commission by all the states. The failure in achieving the stipulated targets to some extent was due to slackness in expenditure control. Many of the states had already drawn up the medium term reform programs with specific monitorable targets in the context of the Medium Term Fiscal Reform Facility instituted by the EFC's recommendation. Following the recommendations of the Twelfth Finance Commission, a major incentive has been linked to enactment of a Fiscal Responsibility Legislation by the state Governments. Some states like Karnataka, Kerala, Tamil Nadu, Punjab, and Uttar Pradesh have already enacted fiscal responsibility legislations. Several other states are also taking similar steps. The next Chapter discusses the main features of UP's Fiscal Responsibility Legislation in the context of TFC's recommendations regarding debt relief and consolidation.

Chapter 3: Fiscal Responsibility and Budget Management Act and Centre's Debt Consolidation and Relief Facility

In this chapter, we look at (1) the salient features of UP's Fiscal Responsibility and Budget Management Act (FRBMA), (2) the implications of the Recommendations of the Twelfth Finance Commission, and (3) Centre's Debt Consolidation and Relief Facility that has been instituted following TFC's recommendations.

3.1 Fiscal Responsibility Legislation

The Uttar Pradesh Fiscal Responsibility and Budget Management Act, 2004 was passed by the Uttar Pradesh Legislature and assented to by the Governor on February 26, 2004. The Act requires and enjoins the state Government to ensure fiscal stability and sustainability and to enhance the scope for improving social and physical infrastructure and human development by achieving sufficient revenue surplus, while reducing fiscal deficit and removing impediments to the effective conduct of fiscal operations of the State Government and use of a medium-term fiscal framework and for maters connected therewith or incidental thereto.

The Act, at the outset, clarifies the basic concepts used in the text. By "annual budget" the reference is to the annual financial statement laid before both Houses of State Legislature under Article 202 of the Constitution. "Current year" means the year preceding the year for which budget and Medium Term Fiscal Restructuring Policy are being presented. "Fiscal deficit" refers to the excess of total disbursements from the consolidated fund of the state (excluding repayment of debt) over total receipts into the fund excluding the debt receipts during a financial year. This could also mean the excess of total expenditure from the consolidated fund of the state (including loans but excluding repayment of debt) over own tax and non-tax revenue receipts, devolution and other grants from Government of India to the State, and non-debt capital receipts during a financial year which represents the borrowing requirements, net of repayment of debt of the state government during the financial year. "Previous year refers to the year preceding the current year. "Revenue deficit" is the difference between revenue expenditure and revenue receipts while "total liabilities" refers to the liabilities under the consolidated fund of the state and the public account of the state.

The state government at the time of presentation of the annual budget is required to lay before both the houses of Legislature a Medium Term Fiscal Restructuring Policy. This will contain the assessment of the revenue receipts and expenditure of the government and also the use of capital receipts including borrowings for generating productive assets. The Medium Term Fiscal Restructuring Policy will set forth five-year rolling targets for the prescribed fiscal indicators.

The Medium Term Fiscal Restructuring Policy, among other things, will lay down the medium term fiscal objectives of the state government; assess the performance on the basis of the prescribed fiscal indicators *vis-à-vis* the targets set out in the budget, and the likely performance in the current year as per the revised estimates along with a statement on the fiscal position of the state. It would also lay down the priorities and targets of the state government in the fiscal areas for the next financial year, which relate to taxation, expenditure, borrowings and other liabilities, lending and investments, pricing of administered goods and services, guarantees and activities of Public Sector Undertakings that have potential budgetary implications. An evaluation of the current policies should also be provided, particularly whether they are in conformity with the fiscal management objectives laid down by the Medium Term Fiscal Restructuring Policy.

The Fiscal Responsibility Act also provides that the state government should take appropriate action to eliminate revenue deficit and contain the fiscal deficit as percentage of GSDP by 31st March, 2009 within prescribed limits. The total liability by 31st March, 2018, must not exceed 25 percent of the estimated gross state domestic product at the end of that year. The secrecy involved in the preparation of the annual budget should be minimised to the extent feasible and measures should be adopted to ensure transparency in fiscal operations. The annual budget and the policies announced at the time of budget are to be consistent with the objectives and targets specified in the Medium Term Restructuring Policy for the coming and future years. The finance minister will have to present half-yearly reviews of the trends in receipts and expenditure in relation to the budget to both the Houses of the State Legislature. The review should capture any deviation or likely deviation in meeting the obligations of the State government. If deviations are substantial and relate to the actual or the potential budgetary outcomes, they should be analysed as to how much of the deviation can be attributed to general economic environment and to policy changes by the state government. The remedial measures that are proposed by the state to tackle the problem should be presented. Whenever supplementary estimates are presented to the House of Legislature, appropriate statement of accounts should also be presented giving reasons for the same.

The state government may by notification make rules for carrying out the provisions of the Act without prejudice to the fiscal indicators and the term of the Medium Term Fiscal Restructuring Policy referred to in the Act. No legal proceedings or prosecution shall lie against the state government or any officer for actions done in good faith under this Act. The provisions of this Act are in addition to and not in derogation of the provisions of any law for the time being in force. If any difficulty arises in giving provision to this Act, the state government may, by order published in the Gazette remove make such provisions that are not inconsistent with the provisions of this Act.

3.2 Recommendations of the Twelfth Finance Commission: Implications for Uttar Pradesh

The Twelfth Finance Commission has come out with a suggested plan for restructuring public finances in the country covering both the Union and the state Governments. Some of the suggestions are summarized below. The reform strategy aims at strengthening growth by increasing public sector saving and government's capital expenditures relative to GDP. This requires that the share of revenue deficit in fiscal deficit should be reduced. In the macroeconomic framework for fiscal correction, the Commission has taken 7 percent real growth on average and 5 percent inflation rate. Fiscal correction by 2009-10 requires that the combined tax-GDP should be increased to 17.6 percent, primary expenditure to a level of 22 percent of GDP and capital expenditure to nearly 7 percent of GDP. With regard to debt and fiscal deficit, it has been stipulated that with a combined fiscal deficit of 6 percent of GDP and nominal growth rate of 12 percent per annum, the system will eventually converge to a combined debt of GDP ratio of 56 percent. The present level is estimated to be as high as 81 percent of GDP, with external debt measured at historical exchange rates. This should at a minimum be brought down to 75 percent by the end of 2009-10.

With the system of on-lending by the centre to the state governments being discontinued over time, the long-term goal for the centre and states for the debt-GDP should be 28 percent each. Their fiscal deficit to GDP ratio targets may be fixed at 3 percent of GDP each. In both cases, revenue deficit should be eliminated by 2008-09.

Under the given targets of revenue receipts to GDP ratios, the centre's interest payment relative to revenue receipts would reach about 28 percent by 2009-10. In the case of states, the level of interest payments relative to revenue receipts would fall to about 15 percent by 2009-10.

States are to follow a recruitment and wage policy in a manner such that the total salary bill relative to revenue expenditure net of interest payments and pensions does not exceed 35 percent.

The TFC has recommended that for availing the debt-relief scheme, the enactment of the fiscal responsibility legislation is a must for the states. Provided that the states meet the stipulated conditions, the central loans to states contracted till 31.03.04 and outstanding on 31.03.05 may be consolidated and rescheduled for a fresh term of 20 years and an interest rate of 7.5 percent charged. A debt write-off scheme linked to the reduction of revenue deficit of states has also been introduced. Under this scheme, repayments due from 2005-06 to 2009-10, on central loans contracted up to 31.03.04 and recommended to be consolidated, will be eligible for write off. The quantum of write off of repayment will be linked to the absolute amount by which the revenue deficit is reduced in each successive year during the award period. For future lending, the states can approach the market directly. External assistance may be transferred to the states on the same terms and conditions as attached to such assistance by external funding agencies. All states should set up sinking funds for amortization of all loans including loans from banks, liabilities on account of NSSF etc. Also, states should set up guarantee redemption funds through earmarked guarantee fees.

Every state should set up a high level monitoring committee headed by the Chief Secretary with the Finance Secretary and the concerned Secretaries/Heads of Departments as Members for monitoring proper utilization of the Finance Commission grants. The committee should meet at least once in every quarter and review and issue directions for midcourse corrections. The committee should monitor both financial and physical targets.

The share of the state in the net proceeds of shareable central taxes shall be 30.5 percent. For this purpose, additional excise duties in lieu of sales tax are treated as a part of the general pool of central taxes. After these are transferred back to the states, the share of the states in the net proceeds of shareable central taxes shall be reduced to 29.5 percent. If any legislation is enacted in respect of service tax after the Eighty Eighth Constitutional Amendment is notified, it has to be ensured that the revenue accruing to a state under the legislation should not be less than the share that would accrue to it, had the entire service tax proceeds been part of the shareable pool. The indicative limit of over all transfers to states may be fixed at 38 percent of the Centre's gross revenue receipts.

A total grant of Rs. 20,000 crore for the *Panchayati Raj* Institutions (PRIs) and Rs. 5000 crore for the urban local bodies may be given to the states for the period 2005-10. The distribution for the low income states is shown in the Table 3.1.

Table 3.1: Local Bodies: Share of States in Allocation (2005-10)

States	**Panchayats**		**Municipalities**	
	Percent	**(Rs. Crore)**	**Percent**	**(Rs. Crore)**
Bihar	8.120	1624	2.840	142
Madhya Pradesh	8.315	1663	7.220	361
Orissa	4.015	803	2.080	104
Rajasthan	6.150	1230	4.400	220
Uttar Pradesh	**14.640**	**2928**	**10.340**	**517**
Uttaranchal	0.810	162	0.680	34
West Bengal	6.355	1271	7.860	393
All States	**100.000**	**20000**	**100.000**	**5000**

Source: Report of the Twelfth Finance Commission (2004).

The PRIs should be encouraged to take over the assets relating to water supply and sanitation and utilise the grants for repairs/rejuvenation as also the O & M costs. The PRIs should at least recover 50 percent of the recurring costs in the form of user charges. 50 percent of the grants provided to each state for the urban local bodies should be earmarked for the scheme of solid waste management through public-private partnership.

Based on the assessment of needs and development concerns of the states, grants-in–aid of the revenues of the states for the award period 2005-10 have been recommended. The grants-in-aid to cover non-plan revenue deficit have been the largest component of the Finance Commission grants. These have been assessed in a normative manner for the pre-devolution and post-devolution situations. Tables 3.2 & 3.3 show the assessment regarding non-plan revenue surplus/deficit respectively for the assessed pre-and post-devolution situations.

Table 3.2: Pre-Devolution Non-Plan Revenue Surplus/Deficit

(Rs. in Crore)

State	2005-06	2006-07	2007-08	2008-09	2009-10	2005-10
Bihar	-8327.27	-8623.72	-9412.75	-9719.92	-10130.36	-46214.02
Madhya Pradesh	-1979.58	-1463.29	-2008.59	-1336.55	-468.17	-7256.18
Orissa	-5207.47	-5272.97	-6117.81	-6190.06	-6300.37	-29088.68
Rajasthan	-5098.50	-4666.61	-5046.73	-4396.04	-3461.81	-22669.69
Uttar Pradesh	**-12448.30**	**-11744.71**	**-12338.20**	**-11072.60**	**-9624.16**	**-57227.97**
Uttaranchal	-1971.60	-2047.40	-2243.08	-2289.28	-2325.54	-10876.90
West Bengal	-8892.12	-7993.98	-7309.07	-5679.90	-3626.73	-33501.80
Total States (Deficit)	**-68912.29**	**-64381.63**	**-72190.45**	**-65983.77**	**-58402.47**	**-329870.61**
Total States (Surplus)	**5028.65**	**12253.12**	**16221.48**	**28128.99**	**42600.72**	**104232.96**

Source: Report of the Twelfth Finance Commission (2004).

Table 3.3: Post-Devolution Non-Plan Revenue Surplus/Deficit

(Rs. in Crore)

State	2005-06	2006-07	2007-08	2008-09	2009-10	2005-10
Bihar	1757.18	2921.76	3835.05	5515.02	7428.01	21457.02
Madhya Pradesh	4157.22	5562.61	6053.24	7934.53	10216.81	33924.41
Orissa	-488.04	130.22	82.05	939.76	1916.80	2580.79
Rajasthan	30.61	1205.60	1691.32	3352.69	5468.65	11748.87
Uttar Pradesh	**5167.48**	**8423.22**	**10803.39**	**15540.17**	**21047.22**	**60981.48**
Uttaranchal	-1112.91	-1064.30	-1115.02	-992.02	-830.43	-5114.68
West Bengal	-2438.90	-605.82	1168.44	4069.21	7609.18	9802.11
Total States (Deficit)	**-15091.86**	**-11315.21**	**-10922.15**	**-9998.51**	**-9528.14**	**-56855.87**
Total States (Surplus)	**42584.21**	**63796.71**	**74982.18**	**110170.74**	**152796.40**	**444330.24**

Source: Report of the Twelfth Finance Commission (2004).

The Commission felt that the system of imposing a 70:30 ratio between loans and grants for extending plan assistance to non-special category states (10:90 in the case of special category states) should be done away with. Instead, the centre should confine itself to extending plan grants to the states, and leave it to the states to decide how much they wish to borrow and from whom. A non-plan revenue deficit grant of Rs. 56855.87 crore are recommended during the award period for fifteen states (Table 3.4). Eight states have been recommended for grants amounting to Rs. 10171.65 crore over the award period for the education sector, with a minimum of Rs. 20 crore in a year for any eligible state. For the health sector, seven states have been recommended for grants amounting to Rs. 5887.08 crore, with a minimum of Rs. 10 crore a year for any eligible state. The grants for the education and health sectors are an additionality over and above the normal expenditure to be incurred by the states in these sectors. These grants should be utilized only for the respective sectors (non-plan), i.e., major head 2202 in the case of education and major heads 2210 and 2211 in the case of health. An amount of Rs. 5000 crore is recommended as grants for maintenance of public buildings. These are in addition to the normal maintenance expenditure to be incurred by the states. Grants amounting to Rs. 1000 crore are recommended for maintenance of forests. For heritage conservation, a sum of Rs. 625 crore has been provided for the award period. This grant is for preserving and protecting the historical monuments, archaeological sites, public libraries, museums and archives, and also for improving the tourist infrastructure to facilitate visit to these states. An amount of Rs. 7100 has been recommended, as grants for state specific needs.

Table 3.4: Finance Commission Transfers: Selected States

(Rs. in crore)

States	Share in Central Taxes & Duties (2005-10)	Grants-in-Aid				
		Non-Plan Revenue Deficit (2005-10)	Health Sector (2005-10)	Education (2005-10)	Maintenance of Roads and Bridges (2006-10)	Maintenance of Buildings (2006-10)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Bihar	67671.04		1819.69	2683.76	309.36	359.61
Madhya Pradesh	41180.59		181.64	459.56	586.88	443.02
Orissa	31669.47	488.04	196.37	323.30	1475.08	389.14
Rajasthan	34418.56			100.00	633.32	213.09
Uttar Pradesh	**118209.45**		**2312.38**	**4454.07**	**2403.16**	**600.28**
Uttaranchal	5762.22	5114.69	50.00		324.56	97.60
West Bengal	43303.91	3044.72		391.86	412.92	181.23
Total States	**613112.02**	**56855.87**	**5887.08**	**10171.65**	**15000.00**	**5000.00**

States	Heritage Conservation (2006-10)	State Specific Needs (2006-10)	Local Bodies (2005-10)	Calamity Relief (2005-10)	Total (Col. 3 to Col. 12)	Total Transfers (Col. 2 + Col. 13)
	(9)	(10)	(11)	(12)	(13)	(14)
Bihar	40.00	400.00	1766.00	592.37	7975.79	75646.83
Madhya Pradesh	20.00	300.00	2024.00	1011.27	5141.37	46321.96
Orissa	50.00	170.00	907.00	1199.37	5273.30	36942.77
Rajasthan	50.00	450.00	1450.00	1722.50	4643.91	39062.47
Uttar Pradesh	**50.00**	**800.00**	**3445.00**	**1177.11**	**15262.00**	**133471.45**
Uttaranchal	5.00	240.00	196.00	369.28	6432.13	12194.35
West Bengal	40.00	890.00	1664.00	933.64	7573.37	50877.28
Total States	**625.00**	**7100.00**	**25000.00**	**16000.00**	**142639.60**	**755751.62**

Source: Report of the Twelfth Finance Commission (2004).

3.3 Debt Consolidation and Relief Facility

The TFC has suggested a two-fold strategy for fiscal consolidation and elimination of revenue deficits. The Government of India should not provide loans to the state and the

States may take recourse to the markets for meeting their borrowing requirements. Only in the case for “fiscally weak states” who are unable to raise loans from the market in respect of the loans, which central government was providing as loan component of the central assistance to their plans, the Government of India may raise loans and on-lend the same through the Public Account. Further, the TFC recommended the consolidation of all existing loans provided to the states upto March 31, 2004 and which are outstanding on March 31, 2005, provided the states meet the pre-condition of enacting the Fiscal Responsibility legislation. The central loans to the states estimated to be Rs. 128,795 crore by the TFC are to be consolidated and rescheduled for a fresh term of 20 years, resulting in repayment in 20 equal instalments with an interest rate of 7.5 percent. This debt relief will be available to all states with effect from the year they enact the Fiscal Responsibility and Budget Management legislation and has divided these into two parts: core (non-negotiable) and others (recommendatory). The debt relief during the award period for all states is estimated to be Rs. 21,276 crore in terms of lower interest payments and Rs. 11,929 crore in terms of lower repayment during this period.

In addition to the above, the TFC has framed a scheme of debt-waiver based on fiscal performance, linked to the reduction of revenue deficits of States. Under this scheme, the repayments due on Central loans from 2005-06 to 2009-10, after the consolidation and reschedulement, will be eligible for write-off. The quantum of write-off will depend on the absolute amount by which revenue deficit is reduced in each successive year during the award period from the base level of revenue deficit compiled by TFC. All states will be eligible from the year they have enacted the FRBM Legislation. The benefits of write-off would be available only if the fiscal deficit of the state is contained to the level of 2004-05. In any year, if the fiscal deficit exceeds this level, the benefit of write-off, even if eligible otherwise, would not be given. The TFC estimates that if all States achieve revenue balance by 2008-09, the total amount of write-off will be Rs. 32,200 crore in a period of five years. In order to implement of TFC’s recommendations regarding debt-relief, the central government has brought out a notification entitled ‘The States’ Debt Consolidation and Relief Facility 2005-10’ (DCRF). This is given as Annexure 2 of this study. The next chapter looks at a suitable medium term fiscal policy for Uttar Pradesh taking account of the implications of TFC’s recommendations for Uttar Pradesh and the DCRF.

Chapter 4: Government Expenditure in Uttar Pradesh: Adjustments in the Medium Term

In this chapter, a medium term expenditure policy for the Uttar Pradesh is considered in the light of recent fiscal trends. It takes into account the targets stipulated in the Fiscal Responsibility and Budget Management Act of 2004. It is also designed to take full benefit of the recommendations of the Twelfth Finance Commission as they apply to UP's finances. The budget estimates for 2005-06 provide the latest available set of budget numbers for the new UP. The base year of the projection exercise uses these with some relevant adjustments.

4.1 Fiscal Responsibility Act: Medium Term Targets

a. Fiscal Responsibility Act

As noted in Chapter 3, the Fiscal Responsibility and Budget Management Act (Act Number 5 of 2004) aims at ensuring fiscal stability and sustainability for Uttar Pradesh while enhancing the scope of improving social and physical infrastructure as well as human development. It emphasises, for this purpose, the need for achieving revenue surplus, reduction in fiscal deficit, and prudent management of debt. It envisages limits on fiscal and revenue deficits as well as government guarantees. It also places emphasis on the need for greater transparency and provides for a medium term fiscal framework. It specifically provides that the GoUP shall:

i. reduce revenue deficit to zero by the end of 2008-09;

ii. reduce revenue deficit as percentage of GSDP in each financial year beginning April 1, 2004 in a manner consistent with eliminating revenue deficit by 2008-09;

iii. reduce fiscal deficit to not more than 3 percent of GSDP by the end of 2008-09; and

iv. reduce fiscal deficit as percentage of GSDP in each year beginning April 1, 2004 so as to achieve the target of reducing fiscal deficit to no more than 3 percent of GSDP by 2008-09; and ensure that within a period of 14 financial years beginning from 2004-05, that is by 2017-18, the total liabilities of the state government do not exceed 25 percent of GSDP of that year.

The guarantees are also to be limited as provided by appropriate 'Rules' framed under the Act or any other suitable law or rule. The Government of Uttar Pradesh had earlier signed an MoU with the Government of India for initiating fiscal reforms in 1999-00. It also embarked upon a medium term fiscal policy and accountability strategy, which was placed before the legislature in March 2000. Following the creation of Uttaranchal, this policy was subsequently amended and the new policy is called Medium Term Fiscal Restructuring Policy (MTFRP). This was supplemented by two legislations for reforms in the power sector and the public sector. The medium term expenditure strategy takes account of the benefits and stipulations in the context of the TFC recommendations and the DCRF.

4.2 Expenditure Reforms in the Medium Term

In this section, we look at expenditure projections for Uttar Pradesh under a medium term correction path that is consistent with the targets of the Fiscal Responsibility and Budget Management Act of Uttar Pradesh upto 2008-09. These are also aimed at maximising the benefit to the state under the recommendations of the TFC. The expenditure side provides for reducing subsidies and containing the growth of salary expenditures. Most importantly interest payments can be reduced because of the progressive reduction in the size of debt and the average cost of borrowing in line with the recommendations of the TFC. In particular, the interest rate, on average, starts at a lower effective rate and falls further. The situation would improve progressively as the revenue and fiscal deficits are reduced and the debt-GSDP ratio falls.

In the context of the recommendations of the TFC, the following changes would be important for the state finances of Uttar Pradesh.

i. The share of all states in the shareable pool of Central taxes including the additional excise duties has been increased for 29.5 to 30.5 percent.

ii. The share of Uttar Pradesh in the shareable pool of Central taxes has been increased from 19.137 percent under the recommendations of EFC to 19.264 percent under the recommendations of TFC.

iii. Uttar Pradesh will be the recipient of earmarked grants for health and education as well as for the maintenance of roads and bridges, government buildings, and forests.

iv. Under the recommendations of TFC, grants meant for local bodies, natural calamities and state specific needs have also been increased. The details of various grants are given in Table 4.1.

v. Uttar Pradesh should be eligible for the restructuring of its debt to the central government under the terms and conditions specified by the TFC. In particular, Uttar Pradesh already has a Fiscal Responsibility and Budget Management Act, which provides for reducing the fiscal deficit of the state to 3 percent of GSDP and eliminating the revenue deficit by 2008-09. The immediate benefit of restructuring should come in terms of reduction in the interest rate, which will be fixed at 7.5 percent.

vi. Uttar Pradesh can also avail of the benefit of debt write off under the proposed scheme whereby the benefit is linked to the reduction in revenue deficit in absolute terms.

Table 4.1: Grants for Uttar Pradesh Recommended by the Twelfth Finance Commission

(Rs. Crore)

	2005-06	2006-07	2007-08	2008-09	2009-10	Total
Health	367.63	409.90	457.04	509.60	568.21	**2312.38**
Education	736.87	806.87	883.52	967.45	1059.36	**4454.07**
Roads and Bridges	0.00	600.79	600.79	600.79	600.79	**2403.16**
Buildings	0.00	150.07	150.07	150.07	150.07	**600.28**
Forests	4.00	4.00	4.00	4.00	4.00	**20.00**
Heritage Conservation	0.00	12.50	12.50	12.50	12.50	**50.00**
State Specific Needs	0.00	200.00	200.00	200.00	200.00	**800.00**
Local Bodies Rural	585.60	585.60	585.60	585.60	585.60	**2928.00**
Local Bodies Urban	103.40	103.40	103.40	103.40	103.40	**517.00**
Calamity Relief	221.95	228.36	235.10	242.15	249.55	**1177.11**
Total	**2019.45**	**3101.49**	**3232.02**	**3375.56**	**3533.48**	**15262.00**

Source: Report of the Twelfth Finance Commission (2004).

The Uttar Pradesh government came out with its 2005-06 budget in February 2005 giving estimates of revenues and expenditures for 2005-06. The budget documents also include Uttar Pradesh's Medium Term Fiscal Restructuring Policy (MTFRP). Neither the budget estimates nor the fiscal restructuring programme incorporate the likely impact of the recommendations of the TFC. The MTFRP is based on an implicit assumption of a growth rate of 9 percent per annum until 2008-09. Given that growth rate has picked up substantially in the economy as a whole, the assumed growth rate in UP's MTFRP as appended in the 2005-06 budget documents appears to be too low. In the projections given below, a nominal growth of 12 percent per annum is assumed consistent with the TFC assumptions.

Table 4.2 provides a fiscal profile of adjustment until 2009-10, taking into account the impact of the main recommendations of the TFC. Its main features provide for

i. supporting a higher growth through increase in capital expenditure that should be spent on infrastructure;

ii. investment in human development, particularly, in health and education;

iii. it is assumed that the effective interest rate for the overall debt will fall substantially in 2005-06 to 8.5 percent and continue to fall gradually after that until it reaches a level of 7.5 percent in 2008-09. This also implies that power sector is not in deficit, or no deficit of the power sector is due to any commitment or policy of the state government;

iv. it is indicated that while capital expenditure and revenue expenditure on education and health should increase with respect to GSDP, other components of revenue expenditures are projected to fall relative to GSDP; and

v. of particular importance is the fall in interest payment by a margin of a little less than one percentage point between 2005-06 and 2009-10.

Table: 4.2: Fiscal Adjustments in the Medium Term: A Suggested Path

(Percent to GSDP)

	2005-06	2006-07	2007-08	2008-09	2009-10
Own Tax Revenues	6.94	7.09	7.24	7.40	7.56
Own Non Tax Revenues	0.85	0.88	0.90	0.92	0.95
Transfers from the Centre	9.18	9.23	9.30	9.40	9.53
Share in Central Taxes	6.68	6.83	6.99	7.18	7.39
Non-Plan Grants	1.08	1.00	0.93	0.87	0.81
Plan Grants	1.42	1.40	1.37	1.35	1.32
Total Grants	2.50	2.40	2.30	2.22	2.14
Total Revenue Receipts	16.98	17.19	17.44	17.72	18.03
Interest Payments	4.10	4.00	3.64	3.52	3.38
Pensions	1.57	1.57	1.57	1.57	1.57
Other General Services	3.44	3.28	3.14	3.00	2.86
Total General Services	9.11	8.85	8.35	8.09	7.81
Education	3.58	3.83	4.11	4.40	4.71
Health	0.86	1.00	1.16	1.34	1.56
Other Social Services	1.75	1.71	1.66	1.62	1.57
Total Social Services	6.19	6.54	6.92	7.36	7.85
Total Economic Services	2.90	2.36	2.08	1.53	1.64
C. & A. to Local Bodies	0.78	0.77	0.76	0.74	0.73
Total Revenue Expenditure	18.98	18.53	18.11	17.72	18.03
Capital Outlay	2.40	2.28	2.55	2.82	2.83
Loans and Advances	0.32	0.32	0.31	0.31	0.30
Total Capital Expenditures	2.72	2.60	2.87	3.13	3.13
Non-Debt Capital Receipts	0.14	0.13	0.13	0.13	0.13
Fiscal Deficit	5.14	3.80	3.40	3.00	3.00
Revenue Deficit	2.00	1.33	0.67	0.00	0.00
Primary Deficit	1.04	-0.20	-0.24	-0.52	-0.38
Outstanding Liabilities	55.97	54.35	52.50	50.44	48.58
GSDP	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source (Basic Data): U.P. Budget documents, Report of TFC, and Projections.

The expenditure on education is projected to increase from 3.6 percent of GSDP in 2005-06 to 4.7 percent in 2009-10 and that on health from 0.86 percent to 1.56 percent. Capital outlay is allowed to increase from 2.4 percent of GSDP to 2.83 percent during this period. These increases are consistent with reducing fiscal deficit from 5.1 percent of GSDP in 2005-06 to 3 percent in 2008-09. It may be retained at this level in the subsequent years. The revenue deficit is reduced from 2 percent of GSDP in 2005-06 to zero in 2008-09. It should be maintained at this level subsequently. The ratio of outstanding liabilities including reserve funds and deposits, which stood at 56.0 percent of GSDP in 2005-06 will fall to 48.6 percent by 2009-10. This is mainly due to the emergence of a primary surplus in 2006-07 that increases in magnitude in subsequent years. It will, however, take several more years for the debt-GSDP ratio to come down to the levels recommended by the TFC.

4.3 Restructuring Expenditure: A Seven-Point Strategy

Fiscal reforms are suggested with a view to achieving three primary objectives:

i. restoring revenue account balance and bringing debt and fiscal deficit to sustainable levels;

ii. increasing the productivity of government to serve growth and governance objectives better; and

iii. reducing the structural vulnerability of state finances, keeping in view the long term prospects.

Given the FRBMA and the DCRF, a seven-point strategy of expenditure reforms is suggested relating to the following subset of overall reforms:

i. Pension reforms.
ii. Salary and employment related reforms.
iii. Subsidy reforms.
iv. Capital expenditure augmentation.
v. New plan strategy.
vi. Improving efficacy of government expenditure.
vii. Rationalisation of support to public sector.

The medium term expenditure reform can be taken, consistent with the requirement of fiscal discipline and effective budget management. In this respect, the following three are prerequisites.

i. Rule-based control of revenue and fiscal deficit according to FRBMA.
ii. Debt-related reforms including curbing of contingent liabilities.
iii. Budgeting reforms.

These reforms are discussed below.

a. Objective and Overall Strategies

i. Fiscal Support to Growth Through Investment in Infrastructure and Human Development

State government has a critical role to play in sectors like health and education as also in developing physical infrastructure in sectors like roads, power and irrigation. It is investment in these sectors that will strengthen growth and attract investment from outside. With higher growth, the revenues accruing to the government will also increase. Expenditure has to be restructured such that capital expenditure is increased but focussed on the infrastructure, and revenue expenditure can also be increased in sectors like health and education. We recommend that the revenue expenditure on health and education taken together should increase by more than 1.5 percentage points of GSDP taking the revenue expenditure on these two sectors to well above to 6.0 percent of GSDP by 2009-10. Care should be taken to focus on the augmentation of the non-salary expenditure in these sectors. Additional support to these sectors should also come from an increase in capital expenditure.

ii. Fiscal Support to Poverty Alleviation

Uttar Pradesh is among the higher poverty-incidence states in rural and urban poverty. According to the poverty estimates provided for by the Planning Commission for 1999-00, Uttar Pradesh accounts for the largest number of poor in the country. Its share in the case of both rural and urban poor is about 31 percent of the total number of poor in the two categories. This is far higher than the share of population of the combined state in total population. Apart from the benefits of growth on poverty alleviation, direct fiscal intervention is needed to combat poverty that may consist of state level employment generation schemes and capacity building in rural and urban areas through education and health.

4.4 Expenditure Reforms

a. Pension Reforms

In the context of the growing pension liabilities, new initiatives are needed. First, a Funded Pension Scheme with contributions from the employees, in the case of all new employees, should be brought in place. Secondly, the formula for commutation of a portion of pension entitlement should be revised taking into account the change in the interest rate from the period when the formula was originally worked out. In this context, the initiatives taken by the Central government and some states like Madhya Pradesh should be reviewed for adoption. The feasibility of keeping provident funds in a separate account should also be examined. At present, transactions to and from provident funds to the budget are merely accounting entries. A separate public provident fund for state government employees, teachers and employees of aided educational institutions would lead to greater transparency in transactions. Pension reforms would yield benefits only in the long-term perspective. These reforms however are needed to make state finances less vulnerable to exogenous decisions regarding pensions by making these self-sustaining.

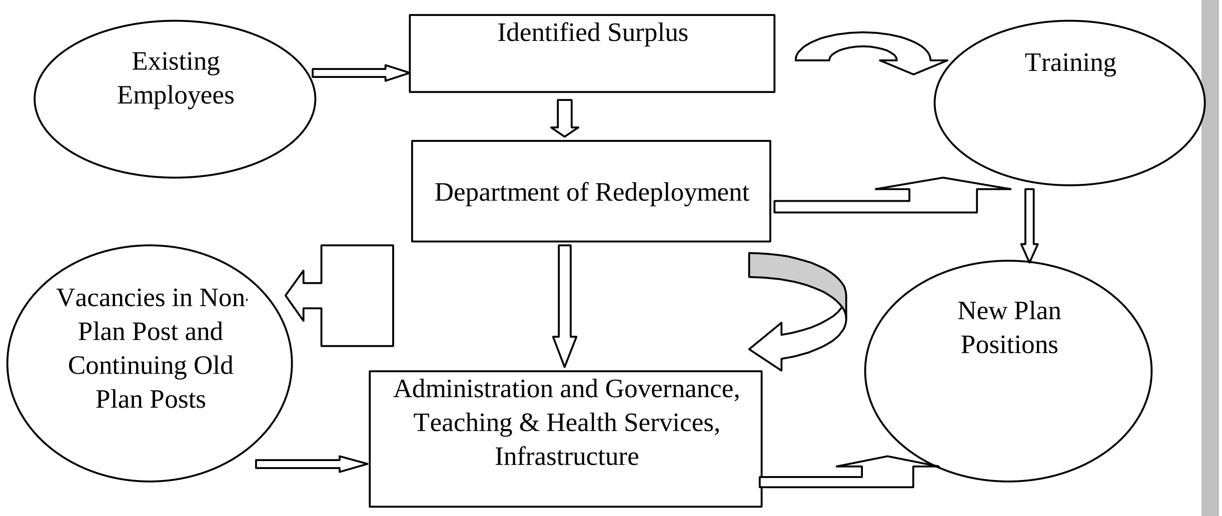
b. Salary (Government Employment) Reforms

In order to contain the growth of the salary bill, all posts that are presently vacant should be reviewed and a significant number of these should be abolished. In addition, a survey should identify department-wise surplus staff. Further, only a fraction of positions should be filled-up on superannuation of employees. In the medium term, the ratio of salary payments to revenue expenditure net of interest payment and pensions should be brought down to the 1996-97 levels, as recommended by the TFC.

Reform in management of government employment is critical to restoring UP's state finances to health. This reform should consist of not only curbing the growth of employment in the government sector but also its productive redeployment. Although UP has experimented with identification of surplus staff earlier also, it should now take this issue up at a much larger scale. As a first step, the Department of Administrative Reforms should identify surplus staff in consultation with the concerned Ministry/Department. These staff should be attached to the Department of Administrative Reforms or a newly created Department of Redeployment. Apart from regular salary, no other expenditures need to be incurred on this staff because they will have no duty other than waiting for redeployment.

This should result in immediate savings. The next step is the process of productive redeployment. The Department of Redeployment should have elaborate bio-data of all such attached staff. No fresh appointments should be made without reference to the Department of Redeployment. More generally, all posts in the Tenth Plan should be filled up with such redeployable staff. Vacancies that arise due to retirement of staff from non-plan or continuing plan schemes should also be filled from this pool. The role of the Department of Redeployment and Training is explained in Flow Chart 4.1. The issue of growth in the number of government employees should be freshly examined after the adjustment period in UP's FRBMA, if the specified targets are successfully achieved.

Flow Chart 4.1: Training and Redeployment



Attempt should be made to arrange for adequate retraining of these staff so that their redeployability increases. Those who are willing and able can also be directed towards education and health sectors. There are also some administrative jobs in these sectors.

c. Subsidy Reforms

Subsidy as a budgetary instrument of promoting social welfare has been overused, and sometimes abused, leading to inefficiencies. The cost of subsidies has generally been underestimated because most subsidies are hidden or implicit. In state budgets, only a very small fraction of subsidies is shown explicitly as subsidies. The state government should explicitly show its subsidies in the budget as much as possible, so that their volumes and continued validity may be discussed each year in the legislature. Many subsidies arise because the government may be participating in the provision of purely private goods where its presence is not warranted. In the few areas like health and education, where subsidies are justified because of large externalities, government should rationalise the subsidy structure, so that subsidies are given more to the economically poorer sections. Subsidies should have a specific time span, after which its utility should be reassessed, and the duration revised; it should be withdrawn in stages. Subsidy reforms should be approached from both the expenditure and revenue sides. On the expenditure side, reducing costs of providing services by reducing operational inefficiency could reduce subsidies without affecting service levels. On the receipts side, one has to target higher recovery rates by linking prices (user charges) to costs. At first, these linkages may be fixed with reference to current costs. Input-linked user charges, partial privatisation of generation and distribution (in electricity), proper metering, setting up bodies for autonomous tariff revisions in power, transport, and other sectors, fees for health and education, should lead to better cost recoveries, and consequently lower implicit subsidies. The subsidy regime should be limited, transparent, and properly targeted.

d. New Plan Strategy

The planning strategy should be completely overhauled. As already noted, the revenue component of plan expenditures has become unduly large. A large part of that relates to salary expenditures. Plans have become scheme-based without a proper backing of cost-benefit analysis. Schemes became employment-intensive and employment generated only salary burdens without formation of productive assets and contribution to output. Salaries became exogenously driven and completely delinked to productivity. The consequence was that the plan, which was meant to be the core of development strategy, actually became a major fiscal liability. This adverse dynamics must be reversed, by a paradigm shift in preparing a Plan. The new Plan must consist of a list of projects where each project is backed by a cost-benefit analysis and each project is ranked on a scale of contribution to growth of output and contribution to non-government employment. The practice of determining the plan size first, and then finding the projects or schemes for the plan size as after-thoughts, must be reversed. Plan size should not be determined by the capacity of the state to borrow. Rather, it should be determined by the selection of such projects as can produce the rate of return higher than the cost of borrowing.

e. Capital Expenditure Augmentation

Capital expenditure relative to GSDP should be increased by at least one percentage point of GSDP. This should be mainly on capital outlay on infrastructure covering power, roads and bridges and information technology, especially communications and large bandwidth. Investment in infrastructure will lend support to a higher GSDP growth.

f. Streamlining Responsibilities

There has been an excessive fragmentation of responsibilities. Numerous departments have been created not because of the compulsions of service needs. Rather, these are often due to the fact that more personnel are available at the senior level than the number of posts. Departmental responsibilities are therefore fragmented so that available personnel can be accommodated. It is more efficient to rationalise the departmental organisation of government's responsibilities and avoid undue fragmentation.

4.5 Monitoring Progress of Reforms and Mid Course Corrections

The progress of reforms needs to be monitored each year. As soon as deviations from the expected reform path are observed, policy corrections should be introduced immediately. An essential feature of reforms is that revenue deficit as percentage of revenue receipts should decline by a margin of 5 percentage points or more in each successive year. If this looks like slipping in a year, a corrective measure should be taken in the light of the relative efficacy of different policy measures in affecting revenue deficit.

Fiscal slippage could be from two sources. One, due to external circumstances beyond the control of the state government, and two, due to inadequate reform measures. The state government has less control on the revenue side as it depends on external circumstances affecting the economy. If a slippage on the revenue side is encountered, it should be counter-balanced by an adequate expenditure side action. The expenditure side is largely under the control of the government except for interest payments and pensions. Harder action on the expenditure side could take the form of complete freezing of new recruitment, compulsory retirement of surplus staff, freezing of DA at current levels, freezing of grants to aided institutions at current levels, reduction in growth rate of non-salary expenditure, and reduction in subsidies. In all these cases, relevant action has already been suggested in the reform scenario. Further action should be resorted to only in the case of revenue side slippage.

Chapter 5: Medium Term Expenditure Reforms: Summary and Conclusions

The state finances of Uttar Pradesh have evolved since 1987-88 in a manner that has led to growing fiscal imbalance. The larger share of interest payments and pension payments has reduced what may be spent on sectors such as health, education and infrastructure. Within these sectors, the ratio of salary expenditure has shot up after the implementation of salary revisions following the recommendations of the Fifth Central Pay Commission. These structural changes have adversely affected the efficacy of government expenditures since the share of capital expenditure has fallen over time. In the case of revenue expenditures, the share of non-salary expenditures which is meant to provide supporting expenditure for the government employees to perform their functions efficiently, has also fallen.

The Twelfth Finance Commission has suggested a programme for restructuring state finances within the context of a Fiscal Responsibility Legislation. This legislation should be aimed at correcting the fiscal imbalance in the system within a stipulated period of time. Several benefits are linked to states undertaking the desired correction. The Government of India has notified the formalities that a state government would be required to go through. In particular, it has to sign a letter of commitment. Uttar Pradesh is in a fortunate position, as it has already enacted the necessary fiscal responsibility legislation.

This study has suggested a path for expenditure reform in the perspective of medium term adjustment. The path of adjustment is consistent with the fiscal responsibility legislation targets for the state and assumes that the benefits potentially accruing to the states and other recommendations of the Twelfth Finance Commission will be fully utilised by the state government. In order to carry out the required adjustment, the desired action programme has been summarised in Table 5.1.

No reform programme can be undertaken in isolation. The expenditure reforms require overall budgetary reforms so that revenue and fiscal deficits are brought under control and resources are released for expenditure restructuring. The supporting reform for the medium term expenditure policy has four main components. These are summarised in Table 5.2.

Table 5.1: Fiscal Reforms: Actions and Targets

Sphere	Desired Action
Fiscal support to the growth	Invest in infrastructure, social and economic.
Fiscal support to poverty alleviation	Short-term; state level employment generation scheme; medium-term; capacity enhancement through targeted expenditure on health and education in high poverty incidence districts.
Pension reforms	For all new employees, introduce a funded pension scheme; for immediate relief on pension burden revise commutation rules (as in Madhya Pradesh).
Salary (government employment) reforms	Set up a department of redeployment; identify surplus staff in all departments; introduce a VRS for surplus staff that are not redeployed in one year; all new plan posts should be filled up only by the surplus on existing non-plan and plan side.
Subsidy reforms	After prices are revised upwards for government services, desirable subsidies (health and education) should be given explicitly; other subsidies should be abolished. A user charges commission will help rationalise user charges.
Capital expenditure augmentation	Focus on infrastructure (health, education, power, and roads).
New plan strategy	Size of the plan should be de-emphasized; focus should be on plan productivity.
Power sector	Facilitate private participation within the framework of new power policy.
Efficacy of government expenditure	More effective monitoring mechanism, improvement in the ratio of non-salary component of revenue expenditure.

Table 5.2: Supporting Reforms for Medium Term Expenditure Policy

Public sector reforms	Disinvest extensively; close down unviable units; increase competition in power sector; set up a Disinvestment Committee; introduce VRS.
Revenue and fiscal deficits	Progress regarding UP's FRBMA targets should be monitored and annual targets should be fixed in the light of the medium-term targets.
Management of debt	FRBMA in place specifying long-term debt-GSDP target. Annual targets of reduction in the debt-GSDP ratio should be followed according to the medium-term fiscal strategy.
Budgetary reforms	Capacity building in budget preparation; on-going evaluation of quality of budget estimates.

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Uttar Pradesh Electricity Reforms Act, 1999.

Annexure 1: The Uttar Pradesh Fiscal Responsibility and Budget Management Act, 2004

No. 388(2)/VII-V-1-1(KA)-8-2004
Dated Lucknow, February 27, 2004

In pursuance of the provisions of clause (3) of Article 348 of the Constitution of India, the Governor is pleased to order the publication of the following English translation of the Uttar Pradesh Rajkoshiya Uttardayitwa Aur Budget Prabandh Adhiniyam, 2004 (Uttar Pradesh Adhiniyam Sankhya 5 of 2004) as passed by the Uttar Pradesh Legislature and assented to by the Governor on February 26, 2004 :-

(U.P. Act No. 5 OF 2004)
(As passed by the Uttar Pradesh Legislature)

AN
ACT

to provide for the responsibility of the State Government to ensure fiscal stability and sustainability, and to enhance the scope for improving social and physical infrastructure and human development by achieving sufficient revenue surplus, reducing fiscal deficit and removing impediments to the effective conduct of fiscal policy and prudent debt management through limits on State Government borrowings, government guarantees, debt and deficits, greater transparency in fiscal operations of the State Government and use of a medium-term fiscal framework and for matters connected therewith or incidental thereto.

IT IS HEREBY enacted in the Fifty-fifth Year of the Republic of India as follows :-

Short title and commencement

1: (1) This Act may be called the Uttar Pradesh Fiscal Responsibility and Budget Management Act, 2004.

(2) It shall come into force on such date as the State Government may by notification, appoint.

2: In this Act, unless the context otherwise requires,-

(a) "annual budget" means the annual financial statement laid before both Houses of State Legislature under Article 202 of the Constitution;

(b) "current year" means the year preceding the year for which budget and Medium Term Fiscal Restructuring Policy are being presented;

(c) "fiscal deficit" means the excess of-

(i) total disbursements from the Consolidated Fund of the State (excluding repayment of debt) over total receipts into the Fund excluding the debt receipts during the financial year; or

(ii) total expenditure from the Consolidated Fund of the State (including loans but excluding repayment of debt) over own tax and non-tax revenue receipts, devolution and other grants from Government of India to the State, and non-debt capital receipts during a financial year which represents the borrowing requirements, net of repayment of debt, of the State Government during the financial year;

(d) "Fiscal Indicators" means the measures such as numerical ceilings and proportions to gross state domestic product or any other ratios, as may be prescribed, for evaluation of the fiscal position of the State Government;

(e) "previous year" means the year preceding the current year;

(f) "revenue deficit" means the difference between revenue expenditure and revenue receipts;

(g) "total liabilities" means the liabilities under the Consolidated Fund of the State and the public account of the State.

Medium Term Fiscal Restructuring Policy to be laid before the Legislature

3: (1) The State Government shall in each financial year lay before both Houses of the Legislature a Medium Term Fiscal Restructuring Policy along with the annual budget.

(2) The Medium Term Fiscal Restructuring Policy shall set forth a five-year rolling targets for the prescribed fiscal indicators with specification of under lying assumptions.

(3) In particular and without prejudice to the provisions contained in sub-section (2), the Medium Term Fiscal Restructuring Policy shall include an assessment of sustainability relating to-

(i) the balance between revenue receipts and revenue expenditure;

(ii) the use of capital receipts including borrowings for generating productive assets.

(4) The Medium Term Fiscal Restructuring Policy shall, *inter-alia*, contain-

(a) the medium term fiscal objectives of the State Government;

(b) an evaluation of performance on the basis of the prescribed fiscal indicators *vis-à-vis* the targets set out in the budget, and the likely performance in the current year as per revised estimates;

(c) a statement on recent economic trends and future prospects for growth and development affecting fiscal position of the State Government;

(d) the strategic priorities of the State Government in the fiscal areas for the ensuring financial year;

(e) the policies of the State Government for the ensuing financial year relating to taxation, expenditure, borrowings and other liabilities, lending and investments, pricing of administered goods and services, guarantees, and activities of Public Sector Undertakings which have potential budgetary implications; and the key fiscal measures and targets pertaining to each of these;

(f) an evaluation as to how current policies of the State Government are in conformity with the fiscal management principles set out in section 4 and the fiscal objectives set out in the Medium Term Fiscal Restructuring Policy.

(5) The Medium Term Fiscal Restructuring Policy shall be in such form as may be prescribed.

Fiscal Management Principles

4: (1) The State Government shall be guided by the following fiscal management principles-

(a) to maintain Government debt at prudent levels;

(b) to manage guarantees and other contingent liabilities prudently, with particular reference to the quality and level of such liabilities;

(c) to ensure that policy decisions of the Government have due regard to their financial implication on future generation;

(d) to ensure that borrowings are used on development activities, which are evaluated to become self-sustained, and creation or augmentation of capital assets, and are not applied to finance current expenditure;

(e) to ensure a reasonable degree of stability and predictability in the level of tax burden;

(f) to maintain the integrity of the tax system by minimising special incentives, concessions and exemptions;

(g) to pursue tax policies with due regard to economic efficiency and compliance costs;

(h) to pursue non-tax revenue policies with due regard to cost recovery and equity;

(i) to pursue expenditure policies that would provide impetus to economic growth, poverty reduction and improvement in human welfare;

(j) to build up a revenue surplus for use in capital formation and productive expenditure;

(k) to ensure that physical assets of the Government are properly maintained;

(l) to disclose sufficient information to allow the public to scrutinise the conduct of fiscal policy and the state of public finance;

(m) to ensure that Government uses resources in ways that give best value for money and also ensure that public assets are put to best possible use;

(n) to minimize fiscal risks associated with running of public sector undertakings and utilities providing public goods and services;

(o) to manage expenditure consistent with the level of revenue generated;

(p) to formulate budget in realistic and objective manner with due regard to the general economic outlook and revenue prospects and minimize deviations during the course of the year;

(q) to ensure discharge of current liabilities in a timely manner.

(2) The State Government shall take appropriate measures to eliminate the revenue deficit and control the fiscal deficit at sustainable level and built up adequate revenue surplus.

(3) In particular, and without prejudice to the generality to the foregoing provisions, the State Government shall—

(a) reduce revenue deficit to nil within a period of five financial years beginning from the initial financial year on the 1st day of April 2004 and ending on the 31st day of March, 2009;

(b) reduce revenue deficit as percentage of Gross State Domestic Product in each of the financial years referred to in clause *(a)* in a manner consistent with the goal set out in clause *(a)*;

(c) reduce fiscal deficit to not more than three per cent of the estimated Gross State Domestic Product within the period referred to in clause *(a)*;

(d) reduce fiscal deficit as percentage of Gross State Domestic Product in each of the financial years referred to in clause *(a)* in a manner consistent with the goal set out in clause *(c)*;

(e) not to give guarantee for any amount exceeding the limit stipulated under any rule or law of the State Government existing at the time of the coming into force of this Act or any rule or law to be made by the State Government subsequent to coming into force of this Act;

(f) ensure within a period of fourteen financial years, beginning from the initial financial year on the 1st day of April, 2004 and ending on the 31st day of March, 2018; that the total liabilities at the end of the last financial year, do not exceed twenty-five per cent of the estimated gross state domestic product for that year;

Provided that revenue deficit and fiscal deficit may exceed the limits specified under this sub-section due to ground or grounds of unforeseen demands on the finance of the State Government due to national security or natural calamity, subject to the condition that the excess beyond limits arising due to natural calamities does not exceed the actual fiscal cost that can be attributed to the calamities.

Provided further that the ground or grounds specified in the first *proviso* shall be placed before both the Houses of Legislature, as soon as possible, after it becomes likely that such deficit amount may exceed the aforesaid limits, with an accompanying report stating the likely extent of excess, and reasons therefor.

Measures for Fiscal Transparency

5: (1) The State Government shall take suitable measures to ensure greater transparency in its fiscal operations in public interest and minimize as far as practicable, secrecy in the preparation of the annual budget.

(2) In particular and without prejudice to the generality of the foregoing provision, the State Government shall, at the time of presentation of the annual budget, disclose in a statement in the form as may be prescribed**—**

(a) the significant changes in the accounting standards, policies and practices affecting or likely to effect the computation of prescribed fiscal indicators;

(b) as far as practicable, and consistent with protection of public interest, the contingent liabilities created by way of guarantees; the actual liabilities arising out of borrowings by Public Sector Undertakings and Special Purpose Vehicles and other equivalent instruments where liability for repayment is on the State Government allocations and commitments made by the State Government having potential budgetary implications, including revenue demand raised but not realized, tax expenditure; losses incurred in providing public goods, and services through public utilities and undertaking; liability in respect of major works and contracts; and subsidy payments and the impact of the same on the fiscal position of the State including in relation to the targets referred to in sub-section (3) of Section 4.

Measures to enforce compliance

6: (1) The Annual budget, and policies announced at the time of the budget, shall be consistent with the objectives and targets specified in the Medium Term Fiscal Restructuring Policy for the coming and future years.

(2) The Minister Incharge of the Department of Finance, shall review, every half year, the trend in receipts and expenditure in relation to the budget, remedial measures to be taken to achieve the budget targets, and place before both the Houses of Legislature the outcome of such reviews. The review report shall be in such from as may be prescribed.

(3) The review report shall explain**—**

(a) any deviation or likely deviation in meeting the obligations cast on the State Government under this Act;

(b) whether such deviation is substantial and relates to the actual or the potential budgetary outcomes, and how much of the deviation can be attributed to general economic environment and to policy changes by the State Government; and

(c) the remedial measures the State Government proposes to take.

(4) Wherever there is a prospect of either shortfall in revenue or excess of expenditure over pre-specified levels for a given year on account of any new policy decision of the State Government that affects either the State Government or its Public Sector Undertakings, State Government, prior to taking such policy decision, shall take measures to fully offset the fiscal impact for the current and future years by curtailing the sums authorized to be paid and applied from and out of the Consolidated Fund of the State under any Act to provide for the appropriation of such sums, or by taking interim measures for revenue augmentation, or by taking up a combination of both;

Provided that nothing in this sub-section shall apply to the expenditure charged on the Consolidated Fund of the State under clause(3) of Article 202 of the Constitution;

Provided further that, while adhering to the fiscal years, the State Government will give priority to protecting certain expenditure defined in the Medium Term Fiscal Restructuring Policy as “High Priority Development Expenditure” (including, *inter-alia*) from curtailment or may impose a recede or partial curtailment.

(5) Whenever one or more supplementary estimates are presented to the House of Legislature, the State Government shall also present an accompanying statement indicating the corresponding curtailment of expenditure and/or augmentation of revenue to fully offset the fiscal impact of the supplementary estimates in relation to the budget targets of the current year and the Medium Term Fiscal Restructuring Policy objectives and targets for the future year.

Power to make rules

7: (1) The State Government may, by notification, make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing powers such rules may provide for all or any of the following matters, namely**—**

(a) the fiscal indicator to be prescribed for the purpose & sub-section (2) of section 3 and clause *(a)* of sub-section (2) of section (5);

(b) the term of the Medium Term Fiscal Restructuring Policy referred to in section 3;

(c) any other matter which is required to be, or may be prescribed.

Protection of action taken in good faith

8. No suit for prosecution or other legal proceedings shall lie against the State Government or any officer of the State Government for anything which is in good faith done or intended do be done under this Act or the rules made thereunder.

Application of other laws not barred

9. The provisions of this Act shall be in addition to, and not in derogation of the provisions of any other law for the time being in force.

Power to remove difficulties

10: (1) If any difficulty arises in giving effect to the provisions of this Act, the State Government may, by order published in the *Gazette* make such provisions not inconsistent with the provisions of this Act as it may deem necessary for removing the difficulty;

Provided that no order shall be made under this section after the expiry of two years from the commencement of this Act.

(2) Every order made under this section shall be laid as soon as may be after it is made, before each house of the State Legislature.

STATEMENT OF OBJECTS AND REASONS

With a view to provide for the responsibility of the State Government to ensure fiscal stability and sustainability, and to enhance the scope for improving social and physical infrastructure and human development by achieving sufficient revenue surplus, reducing fiscal deficit and removing impediments to the effective conduct of fiscal polity and prudent debt management through limits on State Government borrowings, government guarantees, debt and deficits, greater transparency in fiscal operations of the State Government and use of a medium term fiscal framework, it was considered necessary to enact a law.

The Fiscal Responsibility Bill, among other things, provides for the following—

(i) requiring the State Government to lay in each financial year before both Houses of the State Legislature a Medium Term Fiscal Restructuring Policy along with the annual budget which will set forth five year rolling targets of prescribed fiscal indicators.

(ii) specifying fiscal management principles to guide the State Government.

(iii) requiring the State Government to take appropriate measures to eliminate revenue deficit and containing the fiscal deficit as percentage of GSDP by 31st March, 2009 within the prescribed limits.

(iv) requiring the State Government to take suitable measures to ensure transparency in fiscal operations and to minimize as far as practicable, secrecy in the preparation of the annual budget.

(v) to require that the annual budget and the policies announced at the time of budget shall be consistent with the objectives and targets specified in the Medium Term Fiscal Restructuring Policy for the coming and future years.

(vi) half-yearly reviews of the trends in receipts and expenditure in relation to the budget by the Finance Minister and placing the outcome of such review before both the Houses of the State Legislature.

(vii) requiring the Finance Minister to make statement in both the Houses of the State Legislature in respect of any deviation in meeting the obligations cast on the State Government under the Legislation.

(viii) relaxation from deficit reduction targets to deal with unforeseen demands on account of national security or unprecedented natural calamities.

The Uttar Pradesh Fiscal Responsibility and Budget Management Act, 2004 is introduced accordingly.

By order
R. B. RAO.
Pramukh Sachiv.

Annexure 2: The States' Debt Consolidation and Relief Facility 2005-2010 (DCRF)

I. Background

1. Restructuring of State Finances has been a major focus of the terms of reference and objectives of the Finance Commissions. Eleventh Finance Commission (EFC) recommended creation of a scheme of States' Fiscal Reform Facility (FRF) for the period 2000-01 to 2004-05, backed with a Fiscal Reform Facility Incentive Fund (the Fund) of Rs.10, 607.72 to incentives the States to collectively eliminate revenue deficits by 2004-05. Government of India constituted the Fund and advised States to prepare their Medium Term Fiscal Reforms Programmes, outlining the reforms and taking into consideration the reforms suggested by EFC to bring about necessary correction in the revenue deficits. Release from the Incentive Fund was based on improvement in single monitorable fiscal indicator i.e. Revenue Deficit (RD) as percentage of revenue receipt (TRR) by 5 percentage points annually (2 percentage points for special category states prospectively with effect from 2002-03). However, as per the latest available information upto 2004-05 (BE) the aggregate improvement of 28 States in terms of the single monitorable indicator stood at:

Indicator	1999-2000	2000-01	2001-02	2002-03	2003-04(RE)	2004-05(BE)
RD as % of TRR	27.23	23.85	24.49	21.00	22.98	14.24

2. The Medium Term Fiscal Reforms Programme (MTFRP) was accepted by all 28 States and MoUs were signed with 27 States. An amount of Rs. 7216.98 was released from the Incentive Fund to the States upto March 31, 2005.

3. Twelfth Finance Commission (TFC) was mandated to review the Fiscal Reforms Facility introduced by the Central Government on the basis of the recommendations of the Eleventh Finance Commission and suggest measures for effective achievement of its objective. The TFC has not recommended continuation of FRF over the period 2005-10, and has suggested another scheme for achieving the same objective of eliminating revenue deficits, this time by end of the TFC period i.e. 2009-10, linked to States adopting a statutory route for revenue deficit elimination by passing Fiscal Responsibility legislation on the lines suggested by TFC.

II. Recommendations of the TFC on Debt Consolidation and Relief

A. Consolidation and Rescheduling of the Government of India Loans to the States

4. TFC has recommended a two-fold strategy for fiscal consolidation and elimination of revenue deficits. TFC has recommended that the Government of India should not provide loans to the States and the States may take recourse to the markets for meeting their borrowing requirements. Only as an exceptional measure, for" fiscally weak states" who are not able to raise loans in place of the loans which Government of India was providing as loan component of the Central assistance to their plans, Government of India may raise loans and on lend the same through the Public Account. TFC has further recommended consolidation of all existing loans provided to the States upto March 31, 2004 and which are outstanding on March 31, 2005, upon the States meeting the pre-condition of adopting a Fiscal Responsibility legislation on the lines recommended by the TFC.

5. TFC has recommended that the Central loans to States contracted till March 31, 2004 and outstanding on March 31, 2005 (estimated by TFC at Rs. 128,795) may be consolidated and rescheduled for a fresh term of 20 years (resulting in repayment in 20 equal instalments), and an interest rate of 7.5 percent be charged on them. The consolidated loans include some loans, which had been consolidated by earlier Commissions at interest rates lower than 7.5 percent. TFC have included them in the exercise so that management of loans becomes simpler for the Central government. The estimated outstanding loans as per the TFC are given at Annex- A. Government of India would finalise the actual outstanding loans given by the Ministry of Finance prior to March 31, 2004 and which remain outstanding as on March 31, 2005 in the month of July, 2005 after reconciling the same with the States.

6. This general debt relief comprising consolidation, reschedulement and lowering of interest rate to 7.5 percent shall be available to all States with effect from the year they enact the Fiscal Responsibility legislation. TFC has indicated in their recommendations the contents of the Fiscal Responsibility and Budget Management legislation and has divided them into two parts: core (non-negotiable) and others (recommendatory). The core recommendations which need to be incorporated in the Fiscal Responsibility and Budget Management legislation of the States before debt reschedulement would be considered by the Ministry of Finance are as under:

- 6.1 Eliminating revenue deficit by 2008-09
- 6.2 Reducing fiscal deficit to 3 percent of GSDP
- 6.3 Bringing annual reduction targets of revenue and fiscal deficits
- 6.4 Bringing out annual statement giving prospects for the State's economy and related fiscal strategy
- 6.5 Bringing out special reports along with the budget giving details of number of employees in government, public sector and aided institutions and related salaries.

7. The other measures, which are recommended to be included in the Fiscal Responsibility and Budget Management legislation are set out in Annex-B.

8. States would get benefit in repayment on account of reschedulement of these loans. In terms of these recommendations relating to consolidation, reschedulement and lowering of interest rate, the debt relief during the award period for all States put together has been estimated by the TFC at Rs. 21,276 crore in terms of lower interest payments and Rs. 11,929 crore in terms of lower repayments during this period. The same is given in Annex-C.

B. Debt Write-Off

9. In addition to providing general debt relief by consolidating and rescheduling at substantially reduced rates of interest the Central loans granted to States before March 31, 2004 and outstanding as on March 31,2005, TFC has framed a scheme of debt waiver based on fiscal performance, linked to the reduction of revenue deficits of States. Under the scheme, the repayments due on Central loans from 2005-06 to 2009-10, after consolidation and reschedulement as stated above, will be eligible for write-off. The quantum of write-off of repayment will be linked to the absolute amount by which the revenue deficit is reduced in each successive year during the award period from the base level of revenue deficit compiled by TFC. In effect, if the revenue deficit is brought down to zero, the entire repayments during the period will be written-off. The scheme of write-off shall be available for all States from

the year they have qualified for the general debt relief by enacting the Fiscal Responsibility and Budget Management legislation.

10. The modalities of Debt Write-Off would be as under:

10.1 Fiscal performance will be measured with reference to the revenue deficit/ revenue surplus, as worked out by TFC in absolute numbers by taking an average of three years, viz., 2001-02 (Actuals), 2002-03 (Actuals), and 2003-04 (RE). This average will be taken as the base year figure for 200304.

10.2 For States which were in revenue surplus, as per the base year figure (calculated in the manner indicated above), and continue to remain so in the subsequent years till the end of TFC award period, the instalment of repayment due on the Central loans (after consolidation and reschedulement) may be written-off in each of the years from 2005-06 onwards so long as the revenue surplus of the State does not go below the base year level in absolute terms. In the year the revenue surplus is less than that in the base year figure, no write-off will be permitted.

10.3 As for the States which were in revenue deficit as per the base year figure, the revenue deficit is expected to be eliminated by 200809, i.e. over a five year period. Fiscal performance will be measured by the absolute amount by which the revenue deficit is reduced in each year compared to the deficit in the previous year starting from the base year figure. For the purpose of determining the scale at which the relief will be provided, the ratio of the repayment due by a State during the period 2005-10 (of Central loans after consolidation and reschedulement) to the base year revenue deficit figure has been worked out. This determines the amount of write-off of repayment that will be allowed to each State for the reduction of each rupee of revenue deficit. Annex-D states the base year revenue deficit and the ratios that will be applicable to the States for determining the quantum of write-off.

10.4 The actual reduction in the revenue deficit in each year over the immediately preceding year would determine the amount of write-off for the State in the repayment due in the immediately succeeding year. This is calculated by multiplying the above mentioned ratio by the amount of reduction of the revenue 'deficit. The total amount of write-off in a year will, however, be restricted to the repayments due on the consolidated loans in that year. Further, the write off will be admissible only if the State reduces the revenue deficit to a level lower than that in the base year.

10.5 It may be noted that, other things remaining the same, a reduction of revenue deficit is inherent from 2005-06 onwards as a result of the debt relief due to the lowering of the interest rate recommended. **Reduction in revenue deficit, which is at least equal to the interest rate relief is to be treated as an eligibility requirement.** Each State will, therefore, be required to achieve, in each year of the award period, a reduction in the revenue deficit which, compared to the base year figure, is cumulatively higher than the cumulative reduction attributable to the interest relief recommended. Details of the year-wise relief in interest payments and the cumulative reduction in revenue deficit arising out of lowering of interest rate for each State during 2005-10 are at Annex-E.

10.6 If the reduction in revenue deficit in a year is more than the minimum required for the write-off of the entire repayment due in that year, the excess will be carried forward fully to the next year, provided the revenue deficit continued to follow a downward trend in the next year and is lower than the base year figure. On the other hand, if there is an increase in the revenue deficit in the next year, but the revenue deficit is still lower than the base year figure, the entitlement to write-off will be determined on the basis of improvement from the minimum revenue deficit figure of the previous year that would have given full relief in the previous year.

Illustration:

If State A .has the base year revenue deficit figure of Rs 2000 crore and the repayments during 2005-2010 are Rs 1000 (or Rs 200 crore in each year), the ratio for determining the quantum of write-off will be 0.50 i.e. the State will be eligible for write-off of debt equal to 50 percent of the amount of reduction in revenue deficit. If the State reduces its deficit by Rs 300 crore in 2004-05, compared to the base year level, it will qualify for a debt write-off of Rs 150 crore in 2005-06. If, however, the reduction in deficit is of the order of Rs 600 crore, although the State will be eligible for a write-off of Rs 300 crore, the debt write-off in that year will be restricted to the instalment of repayment due (i.e. Rs 200 crore) in the year, the remaining amount (i.e. Rs 100 crore) qualifying for write-off in the next year subject to the State maintaining or further reducing its revenue deficit in the next year. If, on the other hand, in the year 2005-06, the revenue deficit increases by say Rs. 100 from the 2004-05 level, the improvement over the base year level would only be Rs 500 crore. In that event, since an amount of Rs 400 crore has already been utilized for debt relief in the previous year, the State will qualify for a relief in repayment amounting to fifty per cent of the balance of Rs 100 crore i.e. a relief of Rs. 50 crore only in 2006-07.

10.7 If the performance of a State deteriorates in a year, with the revenue deficit registering a higher level over the previous year for which relief in repayment has been availed of, any improvement in the succeeding year will be measured, not with reference to that year, but with reference to the performance level in the previous year up to which relief has been availed of. If the revenue deficit reduction in that previous year was more than the minimum reduction required to qualify for 100 percent write-off of repayment, the revenue deficit in that year may be re-determined notionally keeping in view the minimum revenue deficit reduction that would have qualified the State for 100 percent relief in repayment.

10.8 Looking at the necessity of containing the fiscal deficit, the benefit of write-off would be available only if the fiscal deficit of the State is contained to the level of 2004-05. If, in any year, the fiscal deficit exceeds this level, the benefit of write-off, even if eligible otherwise, would not be given.

Illustration:
In continuation of the earlier illustration, if the revenue deficit of State A goes up to Rs.1800 crore in 2005-06 after being reduced to Rs 1400 crore in 2004-05, it will not qualify for relief in repayment in 2006-07. Also, its performance in 2006-07 for relief in 2007-08 will be measured from the notional level of 2004-05. The notional level in this case would be Rs. 2000 crore minus Rs 400 crore i.e. Rs 1600 crore. This would ensure that no State will be able to avail itself of relief more than once for the same level of improvement over the base. Nor would any State stand penalized for performing better than the minimum required level in any year.

11. In terms of debt write-off package, if a State achieves through a consistent performance, a zero revenue deficit by 2008-09, it will have the facility of having all the repayments due from 2005-10 on Central loans contracted upto March 31, 2004 and consolidated written-off. The total amount that would be written-off if all States achieve revenue balance by 2008-09 is approximately Rs. 32,200 crore in a period of five years.

III. States' Own Fiscal Correction Path

12. TFC has deliberated upon ways to restructure finances of the States to restore budgetary balance and control their fiscal deficits. TFC's growth projections for 2005-10 for the States, based on the working of the TFC and the assumed growth rates, are given in Annex-F. TFC has also recommended State-specific buoyancies for the revenues as a whole. The States now need to work out tax and non-tax specific growth rates to realise the revenue growth projected by the TFC. The States have been advised to bring down their revenue deficits to zero by 2008-09. Bringing down revenue deficits to zero over this period given the growth in revenues would require States to take specific decisions regarding balance adjustment from the expenditure side. As the TFC has projected fiscal deficit to be brought down to 3 percent by 2008-09, it follows that the States would need to plan to raise capital expenditure to 3 percent of GSDP by 2008-09 as the revenue balance would have been restored. Broadly speaking, the TFC has suggested, *inter-alia*, an aggregate improvement of State Finances during the period 2004-05 to 2009-10 as under:

(% of GDP)

Indicator	2004-05	2009-10	Adjustment 2009-10 minus 2004-05	Average Adjustment Per Year
States (Own Tax Revenue)	5.9	6.8	0.8	0.17
Own Non Tax Revenue	1.2	1.4	0.2	0.03
Interest Payment	2.9	2.0	-0.9	-0.18
Total Revenue Expenditure	13.6	13.2	-.04	-0.08
Capital Expenditure	2.6	3.1	0.5	0.10
Total Expenditure	16.2	16.3	0.01	0.01
Revenue Deficit	2.0	0.0	-2.0	-0.40
Fiscal Deficit	4.5	3.0	-1.5	-0.30
Primary Deficit	1.6	1.0	-0.6	-012
Debt (end year of adjusted liabilities)	30.3	30.8	0.6	0.11

13. The Twelfth Finance Commission has mentioned in its report. "…..there is a need to determine borrowing limits for each State taking into account borrowing from all sources including small savings and State's public account and reserve funds. The prescribed borrowing limit on States' aggregate fiscal deficit in our restructuring plan is 3 percent". While discussing operationalising the scheme for sustainable borrowing by the States,

Twelfth Finance Commission has suggested that the annual borrowing undertaken by the States should be kept within sustainable limits. The Central Government has powers to do so under Article 293(2) and in State legislatures also have the power to do so under Article 293(1)". Following the recommendation of the Twelfth Finance Commission, the Government of India has worked out possible annual reduction of fiscal deficit of the States taking the existing level of fiscal deficit, and with the objective of reducing the fiscal deficit to 3 percent of GDP by 2008-09. The same is placed at Annex-G. States' borrowing ceiling under Article 293(3) of the Constitution of India would be determined keeping this in mind.

14. However, keeping all these objectives in view (with State specific variations) the States would need to develop their own Fiscal Correction Path for the Twelfth Finance Commission Award period. Such Fiscal Correction would enable the States to design/amend their Fiscal Responsibility Legislation on a realistic path. The States would, therefore, be expected to provide the milestones of their own Fiscal Correction Path through a letter of commitment along with their Fiscal Responsibility and Budget Management Act, to the Ministry of Finance when they approach Government of India for debt consolidation.

15. States' own Fiscal Correction Path may be based on the following objectives in the light of the TFC recommendations:

- Eliminating revenue deficit by 2008-09
- Reducing fiscal deficit to 3 percent of GSDP
- Annual reduction targets of revenue and fiscal deficits
- States' recruitment and wage policy
- Widening the tax base and modifying tax rates on a year to year basis to achieve the tax growth rates as projected by TFC
- Pricing the services such as irrigation, water charges and bus fare computing the subsidy element and preparing a schedule to reduce the subsidy element
- Indexation of prices/user charges to major input costs such as POL, Dearness Allowance etc.
- The salary burden is already heavy and, at the minimum, the ratio of salaries to revenue expenditure net of interest payments and pensions must not be allowed to increase. It should be progressively brought down to levels prevalent in 1996-97.
- Abolition of vacant posts in Government except State defined priority sector and other measures to contain the wage and salary bill through outsourcing services and hiring civil servants under contract on the basis of specific recruitment rules for the same.
- Other measures.

16. TFC has recommended a multi-dimensional restructuring of Government finances aimed at both the qualitative and quantitative aspect of managing Government finances. In particular, the TFC recommended restructuring covers the following areas, which may also be kept in consideration while the States prepare their own Fiscal Correction Path.

- Taxation reforms aimed at building a non-distortionary and revenue-elastic system of taxation with tax rates that are low, limited in number of rate categories, and stable;
- User charges for services where there is no clear cut case for subsidisation;
- Ensure recovery of current costs, as a short-term objective.

- User charges for services where there is no case for subsidization, aim at full recovery of costs, measured at acceptable efficiency levels, in the long run to ensure rates of return on investments to cover the average cost of borrowing. Expenditure restructuring relating to both sizes and mid sectoral allocations aimed at removing inefficiencies arising from misallocation, design and implementation of schemes, and delivery of services.
- Rationalizing subsidies by reducing their overall volume, increasing their transparency by making them explicit, and improving their targeting;
- Public sector restructuring where, apart from natural monopolies and strategic reasons, there is a strong case for reducing government's involvement.
- Fiscal transfer system where equalizing transfers are given much greater weight and extended to local bodies;
- Suggesting a reformed role for the Plan process;
- Strengthening the role of local bodies to become a more effective instrument in the delivery of local public goods;
- State governments need to take up initiatives similar to those of the Central government for pension reforms. This would also be facilitated by the appointment of a regulator.
- Large amount of capital is locked up in the public sector showing extremely low returns in relation to the average cost of funds to the government. The problem is particularly acute in the case of the States. Out of 1003 State Level Public Enterprises (SLPEs), 599 SLPEs are reported either non-functioning or running losses. Not only the returns on government investment are non-existent or low, but also a large number of SLPEs fail to finalize their accounts. The total amount of investment in respect of the SLPEs, where accounts were finalized, was estimated to be Rs.2, 38,220 crore at the end of 2000-01. Many States have, however, taken steps to close down many of the SLPEs and for disinvestments in others in their Medium Term Fiscal Reforms Programme (2000-01 to 2004-05). This process should be further strengthened. In the period of restructuring, that is 2005-10, State governments should draw up a programme that includes closure of almost all loss making SLPEs. By the end of 2009-10, it is expected that as a result of these measures, the States would have a small but viable set of SLPEs.

17. Some additional information as mentioned below should be appended, in the form of statements, to the present system of cash accounting to enable more informed decision making. An illustrative list of statements which could be included are:

a) statement of subsidies given, both explicit and implicit;
b) statement containing expenditure on salaries by various departments/units;
c) detailed information on pensioners and expenditure on government pensions; data on committed liabilities in the future;
d) statement containing information on debt and other liabilities as well as repayment schedule;
e) accretion to or erosion in financial assets held by the government including those arising out of changes in the manner of spending by the government; implications of major policy decisions taken by the government during the year or new schemes proposed in the budget for future cash flows; and
f) statement on maintenance expenditure with segregation of salary and non-salary portions.

18. TFC noted the absence of a standard definition of revenue deficit with States being allowed selectively to include/exclude the deficits of major State government entities like the State Electricity Board, Road Transport Undertaking etc. for the purpose of measuring performance. It was also noticed that some States have started classifying the grants to local bodies as capital expenditure. Some States are already meeting the deficit of their electricity boards by granting loans or investing in equity rather than providing transparent subsidies. TFC's scheme of debt relief in respect of repayment of loan during 2005-10 is linked to reduction in revenue deficit so as to eliminate it by 2008-09. It is necessary to guard against any attempt to defeat the objectives of the scheme through creative accounting. TFC, therefore, has recommended that the definition of revenue and fiscal deficits is standardized and instructions for a uniform classification code for all States down to the object head are issued. "Unauthorized changes in accounting policies and arbitrary reclassification of expenditure should be viewed seriously by the monitoring agency while granting relief under the scheme."

19. Following definitions of deficits would apply uniformly to all States:

Revenue Deficit	Budgetary Revenue Receipts - Budgetary Revenue Expenditure
Fiscal Deficit	Revenue Deficit + [Budgetary Capital Expenditure, including net loans advanced - Other non-debt Capital Receipts]
Power Sector Revenue Deficit	Power Sector loss/profit net of actual subsidy transfer + increase in debtors during the year in power utility accounts.
Consolidated Revenue Deficit	Budgetary Revenue Deficit + Power Sector Deficit + Interest on SPV borrowings made by PSUs outside budget.

Any revenue expenditure classified as capital expenditure would be added back as revenue expenditure.

20. External Assistance loans transferred on 'back to back' basis would be reflected, wherever required on the basis of current exchange rate.

21. On the basis of the States' Own Fiscal Correction Path (2004-05 to 2009-10), for accepting the Debt Consolidation and Relief Facility, States may send a letter of commitment to the Department of Expenditure, Ministry of Finance indicating the outcome indicators and process milestones with the target date of implementation. A model proforma of outcome indicators is given in Annexure-H.

22. TFC has recommended the constitution of a Monitoring Committee at State level headed by Chief Secretary of the State concerned, with the Finance Secretary and the Secretaries/HoD concerned as members to review the utilization of grants and to issue directions for mid-course correction if considered necessary once in every quarter. The Monitoring Committee may also review the progress of the Own Fiscal Correction Path of the respective State every quarter and advise the corrective action.

IV. Process for Consolidation of Loans

23. The States are requested to file their requests for consolidation of Government of India loans along with a copy of the Fiscal Responsibility and Budget Management Act (FRBMA), passed or modified, taking into consideration the core elements mentioned in para 6 above and the Own Fiscal Correction Path. States may also be expected to provide a copy of their budget documents for 2005-06 and the own Fiscal Correction Path, which are expected to be in line with the Fiscal Responsibility law of the State concerned. If the budget for 2005-06 is not in accordance with the FRBMA, the State concerned may intimate the adjustments which would be made at RE stage to bring the budget in line with FRBMA. Fiscal Reforms Unit (FRU) in the Department of Expenditure would examine the requests of the States. FRU would obtain from the office of the Chief Controller of Accounts (CCA) details of the eligible loans to be consolidated and send the same to the States for verification by their Accountants General. FRU would place the own Fiscal Correction Path of the State, along with the jointly verified list of loans to be consolidated, for consideration of the Central Monitoring Committee as mentioned at para 26. Upon finalisation of Fiscal Correction Path and consolidation of loans by the Central Monitoring Committee, the loans would be consolidated and made effective from April 1, 2005. Excess principal and/or interest recovered from the State would be either adjusted from the recoveries to be made during the remaining part of the year or in the next year, if there are insufficient recoveries to be made in the year.

24. In the interest of their fiscal improvement the States are expected to not only keep the FRBM Act in effect throughout the period of 2005-10, but also to adhere to the provisions thereof. In case, any State does not do so, Government of India may recover the interest relief given to the State on account of consolidation.

V. Process for Debt Waiver:

25. States would be expected to file for the waiver of the principal amount of the consolidated loans falling due in a particular year if the State has met the conditions for getting the debt waiver. The process for the filing claim, verification, and examination by FRU and consideration by Central Monitoring Committee would be as under:

a. Claims for waiver, on the basis of revised estimates of revenue deficit/revenue surplus, along with budget documents and States' Own Fiscal Correction Path/Revised Path, should be sent to Joint Secretary (State Finances), Department. of Expenditure, Ministry of Finance, North Block, New Delhi. Claims may contain details of the reduction carried out in revenue as well as fiscal deficit. Necessary adjustments will be made after the Finance Accounts is made available. The status of FRA may also be indicated.
b. FRU in Department of Expenditure, Ministry of Finance, shall examine the claims and along with the States' Own Fiscal Correction Path/Revised Path and place it before the Central Monitoring Committee which would meet every quarter of the year, to deliberate on and recommend the waivers.
c. The decision of the Central Monitoring Committee would then be put up to Secretary (Expenditure), Ministry of Finance for his approval and as soon as the approval is received, FRU shall issue waiver orders to the Controller of Accounts/PAO of Ministry of Finance.

VI. Central Monitoring Committee

26. A Central Monitoring Committee would be constituted at the Government of India level, with the following composition:

1. Secretary (Expenditure) - Chairman
2. Additional Secretary (Expenditure)
3. Chief Economic Advisor (Dept of Economic Affairs) or his Representative
4. Additional Secretary (Economic Affairs), Dept of Economic Affairs
5. Controller General of Accounts
6. Joint Secretary (Budget)
7. Advisor (FR)- Planning Commission
8. Executive Director, RBI in charge of Internal Debt Management Department
9. Director - NIPFP or his Representative
10. Joint Secretary (Fiscal Responsibility and Budget Management) DEA.
11. Chief Secretary of the State concerned
12. Finance Secretary of the State concerned.
13. Accountant General of the State concerned.
14. Joint Secretary (State Finances) DoE, Ministry of Finance - Member Secretary

27. The Central Monitoring Committee would be entrusted with the following tasks:

a. To consider the details of the States' own Fiscal Correction Path and to examine whether Fiscal Responsibility and Budget Management Act of the State is in accordance with the guidelines.

b. Examine waiver claims received from the State and recommend the quantum of the waiver.

28. Secretary (Expenditure) would be the final authority to decide on the claims of the States, after taking into consideration the recommendations of the Central Monitoring Committee on all matters concerning the Scheme.

(Anurag Goel)
Additional Secretary to Government of India
Department of Expenditure

Dated: June 23, 2005, New Delhi.

Annex-A

Outstanding Central Loans Granted upto 31.03.2004 and Repayment Profile (before Consolidation and Reschedulement) During 2005-06 to 2009-10

(Rs. Crore)

	States	Outstanding Balance on 31.03.2004	Outstanding Balance of these Loans as on 31.03.2005	Block Loans	Small Savings Loans	Mid Term Loans	Pre-1979-80 Consolidated Loans (30 Years)	Pre-1979-80 Re-Consolidated Loans (30 Years)	1979-84 Consolidated Loans (25 Years)	1979-84 Consolidated Loans (30 years)	1984-89 Consolidated Loans (15 years)	Others	Total Repayment Due From 2005-10
		(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**	**(10)**	**(11)**	**(12)**
1.	Andhra Pradesh	18545	15337.14	4185.3	204.52			75.44		108.67			4573.93
2.	Arunachal Pradesh	409.4	389.56	116.71	0.66				0		0		117.37
3.	Assam	2939.83	2099.82	347.32	92.33	465.00		22.12	0	105.63		0.17	1032.57
4.	Bihar	10181.29	7704.08	2153.12	243.79			54.32	0	95.24			2546.47
5.	Chhattisgarh	2748.11	2281.26	618.73	50.14		20.3		0	27.17			716.35
6.	Goa	585.56	528.54	162.24	8.96				0		0		171.1
7.	Gujarat	14037.04	10463.92	2896.52	488.93		52.17		0		27.51		3465.13
8.	Haryana	3627.74	2325.73	639.43	141. 76		23.61		34.92		0		839.73
9.	Himachal Pradesh	1777.37	824.24	207.05	57.35			3.92	0	7.61			275.94
10.	Jammu & Kashmir	2697.73	1895.35	481.47	41.23			27.13	0	85.38			635.2
11.	Jharkhand	3052.48	2637.95	73 1.27	82.53			18.39	0	32.24			864.43
12.	Karnataka	10555.4	8318.17	2229.12	258.86		22.88		0		0		2510.8
13.	Kerala	5517.28	4252.19	1223.04	101.68		50.35		67.11		0		1442.1
14.	Madhya Pradesh	8977.66	750Q.42	2222.68	138.23		55.95		0	74.91			2491.7
15.	Maharashtra	16166.55	7812.88	2137.78	889.24		59.33		0		0		3086.3
16.	Manipur	777.11	754.16	100.7	1.49	371.00		2.21		5.29			480.68
17.	Meghayalaya	356.65	321.07	85.82	6.34			0.36		2.57			95.08
18.	Mizoram	290.56	271.39	74.82	0.34				0		0		75.16
19.	Nagaland	341.33	320.59	95.49	1.58				0	4.43			101.50
20.	Orissa	8965.24	7005.17	1740.6	74.36	692.00		39.77		77.41			2624.14
21.	Punjab	5396.83	3053.69	885.43	227.8	1.67			0		0		1114.90
22.	Rajasthan	9605.4	6833.53	1648.98	186.35	462.50		66.18		81.12		1.02	2446.16
23.	Sikkim	208.45	192.28	55.45	0.85			0.37		2.1			58.76
24.	Tamil Nadu	9180.55	6872.68	2215.75	171.37		19.71		0		0		2406.84
25.	Tripura	555.96	470.1	131.42	9.32		1.55		0		0		142.29
26.	Uttar Pradesh	27407.35	18340.48	5188.9	639.18			85.58	224.50		0		6138.16
27.	Uttaranchal	308.17	288.09	41.83	3.63			4.53	11.90		0		61.89
28.	West Bengal	19056.02	9700.29	2421.67	558.97	438.00	74.06		119.85		0		3612.55
	Total	**184268.06**	**128794.75**	**35038.65**	**4681. 78**	**2430.17**	**379.92**	**400.31**	**458.28**	**709.78**	**27.51**	**1.19**	**44127.60**

Source: Ministry of Finance, Government of India.
Note: The above figures do not include loans given by Ministries/Departments for Centrally Sponsored Schemes/Central Plan Schemes.

Annex-B

Other Measures Recommended to be included in the Fiscal Responsibility Legislation

Taxation reforms aimed at building up non-distortionary and revenue-elastic system of taxation with tax rates that are low, limited in number of rate categories, and stable;

Non-tax revenues where user charges, as a short term objective, ensure recoveries of current costs, and aim at full recovery of costs measured at acceptable efficiency levels in the longer run, in the case of services where there is no clear cut case for subsidization and ensure rates' of return on investment that covers the average cost of Expenditure restructuring relating to both in size and sectoral allocations aimed at removing inefficiencies arising from misallocations, design and implementation of schemes, and delivery of services.

States should follow a recruitment and wage policy, in a manner such that the total salary bill relative to revenue expenditure net of interest payments and pensions does not exceed 35 per cent.

In the case of States, the level of interest payment relating to the revenue receipts would fall to 15% by 2009-10.

The pension liabilities in the case of States account for a larger share of its revenue receipts. This share may increase further in view of the increasing longevity and the number of appointments in the late sixties and early seventies, when the size of the state governments was expanding. State Governments need to take up initiative similar to those of the central Government for pension reforms. This would also be facilitated by the appointment of a regulator:

Rationalizing subsidies by reducing their overall volume, increasing their transparency by making them explicit, and improving their targeting;

Public sector restructuring where, apart from natural monopolies and strategic reasons, there is a strong case for reducing government's involvement

Fiscal transfer system where equalizing transfers are given much greater weight and extended to local bodies;

Suggesting a reformed role for the plan process;

Strengthening the role of local bodies to become a more effective instrument in the delivery of local public goods;

Suggesting institutional framework including ceiling on debt and deficit and mechanisms for their monitoring through state level fiscal responsibility legislation.

Setting up a sinking fund for amortization of all loans including loans from banks, liabilities on account of NSSF, etc. The fund should be maintained outside the consolidated fund and the Public Account and should not be used for any other purpose, except for redemption of loans.

Setting up of guarantee redemption fund through ear marked guarantee fees. This should be preceded by risk weighting of guarantees. The quantum of contribution of the fund should be decided accordingly.

Debt GSDP ratio to be brought down to 28%.

Annex-C

State-Wise Debt Relief after Consolidation of Central Loans Contracted before 31-03-2004 and Outstanding on 31-03-2005

(Rs. Crore)

	States	Repayment	Interest	Total
1.	Andhra Pradesh	739.64	2683.74	3423.38
2.	Arunachal Pradesh	19.98	71.73	91.71
3.	Assam	507.62	153.87	661.49
4.	Bihar	620.45	1268.27	1888.72
5.	Chhattisgarh	146.03	393.77	539.80
6.	Goa	39.06	94.66	133.72
7.	Gujarat	849.15	1840.02	2689.17
8.	Haryana	258.30	387.67	645.96
9.	Himachal Pradesh	69.88	134.79	204.67
10.	Jammu & Kashmir	161.38	264.02	425.4
11.	Jharkhand	204.94	454.49	659.43
12.	Karnataka	431.32	1529.43	1960.75
13.	Kerala	379.14	715.03	1094.17
14.	Madhya Pradesh	616.66	1310.98	1927.64
15.	Maharashtra	1133.12	1217.39	2350.51
16.	Manipur	292.14	27.26	319.4
17.	Meghalaya	14.82	56.49	71.31
18.	Mizoram	7.31	50.54	57.85
19.	Nagaland	21.35	56.06	77.41
20.	Orissa	872.85	1008.43	1881.28
21.	Punjab	351 .48	523.18	874.66
22.	Rajasthan	737.77	962.25	1700.02
23.	Sikkim	10.69	33.96	44.65
24.	Tamil Nadu	688.67	1195.47	1884.14
25.	Tripura	24.77	123.97	148.74
26.	Uttar Pradesh	1553.04	3132.68	4685.72
27.	Uttaranchal*	-10.13	37.70	27.57
28.	West Bengal	1187.48	1547.81	2735.29
	Total	**11928.91**	**21275.65**	**33204.56**

Note: *The state is not getting benefit in repayments as some loans which would otherwise have got fully repaid during our award period are getting rescheduled for a fresh period of 20 years and existing repayment profile of Block Loans seems to involve a moratorium on half the repayment during 2005 to 2009.

Annex-D

Calculation of Incentive Debt Relief Based on Fiscal Performance

(Rs. Crore)

	States	2001-02 (Actual.)	2002-03 (Actual)	2003-04 (RE)	Average Revenue Surplus/ Deficit (2001-02 to 2003-04) [a]	Repayment due from 2005-10 after Consolidation and Reschedule-ment [b]	Annual Repayment Due {(b)/5)}	Ratio of Total Repayment to Average Deficit (2001-02/2003-04) {(b)/(a)}*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	General Category							
1.	Andhra Pradesh	-2881	-3054	-2904	-2947	3834.29	766.86	1.30
2.	Bihar	-1320	-1287	-1107	-1238	1926.02	385.2	1.56
3.	Chhattisgarh	-569	-113	-584	-422	570.31	114.06	1.35
4.	Goa	-229	-167	-92	-162	132.13	26.43	0.81
5.	Gujarat	-6732	-3565	-3462	-4586	2615.98	523.2	0.57
6.	Haryana	-1 055	-685	-904	-881	581.43	116.29	0.66
7.	Jharkhand	-305	-573	142	-245	659.49	131.9	2.69
8.	Karnataka	-3296	-2646	-1318	-2420	2079.54	415.91	0.86
9.	Kerala	-2606	-4122	-3676	-3468	1063.05	212.61	0.31
10.	Madhya Pradesh	-3158	-1169	-5204	-3177	1875.1	375.02	0.59
11.	Maharashtra	-8189	-9371	-9037	-8865	1953.22	390.64	0.22
12.	Orissa	-2833	-1576	-2963	-2457	1751.29	350.26	0.71
13.	Punjab	-3781	-3754	-3539	-3692	763.42	152..68	0.21
14.	Rajasthan	-3796	-3934	-3667	-3799	1708.38	341.68	0.45
15.	Tamil Nadu	-2739	-4851	-3700	-3763	1718.17	343.63	0.46
16.	Uttar Pradesh	-6195	-5117	-19938	-10417	4585.12	917.02	0.44
17.	West Bengal	-8856	-8635	-9376	-8956	2425.07	485.01	0.27
	Total – GC States	-58539	-54619	-71329	-61496	30242.03	6048.41	
	Special Category							
1.	Arunachal Pradesh	56	77	-39	31	97.39	19.48	
2.	Assam	-881	-319	-1634	-945	524.95	104.99	0.56
3.	Himachal Pradesh	-860	-1482	-1508	-1284	206.06	41.21	0.16
4.	Jammu & Kashmir	-336	369	1910	647	473.84	94.77	
5.	Manipur	-161	-87	-280	-176	188.54	37.71	1.07
6.	Meghalaya	-34	84	110	54	80.27	16.05	
7.	Mizoram	-260	-109	-32	-134	67.85	13.57	0.51
8.	Nagaland	-103	-159	99	-54	80.15	16.03	1.47
9.	Sikkim	143	198	163	168	48.07	9.61	
10.	Tripura	54	-81	93	22	117.53	23.51	
11.	Uttaranchal	-205	-458	-1463	-709	72.02	14.4	0.1
	Total Special Category	-2588	-1969	-2582	-2379	1956.66	391.33	
	Total – All States	**-61127**	**-56588**	**-73911**	**-63875**	**32198.69**	**6439.74**	

Note : This represents the amount by which repayment will be written off for every Rupee reduction in revenue deficit.
Revenue surplus (+)/Deficit (-).

Annex-E

Cumulative Relief on Interest Payments after Consolidation, Reschedulement and Lowering of Interest Rate to 7.5 percent on Central Loans Contracted before 31.03.2004 and Outstanding on 31.03.2005

(Rs. Crore)

	States	2004-05 Interest Relief	2005-06 Interest Relief	Cumulative Interest Relief up to 2005-06	2006-07 Interest Relief	Cumulative Interest Relief up to 2006-07	2006-07 Interest Relief	Cumulative Interest Relief up to 2007-08	2008-09 Interest Relief	Cumulative Interest Relief up to 2008-09	2009-10 Interest Relief	Cumulative Interest Relief up to 2009-10
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1.	Andhra Pradesh	0	611.66	611.66	582.74	1194.40	548.11	1742.51	499.42	2241.93	441.81	2683.74
2.	Arunachal Pradesh	0	16.4	16.40	15.63	32.03	14.65	46.68	13.32	60.00	11.73	71.73
3.	Assam	0	68.75	68.75	48.64	117.39	28.05	145.44	6.49	151. 93	1.94	153.87
4.	Bihar	0	303.45	303.45	281.58	585.03	257.94	842.97	229.24	1072.22	196.05	1268.27
5.	Chhattisgarh	0	91.38	91.38	86.18	177.56	80.11	257.67	72.59	330.27	63.50	393.77
6.	Goa	0	22.26	22.26	21.01	43.27	19.32	62.60	17.20	79.80	14.85	94.66
7.	Gujarat	0	427.83	427.83	407.03	834.86	380.98	1215.84	347.05	1562.89	277.13	1840.02
8.	Haryana	0	95.72	95.72	87.96	183.68	78.71	262.39	68.37	330.76	56.90	387.67
9.	Himachal Pradesh	0	32.46	32.46	30.11	62.57	27.36	.89.92	24.23	114.15	20.64	134.79
10.	Jammu & Kashmir	0	64.00	64.00	59.12	123.13	53.60	176.73	47.27	224.00	40.02	264.02
11.	Jharkhand	0	103.09	103.09	118.27	221.36	87.75	309.12	78.19	387.30	67.19	454.49
12.	Karnataka	0	348.77	348.77	332.91	681.68	312.84	994.52	284.43	1278.95	250.48	1529.43
13.	Kerala	0	170.47	170.47	158.90	329.37	145.43	474.80	129.81	604.61	110.42	715.03
14.	Madhya Pradesh	0	297.45	297.45	284.53	581. 98	268.42	850.4 0	243.64	1094.04	216.94	1310.98
15.	Maharashtra	0	319.63	319.63	284.34	603.97	246.34	850.30	205.55	1055.86	161.54	1217.39
16.	Manipur	0	29.90	29.90	16.46	46.35	2.86	49.21	-11.01	38.20	-10.94	27.26
17.	Meghalaya	0	12.84	12.84	12.25	25.08	11.49	36.57	10.55	47.12	9.37	56.49
18.	Mizoram	0	11.22	11.22	10.83	22.05	10.29	32.34	9.56	41.90	8.64	50.54
19.	Nagaland	0	13.12	13.12	12.35	25.47	11.41	36.87	10.26	47.13	8.93	56.06
20.	Orissa	0	277.36	277.36	240.71	518.08	200.20	718.28	155.94	874.22	134.21	1008.43
21.	Punjab	0	129.98	129.98	118.40	248.38	105.38	353.76	90.48	444.24	78.94	523.18
22.	Rajasthan	0	253.98	253.98	223.94	477.92	190.97	668.89	155.39	824.28	137.97	962.25
23.	Sikkim	0	7.82	7.82	7.42	15.24	6.91	22.15	6.27	28.42	5.54	33.96
24.	Tamil Nadu	0	292.30	292.30	269.44	561.74	241.98	803.72	211.20	1014.92	180.56	1195.47
25.	Tripura	0	30.93	30.93	28.16	59.08	25.08	84.16	21.66	105.82	18.15	123.97
26.	Uttar Pradesh	0	743.28	743.28	695.26	1438.53	634.65	2073.18	564.15	2637.33	495.35	3132.68
27.	Uttaranchal	0	7.21	7.21	7.40	14.61	7.53	22.15	7.69	29.83	7.87	37.70
28.	West Bengal	0	398.77	398.77	356.52	755.29	309.18	1064.47	256.74	1321.21	226.60	1547.81
	Total	**0**	**5182.04**	**5182.04**	**4798.09**	**9980.13**	**4307.52**	**14287.65**	**3755.70**	**18043.35**	**3232.30**	**21275.65**

Annex-F

Comparable GSDP Growth Projections

(Rs. Crore)

	States	2004-05*	Nominal G. Rate	Comparable Projection Based on Nominal G. R. Suggested by TFC				
				2005-06	2006-07	2007-08	2008-09	2009-10
1.	Andhra Pradesh	220343	11.00	244581	271485	301348	334496	371291
2.	Arunachal Pradesh	2792	12.80	3149	3552	4007	4520	5099
3.	Assam	47814	11.00	53073	58911	65392	72585	80569
4.	Bihar	72195	11.00	80136	88951	98736	109597	121653
5.	Chhattisgarh	37839	11.00	42001	46621	51750	57442	63761
6.	Goa	13682	12.80	15434	17409	19638	22151	24986
7.	Gujarat	158067	12.80	178299	201122	226865	255904	288660
8.	Haryana	80439	12.00	90092	100903	113011	126573	141761
9.	Himachal Pradesh	23780	12.80	26824	30258	34131	38499	43427
10.	Jammu & Kashmir	27239	11.00	30236	.33562	37254	41351	45900
11.	Jharkhand	42522	11.00	47200	52391	58155	64552	71652
12.	Karnataka	155502	12.80	175407	197859	223184	251752	283976
13.	Kerala	105330	11.00	116916	129777	144052	159898	177487
14.	Madhya Pradesh	100521	12.00	112584	126094	141225	158172	177153
15.	Maharashtra	355952	12.00	398666	446506	500087	560098	627309
16.	Manipur	6434	11.00	7142	7928	8800	9768	10842
17.	Meghalaya	6010	11.00	6671	7404	8219	9123	10127
18.	Mizoram	2887	11.00	3205	3557	3949	4383	4865
19.	Nagaland	6892	11.00	7650	8491	9425	10462	11613
20.	Orissa	54456	11.00	60446	67095	74475	82668	91761
21.	Punjab	92269	11.00	102418	102421	102423	102426	102429
22.	Rajasthan	110665	12.80	124830	140808	158832	179162	202095
23.	Sikkim	1945	12.00	2179	2440	2733	3061	3429
24.	Tamil Nadu	183067	12.80	206500	232932	262747	296379	334315
25.	Tripura	11724	12.00	13131	14707	16472	18448	20662
26.	Uttar Pradesh	244308	12.00	273625	306460	343236	384424	430555
27.	Uttaranchal	19321	11.00	21447	23806	26425	29331	32558
28.	West Bengal	221334	12.80	249665	281622	317669	358331	404197
	Total	**2405331**		**2693506**	**3005073**	**3354238**	**3745556**	**4184131**

Note: * estimated by TFC.

Annex-G

Fiscal Deficit Reduction Path of the States

(Percent to GSDP) (Rs. Crore)

Sr. No.	States	Anticipated FD Reduction Ratio Per Year						Projected FD as Per TFC Suggestion					
		2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
1.	Andhra Pradesh	-3.66	-3.53	-3.40	-3.26	-3.13	-3.00	-8065	-8629	-9220	-9836	-10477	-11139
2.	Arunachal Pradesh	-19.38	-16.11	-12.83	-9.55	-6.28	-3.00	-541	-507	-456	-383	-284	-153
3.	Assam	-6.06	-5.45	-4.84	-4.23	-3.61	-3.00	-2899	-2893	-2850	-2763	-2622	-2417
4.	Bihar	-6.24	-5.59	-4.94	-4.30	-3.65	-3.00	-4505	-4482	-4398	-4242	-3998	-3650
5.	Chhattisgarh	-5.16	-4.73	-4.30	-3.87	-3.43	-3.00	-1954	-1987	-2004	-2001	-1972	-1913
6.	Goa	-3.63	-3.50	-3.38	-3.25	-3.13	-3.00	-497	-541	-588	-639	-692	-750
7.	Gujarat	-6.24	-5.60	-4.95	-4.30	-3.65	-3.00	-9870	-9977	-9949	-9750	-9338	-8660
8.	Haryana	-2.05	-2.24	-2.43	-2.62	-2.81	-3.00	-1652	-2021	-2454	-2963	-3558	-4253
9.	Himachal Pradesh	-10.55	-9.04	-7.53	-6.02	-4.51	-3.00	-2508	-2424	-2278	-2054	-1736	-1303
10.	Jammu & Kashmir	0.07	0.07	0.07	0.07	0.07	0.07	19	21	23	26	29	32
11.	Jharkhand	-4.06	-3.85	-3.63	-3.42	-3.21	-3.00	-1725	-1815	-1904	-1991	-2073	-2150
12.	Karnataka	-3.82	-3.65	-3.49	-3.33	-3.16	-3.00	-5935	-6408	-6905	-7425	-7964	-8519
13.	Kerala	-5.46	-4.97	-4.48	-3.98	-3.49	-3.00	-5751	-5808	-5808	-5739	-5583	-5325
14.	Madhya Pradesh	-8.18	-7.14	-6.11	-5.07	-4.04	-3.00	-8222	-8043	-7702	-7163	-6384	-5315
15.	Maharashtra	-5.51	-5.00	-4.50	-4.00	-3.50	-3.00	-19596	-19950	-20107	-20014	-19609	-18819
16.	Manipur	-12.83	-10.86	-8.90	-6.93	-4.97	-3.00	-825	-776	-705	-610	-485	-325
17.	Meghalaya	-5.10	-4.68	-4.26	-3.84	-3.42	-3.00	-307	-312	-316	-316	-312	-304
18.	Mizoram	-14.41	-12.13	-9.84	-7.56	-5.28	-3.00	-416	-389	-350	-299	-231	-146
19.	Nagaland	-6.64	-5.91	-5.18	-4.46	-3.73	-3.00	-458	-452	-440	-420	-390	-348
20.	Orissa	-9.75	-8.40	-7.05	-5.70	-4.35	-3.00	-5310	-5078	-4730	-4245	-3596	-2753
21.	Punjab	-6.24	-5.60	-4.95	-4.30	-3.65	-3.00	-5762	-5731	-5067	-4402	-3737	-3073
22.	Rajasthan	-7.01	-6.21	-5.41	-4.60	-3.80	-3.00	-7759	-7750	-7613	-7313	-6812	-6063
23.	Sikkim	-7.37	-6.50	-5.62	-4.75	-3.87	-3.00	-143	-142	-137	-130	-119	-103
24.	Tamil Nadu	-4.36	-4.09	-3.82	-3.55	-3.27	-3.00	-7990	-8449	-8895	-9317	-9700	-10029
25.	Tripura	-5.86	-5.29	-4.72	-4.14	-3.57	-3.00	-687	-695	-694	-683	-659	-620
26.	Uttar Pradesh	-8.12	-7.10	-6.07	-5.05	-4.02	-3.00	-19841	-19420	-18611	-17328	-15470	-12917
27.	Uttaranchal	-12.16	-10.33	-8.50	-6.66	-4.83	-3.00	-2349	-2215	-2022	-1761	-1417	-977
28.	West Bengal	-6.22	-5.58	-4.93	-4.29	-3.64	-3.00	-13768	-13922	-13890	-13622	-13058	-12126
	Total							**-139317**	**-140794**	**-140070**	**-137380**	**-132248**	**-124115**

Annex-H

Outcome Indicators of the States' Own Fiscal Correction Path

(Rs. Crore)

		(Base Year Estimate)	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**
A.	**STATE REVENUE ACCOUNT**							
1	Own Tax Revenue							
2	Own Non-tax Revenue							
3	Own Tax + Non-tax revenue (1+2)							
4	Share in Central Taxes and Duties							
5	Plan Grants							
6	Non-Plan Grants							
7	Total Central Transfer (4 to 6)							
8	Total Revenue Receipts (3+7)							
9	Plan Expenditure							
10	Non-Plan Expenditure							
11	Salary Expenditure							
12	Pension							
13	Interest Payments							
14	Subsidies – General							
15	Subsidies – Power							
16	Total Revenue Expenditure (9+10)							
17	Salary + Interest + Pensions (11+12+13)							
18	As % of Revenue Receipts (17/8)							
19	Revenue Surplus/Deficit (8-6)							
B.	**CONSOLIDATEED REVEUE ACCOUNT**							
1	Power Sector Loss/Profit net of actual subsidy transfer							
2	Increase in debtors during the year							
3	Interest payment on off budget borrowings and SPV borrowings made by PSU/SPUs outside budget							
4	Total (1 to 3)							
5	Consolidated Revenue Deficit (A. 19 + B.4)							
C.	**CONSOLIDATED DEBT**							
1	Outstanding Debt Liability							
2	Total Outstanding Guarantee of which (a) Guarantee on Account Off Budgeted Borrowing and SPV Borrowing							
D.	**CAPITAL ACCOUNT**							
1	Capital Outlay							
2	Disbursement of Loans and Advances							
3	Recovery of Loans and Advances							
4	Other Capital Receipts							
E.	**GROSS FISCAL DEFICIT (GFD) #**							
	GSDP (Rs. Crore) at Current Prices							
	Actual/Assumed Nominal Growth Rate (%)							

Note: # GFD as per the para 19 of the guidelines.