

State Finances in India

An Overview

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Scheme of Presentation

- Introduction
 - Trends in Fiscal Imbalances in States.
 - Reforming the Tax System: Introduction of VAT
 - Reforming Other Taxes
 - Non-Tax Revenues
 - Problems with the transfer system.
 - Reforming State Expenditures: Infrastructure Problems
 - Issues in Public service delivery
 - Issues in sub-state fiscal decentralisation
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Introduction

- Role of state governments in a liberalised environment**
 - **Macroeconomic;**
 - **infrastructure;**
 - **regional equity,**
 - **revenue losses**
 - Steady deterioration in state finances**
 - Finance Commission's restructuring plan**
 - Why Reforms? To create a competitive environment.**
 - Reforms are relatively recent and not deep enough.**
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Trends in Fiscal Imbalances

- Decline in fiscal deficits in initial years even when revenue deficits increased - adjustment at the cost of capital expenditures. Sharp deterioration after salary revision – vicious cycle.
 - Additional deficits and contingent liabilities – power sector.
 - Gradual improvement after 2000-01.
 - Individual states:
 - Focus on containing revenue and fiscal deficits.
 - Increasing fiscal stress and varying responses from different States.
 - No correlation of revenue or fiscal deficit with per capita GSDP
 - Worst case scenario: West Bengal and Punjab. No attempt to contain deficits. High deficit and poor tax- GSDP ratio
 - Best case scenario: Tamil Nadu and Haryana.
 - Poorer states: Bihar and UP. Focus on deficit reduction. Crowding out developmental spending.
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Table 1
Trends in Fiscal Indicators of State Governments

Year	Gross Fiscal Deficit	Gross Primary Deficit	Revenue Deficit	Per cent of revenue Deficit to fiscal deficit	Capital Outlay	Expenditure on social and economic services	Per cent of total liabilities to GDP
1990-91	3.20	1.78	0.93	29.06	3.4	11.10	22.46
1995-96	2.65	0.80	0.69	26.04	2.7	9.70	21.04
1996-97	2.72	0.85	1.18	43.38	2.5	9.60	21.06
1997-98	2.90	0.93	1.07	36.90	2.7	9.50	21.82
1998-99	4.27	2.20	2.51	58.78	2.7	9.40	23.19
1999-00	4.72	2.39	2.78	58.90	2.7	9.70	25.48
2000-01	4.28	1.81	2.56	59.81	2.7	10.10	27.84
2001-02	4.23	1.47	2.61	61.70	2.7	9.50	29.92
2002-03	4.15	1.30	2.24	53.98	3.5	9.30	31.88
2003-04	4.40	1.47	2.22	50.45	5.3	9.90	32.96
2004-05*	3.84	1.03	1.39	36.20	5.3	9.90	32.99
2005-06**	3.07	0.42	0.70	22.80	3.5	9.20	32.53

Source: Reserve Bank of India(2005), Handbook of Statistics on The Indian Economy,.

Important Fiscal Performance Indicators in States

State	Average Per Capita GSDP (Rs)	Per cent of Revenue Deficit to GSDP	Per cent of Fiscal deficit to GSDP	Per cent of revenue to fiscal deficit	Per capita Development Spending (Rupees)	Per Cent of Tax to GSDP
	1999-02	2000-03	2000-03	2000-03	2002-03	1999-02
Andhra Pradesh	18869	-2.03	-4.57	44.42	2531.32	7.27
Bihar	6539	-1.87	-4.52	41.37	1075.81	4.24
Goa	56599	-2.44	-4.68	52.14	9207.14	6.80
Gujarat	22708	-4.66	-5.74	81.18	2985.95	7.74
Haryana	26256	-1.32	-3.69	35.77	2778.35	7.78
Karnataka	20703	-2.21	-4.37	50.57	2688.97	8.18
Kerala	22824	-4.17	-5.13	81.29	2762.29	7.81
Madhya Pradesh	13340	-2.05	-3.94	52.03	1859.41	5.49
Maharashtra	26994	-3.09	-4.12	75.00	2714.31	7.49
Orissa	11234	-4.91	-7.84	62.63	1702.88	5.16
Punjab	28030	-4.53	-6.14	73.78	2494.46	5.73
Rajasthan	15059	-3.87	-6.05	63.97	1982.60	6.14
Tamil Nadu	22587	-2.5	-3.75	66.67	2568.32	8.63
Uttar Pradesh	10798	-2.98	-5.07	58.78	1187.42	5.45
West Bengal	17377	-5.47	-7.31	74.83	1512.49	4.22
Non-Spl. Cat. States	17022	-3.19	-4.97	64.19	2034.27	6.7
Spl. Cat. States	16238	-2.53	-7.04	35.94	3474.96	3.1
Total	16978	-3.15	-4.08	77.21	2125.24	6.54

Figure 1
Fiscal Indicators of States in India

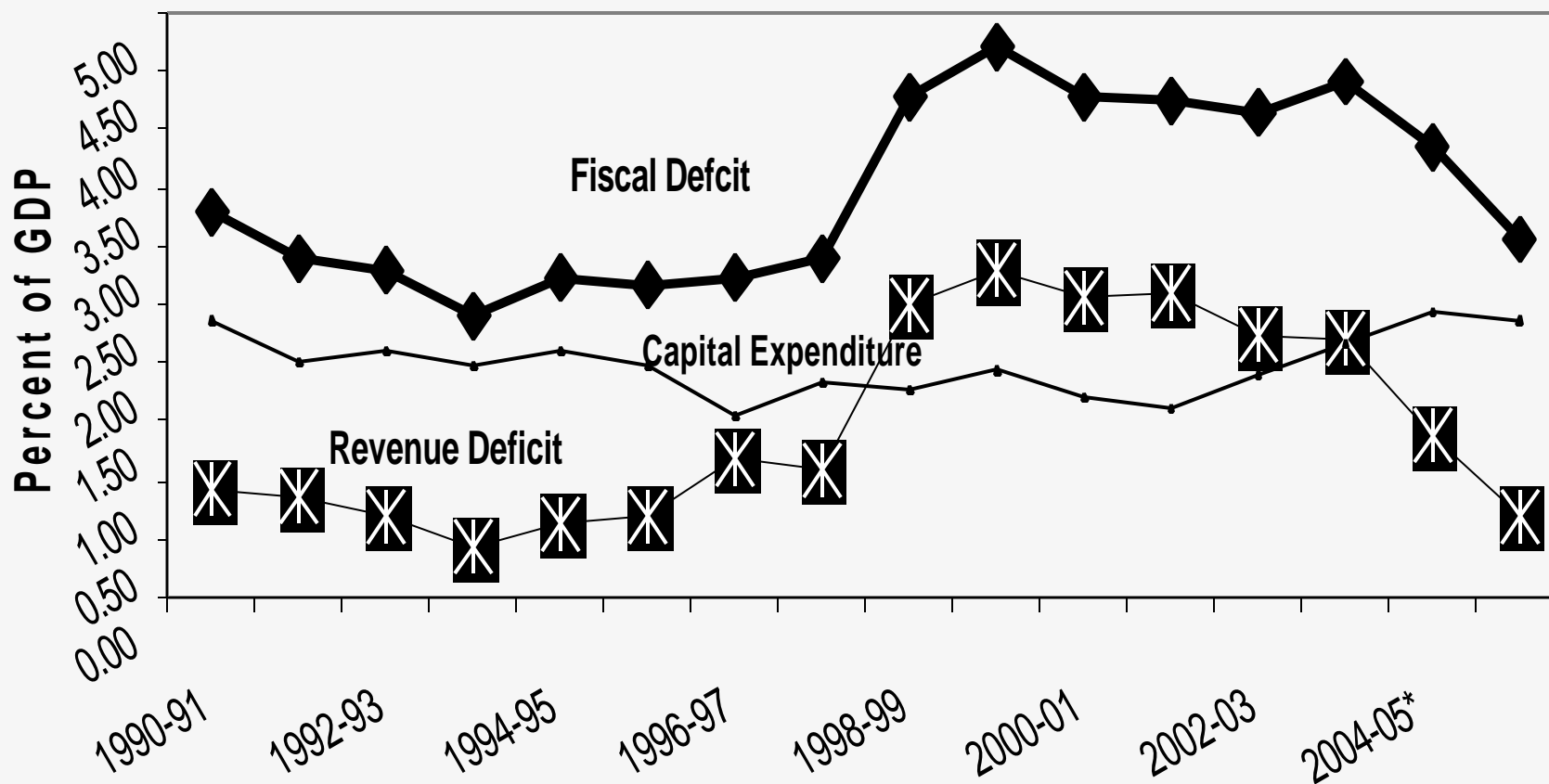


Figure 3
Revenue and Fiscal Deficits According to Per Capita GSDP in States

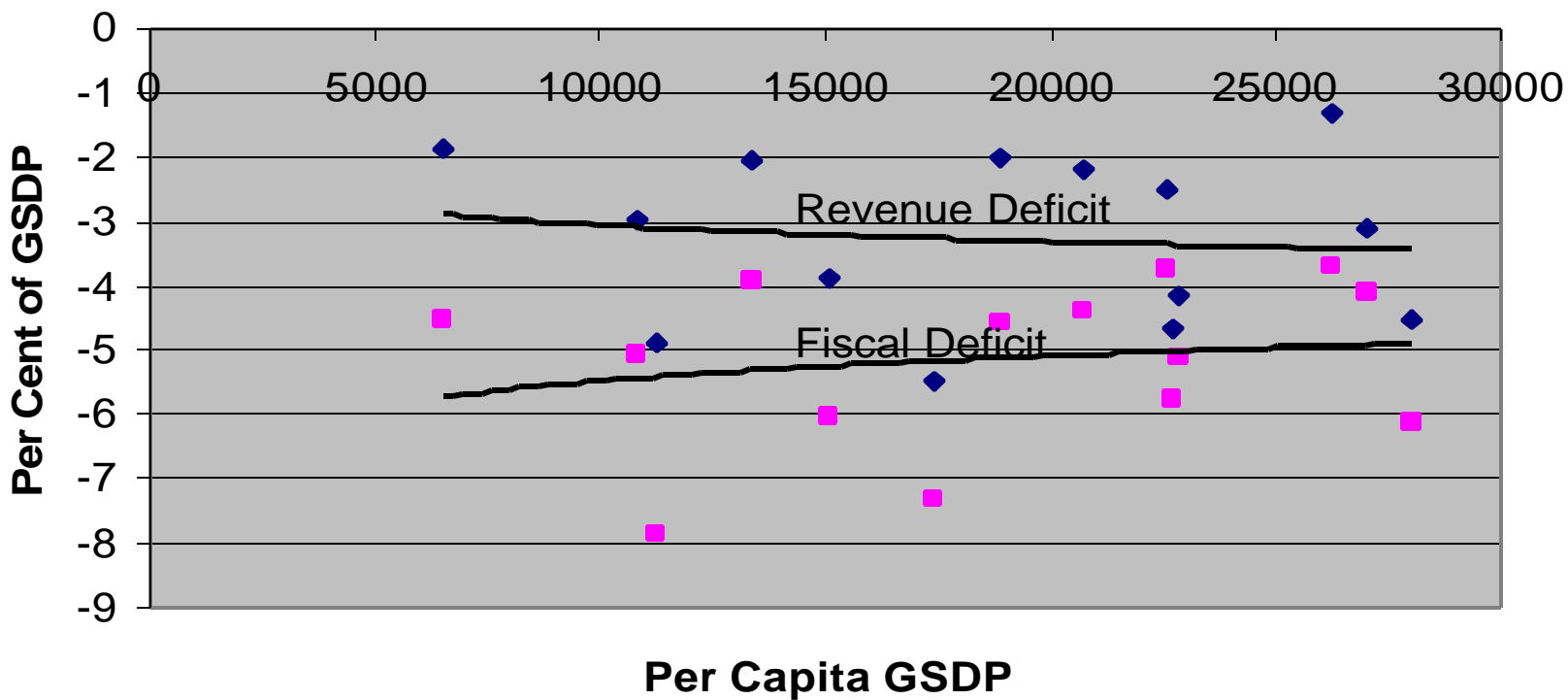
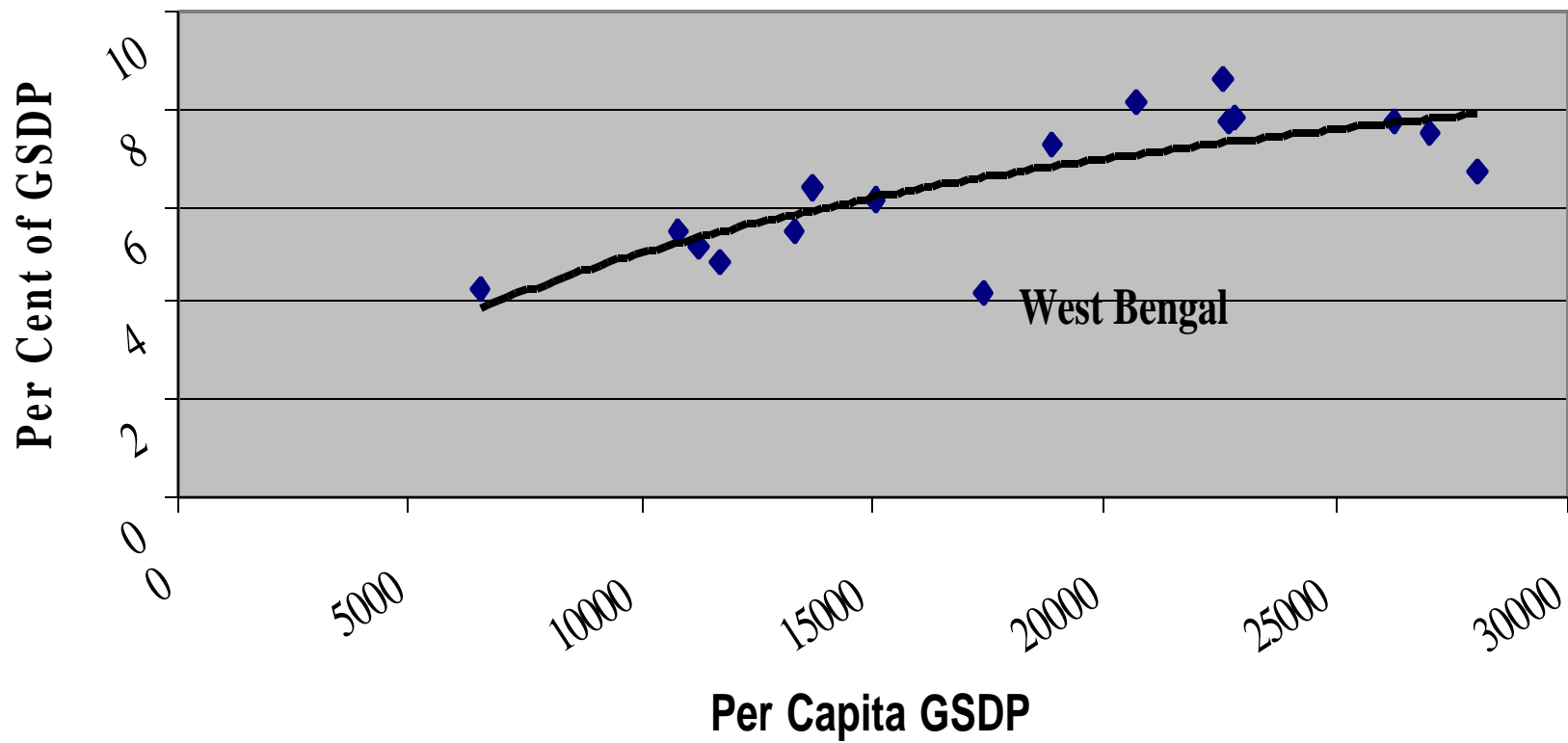
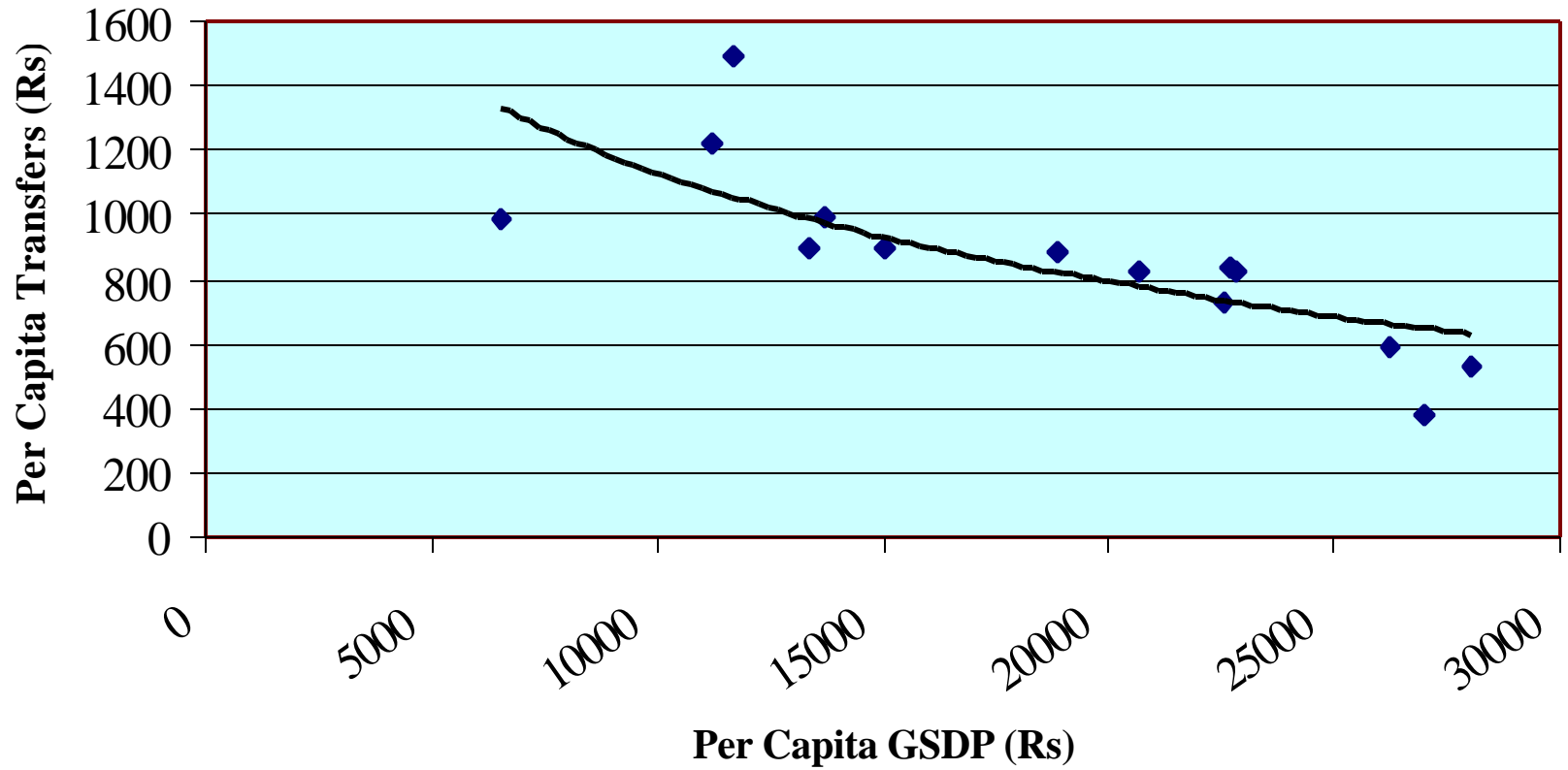


Figure 5
Tax - GSDP Ratios According to Per Capita GSDP



Equalization in Central Transfers to States (2002-03)



Equalization in Indian Federalism - 2002-03

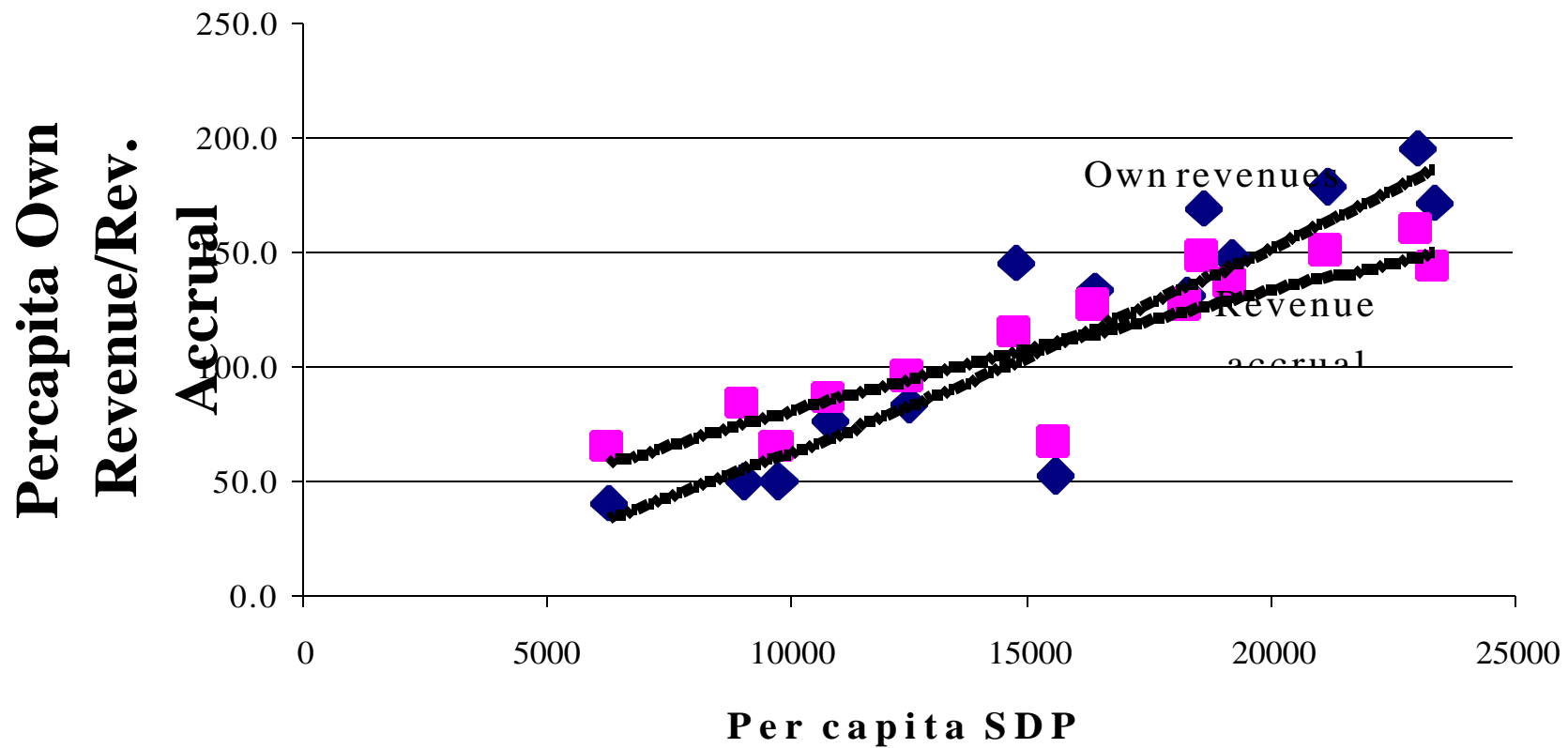
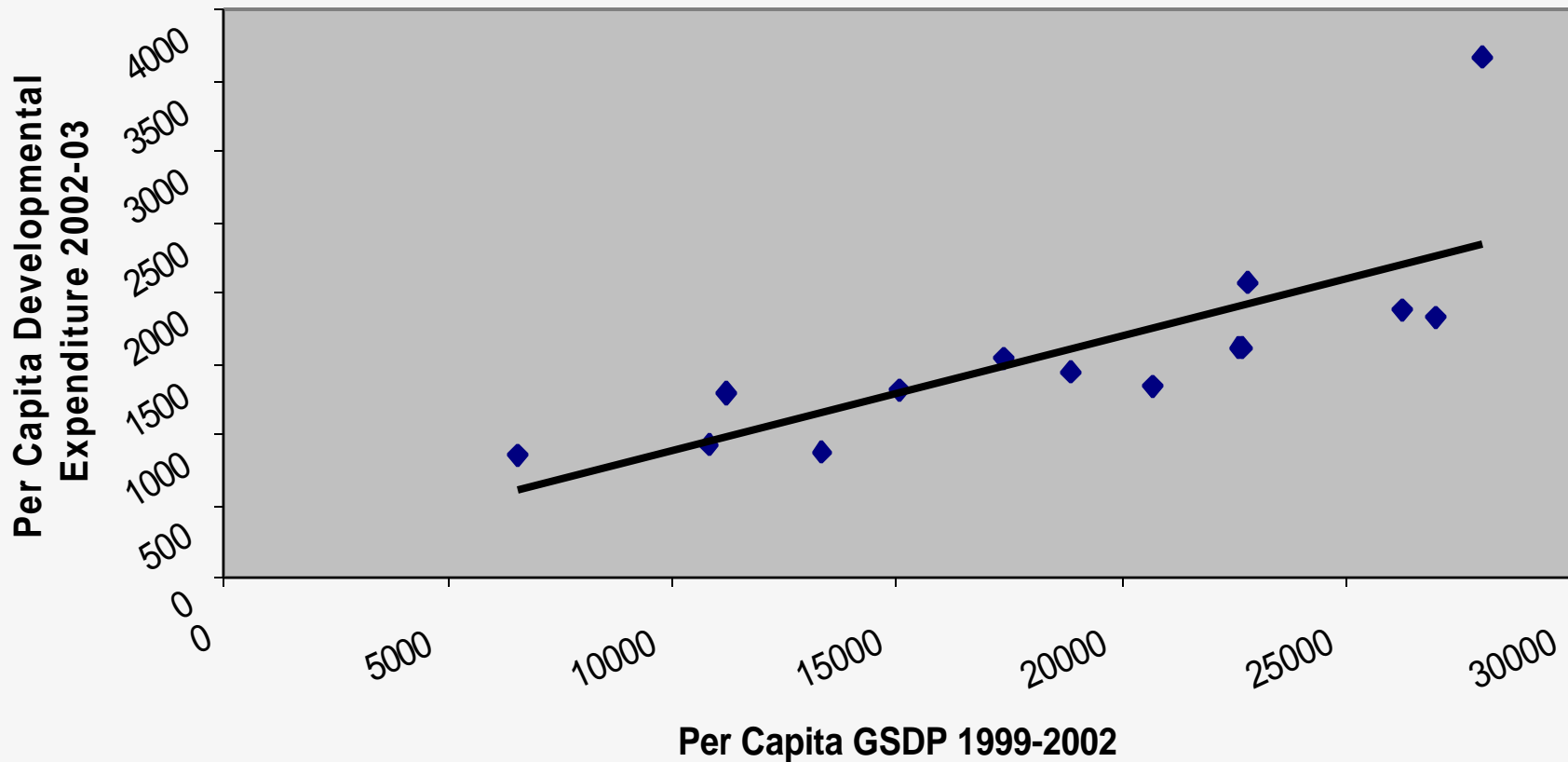


Figure 2
Per Capita Development Expenditure According to the
Level of Development in Different States



Growth of States' Revenues and Expenditures

Per cent per year

	14 Non-Special Category States		28 States	
	1980-81 to 1989-90	1990-91 to 2002-03 RE	1980-81 to 1989-90	1990-91 to 2002-03 RE
Own Tax Revenue	15.82	13.18	15.92	13.89
Own Non Tax Revenue	13.13	9.47	12.54	10.78
Total Transfers	14.58	10.80	15.84	11.59
Total Revenues	14.91	11.80	15.30	12.55
Revenue Expenditure	16.69	13.82	17.07	14.38
Capital Expenditure	8.80	10.43	9.69	11.74
Total Expenditure	15.07	13.41	15.53	14.03

Reforming the Tax System: Value Added Tax

- Most important reform initiative
 - Problems with the design
 - Large number of items under 4%, differentiation in terms of inputs and outputs; fixed rates versus floor rates.
 - Phasing out CST – A major challenge.
 - Need to include services in the base.
 - Resolving the issue of services with all –India nature.
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Reforming the Tax system: Other Taxes

❑ Reasons for poor revenue performance:

- Complex structure; evasion and avoidance; exemptions and narrow base; poor information system, administrative machinery and enforcement mechanism.

❑ Reforms:

- Need to get rid of multiple levies.
 - Need to rationalise transport levies.
 - Assign land revenue to local bodies.
 - Agricultural income tax – should become part of the over all income tax system in the long run.
 - Stamps: Reduction in rates and guided valuation system;
 - Excise duties: ease supply side restrictions; earmark collections for social causes.
 - Property tax reform: Rent Control Act and Land Ceiling Act are constraints. Need to phase out Octroi.
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Problems with Central Transfers to States

- Multiple agencies;
 - Finance Commission Transfer System:
 - Tyranny of the base year
 - Fiscal dentistry
 - Plan transfers: general economic indicators;
 - Central sector and centrally transferred schemes: disequalising.
 - Invisible transfers when there are controls on prices and outputs; origin based taxes etc
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Infrastructure Issues

- ❑ Poor state of infrastructure
 - ❑ Fiscal stress hinders required level of fresh investments and maintenance.
 - ❑ Problem is more severe in poorer states with inter-regional growth dimensions;
 - ❑ Reforms: Need to make a distinction between commercially more viable and less viable infrastructures; private sector participation;
 - ❑ Put in place a good asset management system;
 - ❑ Allocating norm based resources to maintenance.
 - ❑ Infrastructure spending should move from being a residual to a priority item.
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Efficient Service Delivery

- Issues: Poor access to disadvantaged, equity, intra-state disparities, urban-rural divide and poor quality of service delivery;
 - Reforms:
 - Critical review of existing programs and eliminate those that have outlived their relevance or utility;
 - Revamping programs or schemes with identical or similar objectives;
 - Achieving productivity gains through efficiency in the use of resources;
 - Improved targeting;
 - Private sector participation in public service delivery and to generate competitive environment;
 - Empower the Panchayats/ municipalities to appoint teachers and manage schools.
 - Bringing about greater and purposeful accountability by involving the community and users of services
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Improving Service delivery: Issues in Fiscal Decentralization

- ❑ Issues are different for urban and rural areas.
 - ❑ Expansion in the role of local governments and need for reforms
 - ❑ Need for unambiguous assignments
 - ❑ Need to build local enforcement capacity to raise revenues;
 - ❑ Accountability issues: Gram sabhas below and higher level governments above;
 - ❑ Information system;
 - ❑ Synergy between local governments and autonomous bodies and NGOs;
 - ❑ More professional functioning of the SFCs.
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Concluding Remarks

- Reforms in State finances critical not merely to contain deficits but also to ensure efficient infrastructure provision.
 - Focus on containing deficits has crowded out spending on social and physical infrastructure
 - Problem is particularly severe in low income states and this has ominous portends for inter-regional disparities.
 - Reforms are needed in tax, expenditure as well as transfer systems.
 - There are serious problems in the delivery systems. While spending on development heads is abysmal in poorer states, emphasis should not merely be on spending more but also on spending better.
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