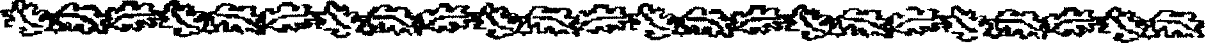
CHAPTER 4



CHAPTER - FOUR

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Introduction

The finances of both central government and state governments in India have been under tremendous pressure in recent times. They have gone into a critical stage during the last decade or so In recent years that state finances have been under presure as reflected in various, fiscal indicators such as fiscal deficit, revenue deficit, primary deficit, the level of debt and rise in debt service obligation. The gross fiscal deficit for all states was 3.3 percent in 1990-91 which raised to 4.7 percent in 1999-2000. The gross fiscal deficit of the states has shown continuous increase over the years mainly due to higher level of revenue deficit. The increase in the revenue deficit has resulted from inadequate buoyancy in revenue receipts and rising level of revenue expenditure.

(II) Need for fiscal correction

Fiscal consolidation measures in federal countries like india need fiscal reforms of national as well as state level. Aggregate government liabilities. That is public debt. G.D.P. ratio has risen to nearly 80percent This must be brought down as stated earlier to 60 percent of G.D.P.

Most of this high amount of public debt is used for revenue expenditure. Ever increasing interest payment liabilites has its severe impact on revenue expendtiture. In addition to this administrative cost, pension liabilities are further burdening the non-developmental revsenue expenditure and it exceeds revenue receipts.

Like centrel government, the financial condition of the state government in India has also been a cause for concern over the years the consolidation financial position of the state government has shown a marked deterioration in some of their major deficit indicators on the fundamental weakness of the state government finances in India, can be attributed to the increase in non-development expenditure particularly the revenue component of the Non development expenditure and interest payment as a proportion of revenue receipts.

These problems have been aggravated a great deal over the past few years because of variety of reasons. The resource constraints in state finances have been accentuated by a near stagnant tax-G.D.P. ratio, rising share of Non developmental outlays in total expenditure large volumes of hidden or implicit subsidies etc. fiscal situation in the states has also come under much greater pressure with the acceptance of the report of the 5th pay commission by several state governments in India.

The slow growth in revenue mobilisation at the state level has posed serious difficulties for the state government's to meet their expenditure most Importantly, state government's has to find a way to reduce their expenditure on wages and salaries of their employees. The state governments expenditure on administrative services rose 44.3 on account of the revision of pay scale of government employees following the 5th pay commission awards. All this aggravates the revenue deficit. The growth of which has led to fiscal stress at the state level.

III) Government of India Initiatives

Against the background of fiscal crisis in the 1990's, the Government of Indial constitute the committe on fiscal responsibility legislation on Janewary 17, 2000 to go in to various aspects of the fiscal system and recommended draft legistation on fiscal responsibility. Accordingly the fiscal responsibility and Budget Management bill 2000 was introduced in lok sabha in December 2000.

The preamble to the bill states its objectives which are as follows.

a) Ensure inter-genrational equity in fiscal management and long term macro economic stubility.

b) Achieve sufficient revenue surplus

c)Eliminate fiscal deficit and remove fiscal impediments in the effective conduct of monetary policy.

d) Evolve prudential debt management policy consistent with fiscal sustainability through limits on the central government borrowing debt and deficits.

e) Develop greater transparently in fiscal operation of the central government and conduct fiscal policy in a medium term frame work.

The major feature of the bill are as follows

i) Reduce revenue deficit by an amount equivalent to one percent or more of the estimated GDP at the end of each financial year on the 1st day of April

ii) Reduce Revenue deficit to nil within a period of five years beginning from the initial financial years on the 1st day of April 2001 and ending on the 31st day of march 2006.

iii) Build up surplus amount of revenue and utilize such amount for discharging liabilities in excess of assets.

iv) Reduce fiscal deficit by an amounting equivalent to one half percent or more of the estimated GDP at the end of each financial year beginning on the 1st April.

v) Reduce fiscal deficit for a financial year to not more than two percent of the estimated GDP for that years on 1st April 2001 and ending on 31st March 2006.

vi) Ensure that the government do not give guarantee for any amount exceeding one half percent of the estimated GDP in any financial year. Further the central government has to ensure within a period of ten financial years.

Further the central government has to ensure within a period of ten financial years beginning from the financial year on the 1st April 2001 and ending on the 31st march 2011, that the total liabilities (including externd debt of current exchange rate of the end of financial year) do not exceed 50percent of the estimated GDP for the year.

There are provisions for relaxation from deficit reduction to deal with unforseen demands on the finances of the central government on account of national security or natural calamities of national dimension however, the central government shall not borrow directly from the RBI.

But the central government may borrow from RBI by way of advances to meet temporary excess of cash disbursement over cash receipts during any financial year in accordance with the government with RBI.

vii) The bill also envisages measures for fiscal tranparency namely-

a) The central government shall take suitable measures to ensure greater transparancy in its fiscal operations in public interset and minimise as for as practicable secrecy in the preparation of the annaul budget. In particular the central government shall at the time of presentaion of the annual budget disclose in a statement.

Significant changes in the accounting standards, policies and practices affecting of likely to affect the computation of prescribed fiscal indicators.

As far as practicable and consistent with protection of public interest, the contigent liabilities created by way of guarantees including guarantees to finance exchange risk on any transactions, all claims and commitment made by the central government having potential budgetary implications including revenue demands raised but not realized and liabilites in respect of major works and contracts.

iv) state government initiatives :

Like central government, the state government have seen experiencing fiscal stress in recent years as evident from large and increasing fiscal and revenue deticits. The rise in the gross fiscal deficit (GFD) was pronounce in the second half of the 1990's with an increasing high proportion being accounted for by the rising revenue deficit. In recent years on an average, more than one half of the GFD has been on account of revenue deficit. This implies that a significant proportion of the borrowed funds have been utilized for meeting revenue

expenditure. The consequential accumulation of debt and debt service obligetions has put constraints on the states ability to under take developmental activities viz provision of economic and social intrastructure. In order to address this problem, the state have been undertaking a number of policy measures relating to revenue argumentation, containment of expenditure and public sector reforms. The states initiatives towards fiscal reforms have also been supplemented by the central government.

Fiscal reforms of the state's Level have assumed critical importance in recent years while measures towards reforms have been undertaken by many states some states have initiated steps to provide statutory backing to the fiscal reform process.

v) 1) Karnataka fiscal responsibility Act

As announced in the karnataka budget for 2001-2002. The government of karnataka had prepared a fiscal Responsibility Bill subsequently, this has been notified as the fiscal Responsibility act in the Karnataka Gazette dated August 30, 2002

The key features of Karnataka fiscal responsibility act are as under

a) Reduction in the revenue deficit to nil within four financial years beginning April 2002 and ending march 31,2006

b) Reduction in the fiscal deficit to not more than 3percent of the estimated gross state domestic product (GSDP) within four financial years begining from April 2002 and ending march 31, 2006.

c) Reduce revenue and fiscal deficits as a percentage of GSDP in each of the financial year.

d) Limiting the guarantees within the prescribed limits under the guarantees act

e) ensure that by end of March 2015 the total liabilities do not exceed 25percent of the estimated GSDP for that year.

In addition to these fiscal targets, the act provides for a medium term fiscal plan (MTFP) setting forth a four year rolling target for prescribed fiscal indicators. This would also include an assessment of the sustainability relating to the balance between revenue receipts and revenue expenditure and the use of capital receipts including borrowing for generaitng producitve assets. The medium term fiscal plan would also contain an evaluation of the performance of the prescribed fiscal indicators in the previous year vis - a- vis the targets set out earlier and the likely performance in the current year as per revised estimates.

vi) Fiscal Responsibility and Budget Management Bill of punjab

The Punjab government has introduced the Fiscal Responsibility and Budget Management Bill in the state legislature. The bill provides for the state government's responsibility to ensure inter generational equity in fiscal management and long term financial stability for achieving sufficient revenue surplus eliminating fiscal deficit prudential debt management, greater transparency in fiscal operaion and conducting fiscal policy in a medium term frame work.

The state governments all

a) contain the rate of growth of fiscal defict to 2percent perannum in normal terms

b) Reduce revenue deficit as percent of total revenue receipts by at least five percentage points from the previous year unit fiscal balance is achieved

c) Cap the ratio of debt (GSDP) of the level achieved in the previous years subject to an absolute ceiling of forty percent to be achieved by 2004-2005.

d) capital out standing guarantees on long term debt to 80 percent of revenue receipt of the previous year.

VII •) Fiscal responsibility and management bill of Maharashtra.

Maharashtra government has Introduce the Fiscal Responsibility and Budget Management Bill in the state legislature. The main features of the bill are as follows.

a) Ensuring that for a period of 5 years from the appointed day the revenue expenditure shall not exceed revenue receipts

b) Bringing budgetory transparency by identitying all liabilities (past and present) constitution of a doubtful loans and equity fund.

c) presenting to the legislature every year estimated yearly pension liabilities worked out an actual basis for the next ten years.

d) preparation of the budget in a multi year frame work and presenting three years forward estimates of revenue and expenditure.

e) Restriction on borrowing, regulating salary expenditure ceiling on expenditure on grant in aid institution and ceiling on subsidies.

f) Achieving the non salary development expenditure not less than 60percent of total expenditure.

g) To regulate the guarantees issued during the year so that the amount of risk due to such guarantees shall not exceed 1.5percent of expected revenue receipts and to classify the guarantee obligation according to the risk of development.

h) Constitution of the fiscal advisory board to advise the government on matters relating to the implementation of the fiscal responsibility legislation.

On fiscal correction, through legislation what is crucial is the political will of the government both of the centre and state level to put into acutal pricing policy and make serious efforts to reduce revenue deficit. The state government will have to realise that annual budget making is a integral part of a medium form fiscal policy framework and hence more annually in a direction that leads to effective implementation of the desire objectives of fiscal correction such concerted effort only will read to rectification of the fiscal crisis that state Government face.

VIII Policy Development

In order to improve the financial Position of the states, their budgets for 2002-2003 have proposed to take measures towards revenue augmentation, expenditure compression public sector undertaking (PSUS) reforms. Promotion of private investment in crucial sectors and institutional refoms. These measures

broadly include enhancement of the revenue receipts through revision of tax rates broadeing of tax base and improved tax compliance other important initiatives relate to the preparatory work for introduction of value addex tax (VAT) and rationalisation of user charses relating to power, water, transport etc. on the expenditure front, a number of states have proposed to contain revenue expenditure through a set of economy measures such as restrictions on fresh recruitment/creation of new posts and containing growth in administrative expenditure . Three states have proposed introduction of a new contributory pension scheme for newly recruited staff. A few states have set up committees / commissions relating to fiscal reforms state wise the government of Punjab has constituted a cabinet committee on fiscal management. While Tamilnadu has a decided to constitute a Tex reforms and revenue augmentation commission. The tax reforms commission constitutional by Karnataka has already submitted its report to the state government.

The Initiative/measure pertaining to state level PsUs rerforms have been proposed by a number of states. The government of Maharashtra has constituted a bond for restructuring of the state PsUs which will also faciliate divestment or closure where ever necessary.

Supplementing the states effort the centre has also initiated measure to encourage fiscal reforms of the state level. The eleventh finance commision (EFC) had recommended institution of an incentive fund for the purpose of encouraging fiscal reforms in the states.

On the basis of monitorable fiscal reforms programme. The government of India has drown up a scheme colled the "States fiscal reforms facility" (2000-01 to 2004-05) under this scheme on incentive fund of Rs. 10,607crores has been earmarked over a period of five year to encourage the states to implement monitorable fiscal reforms, In this connection, a number of states have been drawn up medium term fiscal return programme (MTERP) in consultation with the central government. The MTFRP of states over various areas such as fiscal consolidation public sector enterprises reforms power sector reforms fiscal transperency etc. further the Union Budget 2002-2003 had a made provision for reform linked assistance of Rs 12,300 crocres for states under various schemes such as a accelerated power development programme (ARDRP). Accelerated irrigation benefit programme (AIBP) Urban Reforms Incentive fund (URIF) and Rural Infrastructure development fund (RIDE) In addition a lump sum amount of Rs. 2,500 crore has been proposed for implementing policy reforms in sectors which are constraining growth and development.