Financing the Plan

15.1 The size of the Central sector Plan was expected to be 6.44 per cent of GDP and that of the State sector Plan 4.69 per cent. Resources realized are of the order of 5.36 per cent and 3.64 per cent respectively. In respect of both the Centre and the States, realization has been short of the targeted level by around 1 per cent . Although Plan expenditure was lower than targeted, dependence on borrowing has been higher than planned at the Central and the State level. It is evident also that States have been under greater stress for Plan financing, due to shortfall in anticipated tax sharing from the Central government, drain on budgetary resources attributable to the power sector deficit and the need to meet fiscal reform targets laid down legislatively or in agreements entered into with the Central government and multilateral agencies.

15.2 The Tenth Plan had targeted a public sector outlay of Rs.15,92,300 crores at 2001-02 prices. This was 67.4 per cent higher than Ninth Plan realizations. Of this Rs.15,25,639 crores had been allocated sector-wise in Central, State and UT Plans. In the case of the Centre, the unallocated component was targeted to be raised through internal and extra-budgetary resources (IEBR) of Central public sector undertakings (CPSUs). In the case of States, resources over and above allocations made for the Core Plan were to be raised as own resources.

15.3 To achieve the objectives of securing a sustainable debt burden and restricting public sector draft on private savings to a reasonable limit, only 6.6 per cent of the projected increase in resources over Ninth Plan realizations was planned to come from borrowings and the rest from non-debt resources. It was recognized that such a high level of contribution from non-debt resources would be possible only by raising the tax/ GDP ratio, increasing user charges, compressing expenditure on administration and establishment and improving the commercial management of public enterprises.

15.4 Moreover, taking into consideration the fiscal difficulties of States and their relatively harder budget constraint, resource targets were formulated within a policy scenario in which the fiscal and revenue deficits of the States was expected to decline more than those of the Centre. Between 2002-03 and 2006-07, the Central fiscal deficit was targeted to come down by only 1 percentage point of GDP and the revenue deficit by 1.5 percentage points. Greater fiscal correction was expected at the State level, with a fall in the all-State fiscal deficit by 2.1 per cent of GDP and in revenue deficit by 2.3 per cent.

15.5 The consolidated picture of resource realization for the first four years of the Tenth Plan by Central and State governments is given in Table 15.1. 78 per cent of the five year target is normally expected to be realized during this period. As against this, 66 per cent of the Core Plan of States has been realized and 62 per cent of the Central Plan. This is an improvement on the level achieved in real terms at the close of the Ninth Plan-19 per cent shortfall in realization for the State Plan and 17 per cent for the Central Plan. However, the debt position of both the Centre and the States has deteriorated.

15.6 It now also appears that State governments as a group will achieve a lower level of reduction in fiscal and revenue deficits (1.3 per cent and 1.4 per cent respectively) than targeted in the Tenth Plan. At the Central level, however, the fiscal targets in the Fiscal Responsibility and Budget Management Act

Table 15.1
Public Sector Resources & Allocations-tenth Plan (2002-07)

Rs.crores at 2001-02 prices Sources of funding	STATES & UTs Required	Allocated	Realised 1st 4 years	% realised
CENTRE				
Budgetary support	405735	405735	296628	73.1
IEBR	515556	487448	275554	53.4
Total	921291	893183	572183	62.1
STATE				
Core Plan	590948	590948	390175	66.03
Balance	80061	41508		
Own resources	38553			
Central Assistance	41508	41508		
Total	671009	632456	390175	58.15
GRAND TOTAL	1592300	1525639	962358	60.4% on Total Plan
				63.07% on Core Plan

(FRBM Act) have mandated much larger reduction in fiscal and revenue deficits (1.2 per cent and 2 per cent respectively) than the original Tenth Plan targets. Moreover, the Twelfth Finance Commission (TFC), while recommending increased devolution of taxes and non-Plan grants from the Centre to the States has suggested that loans from the Centre be replaced by market borrowings and made debt relief conditional on adoption of fairly strict fiscal responsibility targets at the State level also.

15.7 These developments in respect of both the resources actually raised for the Central and State Plans during the first four years of the Tenth Plan and issues of concern have been assessed in greater detail in this chapter.

CENTRAL PLAN RESOURCES

15.8 Total Central Plan resources in the first four years are around Rs.5,72,183 crores which is about 62 per cent of the Tenth Plan target, compared with an expected realization of 78 per cent of the five year target. This implies a shortfall of 16 per cent.

RESOURCE CONSTRAINTS

15.9 This outcome is on account of resource raising constraints as also in some part due to macroeconomic developments, particularly on the external front. In the interests of debt sustainability, the gross fiscal deficit of the Centre had been targeted to be progressively reduced from 5.9 per cent of GDP to 4.3 per cent in 2006-07 with an average level of 4.73 per cent during the Tenth Plan period. During the first four years of the Tenth Plan, the fiscal deficit was brought down substantially. Reduction of the fiscal deficit in 2004-05 was due in part to repayments made by States under the debt swap scheme. From 2005-06, this process will be replaced by the debt consolidation/writeoff and interest rate reduction package recommended by the Twelfth Finance Commission. Budget Estimates for 2005-06 indicate that there will be further improvement in the fiscal deficit. However, this improvement is predicated on the assumption that Plan loans to States will be replaced by their borrowing directly in the market. However, there is a possibility of Central borrowing to onlend to fiscally weak States who will be unable to borrow in the

Table 15.2
Central Plan Resources (2002-03 to 2005-06)

Rs.crores / %

Item	2002-07 Tenth Plan	2002-03 Actual	2003-04 Accounts	2004-05 RE	2005-06 BE	Realised 2002-03 to 2005-06	% Realisation (2002-2006)
1. Balance from current revenues	-6385 -(0.69)	-51235 -(39.36)	-36124 -(27.45)	-28253 -(21.24)	-14213 -(8.01)	-129825 -(22.69)	
2. Borrowing including net miscellaneous capital receipts	685185 (74.37)	168435 (129.39)	161016 (122.36)	138737 (104.32)	123915 (69.84)	592103 (103.48)	86.4
3. Net inflow from abroad (grants & loans excluding external commercial borrowing)	27200 (2.95)	-9707 -(7.46)	-10590 -(8.05)	10668 (8.02)	10812 (6.09)	1184 (0.20)	4.4
4. Gross Budgetary Support (1+2+3)	706000	**107493**	**114302**	**121153**	**144873**	**@487821**	**69.1**
5. Central assistance for State and UT Plans	**300265**	**43515**	**47134**	**48376**	**52167**	**@191192**	**63.7**
6. Gross Budgetary Support for Central Plan (4-5)	405735 (44.04)	63978 (49.15	67167 (51.04)	72777 (54.72)	92706 (52.25)	296628 (51.84)	73.1
7. Internal & Extrabudgetary Resources of Central public entreprises	515556 (55.96)	66199 (50.85	64422 (48.96)	60220 (45.28)	84714 (47.75)	275554 (48.16)	53.4
8 Total Central Plan (6+7)	921291	130177	131590	132997	177420	572183	62.1

Note: Figures in brackets indicate shares of resources in total Central Plan
@ In 2005-06, to implement the recommendations of the Twelfth Finance Commission, the loan component of Central assistance for State and U.T. Plans has not been provided in the Central budget, as States have been given the option of raising it directly from the market. This is reflected in lower borrowings by the Central government. GBS and Central assistance figures include also the loan component of Central assistance (Rs. 24,358 crores at constant prices).

market. If this eventuality arises, the Central deficit may be higher than in the Budget Estimates.

15.10 The revenue deficit of the Central government was 4.4 per cent in the first year of the Tenth Plan, but this was brought down to 3.5 per cent in 2003-04 and the R.E.s for 2004-05 indicate a further improvement to 2.7 per cent . This level is expected to be maintained in 2005-06 also.

15.11 Despite the reduction in Central government debt on account of the debt swap scheme, the Centre's total dependence on borrowings as a source of Plan financing has been higher than originally targeted for the Tenth Plan period. More than 86 per cent of the resources raised in the first four years would be in the form of debt (including net miscellaneous capital receipts). This source was expected to decline from the Ninth Plan level of 5.78 per cent of GDP by one percentage point in the Tenth Plan period. Instead, in the

Table 15.3
Projections & Realisations Scaled by GDP- Xth Plan Centre (%)

	Ninth Plan		Projected		Realised				
		2001-02	2006-07	Xth Plan Avg.	2002-03	2003-04	2004-05 RE	2005-06 BE	Xth Plan Avg
1 Gross budgetary support	4.02	4.33	5.4	4.93	4.5	4.4	4.4	4.9	4.55
2 Fiscal deficit	5.82	5.9	4.3	4.73	5.9	4.5	4.5	@4.3	4.8
3 Borrowings (including miscellaneous capital receipts)	5.78			4.78	7.1	6.2	5.1	4.2	5.6
4 External inflows (net)	0.22			0.19	-0.4	-0.4	0.4	0.4	-0.02
5 Balance from current revenues	-1.98			-0.04	-2.2	-1.4	-1.0	-1.3	-1.3
6 Central revenues (net)		8.8	10		9.4	9.6	9.7	10	9.7
7 NonPlan revenue expenditures		10.6	9.1		10.8	10.3	9.5	9.4	10
8 Central Assistance (States & UTs)	1.76			2.09	1.8	1.8	1.8	@1.8	1.8
9 Gross budgetary support net of Central Assistance	2.26			2.79	2.7	2.6	2.7	@3.1	2.8
10 Internal resources of Central public undertakings	2.15			2.85	1.6	1.3	1.2	1.5	1.4
11 Extrabudgetary resources of Central public undertakings	0.75			0.75	1.2	1.2	1.0	1.4	1.2
12 Internal & extrabudgetary resources of Central public undertakings				3.6	2.8	2.5	2.2	2.9	2.6

first four years, it has in fact decreased by only .18 per cent.

15.12 The most important reason for the excessive reliance on debt financing during the Tenth Plan has been the large negative Balance from Current Revenues (BCR). The Tenth Plan had targeted an improvement in BCR from the negative level of 1.98 per cent of GDP in the Ninth Plan to around 0.04 per cent. This improvement was to be achieved by increasing Central revenue (net of States' share) from 8.8 per cent of GDP in 2001-02 to 10 per cent in 2006-07 and reducing non Plan revenue expenditure from 10.6 per cent of GDP to around 9.1 per cent for the same period. In terms of realizations, net Central revenues have almost reached the target of around 10 per cent of GDP and Non Plan revenue expenditure appears to have fallen to 9.4 per cent in

2005-06 (B.E.). However, much of the improvement relates to 2004-05 R.E.s and 2005-06 B.E. The average level of non Plan revenue expenditure realized in the first four years is only about half a percentage point lower than the level reached at the end of the Ninth Plan.

15.13 The distribution of GBS between the Centre and the States also departed somewhat from the Tenth Plan target. The Tenth Plan had assumed the share of Central assistance for State Plans at 42.5 per cent of gross budgetary support (2.09 per cent of GDP as against 1.76 per cent realized during the Ninth Plan). However, actual realizations are likely to be slightly lower (39 per cent), mainly reflecting the fact that many of the critical activities in areas such as education, health, employment generation etc., which fall in the State sector are financed through Centrally Sponsored Schemes (CSSs). There is no consensus as yet on whether and to what extent these schemes can be transferred to the States.

15.14 Gross budgetary support (GBS) in the Central Budget had been targeted at Rs.7,06,000 crores. Netting out Central assistance for State and UT Plans of Rs.3,00,265 crores, net GBS for the Central Plan was targeted to be Rs.4,05,735 crores or 4.9 per cent of GDP on average. During the first four years, the net GBS for the Central Plan averaged only 4.4 per cent of GDP, significantly below the Tenth Plan target of 4.9 per cent.

15.15 The role of external assistance in financing the Plan was very different from that originally envisaged because of an unexpectedly favourable external position. External assistance is availed of both as loans (included in overall borrowings of government) and grants (covered under nontax revenue receipts). Tenth Plan projections aimed only at a slight reduction of the scale of net inflow from abroad from 0.22 per cent of GDP in the Ninth Plan to around 0.19 per cent. In the first four years of the Tenth Plan, net inflows were negative in the first two years (-0.4 per cent) and are expected to be only 0.4 per cent in 2004-05, due to the conscious policy adopted by government in the first two years to prepay high cost loans keeping in mind the comfortable foreign exchange position. There will be no appreciable increase in net external inflows with reference to GDP in 2005-06 also.

15.16 Internal and extra-budgetary resources of Central public sector undertakings were expected to provide more than half (56 per cent) of the resources for the Central Plan during the Tenth Plan. Internal resources cover retained profits and depreciation and extra budgetary resources include borrowings of CPSUs through debentures, bonds, external commercial borrowings and the like. IEBR of Rs.5,15,556 crores were targeted to be raised by CPSUs (by higher operational efficiency particularly in the railways and power sectors) during the Tenth Plan period, of which normally Rs.4,02,134 crores should have been realized during the first four years. Actual realization is only around half this amount (Rs.2,75,554 crores) In terms of GDP, the shortfall is 0.7 per cent (2.9 per cent realized against the expected level of 3.6 per cent).

15.17 It is a matter of concern that the shortfall in IEBR is much higher than that in net budgetary support for the Central Plan. Independent resource generation is the prime test of commercial viability and self sustainability for a PSU. It makes these corporates less dependent on government (in terms of budgetary support and guarantees) for planning and investment decisions and increases their creditworthiness while accessing the capital market. Failure to raise IEBR as targeted during the first four years of the Tenth Plan is a serious matter that must be addressed.

THE FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT ACT

15.18 A major policy initiative that has implication for the availability of resources for financing the Plan is the Fiscal Responsibility and Budget Management (FRBM) Act enacted in 26/8/2003. The Act originally provided for reducing the gross fiscal deficit to 3 per cent of GDP and completely eliminating the revenue deficit at the Central level by end March 2008, but the target year has had to be moved further out to 2008-09 in the 2004-05 finance bill.

Table 15.4

		Revised Estimates 2004-05	Budget Estimates 2005-06	Targets for	
				2006-07 original	2006-07 revised
1	Revenue Deficit	2.7	2.7	1.1	2.0
2	Gross Fiscal Deficit	4.5	4.3	3.6	3.8
3	Gross Tax Revenue	9.8	10.6	12.1	11.1
4	Total outstanding liabilities*	68.8	68.6	67.8	68.2

*including external public debt at current exchange rates
Figures are taken from the MTFP Statement tabled with the Central budget for 2005-06; targets for 2006-07 originally indicated in the Statement tabled with the 2004-05 budget have also been presented.

15.19 In accordance with requirements laid down in the Act, the Medium Term Fiscal Policy Statement (MTFP) was laid before the Parliament along with the Union budgets for 2004-05 and 2005-06. They set three year rolling targets for fiscal indicators as given below:

15.20 The fiscal restraint required for fulfilment of MTFP targets will put pressure on availability of GBS for the Plan as a whole for the remaining period of the Tenth Plan, unless there is either a dramatic improvement in revenue realization and in internal resources or non Plan expenditure can be cut. The revenue prospects in 2006-07 depend critically upon the effectiveness of measures for rationalizing the tax system and tax administration. Expansion of the tax base, rationalization and integration of service tax with commodity excises and better enforcement should help to maintain the share of net revenue receipts of the Centre to GDP at 10 per cent in the final year of the Tenth Plan, thus reaching the target average in the terminal year. However, other non-debt receipts will be clearly below original expectations, due to lower disinvestment receipts and lower interest inflows from States on account of the debt swap program and loan rescheduling recommended by the Twelfth Finance Commission.

15.21 On the expenditure front, it should be feasible to control employment and, therefore, wage payments and if interest rates stabilize, interest payments. Going by earlier trends, however, there could be slippage in the projected improvement in non Plan revenue expenditure indicated in 2004-05 R.E.s and 2005-06 B.E.s. The Tenth Plan target of bringing non Plan revenue expenditure down to 9.1 per cent of GDP may not therefore be realized. On present prospects, the overall balance from current revenue will remain negative over the remaining period of the Tenth Plan. In this respect, the Centre's performance shows a clear shortfall compared with Plan targets.

15.22 The Central budget estimates for 2005-06 show lower borrowing requirements because of the expectation that States will be capable of raising the entire loan component of Central assistance directly from the market. While some States may succeed in raising the necessary resources, many may not be able to do so. Much depends upon market perceptions of State creditworthiness, credit demand from the private sector, the level and nature of Central borrowing etc. If a number of States are unable to do such borrowings, the Central government will have to continue to provide loan support for State Plans. The share of borrowings in Plan financing could thus be higher than anticipated for 2005-06 as well as in the following year.

OUTSTANDING POLICY ISSUES

15.23 The need to achieve FRBM targets in the medium term perspective could affect public sector resource raising for the Plan. Latest data and revised annual targets (Table 15.4) indicate that although Tenth Plan targets may be realized, substantial adjustment to the extent of 2 per cent of GDP might be necessary at the commencement of the Eleventh Plan to fulfil statutory requirements. Tradeoff between development and adjustment could become an issue if this does not materialize. There are some areas in which policy and procedural changes could increase resources and improve growth prospects. The balance from current revenues could be improved through a strategy focused both on revenue raising as well as on curtailing unprofitable expenditure and reducing leakages.

15.24 There is still scope for rationalising direct and indirect tax measures and user charges based on the twin principles of equity and economic neutrality and focusing on improving compliance and tax administration. Tax tools and governance can be managed better to promote entrepreneurship and superior economic performance so that the resultant improvement in growth is reflected in increased budgetary inflows. For this, tax bases should expand and distorting exemptions further removed. On the direct tax front, there is substantial scope for taxpayer friendly automatised and computerized administration that can reduce collection costs, improve compliance and curtail rent-seeking and harassment.

15.25 The major thrust area on the tax side must, however, be on indirect taxation. Customs revenues are likely to become considerably less significant if tariff rates are further reduced in line with already declared government policy. In this context it will become even more essential to streamline the interface of domestic indirect taxes with customs, both in terms of design and procedures, to facilitate the continued growth of domestic manufacturing. This is especially urgent as regimes will require to be put in place to operationalise the Free Trade Agreements already entered into with various countries and trade blocs.

15.26 The most critical reform required in view of the above is in the area of domestic consumption taxation. The plethora of uncoordinated overlapping imposts at the State level and lack of an integrated goods and service tax even at the Central level violates the principle of economic neutrality and handicaps domestic industry and trade vis-à-vis foreign competitors. However, the coordinated countrywide goods and service tax indicated by the Task Force on the FRBM appears as of now to be only a distant goal. Detailed consultations with States must necessarily precede acceptance of such a tax, but dialogue on this can be initiated only after all States adopt a common VAT system and the system of State VATs extended to cover both goods and services.

15.27 Some sort of value added taxation is likely to be adopted by most, although not all, States by 1/4/2005. But this will need to be further refined (through assimilation of other State commodity taxes like turnover and entry tax and octroi) and integrated with the many State level taxes on specific services existing today. The full reform of the indirect tax structure that is necessary to maintain revenue growth while coping with pressures of globalisation is still only at a preliminary stage.

15.28 A thorough revamp of the indirect tax structure through rationalization of the tax base, constitutional and statutory reform and better administration can release the potential of local industry and business and contribute significantly to higher competitiveness and growth. Constraints that may arise in this regard will have to be recognized and managed. There will be a lag effect in introducing VAT since losses incurred by States in early years may not be fully compensated by increased Central revenue. In the case of income tax, revenue growth due to onetime improvement in tax administration may not be sustainable at the same level; the use of presumptive income indicators has brought in more returns but most of them are from persons exempt from tax.

STATE PLAN RESOURCES

15.29 Tenth Plan targets of resources for State and UT Plans were Rs.6,71,009 crores, but Core Plan resources were placed at a lower level of Rs.5,90,948 crores. The unfunded gap of Rs.80,061 crores was expected to be funded through Rs.38,553 crores of own resources of

States and Rs.41,508 crores of Central assistance. The resources likely to be realized during the first four years of the Tenth Plan has been computed using latest data for the first two years and approved schemes of financing/estimates for 2004-06. Realisation levels in the first four years are likely to be 58 per cent of the quinquennial target, lower than those for the Central Plan. Although somewhat better, at about two-thirds, if only the Core Plan is concerned, this is still 16 per cent short of the targeted level.

15.30 In terms of GDP, budgetary resources for the Tenth Plan were targeted to grow from 3.85 per cent in 2001-02 to 4.2 per cent in 2006-07, averaging 4.1 per cent against the Ninth Plan realization of 3.14 per cent. Aggregate Plan resources were expected to reach an average level of 4.69 per cent against 3.8 per cent for the Ninth Plan, but realization in the first four years is only around 3.64 per cent of GDP. The realization level has improved gradually from year to year, as State governments tried to cope with fiscal stress and debt servicing liabilities in the wake of the implementation of the Fifth Pay Commission's recommendations. A further improvement is expected in 2005-06 due to the effects of implementation of the recommendations of the Twelfth Finance Commission regarding tax sharing, non Plan revenue grants and debt relief. The Twelfth Finance Commission has augmented the share of States in tax devolutions from 29.5 per cent to 30.5 per cent and raised non Plan grants to equalize their fiscal capacities. Such grants are geared to meet revenue gaps in States with low levels of own revenues as well as fund the requirements of specific priority sectors.

15.31 In absolute numbers at 2001-02 prices, Rs.3,90,175 crore are likely to be realized to fund Core Plans of States in the first four years

Table 15.5
Targets & Realisations for Xth Plan – State

(Rs.crores)

Source of Financing	Xth Plan Targets	Core Plan Resources	Realised in first 4 years	Realisation as % of Plan Targets	Realisation as % of Core Plan Targets
I. Balance from Current Revenues	26578	-15295	-88917		
	(3.96)	*-(2.59)*			
II. Resources of Public Undertakings	82684 *(12.32)*	82684 *(13.99)*	284412 *(72.89)*	82.64	81.85
a) Internal Resources	-7760 -(1.16)	-7760 -(1.31)			
b) Extrabudgetary Resources	90444 *(13.48)*	90444 *(15.30)*			
III. Borrowings including Net MCR	261482 *(38.97)*	264802 *(44.81)*			
A. States' Own Resources (I+II+III)	**370744** *(55.25)*	**332191** *(56.21)*	**195495** *(50.10)*	**52.73**	**58.85**
B. Central Assistance	**300265** *(44.75)*	**258757** *(43.79)*	**194680** *(49.90)*	**64.84**	**75.24**
C. Aggregate Resources (A+B)	**671009**	**590948**	**390175**	**58.15**	**66.03**

Note:
1. In the first 4 years 82% of total Plan resources of States were raised through borrowings (including net MCR) and resources of public undertakings which were also by and large borrowings.
2. The share of each resource component in aggregate Plan resources is indicated within brackets

as against the Rs.4,60,939 crore target for this period. This shortfall was largely on account of lower GDP growth and lower than expected transfers of Central tax revenue to States (since the tax/GDP ratio at the Central level was lower than forecast). In addition, reforms expected at the State level, such as on VAT and in the power sector have also been delayed.

15.32 Measures were taken by the Central government to oversee medium term fiscal reform at the State level as required by the Eleventh Finance Commission. Structural adjustment was also promoted through multilateral funding in selected States (Gujarat, Madhya Pradesh, Andhra Pradesh, Karnataka and Uttar Pradesh). A fair amount of interest relief was made available through the debt swap policy initiated by the Centre in 2002-03. These measures mitigated to some extent adverse effects on State Plan resources of the debt-servicing and pension overhang of the

Table 15.6
Targets & Realisations With Reference to GDP for The X Plan – States

Source of Financing	IX Plan Targets Ninth Plan	Targets				Realised				
		2001-02	2006-07	Tenth Plan Average	Tenth Plan (Core Plan)	2002-03	2003-04	2004-05	2005-06	Tenth Plan Average
Budgetary Resources	3.14	3.85	4.2	4.1						
I. States' Own Resources (A+B+C)	2.04			2.6	2.3	1.63	1.55	1.81	2.28	1.82
A. Borrowings including Net MCR	2.74			1.82	1.9	*3.12	*2.79	*2.49	*2.37	*2.69
B. Balance from Current Revenues	-1.36			0.19	-0.11	-1.49	-1.25	-0.68	-0.09	-0.88
1. Non-Plan Revenue Receipts @		10.27	11.00			9.10	9.21	9.51	9.51	9.34
2) Non-Plan Revenue Expenditure @		12.15	10.32			10.66	10.53	10.30	9.68	10.29
C. Internal & Extrabudgetary Resources of State Public Undertakings	0.66			0.58	0.58					
a) Internal Resources	-0.45			-0.05	0.05					
b) Extrabudgetary Resources	1.11			0.63	0.65					
II. Central Assistance	1.76			2.09	1.8	1.62	1.76	2.09	1.82	1.82
III. Aggregate Plan Resources (I+II)	3.80			4.69	4.14	3.25	3.30	3.90	4.10	3.64

* Includes also IEBR and resources of public undertakings.

@ Revenue receipt targets were fixed with reference to gross non-tax revenue from departmental undertakings but realizations were on net basis. This will slightly lower realization figures but will not affect the BCR.

Table 15.7
Additional Resources on Account of TFC Grants & Debt Relief (Interest) to States - 2005-06 & 2006-07

(Rs. crores)

State	2005-06	2006-07
Arunachal Pradesh	61.31	81.44
Assam	818.56	709.71
Himachal Pradesh	1527.07	1587.23
Jammu and Kashmir	256.06	339.20
Manipur	502.08	558.95
Meghalaya	118.48	140.83
Mizoram	203.51	256.44
Nagaland	242.95	340.53
Sikkim	-91.88	-72.70
Tripura	619.16	680.46
Uttaranchal	1185.66	1305.45
Total (special category)	**5442.95**	**5927.53**
Andhra Pradesh	868.73	1293.38
Bihar	1225.95	1560.00
Chattisgarh	256.57	442.67
Goa	21.17	43.42
Gujarat	608.47	927.85
Haryana	154.53	263.82
Jharkhand	402.94	664.84
Karnataka	460.07	1026.80
Kerala	774.23	613.20
Madhya Pradesh	749.18	1089.79
Maharashtra	664.32	1078.21
Orissa	1061.82	1073.37
Punjab	1730.14	1259.54
Rajasthan	531.10	853.25
Tamil Nadu	476.17	910.39
Uttar Pradesh	2228.21	3262.23
West Bengal	3127.62	1644.55
Total (Non-Spl Cat.)	**15341.22**	**18007.31**
GRAND TOTAL	**20784.17**	**23934.84**

Fifth Pay Commission. The gross fiscal deficit of States, which had been targeted to fall from 4.47 per cent of GDP in 2001-02 (3.37 per cent average for Ninth Plan) to 2.19 per cent in 2006-07 (Tenth Plan average of 3.19 per cent) has been falling gradually; from 4.15 per cent in the first year of the Tenth Plan, it has declined to 2.67 per cent in 2005-06.

15.33 The Tenth Plan targets had assumed that the BCR would improve from the Ninth Plan average level of -1.36 per cent of GDP to a surplus of .19 per cent of GDP during the Tenth Plan. To achieve this target, non Plan revenue receipts were targeted to grow from 10.27 per cent of GDP to 11 per cent between 2001-02 and 2006-07 and non Plan revenue expenditure to decline from 12.15 per cent to 10.32 per cent of GDP. Non Plan revenue receipts of the States as a percentage of GDP have improved but less than projected. The fall in non Plan revenue expenditure has been more encouraging; it remained above 10 per cent in the first three years and is now projected to fall below this level in the fourth year (implying overachievement of the Tenth Plan target). As a consequence, there has been improvement in the BCR position of States in the first three years of the Tenth Plan, as the effects of structural reform and fiscal restraint made themselves felt, although the average Tenth Plan targeted level was not reached (not even in terms of the Core Plan). At the close of 2004-05, the BCR is expected to be around Rs.-24486 crores against the target of Rs.-15295 crores for the final year of the Core Tenth Plan.

15.34 There will be substantial increase in transfers to States in 2005-06 on account of the higher tax sharing and non-Plan grants recommended by the Twelfth Finance Commission. The degree of improvement expected in each of the last two years in terms of grants and debt relief, as estimated by the TFC is given State-wise in Table 15.7. All this improvement may not get directly reflected in the BCRs of individual States, since State governments may use the room for maneouvre to increase non-Plan expenditure on essential items (like maintenance of public assets) or to retire high cost debt. Nevertheless, after taking account of these factors, the BCR will improve significantly in 2005-06, but it will still be negative. Moreover, for some States, notably West Bengal, Punjab, Kerala and Assam, additional resources provided by the TFC will taper off after the first year.

15.35 Despite corrective measures taken by States on their own initiative, with structural adjustment assistance from external lenders and Medium Term Fiscal Reform Programme (MTFRP) aid from the Finance Ministry under fiscal contraction guidance offered by the RBI, they have not been able to fully recover from the stress generated by debt-servicing requirements created as a consequence of borrowings undertaken to meet revenue deficits after implementing the recommendations of the Fifth Pay Commission. As much as 73 per cent of aggregate Plan resources for State Plans were raised through borrowings (including borrowings by public undertakings), when the targeted level for the Core Plan was only 59 per cent . States have drawn almost 82 per cent of borrowings targeted during the entire Tenth Plan (in Core Plan terms) in the first four years as against the expected 78 per cent . Yet there is a shortfall in the Core Plan. This is despite reduction in debt-servicing costs because of debt swap operations and greater resort to market borrowings in the falling interest rate scenario.

15.36 Data based on approved financing schemes for 2004-05 and 2005-06 (Table 15.6) indicate that the share of States' own resources in aggregate Plan resources was only 50 per cent against the target of 55 per cent, although later estimates of the likely actual utilization of external aid by States in 2004-05 (available in the Central budget for 2005-06) would improve this slightly to 51 per cent. The share of Central assistance was 49 per cent against 44 per cent targeted under the Core Plan.

15.37 Debt outstanding is still high in a number of States and this is reflected in high debt ratios with consequent preemption of total revenue receipts by interest payment commitments (Table 15.8). Himachal Pradesh and West Bengal are severely debt-stressed with interest payments pre-empting more than 40

Table 15.8
State Debt Situation 2004-05

(%)

State	Interest Payments to Total Revenue Receipts	Debt to Total Revenue Receipts
A. Special Category States		
1. Arunachal Pradesh	11.61	92.18
2. Assam	14.40	129.35
3. Himachal Pradesh	41.31	422.52
4. Jammu & Kashmir	12.10	169.67
5. Manipur	21.67	207.42
6. Meghalaya	11.43	137.12
7. Mizoram	17.52	212.25
8. Nagaland	15.39	142.52
9. Sikkim	4.93	53.17
10. Tripura	13.35	170.94
11. Uttaranchal	17.16	203.17
Total A	**16.53**	**177.87**
B. Non-Special Category States		
1. Andhra Pradesh	23.21	206.31
2. Bihar	23.63	263.30
3. Chattisgarh	14.37	142.72
4. Goa	12.41	87.04
5. Gujarat	28.58	339.06
6. Haryana	23.05	223.08
7. Jharkhand	10.69	196.30
8. Karnataka	15.10	178.65
9. Kerala	25.15	294.89
10. Madhya Pradesh	21.19	244.27
11. Maharashtra	24.40	232.10
12. Orissa	30.20	335.06
13. Punjab	24.70	307.86
14. Rajasthan	29.55	343.04
15. Tamil Nadu	21.09	202.75
16. Uttar Pradesh	30.80	347.82
17. West Bengal	47.93	490.10
Total B	**25.42**	**273.70**
ALL STATES	**24.37**	**262.37**

per cent of total revenue receipts and debt burden more than four times their total revenue receipts. Gujarat, Orissa, Punjab, Rajasthan and Uttar Pradesh also have a high debt overhang.

15.38 Table 15.9 presents the achieved level of resources in the first four years as a percent of the five year Core Plan target for each State separately. The average for all States is 69.48 per cent , which is below the expectation of 78 per cent in four years. It is worth noting that there is considerable variation among the States with several States (Andhra Pradesh, Chhatisgarh, Goa, Haryana, Jharkhand, Karnataka, Madhya Pradesh) being above 80 per cent , while some (Maharashtra, Orissa, Punjab, Uttar Pradesh and West Bengal) are below 60 percent.

ISSUES FOR STATE PLAN RESOURCES

15.39 At the close of the Ninth Plan and in the first three years of the Tenth Plan, Plan financing within the federal fiscal framework was strained by the inability of States to generate revenue surpluses to meet Plan requirements on the revenue and capital accounts in sectors falling under their jurisdiction. This led to continuing underachievement of approved Plan outlays in many States and dependence on Central assistance. Inadequate availability of own resources for State Plans contributed to proliferation of special purpose Central assistance for infrastructure as well as human development through Centrally sponsored schemes (CSSs) and additional Central assistance (ACA). Experience with these programs has not been uniformly satisfactory, as they are often considered to be rigid and inflexible offering limited scope for adjustment to State specific requirements and conditions. The contribution of States themselves to Plan resources has fallen below 2 per cent of GDP, but several critical developmental tasks devolve on them alone. Improving resources of States on a sustainable basis, providing incentives for developmental performance, fiscal prudence and accountability and putting in place successful and flexible mechanisms for intergovernmental

TABLE 15.9
Achieved Resource Levels (First 4 years)
(Target 78%) (%)

State	Achieved
A. Special Category States	
1. Arunachal Pradesh	61.65
2. Assam	81.98
3. Himachal Pradesh	54.03
4. Jammu & Kashmir	68.39
5. Manipur	61.48
6. Meghalaya	66.56
7. Mizoram	87.99
8. Nagaland	78.94
9. Sikkim	98.78
10. Tripura	50.40
11. Uttaranchal	88.86
Total A	**70.16**
B. Non-Spl. Category States	
1. Andhra Pradesh	87.69
2. Bihar	62.52
3. Chattisgarh	92.02
4. Goa	80.38
5. Gujarat	73.40
6. Haryana	85.03
7. Jharkhand	95.16
8. Karnataka	90.99
9. Kerala	60.53
10. Madhya Pradesh	89.34
11. Maharashtra	48.83
12. Orissa	51.54
13. Punjab	52.62
14. Rajasthan	84.25
15. Tamil Nadu	67.69
16. Uttar Pradesh	56.47
17. West Bengal	52.53
Total B	**69.40**
ALL STATES	**69.48**

transfer are key issues, not only in the remaining period of the Tenth Plan but even more for the Eleventh Plan.

15.40 The first two of these tasks are being addressed to some extent by the recommendations of the Twelfth Finance Commission. From the resource point of view, in absolute terms, during the remaining two years of the Tenth Plan, the BCR position of States will improve both by increase in the size of nonPlan transfers from the Central government as well as by reduction of the interest burden on outstanding Central loans to States under the TFC's debt relief package. However, the extent of improvement likely in the final year of the Plan will be far more muted than that expected in 2005-06. For some States (Assam, Kerala, Punjab and West Bengal) there could even be a lower level of Central transfers (Table 15.9). Drawal on specific purpose grants recommended by the TFC will also depend on the capacity and willingness of States to channel resources to core sectors of physical and social infrastructure.

15.41 The TFC has suggested substitution of Central loan financing by direct access of States to the market and, whenever such lending to States becomes necessary, alignment of Central lending rates to the marginal cost of borrowing for the Centre. The full benefits of this strategy will depend on the extent to which markets are able to meet the requirements of the States and on the States' responses to market perceptions of sustainable development performance. In this context,

(a) States must be encouraged to move to marketbased borrowing over a period of time by designing instruments and procedures that increase their flexibility and autonomy in dealing with markets
(b) Markets should be sensitized and equipped with effective credit appraisal tools and there must be scope for diversification of risk and secondary trading
(c) Institutional procedures need to be evolved to operationalise debt caps and statutory controls must remain sensitive to developmental priorities.

The challenge is to manage the transition without affecting the liquidity position of States or disrupting resource availability for core areas.

15.42 Withdrawal of the debt swap scheme could give States a larger quantum of small savings resources for funding their Plans. However, immediate withdrawal of the Centre from intermediation between financial markets and States could have differential effects across States. It could raise the margin between coupon rates on Central and State paper beyond the current level of 150 basis points. Over time, the impact of the shorter maturity profile of market loans will be felt on the entire debt portfolio of State governments neutralizing the relief in repayments obtained through the loan reschedulement recommended by the TFC. Moreover, since the debt relief package is conditional on reducing the revenue deficit to zero, the most debt-stressed States may be unable to avail of this, opening up a difference between these states and those which can clean their balance sheets through debt write-offs. Debt stressed States, as well as those which are not yet equipped to handle markets and are likely to be the most vulnerable, will require additional attention and support, so that they do not fall behind the rest of the country in terms of developmental goals.

15.43 While the substantial non-Plan assistance recommended by the TFC has been accepted by the Central government, this will not by itself make State Plan resources buoyant on a continued and sustainable basis. The pace of fiscal correction initiated by several States will have to be maintained and quickened. The focus must be on radical reform of own tax and nontax revenue structures and contraction of inessential non-Plan expenditure. Some States have reviewed the changes required to arrest the dip in revenue buoyancy below 1 observed since the second half of the nineties and have started working on extending the tax base, rationalizing slabs, rates and exemptions and improving administration and compliance. (Box) Reform is urgently required in State excise, stamp duties and registration fees and motor vehicle taxes. The rationalisation of stamp duty structure incorporated in the urban reform package promoted by the Central government targeting a 5 per cent rate by the close of the Tenth Plan, which has been formally accepted by at least half the States should become the general norm. The ceiling for property tax which has been fixed in the Constitution at an annual level of Rs.2500 per taxpayer must be lifted or increased to enable States to raise resources. Other stagnant revenue sources are royalties and forest revenues. But the central issue is conversion of existing multiple cascading goods and service taxes into an integrated VAT on consumption, since taxes on consumption account today for almost three quarters of States' own tax revenue.

15.44 The implementation of VAT (earlier implemented only in Haryana) has begun in a number of States on 1/4/2005. This is a welcome development with substantial potential benefit in the future. Even though large revenue loss is not expected in the transition to VAT that could affect BCR projections or Plan financing, the Central government has, nevertheless, earmarked resources for a safety net to compensate States for any possible revenue loss caused by the introduction of VAT. Transitional problems are not unknown in international experience but there is no doubt that adoption of VAT is a major step forward. It will improve State revenues as well as promote growth (which in turn will benefit the State and Central exchequer) by making the system economically neutral.

15.45 As VAT proceeds, certain additional issues will need to be addressed. For example, ideally, there should be a floor rate, not a uniform rate and additional excise duty should be levied by States. Central sales tax should also be removed. On some of these, e.g. CST, the Empowered Committee has already suggested a road map, linked to setting up a Tax Information Network. The major challenge is to eliminate fiscal barriers to inter-State trade and commerce by making VAT destination based as quickly as possible. The Central government's compensation package for revenue loss in the transitional period should not generate perverse incentives that affect design of the optimal tax structure as well as efficient tax administration. The revenue neutral rate should not be driven down through a large exemption list. Economic neutrality and improved compliance also call for classification of goods in terms of value addition, not as inputs or finished products. Finally, the commodity tax room available to the Centre and States will have to be determined with

Action Taken by Some States to Halt Fall in Revenue Buoyancy

Expert Commissions have been appointed by some State governments to review the structure of their tax and nontax revenues.

- The Government of Karnataka has done a full scale review of its tax and nontax structure through expert Tax and Revenue Reforms Commissions, which have made farreaching suggestions for promoting growth and improving revenues though fundamental reform of the fiscal structure.
- The Government of Andhra Pradesh has done a similar exercise through a Revenue Reforms Committee which has recommended measures for raising revenues from different tax handles as well as methodologies for forecasting such resources
- The Govt.of Tamil Nadu's Taxation Reforms and Revenue Augmentation Commission has also provided valuable advice on reform of the State's tax structure as well as administration.

The three sets of documents provide insights and suggestions which could be adopted over the country as a whole to reform all consumption taxes (both on goods and services), reduce stamp duty, rationalise excise duty and motor vehicle tax, modify the structure of other major taxes and rationalize sources of nontax revenue (user charges, royalties, fees and fines etc.)

reference to the constitutional responsibilities of each level within the federal setup. In all these respects, the existing VAT design is a good beginning, with further elaboration anticipated with its progress.

15.46 These major reforms impending in the area of consumption taxation, the principal source of States' own tax revenue, will increase the level of uncertainty regarding availability of resources for State Plan financing. Simultaneous shift to the new policy of direct recourse to market borrowing could further disrupt resource flows for planned development. Above all, the debt overhang of States has still to be addressed. This goes beyond budgeted liabilities or debt incurred by States on the security of the Consolidated Fund to encompass guarantees, the Public Account, unfunded pension, unrecognized obligations and the negative net worth of public undertakings and special purpose vehicles and unpaid bills.

15.47 Swap of Central debt has already changed the composition of the State debt portfolio in favour of market based instruments and exposed States to credit appraisal by independent agencies. This process will be hastened through operationalisation of TFC recommendations. Direct market access by States can improve accountability and fiscal responsibility, but capacity to go to the market without Central support is not uniform across States. States unable to exercise the market option require appropriate risk mitigation support from the Centre, incentivised for fiscal performance. In the transitional period, Central loans may have to be continued at market linked rates, as suggested by the TFC itself, with effects on the Centre's own fiscal deficit. Debt caps and fiscal responsibility legislation will also have to be implemented within the developmental priorities of the Plan if they are not to become a constraint on Plan investment. Common deficit management parameters suggested by the TFC would have to give way to a case by case approach to debt management for different States.

15.48 Decline in the share of Central loans in State debt portfolios has brought into sharp focus unresolved issues related to the lending policies of public financial institutions and national cooperatives like NCDC, LIC, GIC, NABARD and HUDCO. These bodies will have to introduce good appraisal procedures and viability assessment methodologies into current standardized programs, so that worthwhile projects with developmental potential are promoted on merits at risk-differentiated interest rates and State guarantees sought only when unavoidable. An issue that was not addressed by the TFC is the need for interest rate relief and debt swap for loans by term lending institutions at very high rates in the past.

15.49 A potentially disturbing development on the debt side concerns the nature and cost of borrowings from the National Small Savings Fund (NSSF). The Twelfth Finance Commission has provided no relief on this account, which is the principal source of Plan loans for many States and might soon account for a disproportionate share of the States' debt servicing burden. Some States whose BCRs can be expected to worsen due to reduction in non-Plan transfers from the Centre in the concluding year of the Tenth Plan will also be those most burdened with NSSF loans.

15.50 Under existing policies, lending rates from this source continue to remain several percentage points above the coupon rate for State paper in the market reflecting the fact that the interest rate on these savings is fixed administratively by the Central government and the cost of administering the scheme is also high. Furthermore, there is no scope for prepayment. States that have access to alternate sources of market funds are seeking substitution of NSSF entitlements by other borrowings. NSSF liabilities could then devolve on the Central budget to some extent and this may in turn cause the Centre to push other States even further into this relatively high cost source.

15.51 Review of the current structure of the NSSF appears imperative, not only with regard to the interest rate mix offered on various savings schemes but also with an eye to rationalization of commissions offered to agents, optimal investment of surpluses and efficient management. More generally, although small savings are now off the Central Budget, the Centre's ability to fix lending terms and its growing importance as source of finance for State Plans makes this a potentially disruptive issue in Centre-State financial relations which needs to be confronted directly and with urgency.

15.52 The losses incurred by power utilities have imposed a major drain on State resources. As against the earlier obligation to provide a statutory rate of return for Electricity Boards and rural electrification subsidy, there is now the impact of open-ended guarantees for market resources raised by State-owned utilities as well as tariffs contracted with independent power producers (IPPs) and Central power utilities, obligations related to restructuring plans (and debt relief packages) and subsidy orders passed by Regulatory Commissions. Since most power utilities continue to be State-owned, they revert back to budgetary support to shore up their balance sheets. Power sector reform has proceeded slowly with hiccups and backtracking. (Chapter 10, paras 10.15 and 10.16). The need for improving the efficiency of the transmission and distribution structure by making it responsive to market signals is acknowledged, but several thorny issues relating to pricing, privatization, unbundling and power trading have not been fully resolved.

15.53 Meanwhile, the State budget continues as a safety net for the deficits of electricity boards and their successor undertakings. Accounting practices of power utilities differ depending on their formal structure as departmental undertakings, Electricity Boards, public enterprises and private or joint sector companies with different degrees and types of unbundling. Dependence on State support, which is understated at the planning stage, is a major factor in non-realisation of approved resource levels. Shift to formal regulatory procedures has, however, improved the situation and provided benchmark data on the budgetary burden of the power sector. Structural reform of these utilities is essential to ensure availability of resources for State Plans.

15.54 Another disturbing development needs to be reversed. Central power utilities, with assured rates of return determined by the Central regulator largely on cost-plus basis and access to mechanisms for adjustment at source of claims on State utilities out of Central Plan assistance, have begun to take over investment in power generation and transmission from cash-strapped State electricity boards, which enjoy little negotiating strength in the fixation of power sale tariffs. (Chapter 10, paras 10.14 and 10.16). The cumulative burden of these costs devolves eventually on State budgets.

15.55 On the expenditure front, improvement in the BCR must focus on better quality expenditure and policy reform. Pension and public sector reform are inevitable, with or without dilution of government equity. The significance of adequate maintenance expenditure for economic and social infrastructure must be recognized. Fiscal consolidation and Plan financing must be done with adequate safeguards for such sectors and where necessary budgetary provisions should be enhanced.

15.56 Disparities among States are growing in terms of per capita NSDP as well as HDIs. While developed States may be able to raise own resources or leverage private and institutional funds, most special category States and lower income ones depend on Central revenue flows for a substantial share of expenditure. Their Plan sizes could be affected by decline in the Centre's tax/GDP ratio as well as shift to market based financing. Special category States also have a structural imbalance and use Plan resources to fill their non-Plan gap. For such States, dependable sources of own resources have to be identified and tapped to make them self-reliant, responsible and efficient. Till then, improved cash management and adequate levels of transfer are essential not merely to fund State Plans but also to provide counterpart funds for Centrally sponsored schemes.

15.57 The role of external aid has been sharply reduced in Tenth Plan financing although it has had a significant beneficial impact at the State level in inducing fiscal consolidation and restraint through structural adjustment lending. Evaluation reports confirm that externally aided projects do ensure better service delivery through detailed program design and closer monitoring of outcomes. Back to back transfer of external aid to States is a move in the right direction as it will promote responsibility and accountability on the part of States and pass on financial incentives tied to priority sectors to implementing States. There may also be a case for tying external aid inflows to the achievement of Millennium Development Goals linked to poverty alleviation, infrastructure, health and education particularly in less developed and special category States.

15.58 In a federal fiscal environment, for managing vertical and horizontal imbalances, general purpose transfers can equalize to some extent divergence in the capacities of States to meet their constitutional responsibilities, but specific purpose transfers are unavoidable to provide a minimum level of services to all citizens. The roles of the Centre and States in funding investment in physical infrastructure and social sectors are changing, with growing demand for redistributive transfers. The Centre seems to be taking over some of the revenue responsibility of States through major CSSs like those in education, for example. Widespread criticism of the proliferation of Centrally sponsored schemes and Additional Central Assistance has not yet thrown up a satisfactory alternative model for providing minimum developmental levels in laggard States. The practice will have to continue but essential correctives must also be put in place. Apart from overall simplification and rationalization of existing Centrally sponsored schemes, there is urgent need to bundle together disparate CSS programs in key sectors like agriculture, water resource management, health etc. and make funds available with greater flexibility to implementing districts and panchayat bodies so that local ownership, initiative and supervision become possible to achieve program targets and outcomes. Further work will have to be done forthwith in this area to develop appropriate models.

15.59 The challenge for both CSSs and external aid is to ensure that limited resources are allocated to sectors and regions to produce optimal results. Since inter-State divergences are high, there will be a trade-off between equity and efficiency. Better-off States have also to be drawn into a consensus using transparent fund allocating mechanisms.

15.60 A large unexplored source of Plan financing that is yet to be understood and tapped is local body finance. Data for urban areas is available, but it is inadequately understood, collated and analysed. For rural areas, despite figures put out by State Finance Commissions, hardly any work has been done. Kerala and Karnataka alone have reconciled and validated with difficulty panchayat level data. Such analysis must be undertaken rapidly in all States. Field level experience in Karnataka and Kerala supports the hypothesis that an empowered and enlightened local body will willingly raise resources for desired local programs. Statutory provisions for resource raising by local bodies must be revitalized so that property taxes, user charges and fees are brought into line with perceived needs. This could be an area of great potential for future Plan financing.

THE WAY FORWARD

- The feasibility of financing the remaining part of the Tenth Plan will depend very critically on the ability of the Centre to increase its tax revenues. This requires expeditious removal of exemptions and an approach that takes into account effects likely from reduction of customs duties. Slippage in this area could lead to a tradeoff between FRBM targets and growth in the early years of the Eleventh Plan.
- In view of the limitation on expenditure by fiscal legislation, the Special Purpose Vehicle for financing infrastructure announced in the budget provides a

mechanism for directing additional resources to infrastructure and needs to be operationalised at the earliest.

- Where the NCMP allows sale of equity of Central PSUs, additional resources may be available. Whether and how this can add to Plan finances would however depend on the way the Fund set up for this purpose is designed. This matter needs to be examined.
- Rationalisation of domestic indirect tax structures is required not only to increase buoyancy and reduce cascading but also for customs duties to provide true protection to domestic industry. The transition to VAT enables reduction in economic disparities and should encourage investment. Its expansion to all States and a future move to the destination principle should further strengthen its structure. The goal should be movement to a comprehensive consumption tax regime at the level of both the States and the Centre.
- The power sector continues to be a burden on State finances with effects related to the operation of Central public sector utilities also. Comprehensive reform in this area will have a significant effect on Plan financing as a whole.
- The TFC has correctly pointed towards a shift of State borrowings from the Centre to markets to enable them to raise resources in an autonomous and responsible manner. However, balance sheets of States need to be cleaned before they are made to depend upon the market for loans. Debt relief offered by the TFC is limited to interest on Central loans with debt write-off is conditional on States being able to eliminate their revenue deficits. This is inadequate for severely debt-stressed States. Because of their high and inelastic interest burden, some of these States will not be able to eliminate their revenue deficits and become ineligible for debt relief. Such States will not only have to forego the full TFC benefits but are also likely to face higher costs in future market borrowings. This needs to be rectified urgently through a more case sensitive approach.
- If States are to have the option of not borrowing from the NSSF, the maturity transformation currently made by this fund should be removed. In parallel with market loans, States should be on-lent at the same maturity as collection and at rates which differ only by a reasonable commission charge.
- The whole area of Centrally Sponsored Schemes remains unresolved. Although the NCMP mandates reduction in the number of such schemes, it also suggests large increases in expenditure on some of these schemes. This is an outcome of the fact that expenditure compression in the past has led to cuts in areas such as health and education. The issue needs to be approached with greater sensitivity to the nature and quality of expenditure compression in future fiscal responsibility measures.