CHAPTER V

State Finances

Jammu and Kashmir is one of the ten special category states of the country. The state has not been able to generate sufficient revenue from its own resources and has been facing serious financial problems. The problem became all the more serious due to the prevailing circumstances in the state affecting both revenue and expenditure. The state suffered from militancy for a long period, since 1989 onwards, resulting in the erosion of the tax base, increase in expenditure, destruction of infrastructure and various other factors related with disturbed law and order. The state income did not grow and it became difficult to collect user charges and sales tax revenue. It also went into arrears. Because of continued tax and non-tax revenue shortfalls and heavy pressures on expenditure, the deficit has been increasing significantly. The account of the state government for 2000-01 closed with a revenue deficit of Rs.961 crore showing an increase of 77 per cent over the deficit in the previous year. The fiscal deficit increased from Rs. 1338 crore in the year 1999-00 to Rs.1873 crore in 2000-01, registering an increase of 40 per cent.

The development process in the state has largely suffered due to inadequacy of resources and steep rise in the expenditure during the years of turmoil. The state's inability to generate sufficient financial resources has resulted in the increased dependence on central assistance and borrowings. In 2000-01 the state governments' revenue from its own resources (tax and non-tax) constituted only 21 percent of the total revenue receipts of Rs. 5,660 crore while as grant-in-aid from the central government constituted 67 per cent and the state's share of union taxes and duties constituted 12 percent. While the debt requirements of the state have been growing very fast, the mounting debt servicing burden has been reducing the availability of resources for investment in developmental projects and other services. The interest payment during 2000-01 amounted to Rs. 769 crore constituting 12 per cent of revenue expenditure.

The state government has always been looking out for new ways of augmenting its revenue income. However, the requirement of development and other expenditure has been so enormous that it has been increasingly difficult to contain the deficit or the debt. The total expenditure (revenue and capital) increased from Rs. 4180 crore in 1996-97 to Rs.7547 crore in 2000-01 showing an increase of 80.50 per cent. The problem of large and persistent revenue and fiscal deficits is serious. In fact, the increasing fiscal deficit of the state government over the years and the adverse financial indicators point to improper fiscal management. While the state government needs enough resources for discharging its legitimate functions effectively, the finances of the state have been under considerable stress particularly during the last few years.

Therefore, it is imperative to bring efficiency in the management of state finances and make constant efforts towards mobilization of additional resources. Effective measures and long-term strategic perspectives are required for sound and efficient management of state finances. Keeping this in view, the chapter examines the existing position of state finances and suggests effective measures for curtailment of state expenditure, mobilization of additional resources and for improving financial management practices of the state.

RECEIPTS AND EXPENDITURES OF THE STATE

The state government has four sources of revenue, namely, tax revenue, non-tax revenue, grants-in-aid from Government of India and state's share of union taxes and duties. The tax revenue plays a vital role in the budgeting exercise of the state. Under tax revenue the prominent sources in order of higher revenue collections include sales tax, excise, tax on goods, tax on vehicles, stamp duty, electricity duty, tax on passengers and land revenue. Besides, miscellaneous taxes in the shape of tax on professions, trade, selling and employment, entertainment duty and advertisement, road tax and tourist tax are charged. The non-tax revenue is largely dependent on collection of fee from the consumers on account of supply of goods and services like electric energy, drinking water, irrigation facilities, exploitation of forest wealth, charges of health services, mining, etc. The grant-in-aid from the central government and the state's share of union taxes and duties are the other main sources of income of the state. The status of revenue receipts of the state for the past five years is reflected in Table V.1

Table V.1

Total Receipts of the State

(Rs.in Crore)

Receipts	1996-97	1997-98	1998-99	1999-00	2000-01	Percentage change from 1996-97 to 2000-01
Revenue Receipts	**3223**	**4642**	**4509**	**5514**	**5660**	**+ (76)**
Tax revenue	294 (9.11)	368 (7.92)	437 (9.68)	578 (10.47)	746 (13.14)	+(153)
Non-tax Revenue	183 (5.67)	248 (5.33)	283 (6.27)	405 (7.33)	444 (7.82)	+(143)
State share of union taxes and duties	626 (19.40)	834 (17.95)	1212 (26.85)	1232 (22.32)	675 (11.89)	+(8)
Grants-in-aid from government of India	2120 (65.71)	3192 (68.70)	2577 (57.10)	3299 (59.77)	3795 (66.88)	+(79)
Recovery of loans and advances	**3 (0.09)**	**4 (0.08)**	**4 (0.08)**	**5 (0.09)**	**14 (0.24)**	
Total	**3226**	**4646**	**4513**	**5519**	**5674**	+(76)

Source: Compiled from the report of Comptroller & Auditor General of India, 2001.
( ) = % of total, + = increase, - = decrease

Table V.1 reveals that the total receipts of the state have increased from Rs. 3,226 crore in 1996-97 to Rs. 5,674 crore in 2000-01, indicating thereby an increase of 76 per cent. The share of tax revenue was 9.1 per cent in 1996-97 but has steadily increased over the past years and was 13.2 per cent in 2000-01. It reveals that there is enough scope for tax revenue being the major revenue contributor in future as well. The net increase in tax revenue has been to the tune of 153 per cent during the years 1996-97 to 2000-01. As regards non-tax revenue the share has increased from 5.7 per cent in 1996-97 to 7.8 per cent in 2000-01. Though the increase is steady, but not to the level of increase of tax revenue share. The amount of non-tax revenue has increased from 183 crore in 1996-97 to Rs. 444 crore in 2000-01, registering thereby an increase of 143 per cent.

The state's share of union taxes and duties has been fluctuating over the past years. The absolute revenue under this head has increased from Rs. 626 crore in 1996-97 to Rs. 675 crore in 2000-01 showing an increase of 8 per cent. However, the state's share of union taxes and duties decreased from Rs. 1232 crore in the year 1999-00 to Rs. 675 crore in the year 2000-01, reflecting a decrease of 45.21 per cent. This calls for an in depth investigation in collection and distribution procedures. Grant-in-aid from government of India has increased from Rs. 2120 crore in 1996-97 to Rs. 3795 crore in 2000-01, showing thereby an increase of 79 per cent over these five years. Grant-in-aid forms almost two third of total receipt in the past five years except for the years 1998-99 and 1999-00 where it was less than 60 per cent. The share of recovery of 'loans and advances' has been just less than 0.3 per cent over the last five years, though in absolute terms the amount had increased from Rs. 3 crore in 1996-97 to Rs. 14 crore in 2000-01. Thus the state has not been able to generate enough revenue at its own level and has been mostly depending on the grant-in-aid from the central government which contributes about 70 per cent of the total receipts of the state.

For discharging its Constitutional obligations and for carrying out its legitimate functions, the state government spends money on various activities ranging from maintenance of law and order and regulatory functions to various developmental activities/programmes. The government expenditure is broadly classified into Plan/ non-Plan and revenue/capital. The plan and capital expenditures are meant for asset creation that eventually help to generate revenue stream directly or indirectly whereas the non-plan and revenue expenditures are associated with expenditure on establishment, maintenance and services. The total expenditure of the state for the past five years is reflected in the Table V.2.

Table-V.2

Total Expenditure of the State

(*Rs. in crore)*

Expenditure	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	Percentage increase/ decrease (base year 1996-97)
Revenue Expenditure:	**3129**	**4191**	**4909**	**6055**	**6621**	**+ 111.60**
Plan	348 (8.32)	445 (8.64)	526 (9.44)	704 (10.26)	735 (9.73)	+(111.20)
Non-Plan	2781 (66.53)	3746 (72.78)	4383 (78.73)	5351 (78.03)	5886 (77.99)	+(111.65)
Capital Expenditure:	**1000**	**889**	**596**	**711**	**867**	**- (13.30)**
Plan	924 (22.10)	908 (17.64)	608 (10.92)	791 (11.53)	802 (10.62)	- (13.20)
Non-Plan	76 (1.81)	-19 (0.36)	-12 (0.21)	-80 (1.16)	65 (0.86)	- (14.47)
Disbursement of loans and advances	**51 (1.22)**	**67 (1.30)**	**62 (1.11)**	**91 (1.32)**	**59 (0.78)**	**+ (15.68)**
Total	**4180**	**5147**	**5567**	**6857**	**7547**	**+ (80.50)**

Source: Compiled from the Report of Comptroller & Auditor General of India, 2001.
() = percentage of total + = Increase - = Decrease

Table V.2 depicts that the total expenditure of the state has increased from Rs.4180 crore in 1996-97 to Rs. 7547 crore in 2000-01, thereby showing an increase of 80.5 per cent. The revenue expenditure has increased from Rs. 3129 crore in the 1996-

97 to Rs. 6621 crore in the 2000-01 constituting an increase of 111.60 per cent. The results reflect that the government had made no efforts to arrest the increasing trend in the revenue expenditure, which had increased from 75 per cent of the total expenditure in 1996-97 to 88 per cent in 1998-99 and remained constant thereafter. As against this, the capital expenditure has registered a decreasing trend, from Rs. 1000 crore in the year 1996-97 to Rs. 867 crore in 2000-01, amounting to a percentage decrease of 13.3 per cent. This indicates that the state has given less emphasis on investments and growth-oriented developmental expenditure. The disbursement of loans and advances has increased marginally from Rs.51 crore in the year 1996-97 to Rs. 59 crore in the year 2000-01, recording an increase of 15.67 per cent.

Table-V.3

Break-up of the Expenditure

(Rs. in crore)

Expenditure	1996-97	1997-98	1998-99	1999-00	2000-01	Percentage increase/ decrease base year 96-97
Revenue Expenditure	**3129**	**4191**	**4909**	**6055**	**6621**	**+(111.60)**
General Services (Including interest payment)	994 (23.77)	1717 (33.35)	1907 (34.25)	2414 (35.20)	2448 (32.43)	+146.28
Social services	929 (22.22)	1048 (20.36)	1241 (22.29)	1526 (22.25)	1650 (21.86)	+ 77.61
Economic Services	1206 (28.85)	1426 (27.70)	1761 (31.63)	2115 (30.84)	2523 (33.43)	+109.20
Grants in aids and contribution	0.04	--	--	--	--	--
Capital Expenditure	**1000**	**889**	**596**	**711**	**867**	**- (13.30)**
General Services	25 (0.59)	39 (0.75)	35 (0.62)	49 (0.71)	32 (0.42)	+28.00
Social Services	241 (5.76)	236 (4.58)	210 (3.77)	208 (3.03)	240 (3.18)	-0.41
Economic Services	734 (17.55)	614 (11.92)	351 (6.30)	454 (6.62)	595 (7.88)	-18.94
Disbursement of loans and advances	**51 (1.22)**	**67 (1.30)**	**62 (1.11)**	**91 (1.32)**	**59 (0.78)**	**+15.68**
Total	**4180**	**5147**	**5567**	**6857**	**7547**	**+80.5**

Source: * Compiled from the Report of Comptroller & Auditor General of India, 2001
( ) = percentage of total
+ = Increase - = Decrease

The break-up of the total expenditure reflected in the Table V.3 reveals that in case of revenue expenditure, economic services has received priority, as 36.97 per cent of total revenue expenditure has been spent on it. It is followed by general services (36.97 per cent) and social services (24.92 per cent). As against this, in case of capital expenditure 68.63 per cent has been spent on economic services followed by 27.68 per cent on social services and only 3.69 per cent on general services. In case of revenue expenditure the expenditure on general services, social services and economic services has increased by 146.28 per cent, 77.61 per cent and 109.20 per cent respectively from the year 1996-97 to 2000-01. In the case of capital expenditure where the expenditure on general services has increased by 28.80 per cent but has decreased by 0.41 per cent and 18.90 per cent in respect of social services and economic services respectively during the period 1996-97 to 2000-01.

While investments made out of capital outlay promote developmental, manufacturing, marketing and social activities and led to asset creation, the decrease in the level of capital expenditure is likely to result in a serious shortfall in capital formation, which can have a long-term adverse effect on the state's economy. When the state government uses such portion of its income as well as borrowings for consumption expenditure it arrests the pace of development and lays more burden on the economy. Therefore, government needs to curtail revenue expenditure as well as concentrate on the augmentation of revenue income. The government can reduce its current expenditure by reorganizing itself and reinventing the way of doing work, improving the efficiency of expenditure, reducing subsidies and other unproductive expenditures. Further, in order to analyse the position of state finances thoroughly, Table V.4 reflects total income and expenditure with revenue/fiscal deficits of the state.

Table V.4

Total Income and Expenditure of the State

(Rs. in crore)

Year	Total Income	Total Expenditure	Revenue Expenditure	Revenue Surplus/Deficit	Fiscal Surplus/Deficit
1996-97	3226	4180	3129	+ 94	- 954
1997-98	4646	5147	4191	+ 451	- 501
1998-99	4513	5567	4909	- 400	- 1054
1999-2000	5519	6857	6055	- 541	- 1338
2000-2001	5674	7547	6621	- 961	- 1873

Source: Compiled from the Report of Comptroller & Auditor General of India, 2001.
+ = Surplus - = Deficit

Table V.4 presenting the comparative scenario of income and expenditure of the state reflects a growing mismatch between revenue and expenditure of the state with the resultant deterioration in revenue/fiscal deficits. The table demonstrates that the total income has increased by Rs. 2448 crore, registering an increase of 76 per cent from the year 1996-97 to 2000-01. The net increase in the total expenditure has been to the tune of Rs. 3367 crore, amounting to an increase of 81 per cent. While there has been an increase of Rs. 3492 crore in revenue expenditure (amounting to an increase of 112 percent) capital expenditure showed a decline of 13 per cent during the said period.

The table also shows the revenue and fiscal deficit/surplus of the state for the past five years. The revenue deficit is the difference between revenue receipts and revenue expenditure whereas fiscal deficit basically shows the difference between the total income of the state and its total expenditure. The results indicate that for the years 1996-97 and 1997-98, there was revenue surplus but from the years 1998-99 onwards, not only there was a revenue deficit but that too in an increasing trend. Revenue deficit increased from Rs. 400 crore in 1998-99 to Rs. 961 crore in the year 2000-01, reflecting an increase of 140.25 per cent. Similarly, the fiscal deficit recorded an increasing trend. It increased from Rs. 954 crore in the year 1996-97 to Rs. 1873 crores in the year 2000-2001, registering an increase of 96.33 per cent.

A more disturbing feature of state finances emerging from Table V.4 is that the revenue deficit as a percentage of fiscal deficit has been growing very fast. It increased from 37.95 per cent in the year 1998-99 to 51.31 per cent in the year 2000-01. This reveals that borrowed funds or grants from the Centre are being increasingly used to meet revenue expenses and not used for productive purposes. This can lead the state to a debt trap and may arrest the pace of development. The primary reason for increasing trend in revenue and fiscal deficit has been that the state has not been able to generate additional revenue from its own sources and there has been a phenomenal increase in the revenue expenditure during the last decade. The revenue expenditure, which was 75 per cent of the total expenditure in 1996-97, rose to 88 per cent in 1998-99 and remained constant thereafter. The factors mainly responsible for enormous increase in expenditure were:

- Phenomenal increase in expenditure under security-related items. This expenditure is not fully reimbursed by the central government.
- Increase in the salaries of government employees due to the pay revisions, which has increased more than four times during the current decade. The wage bill of the employees increased from Rs. 700 crore in 1990-91 to Rs. 3000 crore in 1999-2000. Besides, the increasing rate of dearness allowances paid to government employees creates additional burden.
- Higher level of debt servicing due to increase in loans and overdrafts which ranged between Rs. 211 crore in 1996-97 to Rs. 845 crore in the year 2000-

01. The state is in debt trap on account of central loans, market borrowings and other loans besides the bank overdrafts.

- Losses on account of State Electricity Board (SEB) amounts to Rs. 671 crore for 1999-00. The state also owes more than Rs. 700 crore to various power companies.

Further, the revenue of the state has not kept pace with the increasing expenditure. In fact, the performance of J&K has been very poor in mobilizing plan resources during the IX plan. The state was not able to mobilize the plan resources fully during IX plan because:

- The government machinery was not able to work effectively. Due to turmoil in the state and threat perception on the part of the government officials, the revenue collecting authorities were not able to work effectively. They were not in a position to visit different areas for the collection of dues from the consumers, which included power tariff, etc. Further, government machinery was not able to collect the sales tax and other dues during the period.
- Due to the turmoil in the state people could easily avoid paying tax and other dues to the government, and a substantial amount of revenue due from consumers went into arrears, most of which is still unrealized.
- Most of the public sector undertakings of the state have been running into losses continuously. Despite their poor performance and complete erosion of their paid-up capital, the state government continued to provide financial support to these loss-incurring companies. In view of their poor performance, the Godbole Committee recommended closure of most of these enterprises and restructuring/re-engineering of some of these undertakings. However, the government could not take a decision in this regard due to various social, political and economic reasons and this resulted in the enhancement of the burden on the state exchequer.
- Subsidy provided by the government in various sectors has added to the financial woes of the state.

Despite the fact that these factors affected the availability of funds for the business of the government and were responsible for the phenomenal increase in expenditure, inefficient fiscal management further accentuated the problem of deficit. While the problem of large and persistent revenue/fiscal deficits is too serious, it calls for urgent attention. The government should look for effective alternatives to control the deficit and also generate additional resources for making investments for productive purposes and for improving the social and economic infrastructure in the state. Given the present level of the state's social and economic infrastructure, and the limited revenue potential and high growth requirements, it is a difficult task for the state government to generate enough revenue to meet all its requirements. However, it should be able and willing to raise a revenue income that can finance its revenue expenditure in full.

POLICY RECOMMENDATIONS

The state needs to institute improved practices of financial management and radical re-orientation of major policies for improving the efficiency of resource use in the state. In fact, a sound and effective management of state finances calls for efficiency, economy and effectiveness of revenue and expenditure operations. There are many potentialities for improving the revenue receipts in the state The following long-term and short-term measures are recommended for improving the financial management practices of the state:

LONG-TERM MEASURES

I. The revival of tourism in the state to pre-militancy level will not only increase the contribution to SDP but can be perceived as an effective tool for broad-basing the taxation policy structure. However, this option cannot be harnessed at this stage due to the militancy and law and order problems.

II. Attracting capital investment, both domestic and foreign, would enhance the financial strength of the state. The promotion of investment can be strengthened once the law and order situation in the state is increased.

SHORT-TERM MEASURES

Short-term measures shall focus on enhancing revenue realization, to curtail wastage of resources and to ensure effective servicing of the taxation measures.

I. Reduction in expenditure on establishment

Revenue expenditure is the major drain on the limited financial resources of the state. It is a fact that initially due to the adoption of the Fifth Pay Commission Report, there has been a tremendous and immense growth in the revenue expenditure but then it does not account fully for the deterioration in financial profile of the state since 1999 onwards. The total establishment is estimated to be about 3.25 lakh personnel which, given the population of the state and also the need structure, is out-sized. This is the single most contributory factor that has aggravated the problem. Some of the suggestions in this regard are:

(a) Most of the PSUs in the State are moribund and in the red. Public sector undertakings like the JAKFED, AIDC, JKTDC, JK Cable Car, and HPMC can be privatized. Rather, some of these organizations own large assets including cold storages, buildings, huge lands which can fetch good money to the government for investment in the developmental activities.

(b) Government institutions that have outlived their utility can be abolished. For instance, Agrarian Reforms Division in the Revenue Organization where the job can be performed by the Territorial institution; Housing Board because of its overlapping interest with the entity of SDA and JDA (as all these institutions and JDA are doing the same job). Even in the long run, the jobs entrusted to SDA and JDA can be passed on to the Municipal Corporations. Thus, institutions like Housing Board, Agrarian Division and Command Area Development Authorities need to be abolished herewith.

(c) The state government could be assisted by the Government of India or through banking arrangement for implementation of the VR scheme. This scheme can be implemented to begin with for such of the wings of the state government that are required to be abolished. Similar assistance can be given for dispensing with the services of employees of most of the corporations that can be listed for closure. Most of this amount can be offset and countervailed against the realization from the sale and disposal of the assets available with these organizations.

(d) There should also be specific targets for the reduction of the size of the bureaucracy within a definite time frame.

II. Control of overdraft

(a) There should be an upper limit for overdraft that must be fixed keeping in view the critical requirement of the state and be fully enforced through different measures including guidelines from RBI. There should be a special dispensation to cover the overdraft over a period of 3 years. This is virtual reality and has to be dealt with as a malaise.

(b) The Government of J & K should make an arrangement with its official bank, the J & K Bank Ltd., wherein for determining the actual amount of overdraft/ loan on a particular date, the summation of balances, credit or debit, from all the government accounts in the bank, should be used. This can be achieved by opening a central account in the bank with its sub accounts in different branches of the bank. This measure has the potential of saving 10 to 15 crore of rupees annually.

(c) The practice of re-appropriation of funds by different officers of the government beyond their competence should not be allowed without proper permission from higher authorities.

(d) A proper and readily accessible record of works done, under process and planned under different heads with outlays should be maintained at different concerned levels and in all DDOs and treasury offices of the area in order to stop completely the duplication of payments under different heads.

(e) It should be made mandatory for all the government departments to close their books on 31 March and prepare their annual accounts on this date. These reports should be submitted to the finance department in the first week of April. These comparative statements will reveal the position and performance of each departments.

(f) All the functions of the finance department and its offshoots should be computerized and linked with one an other on a priority basis in order to improve the management of finances of the state and bring transparency to financial transactions.

III. Power Sector Reforms

The power sector is confronted with immense problems including deficit in production and supply and huge arrears within the state, particularly from the public sector undertaking and government departments. Some of the measures that can be considered are as follows:

1. To restructure the power sector and carry out large-scale reforms that are aimed at: (a) to reduce losses, (b) to induce accountability, (c) to ensure proper account of power supply and distribution.
2. Universal metering should be implemented with universal coverage to obviate incidence of theft.
3. The power distribution needs to be privatized.
4. An effective system of recovery of dues with suitable incentive structure should be introduced.
5. The moratorium on the recovery of dues amounting to Rs.700 crore by the Central agencies shall be linked with the reformation process.

IV. Funding of Development programme

To boost the economy of the state the central government should ensure accountability. This will ensure infusion of funds for the specified areas/ objectives and will strengthen thrust sectors for which there is a tremendous potentiality in the state. These sectors include urban development, rural development, tourism, agriculture, drinking water, power, forest, employment generation and infrastructure development. In this context, the following steps need to be taken:

1. All the ongoing schemes should be reexamined with reference to zero budgeting and most of the schemes which have the same objective can be merged or converged or can be weeded out, particularly the same schemes which appear on Plan and non-Plan side. Therefore, to avoid overlapping, such schemes should be funded only through one source.
2. Most of the projects which suffer from time and cost overrun need to be reviewed so that the investment decisions are taken in such a way that those projects which can be completed should be accorded priority and those with long gestation and high investment can be taken up only after the prioritized schemes are completed and consummated.

V. Special Category State

Jammu & Kashmir, though classified as Special Category State, was not accorded the dispensation as visualized for these States (with the exception of Assam) in terms of financing the Plan expenditure in the ratio of 90:10 of grant and loan respectively. Although this dispensation was conceded with effect from 1991, the state government has been asking for application of this formula from the date it was applied to all the Special Category States in the country. This measure can be considered as an important tool to offset and countervail the debt liability. Thus by notionally working out the financial dispensation for the state government, this can be adjusted against the debt liability as a one time settlement. This would reduce tremendously the debt burden and would allow for the capital expenditure to pick up, commensurate with the developmental requirements.

VI. Others

1. Most of the Plan expenditure is on maintaining services in education and health sectors. There is a need to explore external funding for critical areas and to get funds from Infrastructural Fund/NABARD.

2. The government should make a complete shift to zero base budgeting.
3. The government should completely shift over to the Value Added Tax System.
4. Security-related expenditure needs to be fully reimbursed. The Government of India has not been able to fully discharge the liability on this account.