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INDIA:FISCAL REFORMS AND PUBLIC EXPENDITURE MANAGEMENT

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[*] Japan Bank for International Cooperation (JBIC) was established in October 1999 as an organization that conducts Japan's external economic policy and economic cooperation. JBIC is pursuing a more enhanced role by integrating the functions of two merged organizations: The Export-Import bank of Japan (JEXIM) and the Overseas Economic Cooperation Fund, Japan (OECF).

Upon the establishment of JBIC, the Research Institute for Development and Finance (JBIC Institute) was created as its research arm. Its research activities are geared toward improving the overall quality of JBIC's operations through systematic analysis of various issues and policies related to JBIC's activities. JBIC Institute was established by merging the two former research institutes: the Research Institute for International Investment and Development (RIIID) of JEXIM and the Research Institute of Development Assistance (RIDA) of OECF.

Foreword

Public Expenditure Management (PEM) is a framework of fiscal reform to enhance effectiveness of public policy. PEM is being applied to fiscal reform in developed as well as developing countries as a core of measures to maximize outcome of public policy. In developing countries, PEM is crucially important to implement various policies for poverty alleviation with scarce resources. In view of this, JBIC Research Institute for Development and Finance (JBIC Institute) has commissioned series of studies on "Public Expenditure Management". The JBIC Research Paper No.10 studied in depth, with Philippines and Punjub Province of Pakistan as case studies, various challenges of PEM in developing countries.

This study on India's financial reform is completed by Dr. K.B.L. Mathur, Economic Adviser in the Banking Division of the Department of Economic Affairs, Ministry of Finance, Government of India, and aims primarily to revise the report "Indian Economic Management" published in 1995 by the same author. In this revision, PEM point of view has been incorporated to reflect most recent agenda in public sector reform. It means that this report can also be read as a comprehensive study on India's Fiscal Reform as well as PEM case study for India.

The report covers wide range of issues on India's fiscal reform, which has made remarkable progress in the last decade of 20th century. We hope this report will be useful for practioners as well as researchers who are concerned with India's economic development and fiscal reform in developing countries in general.

Finally, I would like to express my sincere thanks to Dr. K.B.L. Mathur for his tremendous effort to complete this study.

August 2001

Koji Fujimoto
Executive Director
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Brief Resume of Dr. K. B. L. Mathur

Dr. K. B. L. Mathur (b.1946) is presently working as Economic Adviser in the Banking Division of the Department of Economic Affairs, Ministry of Finance, Government of India. With nearly three decades of experience as an economist with the Government of India, he has been working in the Ministry of Finance with different portfolios now for about a decade and a half. Earlier he held senior positions in the Planning Commission, Government of India for over a decade till 1984.

Dr. Mathur is an acknowledged expert in the fields of macro economic stabilization policy, fiscal federalism, external finance, and management of Indian economic system.

Dr. Mathur is an author of a book on "Management of Indian Economy-Systems and Processes " which was published (May 1995) by the OECF, New Delhi Office. His other major publication is this report "India: Fiscal Reforms and Public Expenditure Management (2001). This work is based on his presentations made by him at JBIC Institute in September 2000.

As U.N. Expert on Mission, Dr. Mathur had completed an assignment (Aug-Nov, 1997) for the Government of Nigeria under a UNDP project. In December 2000, Dr. Mathur was a guest faculty member at a workshop organized by Harvard University, Kennedy School, on "Management of Foreign Aid in Africa Region" held in Nairobi, Kenya.

Besides a Diploma in Advanced Economic Studies from the Manchester University, UK in 1985, Dr. Mathur has represented Government of India in various international for a such as ADB Seminar (1991), SIDA Seminar (1992), International Law Institute, Washington (1992), a visiting researcher at the Institute of Fiscal and Monetary Policy (IFMP), Ministry of Finance, Tokyo (1993), Harvard Institute for International Development (HIID), Harvard University (Summer, 1995), and JICA Sponsored Seminar on Two Step Financing of Small and Medium Enterprises held in Tokyo (November-December, 1999).

In his official capacity of Director in the Banking Division of the Ministry of Finance, Dr. Mathur is a Government of India Nominee Director on the Board of Directors of a nationalized bank and Tourism Finance Corporation of India. Prior to joining the Government of India in 1971, Dr. Mathur was lecturer in the Department of Economics, University of Rajasthan having obtained his post graduate and Ph. D. degrees from the same University.

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Preface

At the dawn of the new Millennium, poverty reduction in the developing world has resurfaced as the most important subject in the literature on economic development. Most international institutions have joined the global campaign against poverty considering it as the greatest challenge before the world economy.

There are no two opinions on any government's objective of removal of poverty. Sustained growth of an economy is considered to be a necessary condition to reduce poverty. This, however, can hardly be achieved without maintaining macroeconomic stability. And a continuing high level of fiscal deficit could be the most serious threat to macroeconomic stability. Fiscal deficit, it is widely agreed, cannot be corrected without effective and efficient public expenditure management (PEM). PEM, therefore, has to be a central instrument of state policy and effective governance.

In this context studies initiated by the JBIC Institute on country specific assessments of PEM systems for a few developing countries is the most effective step towards understanding the issues relating to public expenditure management and poverty reduction in developing countries. This study on 'India : Fiscal Reforms and Public Expenditure Management' is part of the series of such studies the first two being on Pakistan and Philippines. A limited purpose of this study is to assess the public expenditure management system in India with an objective to identify the major tasks ahead.

A brief introduction to Indian economy with some comparative performance indicators of select countries forms the initial part of Chapter 1 on Macroeconomic Trends and Perspectives on Indian Economy. This chapter highlights recent trends in major macroeconomic indicators of the Indian economy, as a background to the perspectives indicated in some important studies/reports covering the Indian economy. Before summarizing the perspectives, an overview of recent economic reforms has also been given. A limited purpose of the chapter being to provide a background of trends and perspectives only any analysis of factors leading to these trends had to be restrained.

An assessment of public expenditure management and fiscal reforms being the main theme of the study it was considered of use to provide a brief introduction to some of the important and unique features of the Indian fiscal system. Chapter 2, therefore, includes some dimensional aspects of the budgetary parameters, fiscal deficit and financing thereof, the plan-budget link, the fiscal federal system, the role of the Central Bank, and introduction to the main game players in the budget formulation process.

Chapter 3 provides an overview of Reforms and Trends in the fiscal sector of Indian economy. Major initiatives in the fiscal sector during the macroeconomic reforms process have been highlighted in part 3.1 of this chapter. These include tax reform measures, public sector restructuring, systemic reforms in governments' borrowing process, expenditure reforms, fiscal reform initiatives of the State governments, and finally the main features of the Fiscal Responsibility and Budget Management Bill 2000 introduced in the Parliament on December 20, 2000. Second part of this chapter (part 3.2) reviews recent trends in government finances. Trends in aggregate balances, receipts and expenditure both for the Central government and State governments have been reviewed to bring out the issues of policy and management.

Chapter 4 on 'Public Expenditure Management (PEM) in India' first traces the link between the ultimate objective of economic policy -- that of removal of poverty and public expenditure management. As governance encompasses PEM, the essentials of good governance and effective PEM are highlighted. With the purpose of assessing effectiveness of PEM in India a framework of PEM cycle developed in studies undertaken by the JBIC Institute for two other developing countries i.e. Pakistan and Philippines is adopted. Each stage of PEM cycle is then assessed for its system, strengths and weaknesses to identify the tasks ahead. An alternate assessment of the budget and financial management practices earlier made in a World Bank study is also reviewed.

Chapter 5 brings out the major issues and recent developments in Decentralization in India. In the context of PEM system already assessed, a limited purpose of this chapter is to identify the main issues relating to fiscal decentralization with a glimpse of international experience on decentralization practices.

Highlights of the preliminary draft of the study were discussed with a group of experts through presentations made by the author at the JBIC Institute in the second week of September 2000. Based on the expert comments and suggestions, a draft of the study was submitted to the JBIC Institute in November, 2000 for comments. This final report incorporates responses to the extensive and expert comments on the draft, received from the JBIC Institute in December, 2000.

K.B.L. Mathur

Acknowledgements

The basic idea for this study originated from Mr. Kaoru Hayashi, Deputy Director General, JBIC Institute, from his deep understanding of the Indian economy through his earlier assignment in India with OECF office and continuing academic interest in India's development effort. For seeing through this study in its present form grateful acknowledgements are due to Mr Hayashi for his valuable contribution in many ways including finalizing and getting the scope of the study approved, organising the presentations and discussions with experts at the JBIC Institute, and sending insightful expert comments on the draft. Mr. Mitsuhide Noguchi, former Director General, JBIC Institute took personal and keen interest during the lecture cum presentations at the Institute. The other experts at the JBIC Institute who extended valuable comments during the presentation meetings include Mr. Yoshihiko Morita, Mr. Masahito Ikeda, Mr. Katsumi Nishina, Dr. Naohiro Kitano, Ms. Yasuko Ose, economist and Ms. Nami Hasegawa extended valuable help during my visit to the Institute and in organising the presentations. Back home, acknowledgements are due to Mr Kasuto Tsuji, Chief Representative JBIC, Mr. Naruhiko Takesada, the ex-representative, Mr. Teruyuki Ito, Representative and Mr. C.K. Gaur, Adviser in JBIC, New Delhi office.

Without the permission and study leave granted by the Government of India this work was perhaps not possible. Shri Anoop Mishra, the then Joint Secretary was generous enough in recommending the study leave which was approved by Shri M. Damodaran, the then Joint Secretary and finally by Shri Devi Dayal, Special Secretary, Banking Division, Department of Economic Affairs, Ministry of Finance. Shri Shekhar Agarwal, Joint Secretary helped me in extending the leave period to enable me complete the task at hand.

Grateful acknowledgements are due to Dr. Y. Venugopal Reddy, currently Deputy Governor, Reserve Bank of India, who as a guru encourages, inspires and guides me. From developing the outline to finalizing the draft of this study also, the guidance from Dr. Reddy has been most generous, as usual for me, and highly valuable. Any error, of course, is solely my responsibility.

During the preparation of various drafts I was lucky to get valuable comments from a large number of my colleagues in the Ministry of Finance. Shri N.R. Rayalu, Financial Adviser in the Ministry and Shri Arun Sharma now Financial Adviser in the Ministry of Science and Technology extended their valuable expert comments particularly on the draft of the chapter on Public Expenditure Management. Shri Dinesh Kumar Tyagi and Shri Alok Kumar,

Directors in the Banking Division consistently encouraged me by responding to the ideas, I was developing at the draft stage.

Professor M.C. Purohit, National Institute of Public Finance and Policy helped through professional interactions on the subject and making available the relevant literature useful for this study.

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Finally, I wish to thank formally also, members of my family, Dr. Sudha Mathur, my wife and Dr. Piyush, my son for helping me in so many ways while concentrating on the work. Parul, my daughter provided me the moral support despite lack of interest in this type of study, her interest currently being only in theory and econometric studies as a postgraduate student at the Delhi School of Economics.

K.B.L. Mathur

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Acronyms

ADB	Asian Development Bank
ADC	Autonomous Development Council
AFS	Annual Financial Statement
AG	Accountant General
ATN	Action Taken Note
BCR	Balance From Current Revenue
BE	Budget Estimates
BF	Bond Fund
BOP	Balance of Payment
CAA&A	Controller of Aid Accounts & Audit
CAD	Current Account Deficit
CAG	Comptroller & Auditor General
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise & Customs
CCA	Chief Controller of Accounts
CCA	Common Country Assessment
CGA	Controller General of Accounts
CID	Center for International Development
CP	Commercial Paper
CPE	Central Public Enterprises
CPI-IW	Consumer Price Index for Industrial Worker
CSO	Central Statistical Organisation
CSS	Centrally Sponsored Schemes
DC	Domestic Credit
DEA	Department of Economic Affairs
DOE	Department of Expenditure
DOR	Department of Revenue
DPC	District Planning Committee
DVP	Delivery Versus Payment
EAP	Externally Aided Project
EFC	Eleventh Finance Commission
EPW	Economic & Political Weekly
FA	Financial Advisor
FC	Finance Commission
FD	Fiscal Deficit
FDI	Foreign Direct Investment
FII	Foreign Institutional Investor
FIs	Financial Institutions

GDP	Gross Domestic Product
GDPFC	Gross Domestic Product at Factor Cost
GFD	Gross Fiscal Deficit
GNP	Gross National Product
GOI	Government of India
GPD	Gross Primary Deficit
GSPD	Gross State Domestic Product
HDI	Human Development Index
IAAD	Indian Audit & Accounts Department
ICOR	Incremental Capital Output Ratio
IDRI	International Development Research Institute
IEBR	Internal and External Budgetary Resources
IMF	International Monetary Fund
INGAF	Institute of Government Accounts and Finance
IT	Information Technology
JBIC	Japan Bank for International Cooperation
M3	Broad Money
MPC	Metropolitan Planning Committee
MRTPC	Monopoly & Restrictive Trade Practices Commission
NDC	National Development Council
NFA	Net Foreign Exchange Assets
NGO	Non Governmental Organisation
NIPFP	National Institute of Public Finance and Policy
NIR	Net Internal Resources
NIRD	National Institute of Rural Development
NNP	Net National Product
NRI	Non Resident Indian
NSDL	National Securities Depository Ltd.
NSE	National Stock Exchange
NSSF	National Small Savings Fund (NSSF)
OCB	Overseas Corporate Body
OECF	Overseas Economic Cooperation Fund
PAC	Public Accounts Committee
PAF	Poverty Alleviation Forum
PAT	Profit After Tax
PC	Planning Commission
PD	Primary Dealer
PD	Primary Deficit
PDO	Public Debt Officer
PDS	Public Distribution System

PEM	Public Expenditure Management
PEO	Programme Evaluation Organization
PFM	Public Financial Management
PIW	Project Implementation Wing
PMU	Project Management Unit
PPF	Public Provident Fund
PRI	Panchayat Raj Institution
PSE	Public Sector Enterprises
PSU	Public Sector Undertaking
RBI	Reserve Bank of India
RD	Revenue Deficit
RE	Revised Estimates
RIDF	Research Institute for Development and Finance
RS	Revenue Surplus
SAG	State Accountants General
SC/ST	Scheduled Castes/Scheduled Tribes
SD	Satellite Dealer
SEB	State Electricity Board
SFC	State Finance Commission
SGL	Subsidized General Ledger
SHCIL	Stock Holding Corporation of India Ltd.
SRA	Self Regulatory Authority
STCI	Securities Trading Corporation of India
TB	Treasury Bills
TDS	Tax Deducted at Source
UNDAF	United Nations Development Assistance Framework
UNDP	United Nations Development Program
UT	Union Territory
VAT	Value Added Tax
WDR	World Development Report
WMA	Ways and Means Advances
WPI	Wholesale Price Index

Chapter Ⅰ
Indian Economy : Macroeconomic Trends and Perspectives

1.1 Introduction

Of late now, Indian economy has been in the spotlight. It has been among the fastest growing economies during the last two decades. Wide ranging economic reforms have taken place. It has undergone a significant structural transformation. The economy is more resilient, less vulnerable to external shocks and has opened up for more potentials. But the attention on the economy is also because it has crossed one billion mark in population and almost a third of the population remains below a modestly defined poverty level. The debate on perspectives for the Indian economy is continuing. A second wave of reforms is already underway. Key determinants of higher growth path, macroeconomic stability, poverty alleviation are being redefined.

This chapter highlights recent trends in major macroeconomic indicators of the Indian economy with an overview of recent economic reforms as a background to the perspectives indicated in some important studies/reports covering development of the Indian Economy. The limited purpose being to focus attention on trends only, any analysis of factors leading to the trends had to be kept out so as to remain within the scope of this study.

Box : 1.1
Indian Economy : An Introduction

A peninsula situated in South Asia, India is the seventh largest country in the world, with a geographical area of 3.29 lakh square kilometers (2.5% of the world area) - about 8.7 times the area of Japan. After China, India is the second most populous country with a billion inhabitants in 1998, accounting for 16.7 per cent of the world population, and about eight times the population of Japan.

On the basis of estimated GNP at US $2144.1 billion in 1999 measured in terms of purchasing power parity, Indian economy is the fourth largest after USA ($8350 billion), China ($4112.2 billion) and Japan ($3042.9 billion). In terms of per capita income level at US $2149 (PPP), however, India ranks 153rd in the ranking of 206 countries. In terms of Human Development Index at 0.563, India's rank is 128 out of the 174 countries. (*See Appendix 1.1 to this Chapter for a comparative view of economic performance of India among select countries.*) The vibrant Indian democracy -- the largest in the world -- has been a unique success story among the developing economies. The Constitutional framework now providing for three layers of elected governments (after 73rd and 74th amendments) has helped strengthen political institutions and a smooth mechanism of fiscal federalism. Cultural and geographical diversities of the country -- having one of the oldest civilizations -- is another distinct feature necessitating the design of a unique economic system for the country.

Historically, prior to gaining independence in 1947, 'India was increasingly reduced to the status of a mere agrarian appendage and a subordinate trading partner of Britain (Chandra, 1992). The development of the economy and the economic system after 1947, therefore, were conditioned and constrained initially to the colonial legacy and the inherited structure. A planned development process during the past five

decades based on the key objectives of growth, modernization coupled with self reliance and social equity helped attaining self-sufficiency in agriculture, establishing a modern industrial base, setting up extensive infrastructure facilities, and above all reducing significantly the percentage of population below the poverty line. The 1990s has been a decade of wide ranging economic reforms. (See part 1.3 of this chapter for an overview of economic reforms)

1.2 Macroeconomic Trends

1.2.1 Indian Economy : Trends in Growth Rate

India has been among the fastest-growing economies in the World over the last two decades, and has achieved trend improvements in growth, literacy, mortality, and poverty rates (IMF, 2000). Trends in growth rate during the post reform period since 1991-92 show a definitive improvement over pre-reform and historical trends (Table 1.1). Some highlights of trends in growth rate of Indian economy are:

- In the year ending March 2000, Indian economy is estimated to have grown by 6.4 per cent.
- The average growth rate during the last three years (1997-98 to 1999-2000) at 6.0 per cent is lower compared to the average 7.3 per cent achieved earlier during 1994-95 to 1996-97.
- Excluding 1991-92 (an outlier year) the economy during 'nineties has grown at an average rate of 6.4 per cent compared to the average annual growth rate of 5.9 per cent during 'eighties.
- The growth trajectory of the economy had shifted during eighties to an average of 5.9 per cent per annum from about 3.5 per cent per annum during the previous three decades (1950-80).
- On average, the first five Plans (five yearly) during 1951 to 1979 (after independence in 1947) achieved 3.5 per cent annual growth rate for the economy. The subsequent three five year plans have achieved increasing growth rate, the 8th Five Year Plan having achieved 6.9 per cent per annum.

1.2.2 Trends in Structural Composition

'The developmental experience of the Indian economy has been different from that of the presently developed countries, as the share of services sector in GDP surpassed that of the agricultural and the industrial sectors in a relatively short span of time. In other words, the economy leap-frogged from the stage of lower order of value addition generally associated with agriculture sector to the

higher level value addition for by the services sector' (RBI, 1999). Important structural changes in the Indian economy are:

- Services sector accounted for 52.3 per cent of the GDP in 1999-2000. Agriculture and allied sector was 25.5 per cent and industry 22.2 per cent of the GDP during the year.
- The structural transformation of the Indian economy is sharp in terms of a significant increase in the share of services sector crossing 50 per cent mark in second half of 'nineties from 40.9 per cent in early 'eighties.
- Agriculture and allied sector is now down to 25.5 per cent from 37.2 per cent in early eighties. There is no significant change in the share of industry sector during the last two decades except for some increase during early 'nineties.
- During the initial years of planning immediately after independence in 1947 agriculture and allied sector was 51.9 per cent of GDP.

Table 1.1 (a) Indian Economy : Growth Rate

(Growth in GDPfc at constant prices)

	Year/Period	*Per cent*
Post Reform		
	1999-2000	**6.4**
	1997-98 to1999-2000 (3 yrs. average)	6.0
	1994-95 to 1996-97 (3 yrs. average)	7.3
	1992-93 to 1999-2000 (8 yrs. average)	6.4
	1991-92	0.8
Pre Reform		
	1990-91	5.4
	1980-81 to 1989-90 (eighties)	5.9
Historical		
	1970-71 to 1979-80 (seventies)	2.9
	1960-61 to 1969-70 (sixties)	4.0
	1951-52 to 1959-60 (fifties)	3.6

Source : CSO, RBI. See end note for sources of tables on macroeconomic trends.

(b) Growth Rates during Five Year Plans

Plan	I	II	III	IV	V	VI	VII	VIII
Period	**(1951-56)**	**(56-61)**	**(61-66)**	**(69-74)**	**(74-79)**	**(80-85)**	**(85-90)**	**(92-97)**
Ave.Annual Growth rate (%)	3.6	4.3	2.8	3.4	4.9	5.7	6.0	6.9

(c) Growth Rates : International Comparision

(GDP growth rates in percent)

Select Countries	1980-90	1990-99	County groups	1980-90	1990-99
India	**5.8**	**6.1**	Low income	4.4	2.4
China	10.1	10.7	Middle Income	3.2	3.5
Pakistan	6.3	4.0	Low and Middle Income	3.4	3.3
Indonesia	6.1	4.7	East Asia & Pacific	8.0	7.4
Thiland	7.6	4.7	Europe & Central Asia	2.4	-2.7
Malaysia	5.3	6.3	Latin America & Caribbean	1.7	3.4
Brazil	2.7	2.9	Middle East & North Africa	2.0	3.0
Korea, Rep.	9.4	5.7	South Asia	5.7	5.7
Japan	4.0	1.4	Sub-Saharan Africa	1.7	2.4
USA	3.0	3.4	High Income	3.1	2.4
			World	**3.2**	**2.5**

Source : World Bank, World Development Report 2000-2001

Table 1.2 (a) Indian Economy : Trends in Structural Composition

Industry/Sector	Post Reform 1999-2000[1]	1993-94 to 1998-99	1990-91 to 1994-95	Pre-Reform 1985-86 to 1989-90	1980-81 to 1984-85	Historical 1965-66 to 1975-76	1950-51 to 1964-65
	(At 1993-94 prices, Revised)						
1 Agriculture and Allied	**25.5**	**28.2**	**29.9**	**32.6**	**37.2**	**42.9**	**51.9**
of which :	(1.3)	(4.0)					
1.1 Agriculture	..	..	27.8	30.1	34.0	38.0	46.4
2 Industry	**22.2**	**21.8**	**25.0**	**24.1**	**22.0**	**19.2**	**15.1**
of which :	(7.5)	(8.3)					
2.1 Manufacturing	17.5	17.0	20.6	20.2	18.5	16.6	13.3
	(8.5)	(9.1)					
3 Services	**82.3**	**50.1**	**45.1**	**43.3**	**40.9**	**37.9**	**33.0**
of which :	(8.7)	(7.9)					
3.1 Trade, Hotel etc., Transport & Communications	21.4	22.7	18.3	17.8	16.8	14.6	4.2
		(6.7)	(8.9)				
3.2 Finance, Insurance, Real Estate, Business, etc.	12.5	11.2	11.2	9.8	8.9	8.3	8.6
		(10.6)	(7.5)				
4. GDP (at factor cost)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	
	(6.4)	(6.4)	(6.9)				

Note : Figures in parenthesis are annual growth rates. 1 - Revised Estimates.
Trend growth rate for 1993 to 1999. (See end note for sources)

(b) Structure of output : International Comparision

(Value added as % of GDP in 1999)

Select Countries/ Countries Groups	Agriculture	Industry	Manufacturing	Services
India	**28**	**25**	**16**	**46**
China	17	50	24	33
Indonesia	20	45	25	35
Thailand	13	40	32	49
Malaysia	14	44	35	43
Low Income	27	30	18	43
Middle Income	10	36	23	55
High Income	2	30	21	64
World	**4**	**32**	**21**	**61**

Source : World Bank. World Development Report : 2000-2001

1.2.3 Indian Economy : Savings & Investments

- In 1999-2000 domestic saving and investment in the Indian economy is expected to be around 23 per cent with a gap of about 1 per cent as implied from the available indicators. (Official estimates on saving and investment are available with a one year time lag).

- In 1998-99 overall saving and investment rates declined significantly at around 23 per cent with a gap of 1.0 per cent from a peak of around 26 per cent in 1995-96 as also from the annual average rates during the period 1993-94 to 1997-98.
- The trends in saving-investment over a longer period show some structural changes:
  (a) Household saving rate has increased to around 18.5 per cent during 1990s (it was 19.8 per cent in 1994-95) compared to 15.7 per cent during 1980s. During the first three five year plans (1950-51 to 1967-68) it was only 8.4 per cent on average.
  (b) Household financial saving rate has outstripped the physical saving rate during 'nineties. It had remained lower than the physical saving rate particularly during first 25 years of the planning era since 1950-51. This is indicative of increased financial intermediation, widening and deepening of the financial system as well as the movement of relative rates of return on assets of the household sector's portfolio (RBI, 99).
  (c) An important structural transformation during nineties over eighties is the sharp jump (almost double) both in the saving and investment rates of the **private corporate sector:** saving rate from 1.9 per cent to 3.9 and investment rate from 4.3 per cent to 7.9 per cent. Of late, (from 1995-96) the private corporate sector investment rate has outstripped the public sector investment rate. This indicates the impact of the reform measures, liberalization, and unshackling of the private sector in the Indian economy during the 'nineties.
  (d) Investment rate in the **public sector** is significantly down to 7 per cent only in 1998-99 from an average of 8.1 per cent during 1993-94 to 1997-98 and 10 per cent during 'eighties. On the other side, the **saving rate has hit the bottom in 1998-99, being almost negligible.** This is mainly due to the increased dis-saving of Government administration. Thus there has been no respite for the public sector borrowing requirements during nineties compared to the previous decade.

Table 1.3 (a) Indian Economy : Saving and Investment

(as percentage of GDP at current market-prices)

	Revised		Pre-Reform		Historical	
	1998-99	1995-96	1993-94 to 1997-98 (5 yrs.)	1980-81 to 1990-91 (11 yrs.)	1968-69 to 1975-76 (17 yrs.)	1950-51 to 1967-68 (17 yrs)
Gross Domestic Saving	**22.3**	**25.5**	**23.5**	**20.4**	**16.2**	**11.9**
Public	Neg.	2.0	1.3	2.8	3.0	2.2
Private Corporate	3.8	5.0	3.9	1.9	1.5	1.3
Household	18.5	18.5	18.4	15.7	11.7	8.4
Financial Saving	10.9	8.9	10.1	7.4	3.6	2.5
Physical Saving	7.6	9.6	8.2	8.3	8.1	6.0
Gross Domestic Investment	**23.4**	**27.2**	**24.8**	**22.5**	**16.9**	**13.7**
Public	7.0	7.8	8.1	10.0	7.2	5.8
Private Corporate	8.3	9.6	7.9	4.3	2.6	2.4
Household	8.1	9.8	8.8	8.2	8.1	5.9
Saving Investment Gap	**-1.0**	**-1.8**	**-1.3**	**-2.1**	**-0.7**	**-1.8**
Public	-6.6	-5.6	-6.8	-7.2	N.A.	N.A.
Private Corporate	-4.5	-4.6	-4.0	-2.4	N.A.	N.A.
Household	10.1	8.4	9.5	7.5	N.A.	N.A.

Source : See end note.

(b) Saving and Investment : International Comparision

(Percentage of GDP)

Countries/Groups	Gross Domestic Savings		Gross Domestic Investment	
	1990	**1999**	**1990**	**1999**
India	**22**	**20**	**25**	**24**
China	38	42	35	40
Indonesia	33	24	31	14
Thailand	34	32	41	21
Malaysia	36	45	34	32
Brazil	21	20	20	21
Korea Rep.	37	34	38	27
Low income countries	21	19	24	20
Middle income	27	26	26	24
High Income	23	22	23	21

Source : World Bank. World Development Report 2000-2001.

1.2.4 Agriculture

The performance of agriculture sector in India is even now dependent on the **extent of normalcy** of the monsoon rain fall. Last five year's food grain production levels show the oscillations and a lack of any trend particularly during 1995-96 to 1997-98. Trends in foodgraings production over a longer period are as follows :

- Growth rate in foodgrains production during 'nineties has been distinctly lower than that in the 'eighties.
- Based on all crop Index numbers of agricultural production (base : triennium ending 1981-82=100), the annual compound growth rate

averaged 1.7 per cent during 'nineties (1990-91 to 1997-98) compared to 3.5 per cent during 'eighties.

- Output expansion of Rice has decelerated during 'nineties compared to 'eighties. Growth rate in Wheat production has decelerated to 3.7 per cent during nineties compared to 4.2 per cent during 'eighties.
- Growth rates in output of coarse cereals has continued to decelerate for a long period.
- Output growth rate for pulses has come down sharply during 'nineties.

Table 1.4 (a) Foodgrains Production

	(Million Tonnes)
1999-2000	205.9
1998-1999	203.0
1997-1998	192.3
1996-1997	199.4
1995-1996	180.4

(b) Annual Compound Growth Rates of Foodgrains Production

(Base Triennium ending 1981-82 = 100)

(per cent per annum)

	Foodgrains	Rice	Wheat	Coarse cereals	Pulses
Post-Reform					
1990-91 to 1997-98	1.66	1.53	3.67	(-)0.49	0.76
Pre-Reform					
1980-81 to 1989-90	3.54	4.29	4.24	0.74	2.78
Historical					
1970-71 to 1979-80	2.08	1.91	4.69	0.74	-0.54
1960-61 to 1969-70	1.72	-8.05	5.90	1.48	1.35
1950-51 to 1959-60	3.22	3.28	4.51	2.75	2.72

Source : Economic Survey, 1998-99 and 1999-2000.

1.2.5 Industry

Industrial production in 1999-2000 increased by 8.2 per cent after growing at a subdued rate of 5.4 per cent on average during the 3 year period of 1996-97 to 1998-99. In 1995-96 the growth rate achieved was 12.8 per cent [Table 1.5(a)]

Over the past three decades, the industrial sector has not shown any definitive trend either in its growth rate or in its contribution to GDP (RBI, 1999):

- In **'nineties** (upto 1998-99), the annual average growth rate has been 5.8 per cent with an increased volatility. It ranged between an absolute fall of 1.9 per cent in 1991-92 to an increase of 12.9 per cent in 1995-96.
- In **'eighties,** the average annual growth rate was 7.8 per cent. It ranged between a low of 1.4 per cent in 1980-81 to a high of 11.2 per cent in 1989-90.

- In **'seventies,** the average annual growth rate was 4.4 per cent. It ranged between (-)2.6 per cent in 1979-80 to 11.6 per cent in 1978-79.

An important structural change indicated by the trends in relative contribution of different industry groups to industrial production is that during the 'nineties, the relative contributions of basic and capital goods sectors declined with a rise in those of intermediate and consumer goods sectors as shown below:

Table 1.5 (a)Relative Contribution of Sectors to Industrial Production
(Use-based Classification)

(Per cent)

	Sector	1981-82 to 1990-91 (Average)	1992-93 to 1998-99* (Average)
(i)	Basic Goods	43.6	35.8
(ii)	Capital Goods	25.0	7.1
(iii)	Intermediate Goods	14.6	35.2
(iv)	Consumer Goods	16.8	21.9
	General Index	**100.0**	**100.0**

* The data relating to 1991-92 were excluded in this period because production was almost stagnant.

Note : The relative contribution is computed as the ratio (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relative industry group.

Source : RBI, Report on Currency and Finance, 1998-99 (Page IV-3).

Infrastructure Industries : There are some encouraging signs of growth (7.7%) in infrastructure industries during 1999-2000, compared to the previous two years (3.9%) and during 1992-97 (5.3%) as shown in **Table 1.5(b).**

Table 1.5 (b) Industrial Production

(Annual Average Growth Rate)

(Percent)

	Post Reform		Pre Reform	Historical*	
	1999-2000(P)	1991-92 to 1998-99	1981-82 to 1990-91	1965-66 to 1979-80	1950-57 to 1965-66
General Index	**8.2**	**5.8**	**7.8**	**4.0**	**7.7**
(a) Manufacturing	9.3	5.9	7.6	3.6	7.8
(b) Electricity	6.6	6.8	9.0	8.7	12.7
(c) Mining and Quarrying	0.7	3.0	8.3	3.4	5.1
Use Based :					
(a) Basic Goods	5.1	6.2	7.9		
(b) Capital Goods	5.4		3.0	11.5	
(c) Intermediate Goods	15.4		7.7	5.9	
(d) Consumer Goods	5.4		5.5	6.7	
(i) Durables	13.3	7.9	13.9		
(ii) Non-Durables	3.2	5.0	5.5		

*Trends growth underlying the Index of Industrial Production. (P) Provisional

Source : See end note.

Table 1.5 (c) Infrastructure Industries

(Annual Average Growth Rate)

(Per cent)

Industry	Weight	Post-Reform				Pre-Reform
		1999-00	1998-99	1997-98	1992-97 (8th Plan)	1985-90 (7th Plan)
Electricity generation	10.2	**7.1**	6.6	6.6	6.6	9.4
a. Thermal (incl. Nuclear)		**9.2**	5.7	6.2	8.8	12.3
b. Hydro		**-2.6**	10.9	8.4	-0.8	3.5
Coal	3.2	**3.0**	-2.0	3.6	4.5	6.4
Steel	5.1	**12.5**	-2.0	0.6	5.7	5.3
Crude oil	4.2	**-2.2**	-2.8	2.8	1.4	3.3
Refinery throughput	2.0	**25.3**	5.2	3.6	4.0	8.0
Cement	2.0	**14.0**	5.6	9.1	8.0	8.7
Fertilizers	2.1	**4.8**	3.7	17.1	3.0	11.1
Total	**28.8**	**7.8**	**2.4**	**5.4**	**5.3**	**7.6**

1.2.6 Money, Credit and Prices

Monetary Aggregates

- Broad Money growth at 16.4 percent in 1999-2000 was lower than the growth rate of 18.2 per cent in the previous year.
- Over a longer period broad money has grown with a trend rate of slightly above 17 per cent. It was 17.3 per cent during 'nineties, 17.2 per cent during 'eighties and 17.5 per cent during 'seventies.

Box : 1.2

Trends in Monetary Variables : The Links

- Trends in monetary aggregate alone or in isolation do not reveal much unless seen in relation to credit or prices.
- Also, it is the composition and sources of money which matter rather than simple monetary aggregates.
- It is the variation in the monetary aggregates which matter rather than the stock, if trends are to be analysed.
- Further, it is the average of levels during a period rather than point to point change in the level, which is more relevent because the monetary variables change on day-to-day basis - at times significantly.
- Finally, there are significant conceptual differences in the coverage of monetary aggregates both inter-temporal as well as inter-country comparisons.

Credit Aggregates

- Trends in net domestic credit and more importantly non-food credit to the commercial sector, show that the growth rate in net domestic credit has slowed down and has been lower at about 14 per cent during 'nineties compared to the trend growth rate of 18.5 per cent (higher than M3 growth rate) in 'eighties and 17.2 per cent in 'seventies.

Structural Shifts

- Some structural changes brought about by the financial sector reforms tend to explain the emerging trends in the lower growth of credit during 'nineties.
- The share of domestic credit (DC) in M3 declined from 116.8 per cent in the 'eighties to 101.7 per cent in the nineties (of which the net bank credit to government declined from 49.1 per cent in the 'eighties to 45.0 per cent in the 'nineties), while the percentage share of Net Foreign Exchange Assets (NFA) increased from 3.7 per cent in the 'eighties to 12.1 per cent in the nineties. This was because of a substantial capital inflow during the nineties.
- There has been a significant change in the composition of reserve money during 'nineties.
- A sharp deceleration in the net RBI credit to the Centre from an annual average of 20 per cent during the, 'eighties to 8.3 per cent during the 'nineties and sharper acceleration in the RBIs net-foreign exchange assets from an annual average of 6.4 per cent to 47.6 per cent during the same period.
- In the 'eighties the bank credit growth was mostly driven by trends in the govt. deficit. Net bank credit to the government expanded at rate of 20.4 per cent as against 15.0 per cent in the 'seventies. Bank credit to commercial sector, on the other hand, decelerated to 17.2 per cent from 18.9 per cent during the same period.
- During the 'nineties, apart from a decline in the growth rate of net bank credit to the government, the growth rate in non-food credit by the commercial banks has also declined (from 18 per cent in 'eighties to 15.0 per cent in 'nineties).
- This reflects two factors: (i) the switch in the asset portfolio of banks to relatively risk free assets like government securities, in the wake of introduction of stringent prudential and asset classification norms, and (ii) availability of alternative instruments/avenues for raising resources by corporate.

Table 1.6 (a) Major Monetary and Banking Aggregates

(Average of Months)

(Average Annual Growth Rates) (Per cent)

	Post Reform			Pre Reform		Historical
	1999-2000	1998-1999	1992-93 to 1998-99	1990-91 to 1991-92	1980-81 to 1989-90	1970-71 to 1979-80
Net Domestic Credit (1+2)	**---**	**16.1**	**13.8**	**15.7**	**18.5**	**17.2**
1.Net Bank Credit to the Government	15.1	18.1	13.2	19.1	20.4	15.0
i)Net RBI Credit to the Government	5.3	18.7	6.7	18.7	21.9	12.2
ii)Other Banks' credit to the Government	21.7	17.9	21.4	19.7	18.6	21.0
2.Bank Credit to Commercial Sector	16.2	14.6	14.4	13.1	17.2	18.9
i)RBI Credit to the Commercial Sector	24.9	13.5	6.4	9.4	13.8	36.9
ii)Other Bank credit to the Commercial Sector	16.4	14.6	14.6	13.3	17.4	18.5
a)Food Credit of Scheduled Commercial Banks	NA	26.2	20.8	97.9	-0.2	42.2
b)Non-food Credit of Scheduled Commercial Banks	15.5	14.4	15.9	12.0	18.0	17.6
Memo Items:						
Reserve Money	11.9	12.2	14.1	16.5	16.5	14.5
Aggregate Deposits	17.4	21.9	17.8	16.9	18.1	20.4
Broad Money (M_3)	17.1	19.7	17.4	16.9	17.2	17.5

Source : See end note.

Trends in Prices

'In India the long-term inflation rate as measured by the variation in the Wholesale Price Index (WPI) on an average basis remained in the range of 8 to 9 per cent (during the period 1970-71 to 1998-99) and the median inflation rate stood at 7.5 per cent for the 'eighties and 8.0 per cent during the 'nineties. The mean inflation rate stayed at 8.0 per cent during the 'eighties against 8.8 per cent during 1990-91 to 1998-99.' (RBI, 1999).

The period from 1995-96 presents a characteristically different price environment in the Indian economy. Not only the inflation has shown a significant deceleration, but also the trend has been maintained for the past five years, with the exception in 1998-99. The rate of inflation declined to 7.7 per cent in 1995-96, to 6.4 per cent in 1996-97, and further to 4.8 per cent in 1997-98. In 1998-99 however, it was 6.9 per cent. On the average of weekly basis, the inflation rate during 1999-2000 moved down to 3 per cent.

The long term trend in inflation shows a significant year to year deviation. During 'seventies the annual rate of inflation ranged between minimum of (-)1.1 per cent to 25.2 per cent. During 'eighties the range was from 4.4 per cent to 18.2 per cent. This has further reduced during 'nineties since 1992-93 [Table 1.6(b)].

Divergence between WPI and CPI : An important aspect of the inflation trend in the 'nineties has been the increase in the divergence of inflation as measured by the consumer price index for industrial workers (CPI-IW) from that measured by the WPI. The CPI inflation increased from 9 per cent during the eighties to 9.9 per cent during the ‘nineties. The average differential of the consumer price inflation and the wholesale price inflation has increased from 1.1 percentage point in the 'eighties to 1.7 percentage points in the 'nineties (in fact it was 6.2 percentage points in 1998-99). Important reasons for the wide differential between WPI and CPI are the difference in the coverage, weighting diagram and methodology of computation. The food group, for example has 27.5 per cent weight in the WPI as against 57 per cent in the CPI-IW.

Table 1.6 (b) Trends in Prices

(Per cent)

	Post Reform			Pre Reform	Historical		
Indices	**1999-2000**	1992-93 to 1998-99 (8 yrs.)	1990-91 to 1991-92 (2 yrs.)	1980-81 to 1989-90	1970-71 to 1979-80	1960-61 to 1969-70	1951-52 to 1959-60
WPI (All Commodities)	**3.3**	7.9	12.0	8.0	9.0	6.3	1.2
(Maximum)		(10.9)		(18.2)	(25.2)	(14.0)	(13.8)
(Minimum)		(4.8)		(4.4)	(-1.1)	(-1.0)	(-12.7)
CPI							
Industrial Worker (IW)	**4.8**	9.5	12.6	9.0	7.7	5.9	2.14
Urban non-manual	**5.0**	9.1	12.4	7.8	7.2	N.A.	N.A.
Agricultural Labour	**3.4**	8.8	13.4	8.1	6.7	N.A.	N.A.

Source : See end note.

Interest Rates

Prime lending rates (PLR) of banks and financial institutions were around 12.5 per cent during 1999-2000. PLR concept was introduced with effect from 1994. Since April 1998 banks were given the freedom to determine the interest rates on loans upto Rs. 0.2 million subject to small borrowers being charged at rates not exceeding the PLR.

The 'Bank Rate' (anchor rate of Central Bank) was reactivated in 1997 with deposit rates (upto one year maturity) initially linked to it. Since July 21, 2000 it is 8 percent. Interest rates on loans above Rs. 0.2 million were freed in October 1994. Earlier the interest rate structure was rationalized reducing it to six categories in April 1992 and three in April 1993. Also, beginning from 1992-93, interest rate in government securities market was progressively deregulated, with the introduction of an auction system. Prior to 1992-93 the administered interest rate structure was quite complicated.

1.2.7 Fiscal Trends

Fiscal imbalances

Trends in fiscal balances have been highly prominent in any macroeconomic analysis.

- Central government's fiscal deficit for the year 1999-2000 (Revised estimates) was 5.64 per cent of GDP.
- State governments fiscal deficit budgeted for 1999-2000 was at its historic high at 4.71 per cent of GDP.
- The combined fiscal deficit of the government was 9.84 per cent of GDP in 1999-2000 which is only marginally lower than the level in 1990-91 (10.0 per cent) which was a crisis year.
- In the first two years after 1990-91 fiscal corrections were visible through reduction in deficits.
- Historically, there was a consistent trend of increase both in revenue deficit and fiscal deficit in the Central government budgets after 1970's. State governments were in revenue surplus even during the first half of 'eighties.

Table 1.7 (a) Fiscal Trends : Deficit and Debt

(As percentage of GDP)

	Post-Reform					Pre-Reform			Historical	
	1999-2000 (RE)	1998-99	1997-98	1996-97	1991-92 to 1995-96 (5 yrs)	1990-91	1985-86 to 1989-90 (5 yrs)	1980-85 to 1984-85 (5 yrs)	1975-76 to 1979-80 (5 yrs)	1970-71 to 1974-75 (5 yrs)
Fiscal Deficit										
Centre	5.64	6.43	5.87	4.90	6.08	8.33	8.21	6.26	4.64	3.44
States	4.71	4.23	2.93	2.79	3.01	3.51	3.15	2.94	2.07	2.21
Combined*	9.84	8.99	7.32	6.40	7.60	10.00	9.44	7.60	5.40	4.50
Revenue Deficit										
Centre	3.81	3.85	3.06	2.40	3.04	3.47	2.58	1.11	(-)0.32	(-)0.31
States	2.96	2.57	1.22	1.34	0.70	0.99	0.26	-0.43	-0.21	-0.04
Combined*	6.77	6.43	4.28	3.73	3.73	4.46	2.84	0.67	-1.53	-0.35
Debt**										
Centre	52.90	50.60	46.20	44.10	48.82	52.85	50.24	38.20	31.69	30.62
States	21.50	19.40	18.00	17.30	18.82	20.59	20.66	17.85	17.83	19.49
Combined (Net)	60.70	55.50	53.50	51.00	55.72	56.20	56.33	43.12	36.79	35.86

*Combined deficits are not the totals of Central and State deficits.
(a) Combined GFD is the GFD of Central budget *plus* GFD of State budgets *minus* net lending from the Central government to State governments.
(b) Combined RD is adjusted for inter-governmental transactions in the revenue account.
** Debt here refers to total internal liability of the Government. Combined debt is net of inter-Govt. debt adjustments.
Source : See end note.

Domestic Debt

Sustainability of debt has been a major issue in analysing the trends in government finances.

- The nominal stock of domestic debt of the combined Government sector has been growing at a rate of about 16 per cent during the later part of the 1990s

reaching to 60.7 per cent of GDP at end-March 2000 as against 55.5 per cent at end March 1999 and 56.12 per cent at end March 1991.

- Central government's debt as per cent of GDP was about 53 per cent at end 1999-2000 almost the same level as in 1990-91. State government's Debt GDP ratio for State governments at 21.50 per cent in 1999-2000 was about a percentage point higher than the level at end 1990-91.
- Historically, there was a sharp increase in the Central government's debt from about (on average) 31 per cent of GDP, in 'seventies to about 50 per cent during the second half of 'eighties. State governments' debt had not increased significantly during the similar period.

Receipts and Expenditures

Receipts

- Central government's gross tax revenue/GDP ratio has fallen by almost 2 percentage points to 8.80 per cent in 1999-2000 from 10.75 per cent in 1990-91. State's own tax revenue/GDP ratio however, has not fallen significantly during the same period.
- Historically tax/GDP ratio both for the Central govt. and for the State Governments had shown about 2 percentage point increase from the first half of seventies to the second half of 'eighties.
- Central government's revenue receipts (net of tax share to States) including tax+non tax revenue at 9.29 per cent of GDP in 1999-2000(RE) was lower by about one percentage point compared to 1990-91 (the crisis year).
- States' revenue receipts including share in Central taxes and grants and non-tax revenue as per cent of GDP in 1999-2000 was lower at 10.86 per cent by almost two percentage points from the average of first half of nineties (1991-92 to 1995-96) and even from the average of such ratio in the second half of 'eighties.

Table 1.7 (b) Fiscal Trends : Receipt and Expenditure

(As percentage of GDP)

	Post-Reform					Pre-Reform			Historical	
	1999-2000 (RE)	1998-99	1997-98	1996-97	1991-92 to 1995-96 (5 yrs)	1990-91	1985-86 to 1989-90 (5 yrs)	1980-85 to 1984-85 (5 yrs)	1975-76 to 1979-80 (5 yrs)	1970-71 to 1974-75 (5 yrs)
Centre										
Gross Tax revenue	8.80	8.16	9.19	9.45	9.77	10.75	11.20	9.93	9.84	8.29
Net Revenue Receipts	9.29	8.48	8.83	9.27	9.96	10.26	11.11	9.43	10.05	8.37
Revenue Expenditure	13.10	12.34	11.90	11.67	13.70	13.73	13.69	10.69	9.73	9.83
Capital Expenditure	2.62	3.51	3.41	3.09	6.78	5.93	6.78	6.13	6.78	6.00
States										
Tax receipts (own)	5.38	4.87	5.17	5.04	5.54	5.63	5.67	5.18	4.73	3.75
Revenue Receipts	10.86	9.80	11.09	10.99	12.89	12.41	12.85	11.90	10.83	8.78
Revenue Expenditure	13.82	12.38	12.31	12.33	13.48	13.40	13.16	11.47	9.62	8.75
Capital Expenditure	1.95	1.87	2.08	1.89	3.26	3.61	3.21	3.79	4.68	4.18

Source : See end note.

Expenditures

- Central government's revenue expenditure as per cent of GDP was 13.10 per cent in 1999-2000. This had shown an increase over the previous 3 years but was lower by about 0.6 percentage points when compared to the first half of nineties and even during second half of eighties when, on average, it was about 13.70 per cent. This level was at its historic high since early seventies.
- State governments' revenue expenditure (BE) was 13.82 per cent of GDP in 1999-2000. Though it was 1.5 percentage points higher over the previous three years, the level was higher only by about 0.5 percentage point when compared to early nineties or even during second half of eighties when it was 13.16 per cent. This level was at its historic high since early seventies.

1.2.8 Foreign Trade

Trends in foreign trade have not been steady particularly during the second half of nineties.

- In 1999-2000 India's exports increased by 13.2 per cent and imports by 11.4 per cent (both in US dollar terms).
- The growth rates for exports and imports during the last three years (prior to 1990-2000) on an average were very low. Export growth rate was 2.0 per cent and imports growth rate was 4.5 per cent during 1996-97 to 1998-99. This was broadly in line with unfavorable external developments.
- The significant changes in India's trade policy were reflected in the trade growth rates during 1992-93 to 1995-96 when exports had increased on average by 15.7 per cent and imports by 17.5 per cent.
- 1991-92 was an exceptional crisis year when exports had declined by 1.5 per cent and imports were compressed to reduce them by 19.4 per cent.
- On an average basis, exports during 'nineties (1992-93 to 1998-99) grew by 9.8 per cent compared to 8.2 per cent (with a wide annual variation) during eighties. Similarly, imports during 'nineties increased (average annual rate) by 12.0 per cent compared to 7.8 per cent during 'eighties.
- Historically, both exports and imports had recorded significantly high growth rates during seventies and very low growth rates during 'sixties and 'fifties.

Trade-GDP Ratio

- India's trade-GDP ratio has shown significant improvement. On an average basis, export-GDP ratio increased to 8.2 per cent during 'nineties (1992-93 to 1998-99) from 5.0 per cent during 'eighties. Import-GDP ratio also increased to 9.4 per cent from 7.7 per cent between these two periods.

Export-Imports Ratio

- On an average basis the export-import ratio has increased substantially from 65.1 per cent during eighties to 87.0 per cent during nineties.

Table 1.8 Foreign Trade

	Growth Rate (% per annum)		Export/ GDP Ratio (per cent)	Import/ GDP Ratio (per cent)	Export- Import Ratio
	Export	Import			
1999-2000	13.2	11.4	8.5	12.3	79.6
Average :					
1996-97 to 1998-99 (Three years)	2.0	4.5	8.3	9.9	83.4
1992-93 to 1995-96 (Four years)	15.7	17.5	8.1	9.0	89.7
1991-92	-1.5	-19.4	7.1	7.8	92.0
1980-81 to 1990-91	8.2	7.8	5.0	7.7	65.1
(Max)	(24.1)	(40.5)	N.A.	N.A.	N.A.
(Min)	(-9.9)	(-5.9)	N.A.	N.A.	N.A.
Historical					
1970-71 to 1979-80	15.8	20.1	6.8	6.7	N.A.
1960-61 to 1969-70	3.5	0.8	3.6	1.7	N.A.
1951-52 to 1959-60	1.2	6.9	0.3	5.4	N.A.

Source : See end notes.

Structural Changes

- There have been significant structural changes in India's external trade during the 'nineties over 'eighties and earlier period in terms of shift away from traditional items of exports to manufactured items, increase in relative share of imports of certain capital goods, edible oils, manufactured fertilizers and a sharp increase in imports of gold and silver during 'nineties compared to 'eighties.
- Recent trends in imports include sharp and significant variations partly due to (a) imports of gold and silver which despite a decline in 1999-2000 by 3.2 per cent accounted for 9.3 per cent (US $4.4 billion) of total imports during the year, and (b) variations in oil prices increase in which resulted to 68.7 per cent growth in POL imports during 1999-2000 compared to a decline by 11.3 per cent in the previous year. Similarly, trends in exports include sharp variations due to a significantly high growth rate in India's software exports ($4 billion in 1999-2000) which averaged around 50 per cent per annum since 1995-96.

1.2.9 Balance of Payments

Trends in the key indicators of balance of payments have shown a comfortable position in the external sector of the Indian economy.

Current Account Deficit (CAD)

- The CAD/GDP ratio has, **on an average,** remained comfortable at just above 1 per cent during the 'nineties after having reached at 3.2 per cent in 1990-91. It was, on average, 2.3 per cent in the second half of 'eighties and 1.6 per cent in the first half of 'eighties.
- The reduced CAD/GDP ratio is mainly because of a significant contribution of invisibles' surplus during the 'nineties:

Invisibles

- Private transfers-the single largest source of invisible earnings were 2.5 per cent of GDP during 'nineties (1993-94 to 1998-99) compared to average 1.4 per cent and 1.0 per cent during the first half and the second half of 'eighties, respectively.
- The average growth rate in total invisible receipts was significantly high at 18.8 per cent during 1993-94 to 1998-99 compared to only 1.7 per cent during the second half of eighties. Invisible payments growth could be contained to an average rate of 14.9 per cent compared to 14.1 per cent during the similar period.
- Invisibles' (net) contribution to the current account of the balance of payments has nearly trebled from an average of 0.8 per cent of GDP in the second half of eighties to 2.2 per cent in 1998-99 and 2.9 per cent in 1999-2000.

Capital Account : Important trends

- Net capital inflows have more than doubled from an average of US $4.0 billion during the 'eighties to an average of US $8.7 billion in the 'nineties since 1993-94.
- The proportion of non-debt flows in total capital flows has risen from about 5 per cent in the later half of the 'eighties to about 43 per cent during 1990-99.
- Cumulative foreign equity investment since 1990-91 has risen to US $29 billion-an increase of almost 10 folds over the outstanding stock of 1990.
- FDI inflows have averaged about US $2.9 billion in the recent period during 1996-99. Portfolio flows were US $1.7 billion during the same period.
- External assistance has declined from 32 per cent of net capital inflows in the second half of eighties to a little less than 10 per cent in the recent 3 years period 1996-99. The share of external commercial borrowings in total capital flows has increased from 26 per cent to 38 per cent during the similar period.

External Debt

- External debt-GDP ratio has been on a declining trend: from a peak of 41.0 per cent in March 1992 to 23.7 per cent in March 1999.
- The Debt service ratio has declined from a peak of 35.5 per cent in 1990-91 to 18 per cent in 1998-99.

- Short-term debt as a proportion of the country's foreign exchange reserves was only 13.3 per cent at end March 1999 compared to 189.3 per cent at end March 1990.
- Concessional debt has declined from 46.7 per cent of total debt at end March 1990 to 37.9 per cent at end March 1999.

Reserves

- Foreign currency assets of RBI had declined from US $5.5 billion at end March 1985 to US $2.2 billion at end March 1991 and to **an all time low of US $975 million** on July 12, 1991. **At end June 1999** these were US $ 30.6 billion.
- In terms of months of import cover, the foreign currency assets now cover imports for 8.2 months compared to **barely a fortnight** during July 1991, 1.1 months at end March 1991 and 4.2 months at end March 1985.

Exchange Rate :

- The exchange rate of the Indian rupee *vis-à-vis* the US$ averaged Rs. 43.44 during 1999-2000 indicating a depreciation of about 2.9 per cent over that of Rs. 42.07 during the previous year. The real effective exchange rate (REER) however, depreciated by 1.2 per cent only.
- In the past seven years since the introduction of the market based exchange rate system, the country has had a variety of episode of long periods of excessive inflows putting upward pressure on exchange rate followed by short spells of drying up of capital flows and the consequent speculative pressures necessitating correction in the exchange rate mainly through Central Banks' intervention.
- The exchange rate regime had transited from a basket linked managed float to market based system in March 1993 via a transitional phase of duel exchange rate between March 1992 and February 1993.

Table 1.9 Key Indicators of Balance of Payments

		Post Reform		Pre Reform		
	1999-2000	1998-99	1995-96	1990-91	1984-85 to 1989-90	1980-81
(*As per cent of GDP*)						
Current Account Deficit	**0.9**	**1.0**	**1.6**	**3.2**	**2.3**	**1.6**
Invisibles (Net)	2.9	2.2	1.5	-0.1	0.8	2.1
Private transfers (Receipts)		2.5	2.4	0.7	1.0	
Investment income (Payments)		1.3	1.3	1.4	0.8	
Capital Account Surplus		**2.0**	**1.3**	**2.4**	**2.3**	
Foreign Investment	1.1	0.6	1.3	0.03	0.1	0.0
of which :						
Direct		0.6	0.6	0.3	0.1	
Portfolio		0.0	0.7	0.00	0.0	
Debt Flows		1.3	0.7	2.0	2.0	
of which :						
Commercial Borrowings		1.1	0.4	0.8	0.6	
External Assistance		0.2	0.3	0.7	0.7	
Overall Balance		**1.0**	**-0.3**	**-0.8**	**-0.0**	
External Debt/GDP Ratio (%)	22.0	23.5	26.3	30.4		
Debt Service Ratio (%)	16.0	18.0	24.3	35.5		
Short term Debt (as % of reserves)	10.6	13.5	23.2	146.5		
Import cover of Res. (No. of Months)	8.2	8.2	6.0	2.5	3.4	4.1
Exchange rate Rupees per US $ *(Period Average)*	43.33	42.07	33.45	17.94	13.82	

Source : See end note.

1.2.10 Social Indicators

Trends in different social indicators present a mixed picture.

- Literacy rate is reported to be 62 per cent in 1997-up by 10 percentage points from 1990-91. It was 34.5 per cent in 1970-71 and just 18.3 per cent in 1950-51. However, some 69 million children between 6-14 years of age are still out of school.
- Life expectancy at birth at 62.4 years (1996 estimate)-up from 50.4 in 1980-81. It was just 32.1 in 1950-51. However, even now close to 2 million children die annually before their first birthday-and most of these deaths are avoidable.
- There is poverty of 'estimates on poverty' for the period beyond 1993-94. 36 per cent people (320 million) were below poverty level in 1993-94. This was a drop from 56.4% (321 million) in 1973-74. However, there is no poverty of debate on poverty estimates or poverty alleviation. The current debate on whether reforms have reduced poverty or not remains inconclusive in the lack of hard data beyond 1993-94. "Preliminary estimates based on data available for the

first six months of the National Sample Survey (NSS) full sample survey from July 1999 to June 2000 suggest that poverty has declined but the decline is much less than what was targeted." (Planning Commission, October 2000).

- Human development index has shown some improvement it being 0.563 in 1998 from 0.510 in 1990 and 0.431 in 1980. However, India ranks 153rd in HDI ranking out of the 174 countries.

Table 1.10 Indian Economy : Social Indicators

	Post Reform	Pre-Reform		Historical		
	Latest Year	1990-91	1980-81	1970-71	1960-61	1950-51
Life expectancy at birth (in yrs.)	62.4 (1996)	58.7	50.4	45.6	41.3	32.1
(a) Male		58.6	50.9	46.4	41.9	32.5
(b) Female		59.0	50.0	44.7	40.6	31.7
Infant mortality	72 (1998)	80	110	129	146	146
Literacy rate (%)	62.0 (1997)	52.2	43.7	34.5	28.3	18.3
(a) Male		64.1	56.5	46.0	40.4	27.2
(b) Female		39.3	29.9	22.0	15.3	8.9
Registered Medical Practitioners (per 10,000 population)	5.1 (1995)	4.7	3.9	2.8	1.9	1.7
Population (million)	965.6 (1997)	846.3	683.3	548.2	439.2	361.1

	1998	**1990**	**1985**	**1980**	**1975**
HDI	0.563	0.510	0.470	0.431	0.405
GDP per capita (1995 US$)	444	331	270	231	222
GNP Per capita PPP (US $)	1700				

Poverty (Official Estimates)

Year	**Poverty Ratio**			**No. of poor (million)**		
	Rural	Urban	Combined	Rural	Urban	Combined
1973-74	56.4	49.0	54.9	261.3	60.0	321.3
1977-78	53.1	45.2	51.3	264.3	64.6	328.9
1983	45.7	40.8	44.5	252.0	70.9	322.9
1987-88	39.1	38.2	38.9	231.9	75.2	307.1
1993-94	37.3	32.4	36.0	244.0	76.3	320.3

Source : See end note.

1.3 Economic Reforms : An Overview

It is by now almost a decade since the process of wide ranging economic reforms was initiated in 1991. Faced with a balance of payments and fiscal crisis, it was well recognized that the relatively higher growth trend during 1980s was not sustainable with the over dominance of public sector, widespread protective system for different sectors of the economy and most complicated regulatory mechanisms. A process of stabilization and structural adjustment was, therefore, initiated since July 1991. Wide ranging policy changes and reform measures were taken up. This has been a continuing process. Now after a decade, a second wave

of reforms is sweeping the discussions on the perspectives of the economy in the new century.

The literature on Indian economy is flooded with reviews of its economic reforms process particularly during the nineties (*see* Annex 1.1). While a detailed review and analysis of the economic reform measures in India is beyond the scope of this study, it may be of use to note some of the important features of economic reform measures; listout the major policy areas of economic reforms, take an overview of the macro economic developments during the post-reform era and identify the directions for future reforms, before looking forward towards the perspectives on Indian economy.

(a) Important features of economic reform measures since 1991.

The Goals of Economic Reform : The fundamental objective of economic reform is to bring about rapid and sustained improvement in the quality of life of the people of India. Central to this goal is the rapid growth in incomes and productive employment. Keeping these goals in view 'the objectives of medium term strategy are to improve the underlying strength of the economy, insure the economy against future crisis and further the fundamental development objective of growth with equity and self-reliance' (GOI, 1993).

Stabilisation and Structural Adjustment : The overall economic reform program was initiated when the Indian economy was amidst an unprecedented economic crisis of both external and internal financial imbalances. The first stage, therefore, was to stabilize the economy by reducing the fiscal deficit in the budget and reducing the current account deficit in the balance of payments. Medium and long-term changes in the policies to effect structural adjustment were initiated along with the stabilization measures.

Gradualism and Evolutionary Transition : "An important feature of India's reform program, when compared with reforms underway in many other countries, is that it has emphasized gradualism and evolutionary transition rather than rapid restructuring or '*shock therapy' "* (Ahluwalia, Montek S. 1994). The reform measures were initiated in the backdrop of a crisis but not a 'system collapse'. Also, the need for economic reforms was being felt even during 1980s when the imbalances were increasing and there were some attempts to liberalise the trade and investment control. However, the change effected were marginal, piecemeal, limited, and inadequate to change the systems in a major way.

Interlinkages and Comprehensiveness : The reform measures initiated have been comprehensive in terms of the scope and coverage to ensure the necessary inter-linkages between different parts of the system. Thus, changes in trade policy, industrial policy, exchange rate policy, etc., were initiated in such a way so as to ensure full impact on the system.

Designing Methodology: Most of the medium and long-term reform measures were designed on the basis of comprehensive studies and reports prepared by expert committees. Chelliah committee for tax reforms, Rangarajan committees on balance of payments, and on public sector enterprises disinvestment, Narismham committee on financial sector, and Malhotra committee on insurance sector are some of the prominent committees formed after initiating the stabilisation measures. The medium-term policy changes were initiated on the basis of recommendations of these committees. Also, the government issued 'discussion papers' on different aspects including the one on 'Economic Reforms: Two years after and the task ahead' (GOI, 1993).

(b) Major Policy areas of Economic Reforms.

The reform process has necessarily to express itself as changes in specific policy areas, affecting the economic system. Highlights of changes in important policy areas, having bearing on the economic system, are summarized below.

Policy Area	Indicative changes in the systems
Fiscal policy	Changes in the system of ❒ Streamlining and rationalizing the levels, structure, and procedures of the tax system. ❒ Changes in the financing pattern of the fiscal deficits through borrowings at market rates and reduced dependence on the system of monetising the deficits. ❒ Changes in expenditure pattern through reduced transfer payments on services, subsidies, budget support to public sector entities, etc.
Monetary policy	Changes in the system of ❒ preemption of resources from the banking sector by the government. ❒ priority sector lending by banks. ❒ provisioning and capital adequacy norms in line with international standards. ❒ interest rate deregulation. ❒ management practices of banking sector.
Capital market policy	Changes in the system of ❒ governing various aspects of the stock market by strengthening the regulatory institutions. ❒ approvals for foreign institutional investors. ❒ Indian companies borrowing abroad.

Trade policy

- ❒ System for licensing of imports, channelisation of imports and export subsidization dismantled or reduced to the bare minimum.
- ❒ The system of foreign exchange allocations through foreign exchange budgeting for imports, etc. dismantled completely.

Exchange rate policy

- ❒ Exchange rate determination system now totally market oriented.

Industrial policy and foreign investment

- ❒ The system of pervasive industrial and licensing abolished for all except select lists.
- ❒ The system of control and regulation of investment and expansion of capacity through Monopolies and Restrictive Trade Practices (MRTP) Act eliminated.
- ❒ System of foreign investment approvals streamlined, opened, and made easy.

Public sector policy

- ❒ Process of disinvestment of government equity in public sector companies initiated.
- ❒ The system of budgetary support to PSEs changed to phase out the support.
- ❒ Selective privatization of public sector activities in the process.

(c) An Overview of Economic Reforms:

Trends in the macroeconomic indicators for the economy as a whole (*see* Appendix 1.2) and for different sectors as given in part 1.1 of this chapter provide a macro view of changes in the Indian economy during the post-reforms era (1990s) over the pre-reform trends with an indicative backdrop of historical trends. An attempt is made here to provide an overview of economic reforms.

- The trend **growth rate** of GDP during the post-reform period is higher over the pre-reform period. However, this is not being considered adequate both in terms of the potentials of the economy and the need of a high growth in terms of a sustained, equitable and job creating growth path to banish the scourge of poverty within a decade - an objective set in 2000-2001 Budget speech of the Finance Minister.
- The inter-sectoral **composition of GDP** has shown a significant structural change after the initiation of reform process. The economy has leap-forged from the stage of lower order of value addition generally associated with the agriculture sector to the higher level of value addition accounted for by the services sector. This structural shift

has major policy implications for future. First, policy initiatives are required to make the services sector more efficient and competitive. Second, deregulation and major policy shifts are required for the agriculture sector to increase productivity and enhance its capacity to reduce poverty.

- The pace and pattern of technological change in **agriculture sector** has reduced during the post reform era mainly because agriculture sector, perhaps is the one which has experienced much less reform compared to other sectors. Agriculture sector is still constrained by widespread regulations over inter-state and even intra-state trade, public procurement system, controls on agro-processing industry and poor rural infrastructure.

Box 1.3
Agriculture Sector : Directions for Reforms

- Future agricultural growth could be speeded by policy and institutional reform in the sector, namely (a) changed pattern of spending to building up of capital assets and a reduction in distortionary subsidies; (b) deregulation of the processing sector and termination of the use of credit subsidy as a transfer mechanism; and (c) empowerment of the poor by improving their access to land and common resources, increasing their control over services and infrastructure in rural areas, and improved safety nets.
- The above-mentioned policy reforms would also help reduce poverty. For example, increased public spending on rural roads, agricultural technology improvement, and irrigation would all help reduce poverty. Growth in the rural non-farm sector would also benefit from improved infrastructure (roads, power, communications) and social services. More efficient and competitive markets can deliver better prices and greater market opportunities to farmers, without raising consumer prices, which would help farmers offset the impact of cuts in subsidies. Better markets together with futures markets and eased restrictions on commodity movements and private participation in international trade can help reduce price fluctuations.

Source : *Planning Commission, GOI (October, 2000)*
Mid Term Appraisal of Ninth Five Year Plan (1997-2002) (Page 74)

- **Industrial policy** has witnessed a significant policy shift during the reform era. Over a period widespread changes have been made in the policy to delicense the sector for investment purposes, deregulate the location compulsions, promote foreign direct investment, redifine the role of government and provide incentive for private sector investment in infrastructure sector and to restructure public enterprises including through disinvestment. However, the lack of infrastructure facilities, intermittent slow down in demand, some tax anomalies and general look of competitiveness continue to constrain the industrial sector to generate a consistent trend growth rate. To enhance the competitiveness in the industrial sector policy reforms on exit policy,

competition policy, research and development and finally effective and independent regulatory institutional mechanisms are being strongly advocated.

- A main thrust of economic reform measures initiated in 1991 was to open up the economy for attracting more private investment in **infrastructure sector**. Extensive policy, legal and institutional changes were made in all the sub-sectors like power, telecom, roads and posts. Notwithstanding some significant gains in the telecommunications where the privately financed services now compete with the public sector, some additions in power generation capacity through privately financed independent power projects and prospects of increased private investment in roads, posts etc., the quality, reliability and reasonably priced infrastructure facilities are still a major constraint in the overall economic growth of the economy. What is now required is a deepening of reforms of the private sector to make a full contribution to meeting India's infrastructure needs. (*See* Annex 1.2 for An Overview of Policy Recommendations of the Country Framework Report for India, under the Auspices of the World Bank Group's Infrastructure Action Program, with funding from the World Bank and the Japanese government).
- **External sector** of the Indian economy has undergone the most significant structural transformation during the current reforms period. A clear shift towards outward looking policy since 1991 (a sharp contrast of inward looking approach during the first three decades of plan period 1950 to 1980) has been at the core of economic reforms for globalization and international competitiveness. The reform process in the external sector included liberalization of trade, market determination of exchange rate, opening up of foreign investment, and gradual liberalization of capital account. These changes have made India's external sector comfortable for the economy as a whole, less vulnerable to external shocks and more competitive through market mechanisms. External trade is buoyant, foreign investment flow has increased, dependence on confessional aid has reduced, external debt has been consolidated, exchange rate is market determined and foreign exchange reserves level has continued to provide the much needed comfort against short-term demand supply mismatches. The continued need to remain vigilant over the international pressures particularly the fluctuations in oil prices and capital flows is perhaps the only major requirement in managing the external sector at least in the short term.
- **Fiscal reforms** were the integral and perhaps the most critical part of the overall economic reforms program. The fiscal stabilization measures

taken immediately after the crisis situation yielded significantly positive results in terms of reduction in fiscal deficit, control in expenditure and marked changes in the fiscal system particularly in the financing pattern of the deficits through reduction in magnetization. However, the continued structural imbalances in terms of falling tax buoyancy, nature of fiscal correction in terms of reduction in investment expenditure, increased interest burden owing to borrowings at market related rates, impact of enhanced salary of government employees, compulsions of increased defense expenditure etc. were some of the major factors which reversed the situation such that at the end of the decade the combined fiscal deficit of Centre and States was almost at the same level as was at the beginning of reform measures. The emerging situation has led the Planning Commission to suggest that 'the second generation of reforms should constitute a program of action aimed at preventing another major economic crisis and should stimulate rapid economic growth in the country during the new century.'

Box 1.4
Directions for Reforms : A Summary

- While in 1991 a severe balance of payments crisis had led to a series of economic reform initiatives, today, almost a decade later, a domestic financial crisis affecting the central and state governments is again leading the way towards a program of second generation reforms. This time the reforms have to embrace all sectors of the economy and cover the central and state governments.
- In the financial sector, there is a need to bring down the fiscal deficit and also the rate of inflation and interest rates. The fiscal deficit has to be brought down both by augmenting revenues and also by curtailing government expenditure through measures like reducing subsidies and downsizing of bureaucracy. The financial crisis affecting the state governments is more severe than that affecting the centre. But the basic reforms that are required are similar in both cases - resource mobilization efforts and austerity.
- In the infrastructure sector, there is a need to attract more private capital while maintaining the momentum of public expenditure. Private initiative will not be forthcoming until the services are appropriately priced to cover the full cost of operations. In the meantime, there is a need to set up regulatory mechanisms which will oversee measures such as pricing of services and other issues. Reform measures in the infrastructure sector would include dismantling of administered pricing mechanisms and avoiding the practices of cross-subsidization wherever possible.
- The industrial sector in India will have to adopt itself to the challenges posed by the WTO regime. A competition policy will have to be introduced. Reforms in labour policy is also necessary. Industrial policy will have to promote private initiatives from domestic as well as foreign investors while the role of the public sector will diminish.
- The public distribution system will have to be made more focused through better targeting. It may be advisable to restrict the coverage of PDS to rice and wheat only. The emphasis under PDS should shift from provision of food subsidy to stabilization of food prices.
- The social sector will also see new initiatives from the side of private capital. In education the target should include achievement of full literacy and improvements in the quality of higher and technical education. In the health sector, while the

access of the poor to public health facilities need to be improved full costs should be recovered from those who can afford to pay. Environment accounting should become an integral part of the plan process. In this regard, the focus on the international dimension should not be lost.

- Decentralization and globalization are among the processes that will shape the new century. Initiatives by the local bodies, NGOs and women need to be encouraged. The process of institution building should be backed up by administrative and legal reforms without which the second generation of reforms will be incomplete.

Source : *Planning Commission, GOI (October 2000)*
Mid Term Appraisal of Ninth Five Year Plan (1997-2002) (Page 510)

1.4 Indian Economy : Perspectives

A synoptic view of overall assessment and perspectives on the Indian economy in this part of the chapter is based on a select few important studies/reports out of the current flow of literature on Indian economy. To keep the assessment and perspective balanced and unbiased, the studies/reports selected are from three sources : Government of India and Reserve Bank of India; International Institutions (IMF, World Bank, ADB, JBIC and UNDP); and academic studies by a few individual experts (*See* Annex-1.1 for highlights). It emerges from these reports/studies that the main determinants of India's economic development; at least during the medium term, would include sustained higher growth rate, removal of infrastructure bottlenecks, further deregulation particularly of agriculture sector, renewed focus an social sector, fiscal consolidation, and above all a strategy on sharp reduction in poverty level.

Growth Rate: The average real growth rate of the economy at 6.4 per cent during 1992-93 to 1999-2000 was higher than 5.9 per cent during the 1980s. Notwithstanding the fact that with these growth rates, India has been among the fastest growing economies in the world over the last two decades, these are not being considered adequate to meet the real challenges of poverty reduction. 'When a satellite is put into orbit, it requires high velocity to ensure exit from the earth's gravitational force; similarly if our economy is to exit from the gravitational pull of poverty, it requires an exit velocity of double-digit growth rate over the next two decades' (Kelkar, 1999). Though not specific to the growth target, Finance Minister while presenting the Union Budget 2000-2001 declared the next ten years as 'India's decade of development'. Bajpai and Sachs (April, 2000) referring to the Finance Ministers statement said: 'we concur that India has a chance for a tremendous breakthrough in economic development this decade' and suggested that government of India may like to set for itself at least two broad goals: *First,* by the year 2010, the per capita income of India would be doubled. Income doubling within a decade requires annual growth in per capita income of 7 per cent per annum; *Second,* by the year 2010, there would be universalisation of education until Class VIII, with a special effort for girls and disadvantaged groups.

There is thus a growing view that even the current relatively higher growth is not adequate and the economy needs to achieve a still higher and sustained growth rate over the longer-term. According to a recent assessment (RBI, Sept., 2000), 'the real GDP growth of the Indian economy is widely believed to be hovering around its "filtered trend rate (a rate that is obtained by smoothening out of cyclical fluctuations around the trend), but the economy has still to 'catch up' to achieve an average growth of 7-8 per cent per-annum or the potential growth as determined by the production possibility frontier. Such an outcome would be rendered possible if the requisite real investment growth occurs along with technology improvements and efficiency gains.

Infrastructure: It is by now well recognized that 'infrastructure bottlenecks are liekly to constrain the achievement of a higher growth rate of 7 per cent and above' (ADB, 2000). In fact 'the need to improve economic infrastructure such as electric power, which constitutes the greatest impediment to economic growth, remains as higher as ever (OECF, 1999). That is why one of the elements listed in the strategy outlined by the Finance Minister for 'India's decade of development' is to "mount a sustained assault on infrastructure bottlenecks in power, roads, ports, telecom, railways and airways". In perspective, 'infrastructure productivity will determine how India will cope with the increasing pace of urbanization, globalization and technological innovations in manufacturing. (Rangarajan C., 2000)

Expenditure reorientation: An important area of concern expressed in most of the reports/studies focusing on poverty in India has been the lack of priority in public expenditure in social sectors like primary education, health etc. The central issue raised in the well known study by Dreze and Sen (1995) on 'India: Economic Development and Social Opportunity', has been 'to expand the social opportunities open to the people'. The need to take the debate on economic policy well beyond the issue of economic reforms in the present form is by now well recognized. 'While the case for economic reforms may take good note of the diagnosis that India has too much government in some fields, it ignores the fact that India also has too little government activities in many other fields, including basic education and health care, which makes people's lives miserable and which also limits the possibility of economic expansion (Dreze and Sen, 1997). Finally, the sensitivity or lack of it, on allocation of resources has reached a point where one strongly feels to say that 'resource transfer to the rich is described as 'incentives' while income-transfer to the poor is described as a 'subsidy' - commonly perceived to be a derogatory term. And, therefore, it is proposed that 'pro-poor oriented growth is possible when intellectual community and policy makers treat markets with the suspicions that they deserve and the poor with the respect that they need' (Reddy, 2000).

Fiscal Consolidation: Most studies/reports while drawing a perspective for the Indian economy accord a very high priority to fiscal consolidation. In fact, in the strategy outlined by the Finance Minister in his budget speech in Feb., 2000, declaring the next 10 years as 'India's decade of development' one of the elements is to 'establish a credible framework of fiscal discipline, without which the other elements of the strategy can fail'. The Economic Survey 1999-2000 (Feb. 2000) had already recognised that 'more effective management of public finances continues to be the central challenge facing all levels of government in India'.

'Faster growth would require durable fiscal consolidation to raise national saving and crowd-in private investment spending' has been a major suggestion on Indian economy in the IMF's 'World Outlook' (May, 2000). Finally, Bajpai and Sachs (April, 2000) have gone to the extent of saying that 'unless substantial fiscal consolidation is achieved, in our view, continued fiscal deficits pose India's greatest risk to future destabilization.'

End Note

Sources of data in different tables on macroeconomic trends.

Unless specified otherwise all the data sets are based on Reports from Government of India and RBI. These include:

RBI:

1. Handbook of Statistics on Indian Economy, 1999
2. Report on Currency and Finance, 1998-99.
3. Annual Report, 1999-2000 and earlier issues.
4. Occasional Papers. Vol. 18 Nos. 2 & 3, June & September 1997 (Special Issue). Particularly for historical trends.

Government of India

1. Union Budget 2000-2001.
2. Economic Survey, 1999-2000 (and earlier issues)

Others

1. Joshi, Vijay and Little, I.M.D. (1994) India : Macroeconomics and Political Economy 1964-1991. (for historical trends).

Appendix 1.1 (a)

Indian Economy : Comparison of Economic Performance Among Select Countries

	Indices	India	Singa-pore	China	Pakistan	Sri Lanka	South Africa	Mexico	USA	Japan
1.	GNP (World bank Atlas method)									
	a. per capita 1999 (in $)	**450**	29,610	780	470	820	3,160	4,400	30,600	**32,320**
	b. ranking of countries	**162**	9	140	160	137	86	71	8	**6**
2.	GNP (PPP)									
	a. per capita 1999 (in $)	**2,149**	27,024	3,291	1,757	3,056	8,318	7,719	30,600	**24,041**
	b. ranking of countries	**153**	7	128	159	136	69	75	4	**14**
3.	GNP annual growth rate of %									
	a. 1980-90	**5.8**	6.7	10.1	6.3	4.0	1.0	1.1	3.0	**4.0**
	b. 1990-99	**6.1**	8.0	10.7	4.0	5.3	1.9	2.7	3.4	**1.4**
4.	Average annual rate of Inflation 1990-98 (in %)	**8.9**	2.1	9.7	11.1	9.7	10.6	19.5	1.9	**0.2**
5.	Gross domestic investment(GDI) as % of GDP (1997-1999)	**23.9**	34.5	38.8	15.7	24.8	15.9	24.8	18.5	**29.2**
6.	Average annual growth of GDI (1990-99)	**7.4**	8.5	12.8	2.1	6.2	3.0	3.9	7.0	**1.1**
7.	Gross domestic savings as % of GDP(1997-1999)	**20.3**	51.4	42.5	11.2	18.3	17.3	23.8	16.7	**30.0**
8.	Average annual growth of exports of goods & services (1990-99)	**11.3**	-	13.0	2.7	8.4	5.3	14.3	9.3	**5.1**
9.	External debt as % of GNP (1998)	**23.0**	-	16.4	52.8	54.9	18.9	42.0	-	**-**
10.	Gross reserves (in US $ billion)									
	a. per capita 1999 (in $)	**5.64**	27.75	34.48	1005	0.45	2.58	10.22	113.1	**87.83**
	b. ranking of countries	**32.7**	76.84	157.73	1.51	1.64	6.35	31.78	60.5	**286.92**
11.	Net foreign direct investment (in US$ billion)									
	a. annual Average 1987-1992	**0.06**	3.67	4.65	0.23	0.06	-0.024	4.31	46.21	**0.91**
	b. 1998	**2.26**	7.22	45.5	0.5	0.35	0.37	10.24	193.4	**3.19**
12.	Composite ICRG risk rating (March 2000)	**64.3**	89.0	72.3	54.3	60.3	70.5	70.5	80.0	**82.0**
13.	Institutional investor credit Rating (March 2000)	**45.3**	80.4	56.6	18.8	35.4	45.2	49.8	92.9	86.9
14.	Stock market capitalization (in US $ billion) in 1999	**184.6**	198.4	330.7	6.97	1.58	262.5	154.0	16635	**4547**
15.	Stock market capitalization As % of GDP in 1997	**33.7**	110.0	22.9	17.8	13.9	179.8	38.9	144.4	**52.9**
16.	Subsidies & other current Transfers as % of total expenditure in 1997	**40**	8	-	8	20	49	51	60	**-**
17.	Education Profile									
	a) Public education expenditure as % of GNP (1995-97)	**3.2**	3.0	2.3	2.7	3.4	8.0	4.9	5.4	**3.6**
	b) Public education expenditure as % of Govt. Expenditure (1995-97)	**11.6**	23.4	12.2	7.1	8.9	23.9	23.0	14.4	**9.9**
	c) Share of pre-primary, primary and secondary in education expenditure (1994-97) (%)	**66.0**	60.3	69.6	79.8	74.8	73.1	82.8	74.8	**81.2**
	d) adult literacy rate 1998	**55.7**	91.8	82.8	44.0	91.1	84.6	90.8	99.0	**99.0**
	e) youth literacy rate 1998	**70.9**	99.7	97.2	61.4	96.5	90.8	96.6	-	**-**
18.	Health Profile									
	a) Public expenditure on health as % of GDP (1990-98)	**0.6**	1.1	2.0	0.9	1.4	3.2	2.8	6.5	**5.9**
	b) % of population with access to improved water source (1990-95)	**81**	100	90	60	46	70	83	-	**96**

(Continued.....)

Indian Economy :Comparison of Economic Performance Among Select Countries (Concluded)

Indices	India	Singa-pore	China	Pakistan	Sri Lanka	South Africa	Mexico	USA	Japan
c) % of population with access to sanitation (1990-96)	**16**	100	21	30	52	46	66	-	**100**
d) ranking of countries per 1000 live births (1998)	**70**	4	31	91	16	51	30	7	**4**
e) life expectancy at birth (in year)	**62.9**	77.3	70.1	64.4	73.3	53.2	72.3	76.8	**80.0**
f) daily per capita supply of calories (1997)	**2,496**	-	2,897	2,476	2,302	2,990	3,097	3,699	**2,932**
g) daily per capita supply of protein in grams (1997)	**59**	-	78	61	52	77	83	112	**96**
h) Doctors per 1 lakh population (1992-95)	**48**	147	115	52	23	59	85	245	**177**
i) Tuberculosis per 1 lakh people in 1997	**118.3**	57.5	33.7	3.1	35.7	242.7	25.0	6.4	**33.6**
j) per cent of infants with low birth weight (1990-97)	**33**	7	9	25	25	-	7	7	**7**
19. Military expenditure as % of GNP in 1997	**2.8**	5.7	2.2	5.7	5.1	1.8	1.1	3.3	**1.0**
20. Highest marginal tax rate in % in 1999									
a) individual	**30.0**	28	45	-	35	45	40	40	**50**
b) corporate	**35**	26	30	-	35	30	35	35	**35**
21. Power & Transportation									
a) power consumption per capita KWH (1997)	**363**	7,944	714	333	227	3,800	1,459	11,822	**7,241**
b) T&D losses (1997) (per cent)	**18**	4	8	24	17	8	14	6	**4**
c) paved road as % of total (1998)	**45.7**	97.3	-	57	95	11.8	29.7	58.8	**74.9**
d) goods transported by rail thousand ton-km per $ million of GDP (PPP) (1998)	**137.1**	-	304.8	26.3	2.03	283.3	62.1	213.8	**101.7**
e) air passenger carried '00000s(1998)	**165.2**	133.3	532.3	54.1	12.1	64.8	177.2	5,881.2	**1017**
22. Communications, information & Science & technology per 1000 people									
a) radios (1997)	**121**	822	333	98	209	317	325	2,146	**955**
b) TV sets (1998)	**69**	348	272	88	92	125	261	847	**707**
c) Telephone mainlines (1998)	**22**	562	70	19	28	115	104	661	**503**
d) PCs (1998)	**2.7**	458.4	8.9	3.9	4.1	47.4	47	458.6	**237.2**
e) internet hosts per 10,000(January 2000)	**0.23**	452.3	0.57	0.34	0.63	39.2	40.9	1,940	**208**
f) scientists & engineers in R&D per million people (1987-97)	**149**	2,318	454	72	191	1,031	214	3,676	**4,909**
g) high technology exports as % of manufacturing exports	**5**	59	15	0	-	9	19	33	**26**
h) waiting time for telephone connection in year (1997)	**1.0**	0.0	0.1	1.2	6.3	0.4	0.8	0.0	**0.0**
23. GFD of Central Govt. (% of GDP)									
a) 1990	**-7.5**	10.8	-1.9	-5.4	-7.8	-4.1	-2.5	-3.9	**-1.6**
b) 1998	**-5.2**	11.8	-1.5	-6.3	-8.0	-2.9	-1.1	0.9	**-**
24. Capital Expenditure of Central Government (% of GDP)									
a) 1990	**1.8**	5.1	-	2.6	6.1	3.1	2.5	1.8	**2.0**
b) 1998	**1.6**	5.1	-	2.5	5.3	1.2	1.9	0.6	**-**

Note : The date for making country comparisons are primarily culled out from World Development Reports and Human Development Reports, World Bank. For the performances of Indian economy during the post-Independence period, they are mostly drawn from Economic Surveys, Government of India, World Development Reports, World Bank and RBI Occasional Papers Vol. 18 Nos. 2 and 3.

Source : Reddy, Y.V. (December, 2000) Indian Economy: 1950; 2000; 2020, RBI Bulletin.

Appendix 1.1 (b)

Indian Economy : Ranking of Select Countries based on various Socio-Economic Indices

Indices	India	Singa-pore	China	Pakistan	Sri Lanka	South Africa	Mexico	USA	Japan	Total No. of countries surveyed
1. Economic creativity Index (2000)	38	3	48	-	-	26	35	1	21	59
a. Technology Index (2000)	38	3	47	-	-	32	11	1	6	59
b. Start-up Index (2000)	38	7	46	-	-	19	51	1	37	59
2. Growth competitiveness Index (2000)	49	2	41	-	-	33	43	1	21	59
3. Current competitiveness Index (2000)	37	9	44	-	-	27	42	2	14	58
4. Microeconomic competi-tiveness index (1999)	42	12	49	-	-	26	34	1	14	58
5. Environmental regulatory Index (1996) $	43	-	40	-	-	27	30	9	12	53
6. Financial market sophisti-cation (1999)	39	9	50	-	-	14	35	1	26	59
7. Corruption perception Index (1996) $	46	7	50	53	-	23	38	15	17	54
8. Human Development Index (1998)	128	24	99	135	84	103	55	3	9	174
a. GDP (ppp) index	0.51	0.92	0.57	0.47	0.57	0.74	0.73	0.95	0.91	174
b. Education index	0.55	0.86	0.79	0.44	0.83	0.88	0.84	0.97	0.94	174
c. Life expectancy index	0.63	0.87	0.75	0.66	0.81	0.47	0.79	0.86	0.92	174
9. Human Poverty Index (1998)*	58	-	30	68	35	33	12	18	9	
10. Recessionary expectations (January 2000) (on score between 0 to 7) #	6.0	6.2	5.4	-	-	6.3	5.2	5.7	4.6	
11. Gloablisation Index annual average % change, 1993-94	2.0	6.0	7.0	-	-	4.0	-4.5	5.0	0.5	
12. Emerging market access Index (2000)	46	86	37	-	-	72	68	-	-	

* for 85 developing countries and 18 industrialized countries (in which USA and Japan belong) separately.

$ - higher the rank greater is the degree of perceived corruption or lack of transparency.

- higher the value less is the Recessionary Expectations.

Source : Reddy, Y.V. (December, 2000) Indian Economy: 1950; 2000; 2020, RBI Bulletin.

SOCIO-ECONOMIC INDICES AND THEIR INTERPRETATION

	Type of Index	What does the Index Attempt to Gauge and its estimation
1.	Technology Index	Based on observed data and survey results, the index measures the level of technology in a country. It takes into account of countries' involvement in innovation and import of technology from abroad.
2.	Start-up Index	This index is also based on observed data and survey results. It measures the condition favouring business start-ups.
3.	Economic Creativity Index	This index combines the above two indices in order to gauge a country's involvement in economically effective innovation or transfer of technology ('technology index') and the condition favouring business start-ups ('start-up index'). The most creative countries are also among the fastest-growing over the past decade. America has pace setting innovation and the best start-up environment. Though Singapore is not a great innovator, its economic creativity is very high through rapid import of technology.
4.	Growth Competitiveness Index	It aims to measure the factors that contribute to future growth of an economy, measured as the rate of change of GPD per person, in order to explain why some countries are improving their prosperity faster than others. Variables that contribute to levels of productivity, high rates of accumulation and innovation and improvements in productivity and statistically significantly are taken into account in constructing the index. The indices are 'economic creativity index', as explained above, 'finance index' and 'international index' all of which are assigned equal weights of one-third. 'Finance index' measures the efficiency of financial system which is conducive to high rates of saving and investment and the 'international index' measures the degree of economic integration with the rest of the world.
5.	Microeconomic Competitiveness Index	It attempts to measure the microeconomic foundations of economic development, rooted in firms' operating practices and strategies as well as in the business inputs, infrastructure, institutions and policies that constitute the environment in which a nation's firms compete. Bivariate relationships between these microeconomic variables and GDP per capita are estimated. And weighting all the variables, common factor analysis is employed to provide a single composite picture of relative microeconomic competitiveness. The factor score of the dominant factor which captures the variance among the variables is interpreted as the index.
6.	Current Competitiveness Index	This index is built upon the microeconomic competitiveness index. The index to identify the factors that underpin high current productivity and hence current economic performance, measured by the level of GDP per person. The index takes into account of a nation's firms' operating practices and strategies and the quality of the nation's business environment. A variety of measures reflecting the sophistication of company operations and strategies are statistically related to GDP per capita and are combined into a sub-index of the sophistication of company operations. Next, a variety of measures reflecting the quality of business environment *viz.,* quality of inputs, availability and sophistication of local

		suppliers of components, machinery, etc., sophistication of local demand and rules governing vitality of competition and the incentives for productive modes of rivalry are statistically related to GDP per capita and combined into another sub-index of the quality of the business environment. The two sub-indices are then combined to obtain the current competitiveness index.
7.	Human Development Index	It measures average achievement in basic human development in one simple composite index. It is based on 3 indicators : a) longevity, as measured by life expectancy at birth; b) educational attainment, as measured by a combination of the adult literacy rate (two-third weight) and the combined gross primary secondary and tertiary enrolment ratio (one-third weight), and c) standard of living, as measured by GDP per capita income in PPP US$. The index for each of these indicators are obtained as ratio of the difference of the actual value from the minimum value to the difference of maximum value from the minimum value. HDI is then obtained as the simple average of these three indices.
8.	Human Poverty Index	For the developing countries (HPI-1), it concentrates on the deprivation in the three essential dimensions of human life already reflected in HDI. First deprivation is represented by % of people not expected to survive age 40 (P1). Second deprivation is represented by % of illiterate adult (P2). The third deprivation represented by the simple average of % of people without access to safe water and without access to health services and % underweight children under five (P3). The index is obtained as cubic root of the simple average of cube of all the three variables. For the industrialised countries (HPI-2), there are four deprivation; a) % of people not expected to survive age 60; b) functionally illiterate; c) % people below income poverty line, set at 50% of median disposable household income, and d) rate of long-term unemployment. The index is obtained as of root of the simple average of cube of all the four variables.
9.	Transparency or Corruption Perception Index	It attempts to assess the level at which corruption among the politicians and public officials is perceived by people working for multinational firms and institutions as impacting on commercial and social life. The index is poll of polls prepared by using 10 different surveys and at least 4 surveys are required to include a country in the list. The score for overall integrity of a country as perceived in the surveys are placed between 0 to 10, with higher score indicating cleaner country. The divergence of views among surveys are recorded by variance.
10.	Emerging Market Access Index	It measures the market openness based on 16 indicators which include average tariff levels, import quotas, rules on intellectual property rights, export subsidies, government procurement policies and investment barriers.
11.	Recessionary Expectations	It is based on the survey of executive opinion on the likeliness of a country going to slump in the next year. The scores are placed from 0 to 7, with higher score reflecting less likeliness of being in recession.
12.	Globalisation Index	It ranks countries by variables such as openness to trade and investment, creditworthiness and the importance of tourism and transfers from foreign workers.

Appendix 1.2

Indian Economy : Select Macroeconomic and Financial Indicators

Item	1999-2000P	1998-99	1997-98	1996-97	1995-96	Average 1990-91 to 1994-95 (5 years)	Average 1980-81 to 1989-90 (10 years)
1	2	3	4	5	6	7	8
1. Real GDP (% change)#	6.4RE	6.8QE	5.0	7.5	7.3	5.1	5.9
2. Industrial Production (% change)#	8.1	3.8	6.6	6.1	13.1	5.3	7.8$
3. Agricultural Production (% change)**	-1.3E	8.2E	-6.1	9.3	-2.7	3.0	5.2
4. Foodgrains Production (Million tonnes)	205.9A	203.0	192.3	199.4	180.4	180.0	146.5
5. Gross Domestic Saving Rate (% of GDP)#	. .	22.3	24.7	23.3	25.5	23.5	20.0
6. Gross Domestic Investment Rate (% of GDP)#	. .	23.4	26.2	24.6	27.2	25.0	22.0
7. Central Government Finances (% of GDP)#							
(a) Total Revenue Receipts	9.2RE	8.5	8.8	9.3	9.3	10.1	10.3
(b) Total Expenditure	15.6RE	15.9	15.3	14.8	15.1	17.9	18.8
(c) Revenue Deficit	3.8RE	3.9	3.1	2.4	2.5	3.2	1.8
(d) Fiscal Deficit	5.6RE	6.4	5.9	4.9	5.1	6.7	7.2
(e) Net RBI credit to the Centre	-0.3RE	0.7	0.9	0.1	1.7	0.9	2.2
(f) Interest Payments	4.7RE	4.4	4.3	4.4	4.2	4.4	2.8
(g) Internal Debt	37.4RE	16.1	25.7	25.3	26.0	28.6	26.5
8. Monetary aggregates (% change)							
(a) Broad Money (M3)	13.9	19.4	18.0	16.2	13.6	18.2	17.2
(b) Narrow Money (M1)	10.2	15.4	11.3	12.0	11.7	19.0	15.1
(c) Reserve Money	8.1	14.6	13.2	2.8	14.9	17.0	16.9
9. Scheduled Commercial Banks (% change)							
(a) Aggregate Deposits	13.9	19.3	19.8	16.5	12.0	18.3	18.1
(b) Bank Credit	18.2	13.8	16.4	9.6	20.1	16.1	16.8
(c) Non-Food Credit	16.5	13.0	15.1	10.9	22.5	15.2	17.8
(d) Investments in Government Securities	24.7	19.4	17.7	20.2	12.4	22.9	19.4
10. Wholesale Price Index (% change)#							
(a) Point-to-Point	6.5	5.3	4.5	5.4	4.4	10.8	7.5
(b) Average	3.3	5.9	4.4	4.6	8.1	10.7	8.0
11. Consumer Price Index-Industrial Workers (% change)							
(a) Point-to-Point	4.8	8.9	8.3	10.0	8.9	10.6	8.9
(b) Average	3.4	13.1	6.8	9.4	10.0	10.4	9.1
12. BSE Sensitive Index (% change)	41.4	-13.6	9.9	5.5	-17.3	42.9	22.3
13. Trade and Balance of Payments							
(a) Exports in US $ (% change)	13.2	-5.1	4.6	5.3	20.8	10.0	8.1
(b) Imports in US $ (% change)	11.4	2.2	6.0	6.7	28.0	7.3	7.2
(c) Current Account (% of GDP)	-0.9	-1.0	-1.4	-1.2	-1.7	-1.4	-2.0
(d) Capital Account (% of GDP)	2.3	2.1	2.4	3.1	1.2	2.3	1.7
14. Foreign Exchange Reserves* (US $ Million)	38,036	32,490	29,367	26,423	21,687	13,865	5,579
15. External Debt* (US $ Million)	98,435	97,666	93,531	93,470	93,730	90,162	. .
(a) Debt-GDP Ratio	22.0	23.5	24.4	24.7	27.1	35.2	. .
(b) Debt-Service Ratio	16.0	18.0	19.0	21.2	24.3	29.0	. .
16. Exchange Rate (Rupee/US $)							
(a) High	42.4400	39.4800	35.6975	34.1400	31.3200	17.2801	7.7300
(b) Low	43.6400	43.4200	40.3600	35.9600	37.9500	32.6458	17.1274

P : Provisional . . : Not available * : As at the end of the period. A : Advance estimates as on June 29,2000.

** On the basis of agricultural production index with base : triennium ending 1981-82 = 100.

Base : 1993-94 = 100 for columns 2 to 6 and 1980-81 = 100 for columns 7 and 8.

E Estimated. RE : Revised Estimates. QE : Quick Estimates.

$ Average for 1981-82 to 1989-90 (9 years)

Source : RBI (August 2000), Annual Report 1999-2000.

Chapter II
Fiscal System in India : Main Features

The Fiscal System : Fiscal system refers to the mechanism through which financial resources for the government and its agencies are procured, channeled or raised, and the scale and pattern of allocation of such resources is determined. In the Indian fiscal system, the budgetary resources and expenditures are determined through the annual budget of the Central Government and the State Governments. The five yearly as well as annual resources and expenditure for development plans of the public sector as a whole are determined by the Planning Commission. Before discussing the fiscal sector reforms and trends in the next chapter, an introduction to important features of the Indian fiscal system in this chapter may be found of use.

2.1 Some Dimensional Features

2.1.1 Budgetary Parameters

For a synoptic macro view of the fiscal system, the combined budgetary disbursements and receipts both for the Central government budget and State governments' budgets are shown in table 2.1. The estimates for budgetary transactions for the third tier of the government *i.e.* panchayats (rural local bodies) and municipalities (urban local bodies) are not yet available in necessary details, as well as, for the latest period. In any case, as of now, most part of the expenditures of the local bodies are out of the transfers from the Central or State government, and thus covered in the disbursements given in table 2.1. The important features of budgetary transactions both for the Central as well as State governments are as follows:

- Total disbursements out of the budgets of the Central government and State governments (net of *inter-se* transfer) form about 29 per cent of GDP.
- Total receipts including the borrowings account for about 28 per cent of GDP.
- Combined (net of transfers) revenue receipts *i.e.* tax plus non-tax receipts form about 18 per cent of GDP, of which tax receipts are 14 per cent of GDP.
- Combined revenue expenditure *i.e.* current expenditure out of the budgets, is about 23 per cent of GDP.
- Recently available estimates indicate that the expenditures of the 'third tier' of the government *i.e.* local governments (both rural and urban) is about 11.5 per cent of GDP. These are not additive to the expenditures of

Central and State governments. Own revenue of these local bodies however is less than one per cent of GDP.

Table 2.1

Combined Receipts and Disbursements of the Central and State Governments 1999-2000 (Revised Estimates)

	Rupees in Billion	Percent to total Disbursements/ Receipts Respectively	Percent of GDP at current market prices (Rs.19318 billion)
I. **Total Disbursements**	**5605**	**100.00**	**29.00**
A. Developmental (a+b+c)	2845	50.76	14.72
(a) Revenue	2283	40.73	11.81
(b) Capital	389	5.94	-2.01
(c) Loans	173	3.09	0.89
B. Non-Developmental (a+b+c)	2604	46.46	13.47
(a) Revenue	2439	43.51	12.62
of which :			
Interest payments	1116	19.91	5.77
(b) Capital	144	2.57	0.74
(c) Loan and Advances	21	0.37	0.10
C. Others (a+b)	156	2.78	0.80
(a) Revenue	51	0.91	0.26
(b) Capital	105	1.87	0.54
II. **Total Receipts (A+B)**	**5513**	**100.00**	**28.53**
of which :			
A. Revenue Receipts	3469	62.92	17.95
(1) Tax receipts	2756	50.00	14.26
(a) Direct Taxes	709	12.86	3.67
(b) Indirect Taxes	2047	37.13	10.60
(2) Non Tax Receipts	713	12.93	3.69
of which :			
Interest receipts	177	3.21	0.91
B. Capital Receipts	2044	37.08	10.58
of which :			
(1) State Provident Funds (Net)	212	3.85	1.09
(2) Recovery of Loans & Advances	70	1.27	0.36
III. **Overall Surplus (+)/Deficit (-)**	**-92**	**-**	**-0.47**
IV. Gross Fiscal Deficit	**1935**	**-**	**9.9***

Source : (Basic Data) RBI. Annual Report 1999-2000

* As per RBI estimate. Ibid.

- Seen separately, the expenditure out of the Central Government budget, accounts for about 15.7 per cent of GDP. Almost similar (15.77%) is the level of expenditure through state governments budgets. Revenue expenditure of the State governments put together is higher at 13.82 per cent of GDP compared to the Central government, whereas the capital expenditure is lower. Tax and non tax revenues of the State governments form a lower proportion of GDP compared to the Centre's net tax receipts and non tax receipts respectively.

Table 2.2
Receipts and Expenditure : Centre and States 1999-2000 (Revised Estimates)

	Central government	State governments
	(Percent of GDP)	
Total Expenditure	**15.72**	**15.77**
Revenue Expenditure	13.10	13.82
Capital Expenditure	2.62	1.95
Tax revenue	6.55	5.38
(for Centre net of transfers to States)		
Non tax revenue	2.75	1.39

Source : Eleventh Finance Commission Report, June 2000.

Box : 2.1
Low Level of Central Government Expenditure

India's Central government expenditure at 15.5 as per cent of GDP in 1999 was second lowest amongst the countries of 'developing Asia', (lowest being for Combodia at 15.1%). It was 16.9% for China, 23.0% for Republic of Korea, 22.9% for Pakistan, 25.6% for Sri Lanka and 49.5% for Maldives. However, the overall budget deficit of the Central Government of India at 5.5% was relatively higher when compared with most of the 'developing Asia' countries except for a few like Sri Lanka (8.0%), Maldives (6.0%), Nepal (6.0%).

(Source : ADB Outlook 2000 Statistical Appendix Tables A21 and A23)

(b) Deficits and financing thereof

The level of fiscal deficit in the Central government budget and State government budgets (for all states) together formed about 10 per cent of GDP in 1999-2000. The important measures of deficits in the budgets are given in table 2.3.

Table 2.3
Levels of Deficits in Government Budgets

(As per cent of GDP)

	Central Government Budget	State Governments Budgets	Combined[1] for Centre and States
Gross Fiscal Deficit (GFD)			
1999-2000 (RE)	5.6	4.8	9.9
1990 to 1998-99 (Average)	5.8*	3.0	7.7
Revenue Deficit (RD)			
1999-2000 (RE)	3.8	2.9	6.7
1990 to 1998-99 (Average)	3.0*	1.0	4.1
Gross Primary Deficit (GPD)			
1999-2000	0.9	2.5	4.2
1990 to 1998-99 (Average)	1.5*	1.2	2.7

* Average of 1991-92 to 1998-99.
Source : RBI, Annual Report 1999-2000, September, 2000.
Notes :

GFD : Excess of total expenditure including loans (net of recovery) *over* revenue receipts (including external grants) and non-debt capital receipts. For Central government, it excludes loans to States/Union Territories against Small Savings Collection.

RD : Difference between revenue receipts and revenue expenditure.

GPD : GFD *minus* interest payments.

[1]Combined deficits are not the totals of Central and State deficits.

(a) Combined GFD is the GFD of Central budget plus GFD of State budgets minus net lending from the Central government to State governments.
(b) Combined RD is adjusted for inter-governmental transactions in the revenue account.
(c) Combined GPD is after adjusting for combined interest payment.

Box : 2.2
Changes in the System of Estimating Fiscal Deficit in the Central Government Budget

The term 'fiscal deficit' in normal use refers to 'gross fiscal deficit' (GFD). GFD is the excess of total expenditure including loans (net of recovery) *over* revenue receipts (including external grants) and non-debt capital receipts. The estimates of GFD and GFD/GDP ratio are however not strictly comparable for the following reasons:

(a) The budget for 1999-2000 made a change in the system of accounting of loans to States and Union Territories against net collections of small savings with effect from 1st April, 1999. The 75 per cent share (now enhanced to 80 per cent) of net Small Savings & PPF collections which was earlier being released to States is now treated as investment in the special securities of the respective State Government and booked under "investments of National Small Savings Fund (NSSF)' created in the Public Account of India. The remaining part of net small savings and PPF collections (Centre's share) is treated as investment in the special securities of the Central government. In other words, under the new accounting system small savings collections are credited to

NSSF. Similarly, all withdrawals would be made out of the accumulation to the fund. Due to this change the non-plan expenditure of the Centre was lower by Rs. 25000 crore in 1999-2000 budget and as a consequence the fiscal deficit was also lower by the similar amount. Inclusive of small savings share of states as earlier would mean GFD/GDP ratio at 5.4% while exclusive of this it would be 4.1%.

(b) The GDP data series has now been revised with a new base as 1993-94. The revised estimates are on average higher than the old series estimates by 5.77 per cent. Thus GFD/GDP ratios prior to 1993-94 with old series of GDP and subsequent ones with the new series are not strictly comparable. This change, however, is applicable to the State Government deficit ratios.

There are some other accounting developments like inclusion of disinvestment proceeds under receipts which were not there prior to 1991-92 and transfer of profits of RBI in excess of the earlier (prior to 1992-93) 25 per cent to the Central budget.

(See Rao, M.G. and Nath, 2000)

The pattern and sources of financing the deficits in the Central government budget and the State government budgets differ. State governments borrow from Central government and cannot borrow directly from donors.

- Fiscal deficit in the Central government's budget for 1999-2000 was financed through market borrowings (70.8%) which included zero coupon bonds, loans in conversion of maturing treasury bills etc., through 'other borrowings and liabilities' (25.2%) which included small savings, provident funds, special deposits, reserve funds etc., and net external assistance (0.8%) which included loans from OECF. (In 1991-92 external assistance had financed 14.9 per cent of the fiscal deficit).
- The State governments' fiscal deficits (1999-2000 RE) were financed through loans (net) from the Central government (42.2%), market borrowings, net (10.4%) and other borrowings (47.3%) which included loans from financial institutions, provident funds, reserve funds, deposits etc.

2.2 Link between budgetary allocations and the public sector plan

The fiscal system has several important inter-linkages between the various organs of the Government. At both the layers of government, the public sector comprises :

- Government departments
- Departmental enterprises, and
- Non-departmental enterprises.

Resources are raised by each different organization and transfers are made to each other under various arrangements. Thus, from the resources raised through the central government budget, some are transferred to the state governments and some to the departmental as well as non-departmental enterprises. Similarly, out of the resources raised by the state governments, some are transferred to state public enterprises and local authorities. With the 73rd and

74th amendment to the Constitution, now the state governments have to form state finance commissions to determine transfer of resources to local authorities including the panchayats.

The budget is a statement of government revenue and expenditure and is prepared by the Ministry of Finance. The public sector plan is prepared by the Planning Commission taking into account the resources available out of the budget for plan and also resources available from the public enterprises for their Plan. The Annual Plan of the public sector, both for Centre as well as States and Union Territories (UTs), for the year 1999-2000 was Rs. 1922 billion, for which about 45 per cent funds (Rs. 862 billion) were from the Central government budget.

Box : 2.3
The Plan - Budget Link

In 1999-2000, out of the total disbursements of Rs. 2839 billion Central Government Budget Allocated :

	(*Rs. in billion*)
15.5% as Budget Support for Central Sector Plan	440
Add : Internal and Extra Budgetary Resources (IEBR) of Central Public Enterprises (PEs)	595
(a) **Total Central Plan**	**1035**
13.4% as Plan Assistance for State Plans	381
Add : States Own Resources	465
(b) **Total States Plan**	**846**
(c) **UTs Plan**	**41**
Total Annual Plan : (a+b+c)	**1922**
Out of Central Budget	**862**

Source : Planning Commission (2000) Annual Plan 1999-2000, and Budget 1999-2000

An important aspect of the plan budget link is that, while for the annual plans the link with the budget can be directly established, in terms of the budget support available for the plan, it is difficult to establish such a link with the medium term plan. In deriving the financing pattern of a medium term plan, it is the concept of balance from current revenues (BCR) or government saving which is more of use. For the annual plan formulation, it is the budget support concept which is directly relevant and is therefore linked to the budget. Another problem in not finding a direct link between the medium term plan and the annual budget is that the estimates for the medium term plan are prepared at some base year constant prices (1996-97 for the Ninth Five Year Plan), whereas, all budget estimates are at current prices. Even so the contribution of PSEs can be compared each year, in terms of the share, this source would have in the financing pattern of the medium term plan.

In the case of States' plan, not all the loans and grants flowing from the union budget enter as resources for the plan. It is the central plan assistance part, both in terms of loans and grants, that is added to the state's own resources for arriving at the size of the state's plan. In preparing the annual plan for the states, the Planning Commission reassesses all the estimates of states own resources. In this respect, while States' revenue and expenditure are critically reviewed by the Planning Commission, the Union budget estimates are usually accepted as provided by the Ministry of Finance.

2.3 The Fiscal Federal System

Constitution of India has specified the expenditure responsibilities as well as the resource raising domains for the central as well as the state governments through the three lists: Union list, State list, and the Concurrent list. Similarly, the revenue raising powers are also specified. Recognizing well an asymmetry in the assignment of tax powers and expenditure responsibilities of the states and the consequent need of transfer of resources from the centre to the states, the Constitution provides for a system of revenue sharing arrangements. Besides, the Planning Commission, Government of India also affect resource transfers under a well developed system.

2.3.1 Forms and channels of central budgetary transfers

The current system of federal transfers in India provides for flow of the Centre's revenue to the States in segments, viz., devolution of a part of the Centre's divisible taxes and grants-in-aid of revenue to States in need of assistance under article 275 of the Constitution through the Finance Commission (FC), transfers through the Planning Commission (PC) in the form of assistance for State Plans, transfers to implement Centrally Sponsored Schemes (CSS) under the Central Sector Plan, and other discretionary transfers. The statutory transfers also have several components, viz., tax devolution, revenue deficit grants, grants for up gradation and special problems, and grants meant for local bodies and calamity relief. Statutory transfers made up of tax devolution and grants under article 275 account for the bulk (about 65 to 70 per cent). Plan grants also form a sizeable proportion (about 30 to 35 per cent).

Box : 2.4
Forms and channels of Central budgetary transfers to States

- **In 1999-2000 out of the total transfers of Rs. 1265 billion (loans+grants) from Centre to States :**
  - 38% were through Finance Commission recommendations
  - 40% through Planning Commission
  - 22% through Finance Ministry.
- **The Form of Transfers :**
  - Share in Taxes 36%
  - Grants 27%
  - Loans 37%
- **Eleventh Finance Commission (EFC) in July, 2000 has recommended that :**
  - 29.5% of net proceeds of Central tax receipts be transferred to States

Rs. 20 billion per annum as grants to States **for Local bodies.**

2.3.2 Some recent changes for Statutory Transfers

Article 280(3) of the Constitution requires the Finance Commission to make recommendations as to the distribution of the net proceeds of shareable taxes between Union and the States, and the allocation between the States of their shares in such proceeds. Formulation of principles that should guide the assignment of share to the States and the determination of individual share of each State constitutes a central task of the Commission.

The Constitution (Eightieth Amendment) Act, 2000 has altered the pattern of sharing of Central taxes between the Centre and the States in a fundamental way. Prior to this amendment, Taxes on Income other than agriculture income and Union duties of excise were shared with States under articles 270 and 272 respectively. The Eightieth Amendment Act has substituted a new article for article 270 and omitted the old article 272. The new article 270 provides as under:

> "270(1) All taxes and duties referred to in the Union List, except the duties and taxes referred to in articles 268 and 269, respectively, surcharge on taxes and duties referred to in article 271 and any case levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and shall be distributed between the Union and the States in the manner provided in clause (2).
>
> (2) Such percentage, as may be prescribed, of the net proceeds of any such tax or duty in any financial year shall not form part of the Consolidated Fund of India, but shall be assigned to the States within which that tax or duty is livable in that year, and shall be distributed among those States in such

manner and from such time as may be prescribed in the manner provided in clause (3).

(3) In this article, "prescribed" means,-

(i) until a Finance Commission has been constituted, prescribed by the President order, and

(ii) after a Finance Commission has been constituted, prescribed by the President by order after considering the recommendations of the Finance Commission".

The Finance Commission is now required to recommend such percentage of taxes or duties referred to in the new article 270 that may be assigned to the States and also recommend the manner in which these may be distributed among the States.

The main changes brought about by this amendment are as follows :

(a) All Central taxes and duties, except those referred in articles 268 and 269 respectively and surcharges and ceases, are to be shared between the Centre and the States.

(b) Only States in which these taxes and duties are 'livable in that year' are entitled to get a share in these taxes and duties.

(c) A percentage of "net proceeds" of these taxes and duties as may be prescribed by the President by order after considering the recommendations of the Finance Commission is to be shared by States.

(d) The percentage of "net proceeds" of these taxes and duties which is assigned to the States in any financial year shall not form part of the Consolidated Fund of India.

(e) The article 270(2) which referred to taxes on income prior to the amendment contained the following provision:

"Such percentage as may be prescribed, of the net proceeds in any financial year of any such tax, except in so far as those proceeds represent proceeds attributable to Union Territories or to taxes payable in respect of Union emoluments, shall not form part of the Consolidated Fund of India."

In the new article 270 which refers to all taxes the words "net proceeds" attributed to Union Territories or to "tax payable in respect of Union emoluments" have been omitted.

(f) The recommendation of the Tenth Finance Commission regarding sharing of "gross proceeds" was also not accepted in the new Amendment Act and the words "the share of net proceeds" was prescribed in order to maintain consistency between articles 270, 279 and 280.

Article 269 has been recast by the Amendment Act. The new article includes only taxes on sale and purchase of goods and taxes on the consignment of goods.

All other taxes that were listed under article 269 prior to the amendment have been deleted from this article.

The above changes partly reflect the change in the transfers from Centre to States as recommended by the Eleventh Finance Commission for 2000-2005 compared to the Tenth Finance Commission recommendations for each state as shown in Table 2.4.

Table 2.4

Devolution of Revenues as recommended by 10th and 11th Finance Commissions

(Rs. Crore)

States	Finance Commission Transfers		Increase Eleventh over Tenth	
	Tenth	Eleventh	Amount	Per cent
Andhra Pradesh	18,082	31,011	12,930	71.5
Arunachal Pradesh	1,768	2,315	547	30.9
Assam	8,328	13,281	4,953	59.5
Bihar	24,656	56,728	32,072	130.1
Goa	622	822	199	32.0
Gujarat	8,876	12,000	3,125	35.2
Haryana	2,793	4,206	1,413	50.6
Himachal Pradesh	4,762	7,460	2,699	56.7
Jammu & Kashmir	7,322	16,428	9,106	124.4
Karnataka	10,521	16,692	9,171	87.2
Kerala	7,722	12,317	4,595	59.5
Madhya Pradesh	16,094	34,998	18,904	117.5
Maharashtra	13,709	19,388	5,678	41.4
Manipur	2,137	3,216	1,079	50.5
Meghalaya	1,889	2,961	1,073	56.8
Mizoram	1,802	2,535	733	40.7
Nagaland	2,793	4,450	1,657	59.3
Orissa	9,707	20,755	11,048	113.8
Punjab	3,590	5,429	1,839	51.2
Rajasthan	11,401	23,589	12,188	106.9
Sikkim	699	1,634	935	133.8
Tamil Nadu	13,361	21,601	8,241	61.7
Tripura	2,873	4,361	1,488	51.8
Uttar Pradesh	36,159	78,509	42,350	117.1
West Bengal	14,980	35,220	20,239	135.1
Total	2,26,643	4,34,905	2,08,262	91.9

Source : RBI study on State Finances, (December 2000).

2.3.3 Transfers to Local Bodies (The third tier of the Government)

The rural and urban local bodies, that is, the panchayats and the municipalities, were in existence even before the seventy-third and the seventy-fourth amendment to Constitution in 1992. Every State had enacted suitable legislation for devolution of functions, powers and responsibilities to these bodies, including the power to raise resources. The Constitutional changes, however, envisage the panchayat and municipalities as institutions of self-governments. It has been made mandatory, under the Constitution, to hold regular elections to these bodies under the supervision of the State Election Commissions. Representation of SCs/STs and women has been made obligatory. The devolution of financial resources to these bodies has been ensured through periodic constitution of the State Finance Commissions that are required to make recommendations on the sharing and assignment of various taxes, duties, tolls, fees etc., and on the grants-in-aid to these bodies from the Consolidated Funds of the States. These provisions are closely related to articles 243G and 243W of the Constitution which require that the State legislature may, by law, entrust these bodies with such powers, functions and responsibility so as to enable them to function as institutions of self-government. In particular, the panchayats and the municipalities may be required to prepare plans for economic development and social justice, and implement the schemes relating thereto including those which are included in the Eleventh and Twelfth Schedules of the Constitution, respectively. The operationalisation of the changes contemplated under the Constitution requires action by both the Centre and the States. The pace of empowerment of these bodies to function as institutions of self-government has, however, generally been slow (EFC, 2000).

A total grant of Rs. 1,600 crore for the panchayats and Rs. 400 crore for the municipalities is recommended by the EFC to be given to States for each of the five years starting from the financial year 2000-01. The amounts indicated by the Finance Commission for maintenance of accounts, audit of accounts and for the development of database, would be the first charge on these grants and would be released by the concerned Ministries of the Government of India, after the arrangements suggested become operational.

Inter-se shares of States in the grants recommended by the Finance Commission for the panchayats and the municipalities have been based on the rural/urban population of the State (40 per cent), index of decentralization (20 per cent), distance from the highest per capita income (20 per cent), revenue effort of the local bodies (10 per cent) and geographical area (10 per cent).

2.4 Role of the Central Bank : The Reserve Bank of India

The Reserve Bank of India as the Central Bank acts as a banker, debt manger, and adviser in several matters relating to budgetary operations of both the Central we well as State governments.

2.4.1 RBI and Central Government

Apart from the most important role of a banker to the government, the RBI acts as a debt manager in close coordination with the Department of Economic Affairs, Ministry of Finance. An important development during 1990s relates to evolution of a system of ways and means of advances to the Central government.

Through an agreement between the Central government and the RBI a system of Ways and Means Advances (WMA)--short-term loans from the RBI to the government has been in operation since 1994. The broad features are as follows:

- A scheme of WMA by the Reserve Bank of India to the Government of India has been evolved to accommodate temporary mismatches in Government receipts and payments.
- The limit for WMA and the rate of interest on WMA is mutually agreed between the RBI and the Government from time to time.
- Any drawls by the Government from the Reserve Bank of India in excess of the limit of WMA is permissible only for ten consecutive working days.
- When 75 per cent of WMA is utilised, the Reserve Bank triggers fresh floatation of Government securities.
- With the discontinuance of the *ad hoc* Treasury Bills and Tap Treasury Bills and the introduction of WMA, the concept of conventional budget deficit loses its relevance. Therefore, the practice of showing budgetary deficit in the Union Budget has been discontinued; instead, gross fiscal deficit has become the key indicator of deficit. As a transparent way of reporting the monetised deficit or net RBI credit to the Central Government, the likely extent of RBI support in respect of dated securities and auction Treasury Bills is to be separately shown as the 'monetised deficit' in the budget document.

A word on the mechanism prior to the introduction of WMA system may be necessary to understand the importance of the new system. At the advent of planning and towards mid-1950s it was mutually agreed between the Central govt. and the RBI that a minimum cash balance of Rs. 50 crore on Fridays and Rs. 4 crore on other days would be held by the Central govt. To adhere to this administrative arrangement, it was agreed that whenever the cash balances in

the Government's account dropped below these levels, the RBI would replenish by creation of *ad-hoc* treasury bills in its favour. The *ad-hoc* Treasury Bills, which were meant to be temporary, gained a permanent as well as a cumulative character. Indeed, they became an attractive source of financing government expenditure since they were available at an interest rate pegged at 4.6 per cent per annum since 1974, i.e. actually at a negative real interest rate. This was a system of automatic magnetization of government deficit.

The new system of WMA from *ad-hocs* required a process of transition. First, through limits on the creation of adhoc Treasury Bills which operated between 1994-95 and 1996-97; Second, during the transition period of two years beginning 1st April, 1997, when *ad-hocs* were eliminated and the new system of WMA was introduced, an overdraft above ways and means was permissible beyond ten continues days, though at a cost. Finally, in order to manage the system a "Monitoring Group on Cash and Debt Management of the Central Government" with representatives from Government of India (Budget Division, Tax Collection Units, Accountants) and the RBI is in operation since April 1997. The group periodically reviews, *inter-alia* the monthly fiscal deficit, progress of borrowing program, instruments of borrowing and cash position of the Central Government on an ongoing basis so as to identify suitable strategies for effective cash management.

2.4.2 RBI and State Governments

Twenty three States have entrusted their banking business, including payments, receipts, collection, remittance of money, management of public debt and issue of new loans to the RBI voluntarily entering into an agreement under Section 21A of the Reserve Bank of India Act, 1934. The RBI advises the States about their daily cash balance at the close of each working day. (*See Thorat and Pattnaik, 1999*).

Provision of Ways and Means Advances (WMA)

Under Section 17(5) of RBI Act, 1934, the RBI provides Ways and Means Advances (WMA) of the States banking with it to help them to tide over temporary mismatches in the cash flow of their receipts and payments. Such advances, are under the Act, "repayable in each case not later than three months from the date of making that advance". There are two types of WMA - normal and special. While normal WMA are clean advances, special WMA are secured advances provided against the pledge of Government of India securities. Any amount drawn by a State in excess of WMA is an Overdraft. An Overdraft Regulation Scheme has been in force from October 2, 1985. As per the scheme in existence before March 1, 1999, both normal and special WMA were linked with

the cash balances of States maintained with the Reserve Bank and the limits for normal and special WMA were revised from time to time depending on the evolving liquidity situation faced by State Governments, ten revisions were affected to the limits of WMA available to States between April 1937 and end February 1999.

The scheme of WMA to State Governments has been revised on the basis of recommendation of the Informal Advisory Committee on Ways and Means Advances to State Governments (Chairman: Shri B.P.R. Vithal). The main features of the revised scheme made effective from March 1, 1999 are:

(a) The base for the revised WMA limits was three year average of revenue receipts plus capital expenditure. Accordingly, the normal WMA limits have been increased by 65 per cent to Rs. 3,685 crore (from Rs. 2,234.40 crore).
(b) The limits of Rs. 851.20 crore existing at present in respect of Special WMA were liberalized. Accordingly, under the revised scheme, there is no upper limit on special WMA as a multiple of minimum balance. The States will be provided special WMA against their actual holdings of dated Government of India securities.
(c) No State shall be allowed to run an overdraft with RBI for more than ten consecutive working days. If overdraft remains beyond ten consecutive working days RBI will stop payment on behalf of the State. The overdraft shall not exceed 100 per cent of WMA limit in a financial year. On the first occasion RBI will advise the State Governments; on a second or any subsequent occasion, the State shall be given only three working days' notice to bring down the overdraft within 100 per cent limit. If this is not adhered to, payments will be stopped.
(d) The interest rate charged on WMA and overdrafts at present are at the Bank Rate and at the Bank Rate plus two percentage points respectively.

If the overdraft persists beyond ten consecutive working days, the Reserve Bank stops payment on behalf of that State Government.

During 1998-99, 17 States resorted to overdraft; of them 11 States took frequent recourse to overdrafts. Five States could not clear their overdrafts with the Reserve Bank within the stipulated time limit and consequently the Reserve Bank had to stop payments on their behalf. (RBI Annual Report-1998-99).

2.4.3 Management of Market Borrowings

The Reserve Bank manages the market borrowings of the State Governments. The market borrowing program of State Governments is finalized by Government of India and Planning Commission. Estimates of aggregated

market borrowings for Centre and State together is indicated to the Government by Reserve Bank of India taking into account the monetary parameters. The Government of India advises State-wise allocation of borrowings to Reserve Bank of India. These amounts are raised from the market in two or three trenches with a pre-announced coupon rate and maturity decided by Government of India. The Reserve Bank of India decides the timing of the floatation of the loan in consultation with the Government of India. A decision has been taken in November 1997 that a choice may be given to State Governments to raise 5-35 per cent of the market borrowing allocations through "Auction" or through "Tap issue" where the amount is not pre-notified.

2.5 Game players in budget formulation

Macroeconomic Policy : The annual budget formulation exercise is based on macroeconomic policy for the economy as a whole. In the process :

- The Economic Division of the Department of Economic Affairs led by the Chief Economic Adviser reviews the latest trends in the economy and provides a macroeconomic perspective in the form of an Annual Economic Survey.
- The Finance Minister holds regular meetings with the team of officials of the Ministry of Finance led by Finance Secretary, which comprises Secretary (Revenue), Secretary (Expenditure), Chief Economic Adviser and the Additional Secretary (Budget).
- The Finance Minister also invites, for seeking suggestions, leaders of various groups which represent, agriculture, industry, small scale units, trade unions, voluntary organizations, financial institutions, economists, about two months in advance while the process of budget formulation is on.
- Regular consultations are held with the Reserve Bank of India at different levels on all aspects having impact of budgetary outcome on monetary policy and financial sector.

Revenue Estimates: The Department of revenue prepares estimates of revenue based on the continuing discussions in the meetings taken by the Finance Minister, where various alternate scenarios are considered.

Non-Plan Expenditure: Secretary, Expenditure, through a series of meetings with financial advisers discusses the non-plan expenditure estimates for the current year as well as for the next year. Additional Secretary, Budget finally adopts them as input in the budget.

Plan Expenditure: Based on an estimated ceiling given by the Department of Expenditure for plan expenditure in the budget, the Planning Commission finalizes the ministry-wise allocations of the budget support for plan

programs/schemes for the Central government. These are based on extensive discussions with each Ministry/Department and the PSEs on their plan proposals and estimates of resources.

External Assistance: The Project Management Unit (PMU) of the Department of Economic Affairs, in consultation with the Controller of Aid Accounts and Audit (CAA&A) prepares project-wise/state-wise estimates of external assistance and these estimates are given to the Planning Commission for incorporating the same while making plan allocations.

(*Some of the important features of the budgetary process are given in Annex*-2.1).

Chapter III
Fiscal Sector : Reforms and Trends

3.1 Fiscal Sector Reforms

Fiscal sector reforms were perhaps the most critical part of the macroeconomic stabilization and reforms initiatives taken by the government after the 1991 economic crisis. Notwithstanding the initial fiscal adjustment measures for correcting the fiscal imbalances immediately after the crisis and the subsequent fiscal reforms, a high level of deficits in the government budgets particularly during the second half of 1990s, continue to constrain growth impulses for the economy. The level of fiscal deficit combined both for the Central government and State governments is more or less at the same level at the end of 1990's as it was at the beginning. Government debt is approaching a critical mark beyond which it could be labeled as unsustainable. Almost all the state governments are facing hard budget constrain in providing even the basic minimum services through budget. Capital expenditure through budget has come down sharply. Public sector saving has hit the bottom, it being almost negligible.

Any review or assessment of fiscal sector reforms should perhaps be seen in the backdrop of certain operational features of the Indian fiscal system which have resulted in a slow and less satisfactory outcome. The complexity of the fiscal issues inter linked with all other macro variables, deeply entrenched systemic elements of administration, historically strengthened rigidities of expenditure pattern, democratic constraints on unpopular fiscal and tax measures, and above all political uncertainties made fiscal reforms, the most challenging task for all shades (different political parties) of governments notwithstanding a near consensus on the need of such reforms. The structural rigidities, therefore, continue despite a wide ranging reform measures.

Complexity and inter-linkages : Tax rationalization process particularly for indirect taxes was not only a matter of complex structure but also inter-linked to reform measures to be taken in other sectors like foreign trade policy, industrial policy, opening of the economy for foreign investment, financial sector reforms etc. The fiscal reform measures thus need be sequenced, aligned and restructured alongwith the reforms in all other sectors.

Administrative structure : The deeply entrenched complex and rigid tax administrative structure has to change with modern practices and even with psychology and spirit of reforms. Even the tax payers lobbies could have interest

in continuing with the same structure of discretionary concessions and *ad hoc* benefits.

Rigidities of expenditure pattern : The allocation of budgetary expenditure in terms of contractual and obligatory payments like interest payments, pensions, defence, transfers to states, etc. have been growing in such a proportion that there has been very little scope of any sharp change in the allocation pattern of expenditure in a short period.

Democratic limitations : It is now well known that there remain certain basic issues which no elected government would prefer to even raise. Taxing agricultural income, sharp reduction of food subsidy, sharp downsizing of government staff etc. are some such issues which no government has been able to face head on, howsoever, critical these may be for correcting fiscal imbalances.

Political uncertainties : Political uncertainties particularly during the second half of the 'nineties was an important factor for delays in implementation of reforms-so speedily required in a well structured sequence.

Late start of State level reforms : It actually took long to realize, formulate and initiate fiscal sector reforms at state government levels despite the need for a well synchronized mechanism for reforms.

Given the wide range of fiscal sector reforms, particularly at micro level, in-terms of changes in tax reforms and expenditure management, it is well beyond the scope of this study to list out all the measures taken during the last decade or so. An attempt, therefore, has been made in this part of the chapter to highlight the major areas of reforms strictly confined to fiscal sector at macro level.

3.1.1 Tax Reforms

Tax reforms during 1990s have been mainly guided by the report of the Chelliah Committee on tax reform (1993). The main objectives have been simplification of the tax system, rationalization of tax rates, fairness in tax system, improvement in tax administration and above all providing a growth promoting tax structure. The wide range of reform measures taken during the last decade include—in the case of direct taxes: moderation of tax rates, widening of tax base, incentives for development of infrastructure and housing and strengthening of enforcement, and—in the case of indirect taxes: reduction in multiplicity of rates, rationalization of the rate structure, drastic reduction in the scope for discretionary changes and uniform floor rates for sales tax by the States. Further, rationalization and improvements in tax administration, of course, is a continuing process.

An assessment of tax reform measures in India (World Bank, Jan., 2000) has shown significant improvements (compared to pre-reform status) in tax structure in terms of 'economic neutrality', equity, revenue predictability (actual/budget ratio), administrative effectiveness etc. but deterioration in revenue adequacy (tax buoyancy) and revenue stability. (*see* Annex-3.1)

3.1.2 Disinvestment / Privatization/Public Sector restructuring

The strategy towards public sector enterprises reform encompasses a judicious mix of strengthening strategic units, privatizing non strategic ones through gradual disinvestment or strategic sale and devising viable rehabilitation strategies for weak units. The latest policy announced in the budget speech 2000-2001 by the Finance Minister in Feb., 2000 had the following as main elements:

- Restructure and revive potentially viable PSUs;
- Close down PSUs which cannot be revived;
- Bring down Government equity in all non-strategic PSUs to 26% or lower, if necessary; and
- Fully protect the interests of workers.

During the last two years, financial restructuring of 20 PSUs has been approved by the Government. As a result, many PSUs have been able to restructure their operations, improve productivity and achieve a turnaround in performance. Even so, a large number of procedural as well as policy issues continue to constrain the progress on disinvestment process.

Various fiscal reform measures relating to Central Public Enterprises (CPEs) undertaken by the Central government have shown some noticeable improvements in the finances of these enterprises during the decade (1990s). In particular, it needs to be noted that budget support (plan+non-plan) to CPEs as a per cent of GDP has come down to only 0.5 per cent in 1998-99 from 1.5 per cent in 1990-91 and CPEs deficit GDP ratio has come down to 1.3 per cent in 1998-99 from 3.0 per cent in 1990-91. Moreover, profitability trends have shown a distinct improvement. The profit after tax, as per cent of net worth, for CPEs, had increased to 10.4 per cent in 1997-98 from 3.9 per cent in 1990-91 (*See* Annex-3.2).

3.1.3 Systemic reforms in Government's borrowing process

Though largely treading on financial sector reforms, the significant changes in the process of central government borrowings to meet the budgetary deficits and temporary mismatches have been part of the fiscal sector reforms as well.

Switchover to borrowings by government at market related interest rates, abolition of the system of automatic monetization of the budget deficit, implementing a new system of ways and means advances, and developing as well as deepening government securities market have changed the whole system of financing the budgetary deficit and its relation with monetary policy stance. (*See* Annex-3.3 for an authentic summary of reform measures relating to Government Securities Market).

The new system of ways and means advances (WMA), already explained in chapter 2, implies vacation of advances made by the RBI to the government with limits fixed for a given time period (Ten days). This system has provided scope for a judicious credit creation, possibilities for monetary targeting, a closer monetary and fiscal policy interactions, and mechanisms for open market operations to take care of surges in inflows of foreign capital. (*Reddy,* 2000b).

Notwithstanding the fact that greater reliance on market borrowings and bond finance (BF) and that too at market related rates rather than less borrowing along with monetization route, has led to an excessive debt burden for the government, empirical testing in a recent research study (Moorthy et.al. 2000 June) has shown that move to market borrowings has been beneficial as :

(i) there is no evidence of a systematic shift to an unstable debt regime during the 1990s;
(ii) reduction in monetization has helped curb the fiscal deficit by inducing a fall in primary expenditures larger than the rise in interest payments,
(iii) the decline in private sector interest rates due to the move to market borrowing indicates that overall costs of private borrowings are likely to have declined, and
(iv) there has been a surge in private investment relative to public investment.

Nevertheless, the study points out that Central and State government finances are in precarious condition due to large non-market debt, unfounded liabilities and contingent liabilities.

3.1.4 Expenditure Reforms Commission

To carry the process of reducing the growth in non-developmental expenditure, the government has set up (in February, 2000) an Expenditure Reforms Commission. The main terms of reference for the Commission are as follows :

- To suggest a road map for reducing the functions, activities and administrative structure of the Central Government.
- To review the framework of all subsidies, both explicit and implicit for maximizing their impact on the target population and minimize cost.
- To review the framework for determination of user charges of Departmental and Commercial activities : suggest an effective strategy for cost recovery.
- To review the adequacy of staffing under Central government Ministries, attached offices etc.
- To review the procedure for setting up of government funded autonomous institutions.
- To consider any other relevant issue concerning expenditure management in government and make suitable recommendation.

The Commission has already submitted to the government a few interim Reports.

3.1.5 Fiscal Reforms Program for the States

Of late, several State governments have been facing acute financial problems due to various structural rigidities as well as *ad hoc* compulsions including steep pay hikes to their employees. Specific time bound fiscal reform programs have, therefore, been discussed in the National Development Council (represented by the Chief Ministers of States) and with the Finance Minister. It was felt that joint effort on the part of the Centre as well as Sates is required to devise a medium term strategy for fiscal reform programs in the States. This strategy has taken the form of a package of advance financial assistance to be provided by the Centre to the States for an appropriate time bound reform program by signing a Memorandum of Understanding (MOU). Thirteen States have so far entered into an agreement with the Centre. These states are Punjab, Rajasthan, Himachal Pradesh, Manipur, Nagaland, Mizoram, Orissa, Sikkim, Uttar Pradesh, Madhya Pradesh, Assam, Andhra Pradesh and Jammu & Kashmir.

The main objective of the program is to wipe out the revenue deficit in the State budget in the medium term. The program components are:

- Reduction in Non Plan Revenue Expenditure, through appropriate taxation and expenditure measures and down-sizing of Government, where possible;
- Pricing/subsidy reforms, to reduce fiscal burden of the State and improve allocative efficiency;

- Institutional reforms, to improve regulation and efficiency in delivery of public services and;
- Reduction in the role of Government in nonessential areas, through decentralization, disinvestment and privatization;

Box : 3.1
Recent Policy Initiatives taken by States to stabilize their finances

The States have recognized the macroeconomic implications of the fiscal problem and some of them have in fact taken several policy initiatives to stabilize their finances. These measures, *inter alia,* include the setting up of Consolidated Sinking Fund for retiring public debt, the setting of ceiling on guarantees to place a cap on contingent liabilities and the establishment of guarantee redemption funds. The States of Assam, Karnataka and Maharashtra have recently presented White Papers detailing the fiscal health of the States in 2000. The States of Andhra Pradesh, Arunachal Pradesh, Goa, Maharashtra, Mizoram, Nagaland and West Bengal have taken initiatives for setting up of Consolidated Sinking Funds to help retire debt repayments. The States of Gujarat and Karnataka have prescribed limits on guarantees, while Rajasthan has proposed the setting up of a Guarantee Redemption Fund. As an important budgetary measure, States have begun to focus on expenditure management through setting up of expenditure reforms committees. Some States have adopted decentralization as the main policy plank through which expenditure moderation would be achieved. Several States have initiated measures for reduction in non-merit subsidies, through better targeting and revision of user charges. On the resource mobilization front, States have set the stage for introducing VAT through an agreement to impose uniform level of sales tax. It is important to note that the financial health and management of State level public sector undertakings have been a cause for concern. To address this issue, Maharashtra has proposed to set up a Board for Financial and Managerial Restructuring. Finally, to enhance transparency in their budgetary practices, several States have published summary critical fiscal indicators in their budgets for 2000-01 along the lines of the document entitled 'Budget at a Glance' presented by the Centre.

(RBI. Annual Report 1999-2000, p. 66)

The important policy initiatives towards reform as culled out from the Budget Speeches of the State Government Budgets for the year 2000-2001 and other supplementary information, classified broadly into fiscal consolidation, institutional and sectoral reforms have been summarised in a recent RBI study (RBI, December 2000) and may be seen in Appendix 3.1.

3.1.6 Project Management Unit (PMU) for Externally Aided Projects.

A mechanism of monitoring the externally assisted projects/programs has been evolved in the form of a Project Management Unit (PMU) in Department of Economic Affairs. The PMU in close coordination with the Controller Aid

Accounts and Audit, Planning Commission and State governments performs the following tasks:

- The Effective monitoring of implementation of EAPs.
- Regular review of disbursements to States.
- Strengthening of procurement procedures.
- Release of advance assistance.
- Coordination between Budget, Planning Commission, External Finance Division and CAA&A.
- Conducting regular training programs.

3.1.7 RBI initiatives on Reforms in State Finances

In response to the emerging new balances, it has been recognized that finances at the provincial level are critical to the realignment of the role of the state in the economy. Contextually, the Reserve Bank started a close and more intensive interaction with State Governments on a regular basis, and on a wide range of relevant issues. Accordingly, several significant initiatives have been taken during the recent years. (RBI, Jan., 2000)

- Reserve Bank in its role as adviser to the States, had examined the implications of contingent liabilities/guarantees granted by the States to facilitate economic activities. A Committee of State Finance Secretaries has, with the active involvement of Reserve Bank, recommended limits on Government guarantees.
- With the support from Reserve Bank, a Committee of Finance Secretaries of State Governments is presently working on the issue of transparency and voluntary disclosure norms for State Budgets.
- Recently, the States have also been encouraged to access the market for a part of their market borrowings. Within the approved borrowing program, the State Governments are provided with the option of raising resources in a flexible manner in terms of method, timing and maturates. The State Governments can borrow from the market between 5 per cent to 35 per cent of the approved borrowing limit under the new scheme. The State of Punjab, Andhra Pradesh, Tamil Nadu and Karnataka have raised funds directly from the market. The gains from the auction mechanism were seen from the fact that the auction based yield were below the pre-announced rates.
- A Committee of the State Finance Secretaries is currently acting in an advisory capacity to oversee the indicators of financial parameters by the Reserve Bank.

- The Reserve Bank has been advising the State Governments in areas such as cash management, funds management and reforms in budgetary practices. Cash management techniques relate to updating of accounts, data analysis, technology improvements, updating of financial accounting and other codes and prompt analysis of monthly data. Modernization of budgetary procedures and financial practices and development of forecasting models or expert systems are some of the issues being examined as a part of reforms in budgetary practices.
- Mounting debt of the State Governments is increasing the burden on future generations. To achieve some inter-generational equity, Reserve Bank has, in consultation with State Finance Secretaries, developed a scheme for Consolidated Sinking Fund which is optional for State Governments.

3.1.8 Fiscal Responsibility Act

On December 11, 2000 the Government has introduced a Bill in the Parliament titled as "The Fiscal Responsibility and Budget Management Bill, 2000" (Annex 3.4). The proposed legislation is to provide for the responsibility of the Central Government to ensure inter-generational equity in fiscal management and long-term macro-economic stability by achieving sufficient revenue surplus, eliminating fiscal deficit and removing fiscal impediments in the effective conduct of monetary policy and prudential debt management, consistent with fiscal sustainability, through limits on the Central Government borrowings, debts and deficits, greater transparency in fiscal operations of the Central Government and conducting fiscal policy in a medium-term framework and for matters connected therewith or incidental thereto.

7. The important features of the Bill, *inter alia*, provide as under:--

(*a*) laying before both Houses of parliament, along with the annual budget, the Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-economic Framework Statement by the Central Government;

(*b*) appropriate measures by Central Government to eliminate revenue deficit and fiscal deficit and build up adequate revenue surplus;

(*c*) elimination of revenue deficit by 31st March, 2006 and bringing down fiscal deficit to 2% of GDP in the same period;

(*d*) prohibition of direct borrowings by the Central Government from the Reserve Bank of India after three years except by way of advances to meet temporary cash needs in certain circumstances;

(*e*) greater transparency in fiscal operations and to minimization of, as far as practicable, secrecy in the preparation of the annual budget;

(*f*) quarterly review of the trends in receipts and expenditures in relation to the budget by the Finance Minister and placing the outcome of such reviews before both Houses of Parliament.

(*g*) the Central Government to cut expenditure authorizations in a proportionate manner, while protecting the "charged" expenditure, whenever there is a shortfall of revenue or excess of expenditure over specified targets.

(*h*) Finance Minister to make a statement in both Houses of Parliament explaining any deviation in meeting the obligations cast on the Central Government under this Act and the remedial measures the Central Government proposes to take.

(*i*) relaxation from deficit reduction targets to deal with unforeseen demands on the finances of the Central Government on account of national security or natural calamities of national dimension.

3.2 Recent Trends in Government Finances

Trends in government finances in India continue to remain worrisome. The stabilization measures and economic reform initiatives taken since 1991 after the economic crisis had an encouraging impact in correcting the fiscal imbalances, particularly during the first two years. The trend, however, could not be maintained. Budgetary imbalances widened again reaching almost the same level towards the end of the decade, as it was at the beginning. Analysis of these developments has revealed dominance of structural rigidities in the government finances, erosion of tax-GDP ratio over a longer period, virtual stagnation of non tax revenue and higher growth rates in expenditure compared to growth rates in revenue receipts. This part of the chapter presents a macro review of recent trends in government finances in India.

Box : 3.2
Basics of Structure of Public Finances

Before reviewing the trends in government finances in India it may be of use to first recall the basics of the structure of public finances in a country. These are best summarised in the Report of the Eleventh Finance Commission as follows:

> "The structure of public finances in an economy is defined by the level and composition of expenditure of the government (current and capital) and the instruments relied upon to finance them, viz., the tax and the non-tax revenue sources and borrowings. The excess of government expenditure over current revenues and other non-debt receipts gets reflected in fiscal deficits financed either by way of borrowings from internal and external sources or through

seignorage, that is money printing. If expenditure persistently exceeds revenues, fiscal deficit, to the extent it is not covered by seignorage, steadily adds to outstanding debt, resulting in increasing interest payments. Unless met with larger revenue receipts, this gives rise to a self-perpetuating spiral of debt and deficit. In the absence of commensurate increase in domestic savings, deficits in government budgets tend to spill over to the external sector in the form of current account deficit leading eventually to adverse balance of payments. This, in turn, jeopardizes the macro-stability, judged by stability of prices consistent with growth at attainable full employment levels. The solvency of the economy also comes under doubt. A restructuring programme is called for to steer public finances away from such a spiral towards sustainable levels of debt and deficit".

3.2.1 Trends in Aggregate Budgetary Balances

Trends in different measures of budgetary balances both for the Central government and State governments as given in table 3.1 for 1990s show that:

- The level of **fiscal deficit** in 1999-2000 **combined** for Central and State governments at 9.84 per cent of GDP was almost at the same level (9.64%) as in 1990-91, the crisis year. Latest available estimates (RBI, 2000, Aug.) show that for 2000-01 (BE) the combined fiscal deficit level at 8.6 per cent of GDP is significantly higher compared to the average of actuals for such a ratio during the period from 1990-91 to 1998-99 which is 7.7 per cent.
- Fiscal deficit in the **Central government** budget for 1999-2000 (RE) at 5.6 per cent of GDP though lower, compared to the 1990-91 level of 8.3 per cent is not significantly lower from any other year during 1990s except for 1993-94. Comparable estimates (excluding states share in small savings) show that the 1999-2000 (RE) level at 5.6 per cent of GDP is higher than the average level of fiscal deficit during 1991-92 to 1998-99, which was 5.0 per cent (RBI, 2000 Aug.).
- State governments together had a fiscal deficit of 4.7 per cent of GDP at its historical high in 1999-2000(RE)-way above the average of 3 per cent for the period 1990-91 to 1998-99.

Table 3.1 Aggregate Budgetary Balance : Centre and States

Year	Fiscal deficit			Revenue Deficit			Primary Deficit		
	Centre	States	Combined	Center	State	Combined	Centre	States	Combined
							(% of GDP Old Series)		
1990-91	8.33	3.28	9.64	3.47	0.84	4.31	4.32	1.69	5.00
1991-92	5.89	2.93	7.17	2.64	0.81	3.45	1.58	1.19	2.19
1992-93	5.69	2.92	7.38	2.63	0.72	3.36	1.29	1.06	2.23
1993-94	7.43	2.49	8.68	4.04	0.47	4.51	2.90	0.56	3.39
1994-95	5.99	2.86	7.36	3.22	0.73	3.95	1.42	0.84	1.93
1995-96	5.38	2.75	6.81	2.66	0.77	3.43	0.91	0.86	1.61
1996-97	5.23	2.97	6.82	2.56	1.43	3.98	0.57	0.97	1.35
1997-98	6.21	3.10	7.74	3.24	1.29	4.53	1.63	1.00	1.40
1998-99	6.80	4.47	9.50	4.08	2.72	6.80	2.13	2.34	3.23
1999-2000(RE\BE)	5.96	4.98	10.40	4.03	3.13	7.16	0.96	2.55	2.13
							(% of GDP New Series)		
1993-94	*7.01*	*2.35*	*8.19*	*3.81*	*0.45*	*4.25*	*2.74*	*0.52*	*3.20*
1994-95	*5.71*	*2.73*	*7.02*	*3.07*	*0.70*	*3.77*	*1.35*	*0.80*	*1.84*
1995-96	*5.10*	*2.60*	*6.44*	*2.52*	*0.73*	*3.25*	*0.86*	*0.81*	*1.52*
1996-97	*4.90*	*2.79*	*6.40*	*2.40*	*1.34*	*3.73*	*0.53*	*0.91*	*1.26*
1997-98	*5.87*	*2.93*	*7.32*	*3.06*	*1.22*	*4.28*	*1.54*	*0.94*	*1.33*
1998-99	*6.43*	*4.23*	*8.99*	*3.85*	*2.57*	*6.43*	*2.01*	*2.22*	*3.06*
1999-2000(RE/BE)	*5.64*	*4.71*	*9.84*	*3.81*	*2.96*	*6.77*	*0.90*	*2.41*	*2.02*

Note: Figures in italics indicate deficits as per cent of GDP (New Series). Old series for 1997-98 to 1999-00 have been derived from the New Series by using a conversion factor 1.0577. For 1999-00, FD and PD of the Centre exclude the States' and UT's share of small savings.
Source: Report of Eleventh Finance Commission, June 2000.

Box : 3.3
Data and Reviews on Government Finances

Government finances being the key to macroeconomic stability remain under constant watch and review and exhaustive reviews on trends and current status are available periodically both from the government as well as RBI publications. It has been a welcome coincidence for this study to have an authentic and detailed review of government finances in the Report of the Eleventh Finance Commission, (a statutory body set up every fifth year) published in June, 2000 by the Government of India. One of the terms of reference of the Commission was to 'review the state of finances of the Union and the States and suggest ways and means whereby the governments, collectively and severally, may bring about a restructuring of the public finances so as to restore budgetary balance and maintain macro-economic stability'. This part of the chapter, therefore, draws heavily on the analysis and data given in the Eleventh Finance Commission Report as well as in Reports from the RBI.

A closer look at the different measures of deficit would reveal perhaps a more worrisome trend in that the fiscal deficits are being driven more and more by deficits in the revenue account of the budget. Thus revenue deficit of the Central government which accounted for about 40 per cent of the fiscal deficit in the budget in 1991-92 is now about 68 per cent. Much more so in the case of state budgets, where the increase in revenue deficit to fiscal deficit ratio is from about 28 per cent in 1991-92 to about 62 per cent in 1999-2000. These trends simply show that the government is increasingly borrowing to finance non-asset creating expenditure from where no returns are expected. Further, the trends in primary deficit, show that increasing interest burden alone, is not the contributory factor in higher level of deficit. Latest available estimates indicate that the combined primary deficit in 1999-2000 (RE) at 4.2 per cent of GDP was highest during 1990s except for the crisis year (1990-91) when it was 5.0 per cent. (In table 3.1 it is low at 2.02%).

Another important trend on deficits is the increasing number of State governments with higher levels of deficit. Thus in 1999-2000, 13 out of the 25 state governments had faced fiscal deficit level of more than 7 per cent of their respective state domestic product, compared to 6 states in 1990-91, 4 states in 1995-96 and 8 states in 1998-99 (**Table 3.2**).

Table 3.2 Frequency Distribution of States according to size of Revenue Surplus/Deficit and Fiscal Deficit [as % of Gross State Domestic Product (GSDP)]

Surplus/ Deficit (-)	1990-91		1995-96		1998-99		1999-2000 BE	
(% of GSDP)	RS/RD	FD	RS/FD	FD	RS/RD	FD	RS/RD	FD
Surplus	8	2	9	0	6	0	4	0
0 to -1	7	0	5	0	1	0	1	1
-1 to -2	4	0	7	3	2	1	7	0
-2 to -3	5	6	2	5	2	0	2	0
-3 to -5	1	5	1	10	9	5	7	8
-5 to -7	0	6	1	3	3	11	2	3
<-7	0	6	0	4	2	8	2	13
Total	25	25	25	25	25	25	25	25

Source : Eleventh Finance Commission (EFC) Report, June 2000.

The continuing precarious position of state government finances is also reflected from the latest available information that during 1999-2000, nineteen State governments resorted to overdrafts with the RBI as against sixteen in 1998-99 and during the fiscal 2000-01 (up to June 30, 2000) eighteen State governments had resorted to overdrafts while two State governments could not

clear their overdrafts resulting in suspension of payments by the RBI on their behalf.

3.2.2 Trends in Revenue Account Receipts

Erosion in tax-GDP ratio over a long period of almost two decades and virtual stagnation in the level of non-tax revenue have been identified as significant contributory factors in higher levels of deficits in the government budgets, notwithstanding the relatively higher growth rates in expenditure.

Deceleration of growth in tax revenues: An analysis of trends in tax revenues by the Eleventh Finance Commission has shown that the buoyancy of tax revenue of both the Centre and the States which had been declining in the eighties, as compared to the earlier two decades went down further in the nineties (**Table 3.3**).

Table 3.3 Tax buoyancy : Centre and States

	Total Tax Revenue (Combined)	Centre's Gross Tax Revenue	States' Own Tax Revenue
1950-51 to 1959-60	1.38	1.38	1.39
1960-61 to 1969-70	1.16	1.15	1.17
1970-71 to 1979-80	1.30	1.27	1.35
1980-81 to 1989-90	1.14	1.15	1.12
1990-91 to 1998-99	0.96	0.91	1.04

Note : Tax buoyancy refers to the change in tax revenue with respect to change in tax base (income). When it is one, tax revenue is buoyant; when more than one it is highly buoyant; and less than one is less buoyant.
Source : EFC ibid.

With regard to gross tax revenue of the Central government the trends show that between 1990-91 to 1998-99 the **tax-GDP ratio declined by 2.6 percentage points** from 10.8 in 1990-91 to 8.2 per cent in 1998-99. This is partly attributable to the change in the structure (sectoral composition) of the real economy where the share of industrial sector has fallen and **services sector has increased significantly without being brought in the tax-net in a significant way.** Some of the other features of trends in tax revenue are as follows:

- Tax revenue, on an average, could finance about 60 per cent of the centre's revenue expenditure during the eighties. The proportion during nineties, however, was about 55 per cent only.
- Continuing reforms and rationalization of the tax structure, have resulted in a **structural shift** in composition of tax revenue (**Table 3.4**).

- A fall in the share of indirect tax collections from about 80 per cent of total tax revenue in eighties to about 70 per cent in the nineties could not be fully compensated by the increase in direct tax revenue.
- On the states' side, the dip in tax buoyancy occurred as revenue from sales tax, the principal component of their own tax revenue, showed a declining growth trend owing to tax competition among the States to attract trade and industry. (EFC, 2000).

Table 3.4 Composition and Tax GDP ratio : Central Taxes

	1990-91	1995-96	1996-97	1997-98	1998-99@	1999-2000 (BE)
Tax Revenue as a Percentage of Gross Tax Revenue						
Direct (a)	**19.1**	**30.2**	**30.2**	**34.7**	**32.2**	**33.5**
Personnel Income Tax	9.3	14.0	14.2	12.3	14.0	15.2
Corporate Income Tax	9.3	14.8	14.4	14.4	17.0	17.4
Indirect (b)	**78.4**	**69.1**	**69.1**	**64.5**	**66.8**	**65.9**
Customs	35.9	32.1	33.3	28.9	28.6	28.5
Excise	42.6	36.1	35.0	34.5	36.9	36.1
Tax Revenue as a Percentage of Gross Domestic Product						
Direct (a)	**2.1**	**2.8**	**2.9**	**3.2**	**2.6**	**3.1**
Personnel Income Tax	1.0	1.3	1.3	1.1	1.1	1.4
Corporate Income Tax	1.0	1.4	1.4	1.3	1.4	1.6
Indirect (b)	**8.4**	**6.5**	**6.5**	**5.9**	**5.5**	**6.0**
Customs	3.9	3.0	3.2	2.7	2.3	2.6
Excise	4.6	3.4	3.3	3.2	3.0	3.3
Gross Tax Revenue#	**10.8**	**9.4**	**9.5**	**9.2**	**8.2**	**9.2**

(a) also includes taxes pertaining to expenditure, interest, wealth, gift, estate duly and VDIS for 1997-98 and 1998-99;
(b) also includes service tax; # includes taxes referred in (a) & (b) and taxes of Union Territories and "other" taxes. Tax revenue figures for the year 1999-2000 are budget estimates and for the years 1997-98 and earlier these are actuals.
@ : Tax data based on Provisional unaudited tax figures as per Controller General Accounts.
Note : 1. Ratio to GDP at current market prices for the year 1990-91 use old series (Base 1980-81) and from 1995-96 onwards use new series (Base 1993-94) of National Accounts Statistics released by the Central Statistical Organization (CSO).
2. The ratios to GDP at current market prices for 1999-2000 are based on CSO's Advance Estimates.
Source : Economic Survey, 1999-2000.

Following are some of the findings relating to Tax Revenue of Central Government and Sales Tax Revenue of States, in a recent study (*Chaudhuri S.*, 2000b).

- Union excise duty collections have failed to keep pace with manufacturing output growth. The weakness has been in the system.
- The principal factor behind the fall in excise duty collections with respect to GDP is not tax policy *per se,* but the administrative mechanism of collection--the amalgam of compliance and of enforcement.
- The reason for the decline in customs duty with respect to GDP is quite obvious. The reduction in very high specific rates has not been fully offset by the combination of a steady depreciation in the external value of the rupee and the increase in the quantum (volume) of imports. It is unlikely that any reversal of the downward movement in the customs duties to GDP would be greatly reversed.
- The most notable feature of the movement of tax collections has been the steadily rising trend in direct tax collections--almost wholly made up of personal income tax and corporation tax collections. The annualized rate of growth for personal income tax in the period 1992-93 to 1999-2000 has been 17.8 per cent. The counterpart figure for corporation tax was 18.4 per cent. Given that the trend rate of growth of GDP at current market prices was 15.4 per cent in this period, the strong buoyancy for both the major direct taxes suggests enhanced collection efficiency--of compliance and of enforcement.
- Although the ratio of sales tax collections to GDP has not changed much, we do know that rate wars between States and competitive fiscal incentives had significantly eroded sales tax collection capability in the States. The concordat mediated by the Union Government in November 1999 has resulted in Uniform Sales Tax code and resulted in better collections in most States in the current fiscal (2000-01). The agreement between the States has also frozen any fresh sales tax incentives to new investment, although incentives already granted would continue to be operative.

3.2.3 Trends in Non Tax Revenue

On the whole, non-tax revenue growth has **practically stagnated** at both levels of government, during the nineties. For the Central government budget, it was, on average, 2.5 per cent of GDP during eighties and the same level during nineties. Apart from the interest receipts the other two main items of non-tax receipts are (i) return on investments of the Government and (ii) recovery of cost of public services. By way of dividend and interest, return on Central government investment in public enterprises even though has shown some

improvement was about 5.21 per cent in 1998-99. Trends in profitability and finances of Central Public Enterprises have shown a distinct improvement during 1990s (*See* Annex-3.2). Rates of return of most of the State government enterprises, based on latest available accounts show that **it does not cover even a fraction of their cost of funds.**

Box 3.4
The Role and Importance of Non-Tax Revenue

As the government borrows resources from the public to invest in new assets, tax revenues should rise through additions to public good assets. Improvement in public infrastructure should lead to improvement in efficiency and in adding new private investment, and hence to buoyancy in tax revenues. Similarly, **non-tax revenues** should rise through increasing dividends from public enterprise investment in infrastructure and other activities. If, however, resources are borrowed for investment in activities which do not yield adequate returns, debt service payments will rise continuously as a proportion of total revenues. This is what seems to have happened in India over the last 20 years. The return on net worth in central public sector enterprises, excluding petroleum companies, is not significantly different from zero. Thus investment made in infrastructure or other activities through public sector enterprises have not yielded pecuniary returns to the government. Such returns would occur as increasing dividend payments from the public enterprises to the central government. **In the budget they would be shown as 'non-tax revenues'.** Wrong pricing policies, inefficient public enterprise operations and other difficulties have all contributed to this situation of low returns.

Mohan, Rakesh (2000)

Results of a study (NIPFP) for the year 1995-96 and 1996-97 has shown that recovery rates were as low as 8.4 per cent of the costs for social services provided by the Centre and 16.6 per cent for economic services implying subsidization varying from 91 to 83 per cent of the costs. **The level of cost recovery is still lower in the case of States.** It is 2.15 per cent for social services and 10.75 per cent for economic services as shown in **Table 3.5**.

Table 3.5 Indicators of Cost Recovery (Ratio of Non-tax Revenue Receipts to Non-Plan Revenue Expenditure) in States

(per cent)

Items	1990-91	1998-99 (RE)
Social Services		
Education	1.17	0.85
Health	4.18	5.47
Economic Services		
Irrigation	8.91	9.56
Power	37.05	11.84
Road	13.73	15.61

(Source : RBI. State Finances : A Study of Budgets 1999-2000, January 2000)

Although not much appears to have been done by the State Governments to increase recovery rates and thus enhance non-tax revenue receipts, some of the State Governments have, of late, announced some specific measures towards increasing non-tax revenue. Punjab government, for example has announced in the State budget for 2000-2001 for Indexation of user charges and fees for transport, power sectors to cost of fuel, salaries, electricity etc. (*see* Appendix 3.1 for state-wise policy initiative).

3.2.4 Trends in Budget Expenditure

(a) Central Government

- Central Government's total budget expenditure (Revenue+capital) as a proportion to GDP is lower at 15.72 per cent in 1999-2000 (RE) compared to 17.85% in first half of nineties and 20.47 per cent in the second half of eighties (1985-90).
- But the worst thing to happen is a sharp fall in capital expenditure/GDP ratio from (average) 6.78 per cent during 1985-90 to just the half at 3.17 per cent (average) during 1995-2000. It was only 2.62 per cent in 1999-2000(RE).
- Even revenue expenditure ratio was lower at 12.16 per cent of GDP during the second half of nineties compared to 13.69 per cent in the second half of eighties.
- The reduction in revenue expenditure/GDP ratio is despite the fact that interest payments/GDP ratio has increased from 3.38 per cent in second half of eighties to 4.73 per cent in 1999-2000.

Table 3.6 Trends in Expenditure : Central Government

(As % of GDP)

ITEMS	1980-81 to 1984-85 (Average)	1985-86 to 1989-90 (Average)	1990-91 to 1994-95 (Average)	1995-96 to 1999-2000 (Average)	1999-2000 (RE)
Total Expenditure	**16.82**	**20.47**	**17.85**	**15.33**	**15.72**
(Revenue+Capital)					
Revenue Exp.	10.69	13.69	13.24	12.16	13.10
Capital Exp.	6.13	6.78	4.61	3.17	2.62
Interest Payments	2.20	3.38	4.37	4.61	4.73
Revenue Expenditure					
minus Interest Payment	8.49	10.31	8.87	7.55	8.37
Pension	0.27	0.42	0.40	0.49	0.74
Revenue Expenditure					
***minus* Interest & Pension**	**8.22**	**9.89**	**6.47**	**7.06**	**7.63**
Grants to States	1.96	2.45	2.44	1.58	1.52

Source : Based on data in Appendix 3.2(a).

- The other major item of expenditure which has increased sharply is the expenditure on pensions.
- Thus, revenue expenditure excluding interest and pension as a per cent to GDP has fallen from about 10 per cent (average) during 1985-90 to about 7 per cent (average) during 1995-2000.
- Contrary to general perception, expenditure on subsidies as per cent of GDP has fallen in the second half of nineties compared to 'eighties, notwithstanding, a slight upward trend during 1995-96 to 1998-99. It has been reduced even in absolute terms during 2000-01 compared to the previous year.
- Even revenue expenditure on defence as percent of GDP has been less than 2 per cent during nineties compared to more than 2.5 per cent during eighties (on average).
- Budgetary support for the Central Plan as proportion to GDP has not increased during nineties.
- Grants to States as per cent to GDP have been lower during 1995-2000 compared to 1990-95 and 1985-90 (on average basis).
- An important recent development leading to bulge in non-plan revenue expenditure during 1997-98 and 1998-99 has been an abnormal increase in the expenditure on salaries of the government staff.

- In 1997-98, as a consequences of revision in pay and pensions, the salary bill of Central government employees (excluding Telecom, Posts and Railway-being departmental undertakings) registered an increase of 33.6 per cent and pension bill by 35 per cent and put together accounted for almost 2 per cent of GDP.
- In fact salaries and pensions together used 20.8 per cent of the total revenue receipts in 1998-99 compared to 17.4 per cent earlier (prior to revision).

A profile of expenditure on major items as per cent of total expenditure (Appendix 3.3a) also brings out that the share of 'other non-plan expenditure' (other than the major items) has shown a decline of almost 2 percentage points in 1999-2000 when compared to the average level of such a share during the second half of eighties.

(b) States : Budgetary expenditure

- Total budgetary expenditure (Revenue+capital) of all the State governments, as a percentage to GDP is lower by about one percentage point from second half of eighties (1985-90) to second half of nineties (1995-2000) on average basis.
- The reduction in total expenditure to GDP ratio from 16.37 per cent in 1985-90 to 15.44 per cent in 1995-2000 is only because of a reduction in capital expenditure to GDP ratio from 3.21 per cent to 2.11 per cent.
- The revenue expenditure to GDP ratio is marginally higher at 13.33 per cent during 1995-2000 (on average) from 13.16 per cent in 1985-90 (on average) mainly because of an unprecedented increase on ratio during 1999-2000 when the ratio is 14.61 (**Table 3.7**).

Table 3.7 Trends in Expenditure : All States

(as % of GDP)

	1980-81 to 1984-85 (Average)	1985-86 to 1989-90 (Average)	1990-91 to 1994-95 (Average)	1995-96 to 1999-00 (Average)	1999-2000 (RE)
Total Expenditure (Revenue+Capital)	**15.26**	**16.37**	**16.08**	**15.44**	**15.77**
Revenue Expenditure	11.47	13.16	13.51	13.33	13.82
Capital Expenditure	3.79	3.21	2.57	2.11	1.95
Interest Payments	0.99	1.42	1.83	2.00	2.27
Revenue expenditure *minus* Interest Payment	10.48	11.74	11.68	11.22	11.55
Pensions	0.29	0.47	0.62	0.87	1.04
Revenue Expenditure *minus* Interest and Pensions	**10.19**	**11.27**	**11.06**	**10.35**	**10.51**

Source : Based on data in Appendix 3.2 (b).

- However, if interest payments and expenditure on pension is taken out, the remaining revenue expenditure as per cent of GDP has fallen from 11.27 per cent in 1985-90 (on average) to 10.35 per cent in 1995-2000 (on average).
- Thus, the increases in interest payments and pensions have been at the cost of capital expenditure of the State governments. 'The net result is that with falling overall expenditure and rising non-developmental expenditures, the State governments' ability to invest in productive activities has been compromised very significantly.' (Mohan, Rakesh, 2000) (*see* Appendix 3.3b)
- The impact of revision in salaries and pensions during the last three years has been much more severe on the state government finances. In several States, salary related expenditure absorbs over two-third and in some (e.g., Maharashtra), nearly three-fourths, of their revenue receipts. According to one estimate (RBI, 1999b) 'additional expenditure commitment on account of pay revision was to the extent of 1.1 per cent of the GDP.'
- Results of an analysis of trends in state government finances during the last two decades in a recent study (Chaudhuri, S, 2000) have shown that the pay revision not only impacted on the 'non-development' component of revenue expenditure, but also the 'developmental component, since these needs include a large proportion of salary related expenses, such as grants-in-aid to schools and colleges for payment of teachers salaries.

Box : 3.5
The Problem of State Finances

In the context of examining the difference in performance among States the problem of State finances has been reviewed in a recent study and in terms of trends it is found *inter alia* that :

- The financial position of most states is actually forcing a continuing squeeze on plan investment. As recently as 1990-91, several states had a positive balance from current revenues (BCR) which contributed something to finance the plan. This balance has now turned negative for almost all states which means that state governments have to borrow to finance the negative BCR, and then borrow even more to finance the plan. (BCR is the surplus of current revenues over non-plan current expenditure. When this is positive, it contributes alongwith borrowed resources, to finance the plan).
- For the 14 states as a whole the ratio of interest payments to tax revenues has increased from 7.7 per cent in 1980-81 to 13.1 per cent in 1990-91 and further to 17.6 per cent in 1996-97. The 10 percentage point increase in interest payments over 17 years for the 14 states taken together has obviously squeezed the capacity of the states to finance normal developmental expenditure from current revenues.
- In 1992-93, SEB losses were Rs. 2,725 crore or 9.8 per cent of total state plan expenditure in that year. They have increased to around Rs. 13,000 crore in 1998-99, which is around 18 per cent of total state plan expenditure.

"'What needs to be done to tackle the financial problem of the States is well known, though that does not make it easier".

--Ahluwalia, Montek S. (2000)

3.2.5 Issues of Policy and Management

The trends in governments finances, as summarized above, raise a large number of macro issues relating to both the policy as well as management of expenditure resources and debt.

	Policy	Management
Expenditure	Expenditure reorientation	Expenditure
Management		
Resources	-Tax policy	-Tax administration
	-Disinvestment	-Management of
assets		
	-Returns on assets	
Debt	Sustainability of Debt	Debt Management

Debt : The nominal stock of domestic debt of the combined government sector has been growing at a rate of about 16 per cent during the later part of the 1990s. At end-March 2000 the stock of domestic debt was 60.7 per cent of GDP. As high levels of public debt have deleterious effects on macroeconomic stability, the need for reducing the fiscal deficit and debt to sustainable levels through institution of policy oriented fiscal rules is widely felt. (RBI 2000, Aug.). On the management of public debt, the issues are to minimize the cost of borrowing and to avoid concentration of debt towards the shorter end leading to bunching of

redemption and roll-over problems. The RBI and the Deptt. of Economic Affairs, Ministry of Finance have a joint committee to regularly review the management of debt operations and status.

Resources : Raising of resources through taxes is a complex and long term policy issue for any government. The tax revenue, among other things, is mainly linked to the developments in the real economy. Major policy decisions have to be taken considering a large number of theoretical principles of equity, progressivity and also the considerations of political pragmatism.

On the management side, the administrative reforms including modernization of the tax collection system is the most critical task for the government.

The policy on non-tax revenue, including returns on investments made in the public sector enterprises, has been an issue of wide debate in the economy. However, it is the management of the process of disinvestment, privatisation and restructuring of PSUs, which is found to be most critical.

Expenditure : It is the expenditure policy which, in the ultimate sense is responsible for the success or failure of the whole fiscal policy stance. It is not the allocation of budgetary resources alone which matter, but there is a larger issue of state policy, effective governance and impact of the expenditure which assumes importance.

Box : 3.6
The need of Expenditure Management

Expenditure management through appropriate prioritization and control is important for any government. The tension between containing the deficit and providing adequate outlays for the relevant heads makes expenditure prioritization an even more important issue in India than what it is in many other countries. There is need for more schools, hospitals, roads, hydroelectric and multipurpose irrigation projects, etc, on the one hand, and sticking to fiscal prudence on the other. One of the traditional ways of safeguarding the fiscal balance is through a strict adherence to appropriate budgeting techniques and procedures.

(*Lahiri Ashok K., 2000*)

Expenditure policy in fact has to pursue all the general objectives of macroeconomic policy : growth, stability and equity. Thus effective management of public expenditure becomes the real challenge. The performance of the state policy at the end of the day is measured only in terms of effectiveness of public expenditure, efficiency of resource use and a responsive system. An attempt has, therefore, been made in the next chapter to review and assess the public expenditure management system in India.

Appendix 3.1

Statement A : Major Policy Initiatives by State Governments in 2000-01

States	Fiscal	Institutional	Sectional
1. **Andhra Pradesh**	To identify performance indicators to assess the quality of expenditure restructuring. To also carry out the exercise of Zero Based Budgeting.	Strengthening governance to ensure provision of efficient and responsive services to the common man through streamlining of systems and procedures.	Continuation of the restructuring of the power sector by setting up four distribution companies.
2. **Arunachal Pradesh**	Sales tax levied for the first time, on five items.	Submission of the report of State Resource Mobilization and Economy Commission.	Focus on horticulture by preparing a macro level plan for the entire State.
3. **Assam**	Proposed to introduce Assam Taxation (Settlement of Disputes) Bill to expedite collections.	Proposed to constitute an 'Assam Infrastructure Development Fund'.	Thrust to be given to farm mechanization. Inauguration of an Export Promotion Industrial Park
4. **Bihar**	Proposed to incorporate codes to the sub heads in various accounts to avoid financial irregularities.	Proposed to computerize the revenue records.	Attempt to strengthen the electricity and irrigation sectors with the help of NABARD.
5. **Goa**	Proposed to levy entry tax. Also proposed to levy cess on milk for dairy development.	Strengthening of decentralization process.	Focus on environment protection through 'Green Goa-Fund' and 'plastics containment fund'.
6. **Gujarat**	Revision/introduction of user charges/fees by Government departments.	Computerization of 10 per cent of office work in Government.	Five milestones set up for Human Development Index. Set up an Indian Institute of Information Technology (I.I.I.T.)
7. **Haryana**	Fiscal restructuring measures through downsizing the Government.	To set up an 'Economic Development Board' under the Chief Minister.	Constitute a 'Haryana Live Stock Development Board'.
8. **Himachal Pradesh**	White paper on fiscal position and emerging fiscal scenario prepared.	Proposal for a 9-point charter to determine a working plan for each department.	Focus on prioritizing the upgradation of farm machinery.
9. **Karnataka**	T ensure that the borrowing programme would be confined to priority sectors and used for capital expenditures. Aboilition of 80 per cent of vacant posts in the government.	A public sector restructuring committee has been set up to make recommendations regarding the future of the State's PSUs.	Commissioning of a Software Technology Park. Setting up of the Infrastructure Development Corporation of Karnataka and continuation of the infrastructure cess.

States	Fiscal	Institutional	Sectional
10. **Kerala**	Restructuring of revenue Department completed. Computerization of treasuries strengthened.	Constituted a Kerala Infrastructure Investment Fund. Steps initiated for computerization of the commercial tax department.	Focus on Information Technology. First phase of State Information Infrastructure is under implementation. Tourism is another area of focus.
11. **Madhya Pradesh**	Attempt economy in administrative expenditure.		Focus on social sector *viz.,* education, health and family welfare, trebles etc.
12. **Maharashtra**	Restriction on filling up of vacancies occurring due to retirement. Borrowing to be used only for investment purposes.	Set up a Board for Financial and Managerial Restructuring. Setting up of an Expenditure Reform Committee. Proposal to initiate reforms in the budget making process through new disclosure norms and greater transparency.	Biggest IT park to be inaugurated in the State.
13. **Manipur**	ARM through tax and cost based user charges proposed. Also proposed to improve the recovery efforts of State Financial Institutions. All Schemes subject to Zero Based Budgeting Scrutiny.	Task Force constituted to assess revenue collection efforts. Voluntary Retirement Scheme to be introduced. Functioning of PSUs to be reviewed.	Upgradation/improvin g the social infrastructure particularly education, water supply and health.
14. **Meghalaya**	The system Letter of Credit for cheque drawing departments and Letter of allotment for other department, introduced to maintain financial discipline and control.		Implementing a Special Urban Works Program to help the urban community. Steps to be taken to create a separate establishment for promotion of information technology in the State.,
15. **Mizoram**	Proposal to stop diversion of Plan Fund for meeting non-plan deficit. Reduction of non-plan non-developmental expenditure.	Strengthening of district level administration	Mechanization and Privatization to be given priority under land development. Setting up of Export Promotion Industrial Parks.
16. **Nagaland**	Enforce a 50 per cent cut in plan expenditure, excluding priority areas. Implement the fiscal reform program as incorporated in the MoU with the Government of India.	Setting up of a 'Committee to look into Manpower Rationalization'.	Restructuring of electricity management with the involvement of village councils. Reorganization and privatization of the transport sector.

States	Fiscal	Institutional	Sectional
17. **Orissa**	State administration to be pruned by 20 per cent to contain non-plan revenue expenditure. Introduction of a Profession tax.	Strengthening institutional mechanisms to counter cyclone and natural calamities.	Setting up of a mega refinery project in Paradeep, with investment of Rs. 8,000 crore.
18. **Punjab**	Indexation of user charges and fees for transport, power sectors to cost of fuel, salaries, electricity etc. Curb in non-productive expenditure through ban on creation of new posts, redeployment of surplus staff, ban on purchase of new vehicles and cap on expenditure on petrol, telephones etc.	To undertake a comprehensive review of functioning of State Public Sector undertakings which would include shutting down of non-functional PSUs after providing suitable safety nets.	A second push to be given to the agriculture sector. Promotion of small and medium enterprises, led by the information technology (IT) sector. The Government has launched a Venture Capital Fund for the IT sector.
19. **Sikkim**	The Government would attempt revamping of administration, revision of user charges, thrust on rightsizing the government and containment of expenditure.		Focus on horticulture, animal husbandry, tourism, power and co-operatives.
20. **Tamil Nadu**	To enhance transparency, information relating to government activities, policy announcements of public interest, etc. have been posted on the website.	The State Planning Commission has reviewed the schemes implemented by various government departments. The government would now examine the recommendations of the State Planning Commission.	Constitution of a Wasteland Development Authority. Setting up of cold storage facilities for preservation of fruits and vegetables. Setting up of industrial, garment, biotechnology and floriculture parks. Separate department has been set up for youth welfare and sports development.
21. **Tripura**	Enhancement in power tariff, leading to 30 per cent increases in revenues of the department.	Tripura Industrial Development Authority is being made functional to promote industrialization.	To set up an Infrastructure Development Fund with a corpus of Rs. 10 crore.
22. **Uttar Pradesh**	A medium-term fiscal policy has been prepared. Simplification in tax procedures.	Strengthening institutional reforms.	Proposal to set up an agriculture university, to explore the development possibilities in agriculture.

States	Fiscal	Institutional	Sectional
23. **West Bengal**	Cash management being strengthened through computerization of treasuries.	Proposed to make at least one primary agricultural credit society within each *gram panchayat*, a multipurpose credit society. Computerization of the Commercial tax directorate has been initiated.	Set up a venture capital fund for information technology. A new incentive scheme to be introduced for setting up industrial units in the State, where instead of tax exemption, a direct annual grant would be given by the State Government for a definite period.
24. **NCT Delhi**	Set up an expenditure review committee to review non-plan expenditure.	Strengthening decentralization and governance strategies.	Proposed to construct an express way on a BOT basis. Establishment of a Hi-Tech City.

Statement B : Initiatives for State Level Power Sector Reforms

State	Status of Reforms and Restructuring
Andhra Pradesh	State Reforms Act enforced and Andhra Pradesh Electricity Regulatory Commission (ERC) has become operational since April 1999. APSEB has been unbundled into Andhra Pradesh Generation Company Ltd. and Andhra Pradesh Transmission Company Ltd. Further four distribution companies have been incorporated out of the APTRANSCO. The APERC has issued its first tariff order.
Arunachal Pradesh	State Electricity Regulatory Commission (SERC) constituted as part of reform.
Assam	Report on tariff rationalization, sponsored by Power Finance Corporation (PFC) submitted. Selection Committee for the selection of chairperson/members, SERC constituted.
Bihar	State has commissioned reforms studies.
Delhi	Government presented strategy paper on reforms and restructuring of power sector. Single member SERC appointed and Delhi Electricity Reforms Bill approved by Ministry of Power, Delhi has since promulgated Reforms Ordinance which provides for unbundling of DVB into one generation company, one transmission company and three distribution companies to be incorporated within three months.
Goa	Government proceeding with restructuring for PFC has sanctioned grant. The notification for setting up SERC issued.
Gujarat	State Reforms Bill being finalized. State Reform Bill submitted to Government of India for approval before introducing the same in the Assembly. Restructuring program emphasized on metering all categories of consumers and imposing cap on agricultural subsidy. SERC functional from March 1999 and is proposing to undertake tariff and reform related studies. SERC has issued first tariff order.
Haryana	State Reforms Act enforced in August 1998 and SERC made operational. SEB unbundled into separate transmission and distribution companies.
Himachal Pradesh	State Government committed to undertake reforms with technical and financial assistance of PFC.
Jammu and Kashmir	Administrative Staff College of India submitted report regarding reforms and formulating long-term perspective plan for 20 years.
Karnataka	State Electricity Reforms Act enforced from June 1999. Two new companies incorporated. SERC functional since November 1999. State signed Memorandum of Agreement (MoA) with Centre, charting out power sector reforms in structured and time bound manner. Completion of privatisation of distribution by December 2001 is the main point of MoA.

Kerala	The State Electricity Board aims to reorganize electricity board into three profit centres for generation, transmission and distribution. Distribution to be further split into three profit centres. CIDA assistance available under Energy Infrastructure Services Project (EISP).
Madhya Pradesh	SERC has become operational since January 1999. Formulated a reform model, which envisages setting up separate power generation, trading, transmission and distribution companies. Measures proposed include 100 per cent metering, reduction of T&D losses, realization of outstanding revenue, etc. State signed MoA with Centre, charting out reforms in structured and time bound manner. Important provisions being 100 per cent electrification of villages, metering of all supplies by December 2001 and at least 75 per cent of the cost of supply of electricity to be charged from consumers.
Maharashtra	State committed to reforms with technical and financial assistance of PFC. Actions were initiated for undertaking tariff and reform related studies. SERC functional since October 1999. MSEB intends formation of Joint Venture Company for distribution of electricity in Bhiwandi area, Thane. MERC has issued first tariff order.
Rajasthan	State Reforms Act enforced. Rajasthan Electricity Board to be unbundled in one generation company, one transmission company and three distribution companies. Rajasthan Electricity Regularoty Commission constituted.
Uttar Pradesh	State Reforms Act enforced. UPSEB unbundled into two generation companies and one transmission and distribution company. UPERC functional. First tariff order issued by UPERC. Privatisation of distribution in Kanpur in the process.
Orissa	First State to initiate power sector reforms. OSEB unbundled. Four distribution companies have been privatized by disinvesting 51 per cent Government equity. OERC has issued three tariff orders.

Source : RBI, (December 2000) State Finances. A Study of Budgets of 2000-2001.

Appendix 3.2 (a)

Revenue and Expenditure of the Central Government

(As % of GDP - Old and New Series)

Item	Average (1980-81 to 1984-85)	Average (1985-86 to 1989-90	Average (1990-91 to 1994-95)	1995-96	1996-97	1997-98	1998-99	1999-2000 (RE)
Gross Tax Revenue	***9.93***	***11.20***	***10.23***	***9.94***	***10.08***	***9.72***	***8.63***	***9.31***
				9.41	*9.45*	*9.19*	*8.16*	*8.80*
less State's & UT's Share	***2.63***	***2.86***	***2.75***	**2.62**	**2.75**	**3.04**	**2.35**	**2.38**
				2.48	*2.57*	*2.87*	*2.22*	*2.25*
Net Tax Revenue	***7.30***	***8.34***	***7.48***	**7.32**	**7.34**	**6.68**	**6.28**	**6.92**
				6.93	*6.88*	*6.31*	*5.94*	*6.55*
Non-Tax	***2.13***	***2.77***	***2.57***	**2.52**	**2.55**	**2.67**	**2.69**	**2.90**
				2.39	*2.39*	*2.52*	*2.54*	*2.75*
Net Revenue Receipt	***9.43***	***11.11***	***10.05***	**9.84**	**9.89**	**9.34**	**8.97**	**9.83**
				9.32	*9.27*	*8.83*	*8.48*	*9.29*
Revenue Expenditure	***10.69***	***13.69***	***13.24***	**12.50**	**12.45**	**12.58**	**13.05**	**13.85**
of which				11.83	11.67	11.90	12.34	13.10
Interest	***2.20***	***3.38***	***4.37***	**4.47**	**4.66**	**4.58**	**4.67**	**5.01**
				4.23	*4.37*	*4.33*	*4.42*	*4.73*
Defence	***2.57***	***2.62***	***1.83***	**1.68**	**1.64**	**1.83**	**1.79**	**1.96**
				1.59	*1.54*	*1.73*	*1.69*	*1.86*
Subsidies	***1.41***	***1.95***	***1.77***	**1.20**	**1.28**	**1.36**	**1.49**	**1.41**
				1.13	*1.20*	*1.29*	*1.41*	*1.33*
Pension	***0.27***	***0.42***	***0.40***	**0.38**	**0.40**	**0.48**	**0.60**	**0.78**
				0.36	*0.37*	*0.45*	*0.57*	*0.74*
Grants to States	***1.96***	***2.45***	***2.44***	**1.90**	**1.81**	**1.56**	**1.49**	**1.61**
				1.80	*1.70*	*1.47*	*1.41*	*1.52*
Non-Plan	***0.41***	***0.57***	***0.52***	**0.54**	**0.48**	**0.29**	**0.24**	**0.33**
				0.51	*0.45*	*0.27*	*0.23*	*0.31*
Plan	***1.55***	***1.88***	***1.92***	**1.36**	**1.34**	**1.27**	**1.25**	**1.28**
				1.29	*1.25*	*1.20*	*1.18*	*1.21*
Capital Expenditure	***6.13***	***6.78***	***4.61***	**3.43**	**3.29**	**3.61**	**3.72**	**2.78**
				3.25	*3.09*	*3.41*	*3.51*	*2.62*
Revenue Deficit	***1.11***	***2.58***	***3.20***	**2.66**	**2.56**	**3.24**	**4.08**	**4.03**
				2.52	*2.40*	*3.06*	*3.85*	*3.81*
Fiscal Deficit	***6.41***	***8.21***	***6.67***	**5.38**	**5.23**	**6.21**	**6.80**	**5.96**
				5.10	*4.90*	*5.87*	*6.43*	*5.64*
Primary Deficit	***4.21***	***4.83***	***2.30***	**0.91**	**0.57**	**1.63**	**2.13**	**0.96**
				0.86	*0.53*	*1.54*	*2.01*	*0.90*
Revenue Deficit as % Of fiscal deficit	**17.25**	**31.44**	**47.96**	**49.35**	**48.93**	**52.23**	**59.91**	**67.52**
GDP at market prices (Old Series)				**1118964**	**1276974**	**1432964**	**1666455**	**1826434**
GDP at market prices (New Series)				*1181961*	*1361952*	*1515646*	*1762609*	*1931819*

Source : Report of the Eleventh Finance Commission, June 2000.

Note :
(1) (-) indicates surplus and (+) indicates deficit.
(2) The figures in italics indicate ratios with respect to GDP at market prices (New Series).
(3) The GDP (Old Series) figures for the years 1997-98 to 1999-2000 have been arrived at by applying the conversion factor 1.0577 on the New Series for the respective years.

Appendix 3.2 (b)

Revenue and Expenditure of All States, consolidated

(As % of GDP - Old and New Series)

Item	Average (1980-81 to 1984-85)	Average (1985-86 to 1989-90	Average (1990-91 to 1994-95)	1995-96	1996-97	1997-98	1998-99	1999-2000 (RE)
Revenue Receipts	**11.90**	**12.85**	**12.79**	**12.02**	**11.72**	**11.73**	**10.37**	**11.49**
				11.38	*10.99*	*11.09*	*9.80*	*10.86*
of which								
Tax	5.18	5.67	5.64	5.52	5.37	5.46	5.16	5.70
				5.23	*5.04*	*5.17*	*4.87*	*5.38*
Non-Tax	2.14	2.02	1.97	2.05	1.84	1.75	1.44	1.47
				1.94	*1.72*	*1.65*	*1.36*	*1.39*
Revenue Expenditure	**11.47**	**13.16**	**13.51**	**12.79**	**13.15**	**13.02**	**13.09**	**14.61**
				12.11	*12.33*	*12.31*	*12.38*	*13.82*
of which								
Interest	0.99	1.42	1.83	1.89	2.01	2.10	2.13	2.40
				1.79	*1.88*	*1.98*	*2.01*	*2.27*
Pension	0.29	0.47	0.62	0.70	0.77	0.81	0.97	1.10
				0.67	*0.73*	*0.77*	*0.92*	*1.04*
Capital Expenditure	**3.79**	**3.21**	**2.57**	**2.29**	**2.01**	**2.20**	**1.97**	**2.06**
				2.17	*1.89*	*2.08*	*1.87*	*1.95*
Revenue Deficit	**-0.43**	**0.31**	**0.72**	**0.77**	**1.43**	**1.29**	**2.72**	**3.13**
				0.73	*1.34*	*1.22*	*2.57*	*2.96*
Fiscal Deficit	**2.98**	**3.20**	**2.90**	**2.75**	**2.97**	**3.10**	**4.47**	**4.98**
				2.60	*2.79*	*2.93*	*4.23*	*4.71*
Primary Deficit	**1.98**	**1.78**	**1.07**	**0.86**	**0.97**	**1.00**	**2.34**	**2.55**
				0.81	*0.91*	*0.94*	*2.22*	*2.41*
Revenue deficit as % of Fiscal Deficit	**22.14**	**12.02**	**24.54**	**28.06**	**47.91**	**41.56**	**60.90**	**56.86**
GDP at market prices (Old Series)				**1118964**	**1276974**	**1432964**	**1666455**	**1826434**
GDP at market prices (New Series)				*1181961*	*1361952*	*1515646*	*1762609*	*1931819*

Figures in italics indicate ratios with respect to GDP (New Series).

Source: Report of the Eleventh Finance Commission, June, 2000.

Appendix 3.3

(a) Composition of Expenditure of Central Government

(Per Cent of Total Expenditure)

	1980-85	1985-90	1990-95	1995-99	1997-98	1998-99 (RE)	1999-2000 (BE)
Non-plan expenditure	59.90	65.52	71.02	74.41	74.54	75.75	72.89
Interest payment	13.07	16.52	24.59	28.34	28.28	27.40	30.99
Defense	16.72	16.35	14.70	14.89	15.20	14.61	16.09
Total subsidy	8.35	9.52	9.86	8.20	8.40	8.76	8.39
Food subsidy	2.62	2.94	2.85	3.09	3.23	3.09	2.89
Other subsidy	5.74	6.58	7.01	5.11	5.17	5.67	5.51
Police	1.24	1.35	1.65	1.94	2.11	2.00	2.08
Pensions	1.60	2.04	2.25	2.87	2.97	3.57	3.57
Loans and advances to states And UTs	2.86	6.03	5.31	6.62	6.82	8.48	0.04*
Grants to state and UTs	2.58	2.76	2.52	2.49	1.90	1.61	2.87
Other non-plan expenditure	13.48	10.95	10.14	9.07	8.86	9.33	8.86
Plan expenditure	40.10	34.48	28.98	25.59	25.46	24.25	27.11
Total expenditure (plan+non-plan)	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Revenue expenditure	63.55	66.91	74.30	78.15	77.71	77.38	3.49
Capital expenditure	36.45	33.10	25.70	21.85	22.29	22.62	16.51
Developmental	59.53	56.41	51.56	46.34	46.81	46.82	NA
Non-developmental	40.47	43.59	48.44	53.66	53.19	53.18	NA

Source : Mohan Rakesh, (2000)

* Because of the new system of transfer of 75% of the net small savings collection to the State w.e.f. 1-4-1999.

(b) Profile of Total Expenditure of State Governments

Category	1980-85	1985-90	1990-95	1995-99	1997-98 (RE)	1998-99 (BE)
Per cent of GDP						
(A) Revenue expenditure (I+II+III)	11.1	13.1	13.6	13.5	13.9	14.1
I Developmental	7.9	9.1	8.9	8.1	8.5	7.8
II Non-developmental	3.1	3.8	4.6	5.2	5.2	6.0
– Interest payments and debt servicing	0.9	1.5	2.0	2.2	2.3	2.3
– Pensions	0.3	0.5	0.6	0.8	0.8	0.9
– Other expenditure	1.9	1.7	2.0	2.2	2.1	2.8
III Other Expenditure	0.1	0.1	0.2	0.2	0.2	0.2
(B) Capital disbursements (I+II)	5.0	4.3	3.4	2.8	3.0	2.8
I Total capital outlay	2.1	2.0	1.6	1.6	1.7	1.5
– Developmental	2.1	1.9	1.6	1.5	1.6	1.4
– Non-Developmental	0.1	0.1	0.0	0.1	0.1	0.1
II Others	2.9	2.3	1.8	1.3	1.3	1.3
Total expenditure (A+B)	16.1	17.3	17.0	16.4	16.9	16.8
Per cent of total expenditure						
(A) Revenue expenditure (I+II+III)	68.9	75.5	80.0	82.7	82.1	83.6
I Developmental	48.9	52.7	52.3	49.6	49.9	46.4
II Non-developmental	19.1	21.9	26.8	32.0	30.8	35.9
– Interest payments and debt servicing	5.3	8.8	11.5	13.4	13.6	13.9
– Pensions	2.1	3.2	3.7	4.8	5.0	5.2
– Other expenditure	11.7	10.0	11.5	13.7	12.2	16.8
III Other expenditure	0.9	0.8	0.9	1.1	1.3	1.3
(B) Capital disbursements (I+II)	31.1	24.5	20.0	17.3	17.9	16.4
I Total capital outlay	13.2	11.2	9.7	9.5	10.0	8.9
– Developmental	12.8	10.9	9.4	9.1	9.6	8.5
– Non-developmental	0.3	0.3	0.3	0.4	0.4	0.4
II Others	17.9	13.2	10.3	7.9	7.9	7.5
Total expenditure (A+B)	100.0	100.0	100.0	100.0	100.0	100.0

Source : Mohan Rakesh, (2000)

Chapter IV
Public Expenditure Management (PEM) in India

4.1 Introduction

There are no two opinions on any Government's objective of removal of poverty. Sustained growth of the economy is considered to be a necessary condition to reduce poverty. Without macroeconomic stability sustained growth cannot be achieved. And continuing high levels of fiscal deficits pose a serious danger to macroeconomic stability. Fiscal deficits cannot be corrected without effective and efficient public expenditure management (PEM). PEM therefore has to be a central instrument of State policy and effective governance.

This chapter first traces the link between the ultimate objective of economic policy—that of removal of poverty and public expenditure management. As governance encompasses PEM, the essentials of good governance and effective PEM are highlighted. With the purpose of assessing effectiveness of PEM in India a framework of PEM cycle is adopted. Each stage of the PEM is then assessed to identify the tasks ahead. An alternate assessment of the budget and financial management practices is also reviewed.

4.1.1 Growth and Poverty

Latest research covering the period of 1980s and 1990s shows that, as in the very long run, growth was a powerful force for reducing income poverty in countries. On average, growth in consumption of the poorest fifth of the population tracked economic growth one-for-one over this period. In the vast majority of cases growth led to rising consumption in the poorest fifth of the population, while economic decline led to falling consumption (WDR 2000-2001). A large number of factors including initial conditions, institutional capacity, right kind of economic policies including fiscal policy reflected in modulate budget deficits and the absence of high inflation, education and life expectancy are conducive to economic growth. The past few decades have yielded a rich crop of lessons about the kind of economic policies that support development. Analysis of these and other experiences consistently find a core set of policies that appear to be essential for growth (WDR, 1997): providing macroeconomic stability; avoiding price distortions; liberalizing trade and investment.

PEM as an instrument is indispensable to achieve the objectives of State policy. Macroeconomic stability requires, among other things fiscal discipline *i.e.* expenditure control; growth and equity requires, among other things, optimal

allocation and efficient use of resources including allocation of public money conducive to growth.

Box: 4.1
Fundamental tasks of a State

Five fundamental tasks lie at the core of every Government's mission, without which sustainable, shared, poverty reducing development is impossible:
- Establishing a foundation of law
- Maintaining a non distortionary policy environment including macroeconomic stability.
- Investing in basic social services and infrastructure
- Protecting the vulnerable
- Protecting the environment

(World Development Report, 1997)

Macroeconomic stability could be endangered by high levels of fiscal deficits. Substantial evidence exists that, in most cases, fiscal profligacy is the main factor behind high inflation, increase in current account deficit (BOP) and finally sluggish or **negative** output growth. High levels of government borrowing (to meet revenue deficit in particular) can hamper growth of real economy by 'crowding out' private investment. It generates upward pressure on interest rates and also reduces the amount of funds available for the private sector investment. Besides crowding out, the public sector investment/expenditure may provide less efficient outcomes compared to the private sector. A recent result of an econometric exercise (World Bank, 2000) for Indian economy has shown that the reduction in the consolidated public sector deficit in the early years of 1990s was accompanied by at least a one for one increase in corporate investment which was the engine of three high growth years.

4.1.2 Governance and PEM

Governance encompasses the methods that societies use to distribute power and manage public resources and problems. It has been found that effective Governance is often the "Missing Link" between national anti-poverty efforts and poverty reduction. Even when a country tries to implement economic policies to foster pro-poor growth and mount targeted poverty programs, inept or unresponsive governance institutions can nullify the impact. (UNDP, 2000)

Box : 4.2
Governance and Control of Public Money

To **govern**, according to an old proverb, is to choose. The **choices** are conditioned by political aspirations and governed by economic realities. Once choices are made, financial resources are **allocated** to achieve the underlying objectives. The choices and the allocation of resources are predicated on the **performance** or the outcome to be secured. The key actions of **choice, allocation, and performance** form the **heart** of the process of the control of public money.

(Premchand A., 2000)

Of the World's 6 billion people, 2.98 billion-almost half live on less than $1 a day, with 44 per cent living in South Asia. (WDR 2000-2001). And what the Asian economies need? 'More than anything else, Asia's success in overcoming its social challenge will depend on the quality of its governance. Good governance requires adopting a policy framework that is responsive to the needs of the people. It also means efficient and equitable **public expenditure management** that results in appropriate investments in human resources, physical infrastructure and social protection.' (ADB 2000).

Box : 4.3
Good Governance and Growth

In a study to find the differences in performance among States (sub-national levels) in India, it is found that the overall policy environment and the quality of governance are important factors determining the growth potential of a state.

'There are several ways in which good governance affects growth. First, it has a direct impact on the effectiveness with which developmental programs are implemented….. Second, the quality of governance can help stimulate growth by making the policy environment more business friendly through deregulation, decontrol and procedural simplification….. Third, the general conditions for law and order are a reflection of the overall level of governance and are particularly important for stimulating private sector investment.

(Ahluwalia, Montek S., 2000)

It being an instrument of governance the well known 'four pillars' of governance are relevant to PEM as well (ADB 1999). These are :

- **Predictability :** Lack of it undermines strategic prioritization, makes it hard for public officials to plan for the provision of services, is an excellent alibi for non-performance to boot. This is needed as a signpost to guide private sector decisions in production, marketing, investment.
- **Transparency :** The IMF assembled in 1998 a 'code of Good Practices on Fiscal Transparency' which covers : clarity of roles and responsibility; public availability of information; open budget preparation, execution and reporting; independent assurances of integrity.

- **Participation** : Needed for (i) sound formulation of expenditure programs; (ii) involvement of external entities; (iii) monitoring of operational efficiency and (iv) feedback.
- **Accountability** : For use of public money and for the results of spending it. All accountability must be for **'performance'** defined as 'achievement of agreed results within the funding provided, without diluting their quality and respecting the prevailing norms of due process.'

4.2 PEM : Concept, Objectives and Dimensions.

4.2.1 PEM : The Concept

As already noted, Public Expenditure Management is an instrument of state policy. It is part of the system of governance. There is a necessary distinction between the expenditure policy question of 'what' is to be done, and the expenditure management question of 'how' it is to be done. (ADB, 1999). Thus the techniques required for formulation of expenditure policy are different from the techniques of using PEM as an instrument to implement the policy. The information and data requirement of PEM would be different from those required for policy.

It also needs to be recognized that PEM in principle, is an analytical framework that enables the state to diagnose and give prescriptions for remedial measures for policy. PEM is not a panacea for mismanagement of macro-economy and poor budget outcomes (JBIC, 2000).

Finally, there is no *one-size-fit all* PEM theory. It is only a technique. Like any other technology from water pumps to agricultural fertilizers to construction public expenditure 'technology' must be appropriate technology, in terms of (i) local factor endowments, (ii) local institutions, and (iii) real local needs (ADB, 1999).

4.2.2 Objectives of PEM

Governments collect money from the public in variety of forms—taxation, rate of services, sale of assets and borrowings. The public in turn expects the provision of cost effective services, and more significantly, a prudent fiscal state of the nation. With the changing role of government, experience of the use of PEM technique in a large number of countries, and the ultimate purpose of state policy in view the objectives of PEM illustrated in table 4.1 below, have a universality about them (*Premchand A. 2000*).

Table 4.1 Objectives Of Public Expenditure Management

Effective Government	— Provision of services to the public within specified time and cost schedules. — Achievement of allocative and technical efficiency. — Ensuring that budgetary intent and outcome are congruent. — Matching outlays with resources. — Provision of management flexibility to the implementation agencies.
Responsive Government	— Achievement of macroeconomic stability. — Responsiveness to changing economic situations. — Responsiveness to the changing needs of the client/consumer. — Provision of a choice to the client/consumer. — Promotion of a utilization culture in lieu of a spending culture.
Accountable Government	— Accountability for results — Provision of accurate information on the status of government finances. — Decision-making process to be transparent.

4.2.3 Dimensions of PEM

Even though PEM is an instrument of state policy and is to be used to achieve specified objectives of the policy, it has over the period of use, become multidimensional. (*See* Annex 4.1 for details). The different categories of objectives to be pursued through PEM include:

(a) Economic and Financial
- Macroeconomic stability
- Effective budgeting

(b) Management aspects
- Financial discipline
- Efficiency gains
- Program and project management
- Financial disclosure

(c) Public interest requirements
- Transparancy
- Accountability
- Client orientation

(d) Political aspects
- Political acceptability
- Citizen participation.

In a PEM framework there are a large number of specific and alternate techniques which can be utilized to achieve these objectives depending on the need, country specific circumstances, institutional capacity etc.

4.2.4 The PEM Framework

Of late, and particularly during the last two years (since 1998) there has been a renewed focus on PEM.

The World Bank publication (1998) on “Public Expenditure Management Handbook” provides a broad framework for thinking about PEM and how it affects budgetary outcomes. With a historical perspective and international experience the handbook contains 'guidelines for improving budgetary and financial management in the public sector' and checklist of practices.

The ADB publication (1999) on “Managing Government Expenditure” provides the basic conceptual framework, the principles of good budgeting, a synthesis of the international consensus on desirable reforms, and the lessons of international experience - both the successes and the failures. It includes a detailed questionnaire for the assessment of PEM systems (by Lawrence J. O'Toole).

The JBIC Institute study (forthcoming) on PEM and its implications provides an analytical framework of budget cycle and assesses the experience of two developing countries (Pakistan and Philippines) along with suggestions.

A Premchand's (2000) work on ‘Control of Public Money' contains both developments in the theoretical framework as well as practical experiences at international level.

4.3 PEM in India : An assessment

An attempt has been made in this study to review, assess and find out the areas for reform in **PEM in India.** It adopts the PEM Cycle Framework (Table 4.2) used by the JBIC Institute in a study for Pakistan and Philippines. Both, the structural aspect (static) and the working aspect (dynamic) are analyzed for all the major elements in each of the stages of PEM cycle. There already exists an assessment of India's PEM (WB, 2000) based on World Bank framework. The ADB framework is largely based on the World Bank handbook.

Fiscal policy being an important component of the macroeconomic policy, the various stages of PEM cycle essentially start from the stage of policy formulation for the budget.

Table 4.2 Stages and Elements in PEM cycle (JBIC framework)

Stages of PEM Cycle	Major Elements
From **"Plan/Program/Activity"** to **"Budgeting"**	Departure from Incremental "Line-Item Budgeting" to "Activity-Based Budgeting" *(Budget Projectization)*
	"Costing" as a Base for PEM Cycle *(Costs Directization)*
From **"Budgeting"** to **"Execution"**	Internal Control System
	Compliance Audit by External Auditors.
From **"Execution"** to **"Evaluation"**	Financial Statements based on Generally Accepted Public Accounting Standard
	Performance Statement
	Multi-Layered Performance Evaluation System
From **"Evaluation"** to **"Feedback"**	Internal Monitoring System of Feedback Action
	Feedback Monitoring by External Auditors

For the purpose of assessing the PEM in India, the method adopted here is to first view the system as it exists today, find the strengths and weaknesses of the system and finally to identify the tasks ahead **for each of the stages** in the PEM cycle.

4.3.1 PEM in India : POLICY

<table>
<tr><td colspan="2" align="center">SYSTEM</td></tr>
<tr><td colspan="2">

Well organized system of policy formulation for the Budget
Game players include Finance Ministry; DEA, DOR, DOE, Planning Commission, Ministries, PSEs. Financial Advisers' (FAs) play crucial role in sectoral policy.
Extensive consultations with the Central Bank and representatives of Industry, Workers, Academia, Agriculture, NGOs, etc.
Review of economy precedes the budget in the form of Annual 'Economic Survey' presented to the Parliament.

</td></tr>
<tr><td align="center">Strengths</td><td align="center">Weaknesses</td></tr>
<tr><td>

Five Year Plan framework is available for annual Plan expenditure in the Budget.
Macroeconomic perspectives are usually outlined in the budget speech.
Periodically a Finance Commission recommends measures on consolidation of finances of both the Centre as well States.

</td><td>

Very little feedback available with Budget makers.
Rigidities do not permit sharp changes in policy particularly for inter-sectoral allocation (see Box 4.4 - next page).
Very little scope of accommodating contingent requirements.
Medium term policies for non Plan budget items not specified.
Annual budget allocations are often not corresponding to the five year allocation made in the five year plan.

</td></tr>
<tr><td colspan="2" align="center">TASKS AHEAD</td></tr>
<tr><td colspan="2">

Medium term policies for the major budget supported programs need be formulated in advance (at least six month prior to finalization of budget).
These policies should be strictly based on expert studies for new schemes and evaluation of impact assessment for the existing schemes.

</td></tr>
</table>

Box 4.4 Rigidities in Budgetary Allocations

(a) Rigidities in Central Government Expenditure

"Over the years the composition of Central Government expenditure has become highly rigid and prone to large, pre-committed increases. More than half of the annual budget outlays are transfer payments. Interest payments, Defense, Internal Security, Major Subsidies, Salaries, Allowances and Pensions and non-plan grants to States account for about 95% of non-plan expenditure and about 70% of total expenditure." (Finance Minster's Budget Speech while presenting Central Government Budget for 2000-2001).

The following table brings out the items of expenditure accounting for about 92 per cent of the total expenditure where significant reallocation in a year or two may not be feasible without a medium term framework for the same.

	2000-2001 Budget	
Total Expenditure	*Rs. Billion*	*Percent of Total*
	3385	**100.00**
Interest Payments	1013	29.93
Defense	586	17.31
Subsidies	228	6.74
Pension	158	4.67
Police	67	1.98
(a) Sub-Total	**2052**	**60.63**
Transfers to States (Loans + Grants)	544	16.07
Support for Central Plan	513	15.15
(b) Sub-Total (Plan)	**1057**	**31.32**
(c) Sub Total (a) + (b)	**3109**	**91.95**

(b) Rigidities of State Governments Expenditure

The Reserve Bank of India has a forum where Finance Secretaries of State Governments regularly meet to discuss the fiscal adjustment problems.

"In terms of managing the fiscal adjustment, the State Finance Secretaries have articulated several issues. The main consensus expressed in the latest (Seventh) Conference can be summarized. The main fiscal problem is structural and, solutions attempted are incremental and consequently their major pre-occupation is how to pay the each day's bills. They argued, that whenever fiscal adjustment is attempted, there is a cut, in non-committed expenditure but not in non-essential one. **A predominant part of the budget is committed expenditure, especially interest, pensions, and salaries, which has no flexibility.** As a consequence, there is often an atrophy of delivery of services in as much as there may be hospitals manned by doctors and nurses but no medicines, electricity or water supply. Grants to several institutions performing vital services are often postponed or reduced on account of fiscal adjustment. They apprehend that cuts in output tend to be highly disproportional to cuts in expenditure making expenditure cuts of non-committed items highly unproductive, thus undermining the reform process. Some of the Secretaries also questioned the efficacy of increasing social expenditures on the ground that opening of new schools often meant only appointed of new teachers who do not turn up in schools in any case. A few felt that efficacy of social expenditures can be improve by decentralization while a others advocated contract employment of teachers instead of life-time employment. **There was virtual unanimity among the State Finance Secretaries that the structural problems underlying fiscal situation in the States cannot be solved unless the issue of high committed expenditures is resolved.** There was also a consensus that the fiscal problem is not State specific but an all-India phenomenon, often a result of policies of the Central Government such as in pay hikes and, solutions would warrant initiatives by and setting an example by the Union Government."

Source : Reddy Y.V. (2000, Nov.) Fiscal Reforms at State-level : Review and Prospects. India States Reforms Forum, 2000.

4.3.2 PEM in India : PLAN/PROGRAM/ACTIVITY

<table>
<tr><td colspan="2">

SYSTEM

- Budget estimates for next years' proposals and current years' revised estimates are sought from Ministries well in advance (six months).
- Specific guidelines are given while seeking information on budget estimates.
- A system of scrutiny at Financial Adviser's (FA) level in the line Ministry.
- Scrutiny, review and discussion in the Deptt. of Expenditure (DoE).
- Finalization of Plan expenditure after review and discussions in the Planning Commission
- A pre-structured investment decision making process exists.

</td></tr>
<tr><td>

Strengths

- Overall ceilings are conveyed by the DOExp to Financial Advisers for non-plan expenditure.
- Ceiling limit for budget support for Plan expenditure is conveyed to the Planning Commission.
- Allocation for programs are made by the Ministries after discussions with the Planning Commission which indicate sectoral ceiling.
- Resources and investment plans of PSEs are estimated jointly by the Ministry, PSEs, PC and DOE.
- Investment decision making process followed strictly in accordance with well laid down guidelines.

</td><td>

Weaknesses

- Large part of the non-plan expenditure escapes activity-wise scrutiny.
- **Absolute lack of cost (value for money) consciousness.**
- No medium term perspective for the continuing activities and allocations for the same
- **Lack of information on macro policy thrust** at the level where budget estimates are prepared.
- Most spending authorities do not undertake any meaningful exercise to review the need for continuing the activity.
- Lack of feedback, performance results, information etc.

</td></tr>
<tr><td colspan="2">

TASKS AHEAD

- Macro policy framework and performance feedback needs to be indicated in advance to those who are supposed to prepare activity-wise budget estimates.
- Activity-wise allocations particularly on non-plan expenditure items need to be discussed in necessary detail.
- **Initiate, develop and insist on cost consciousness for each major activity/program.**
- **Discuss and explore 'least-cost options' with beneficiaries/target groups and professionals.**
- Integrate thinly spread activities for achieving the same objectives.

</td></tr>
</table>

4.3.3 PEM in India : MONITORING OF IMPLEMENTATION

<table>
<tr><th colspan="2">SYSTEM</th></tr>
<tr><td colspan="2">Pre-designed mechanism of monitoring the implementation of major Plan programs by the Ministries concerned.
Program Implementation Wing (PIW) of the Ministry of Statistics and Program implementation monitors progress of implementation of large number of programs/activities/projects and prepares periodic reports for information of decision makers.
Project Management Unit in DEA for externally Aided Projects.</td></tr>
<tr><th>Strengths</th><th>Weaknesses</th></tr>
<tr><td>Ministries\Departments concerned monitor progress of major programs to identify impediments and resolve problems (eg. Crisis Resolution Group in the Ministry of Power).
Flash reports prepared by the Program Implementation Wing (PIW) on mega projects.
Physical progress on infrastructure sectors monitored by the PIW.
Budgetary releases are monitored regularly for externally aided projects by the PMU.</td><td>Monitoring of physical progress is confined to major Plan programs only.
Activities out of the non-plan expenditure are not monitored except for information on expenditure incurred.
Information system on physical progress remains weak particularly for socio-economic Programs.
No mechanism of mid-course correction of Plan programs possible, for lack of timely reports of monitoring.
Physical targets are often unrealistic in comparison to the financial allocations made by the Planning Commission.</td></tr>
<tr><th colspan="2">TASKS AHEAD</th></tr>
<tr><td colspan="2">Performance budget/Reports system in the Ministries should be used for guidance at the plan formulation level.
Improve monitoring of non-plan expenditure in terms of the need, utilization and effectiveness rather than only pace of expenditure.
Stakeholders, participants and beneficiaries should be associated with the monitoring process.</td></tr>
</table>

4.3.4 PEM in India : EXPENDITURE CONTROL

<table>
<tr><td colspan="2">

SYSTEM

- A well defined system of **budgeting for each activity** and within the activity on different objects of expenditure (e.g. salary, travel, materials, consumables etc.)
- All budgetary releases require prior approval of Financial Advisers and higher authorities **in accordance with pre-specified delegated financial powers.**
- A system of internal audit by a wing of the line Ministries called **'internal audit wing'** intended to add and assist management in implementation.
- Controller General of Accounts (CGA) as an Apex accounting authority prepares and consolidates **monthly accounts** of the Union Government based on accounts furnished by individual Ministries.

</td></tr>
<tr><td>

Strengths

- CGA presents a detailed analytical review of Union Govt. accounts **to the Finance Ministry every month.**
- The inspection wing of CGA inspects departmentalized Accounts Offices periodically to check for requisite technical standards of accounting.
- A systematic computerization of government accounting mechanism has been implemented.
- An Institute of Govt. Accounts and Finance (INGAF) imparts intensive **in-service training** on accounts, budgeting, financial management, expenditure control, internal audit etc.

</td><td>

Weaknesses

- The internal audit and control **system remains weak** as it is confined mainly to collection of information.
- Basically it is only an accounts oriented system. There is no audit or control over the objectives, tasks, outcomes or performance.
- The dimensions and complexities of the tasks of audit, very often, are responsible for **restricting the scope** of internal audit to routine checking of accounts.

</td></tr>
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TASKS AHEAD

- Devise systems for operational audit for purposes of finding out "efficiency and effectiveness" of expenditure.
- There has to be a multidisciplinary approach to assess 'efficiency and effectiveness' of the program; it cannot be left to accounting personnel alone as at present.
- Workout and establish appropriate and specific incentive systems of reward for economy and better use and disincentive for slippage in expenditure control.
- Develop appropriate management systems for maintaining expenditure information, usable both at activity control level, as well as, expenditure control level.

</td></tr>
</table>

4.3.5 PEM in India : AUDIT OF EXPENDITURE

<table>
<tr><th colspan="2">SYSTEM</th></tr>
<tr><td colspan="2">• Internal audit of Government Accounts is done by the Indian Audit and Accounts Department (IAAD).
• The Audit Reports prepared by the IAAD are to be approved/countersigned by the Comptroller and Auditor General (CAG) of India which is a Constitutional entity.
• CAG Reports are laid in Parliament/State Legislative.
• A Public Accounts Committee (PAC) of the Parliament/State Legislature scrutinizes the CAG Reports and Action taken by the Govt.</td></tr>
<tr><th>Strengths</th><th>Weaknesses</th></tr>
<tr><td>• CAG has statutory powers to audit the budgetary expenditure of both Central, as well as State Governments.
• The Ministries have to submit Action Taken Notes (ATN) on the Audit paras of the IAAD.
• The Public Accounts Committee of the Parliament scrutinizes the ATNs and submits reports to the Parliament.</td><td>• The CAG audit focuses mainly on financial irregularities.
• The PAC scrutinize only a few of the CAG's reports.
• Accountability aspect remains weak despite such an elaborate system of finding faults, irregularities and even frauds.
• Existing system is not fully equipped to meet with the requirements of meaningful audit of activities/ programs of public expenditure in newly emerging frontier areas of science like nuclear energy, biotechnology etc. because of complexities and technicalities involved.</td></tr>
<tr><th colspan="2">TASKS AHEAD</th></tr>
<tr><td colspan="2">• The reports should be given wider publicity apart from submission to the Parliament.
• Greater emphasis on program audit, efficiency audit, performance audit, value for money etc. required.</td></tr>
</table>

4.3.6 PEM in India : EVALUATION

<table>
<tr><th colspan="2">SYSTEM</th></tr>
<tr><td colspan="2">
As an integral part of the Planning Commission, Government of India, Program Evaluation Organization (PEO) evaluates plan programs.
There exists a pre-designed built in system for evaluation of the programs/projects which are financed through external assistance/donor agencies. World Bank, JBIC and other donors evaluate their financed programs independently.
Some of the programs are got evaluated by the government through external agencies/institutions (by giving grants).
</td></tr>
<tr><th>Strengths</th><th>Weaknesses</th></tr>
<tr><td>
PEO is a well established organization (since 1952) and has produced 177 evaluation reports.
PEO can be assigned any specific evaluation study by the Ministries or the Planning Commission.
</td><td>
There is no regular mechanism for evaluating all the programs/ schemes in a time bound manner.
The focus of the evaluation studies has been only on finding the constraints in implementation and general impact.
Most evaluation reports lack focus on 3Es (Economy, Efficiency and Effectiveness) aspects of the expenditure.
Lack of professionalism and expertise of the evaluators.
</td></tr>
<tr><th colspan="2">TASKS AHEAD</th></tr>
<tr><td colspan="2">
The focus of the evaluation studies has to be on 3Es.
There has to be a consistency in evaluation studies in terms of a time bound schedule for all the major Program/schemes.
Stakeholders, participants and beneficiaries of the programs should be closely associated with evaluation study.
Encourage independent third party evaluation mechanisms on the pattern of donor financed projects.
Adequate expertise and professionalism is required in the evaluation studies.
</td></tr>
</table>

4.3.7 PEM in India : FEEDBACK

<table>
<tr><th colspan="2">SYSTEM</th></tr>
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Of late evaluation studies of PEO are being published and are now being put on Internet System as well.
The Ninth Five Year Plan Document (Vol. I) has taken stock of evaluation studies for charting out the strategy for the Plan
For the first time the Annual Plan (1999-2000) includes brief review of some of the recent evaluation reports.
Some of the Evaluation studies got done from outside agencies are being published by the Govt. (Study on subsidies by NIPFP).

</td></tr>
<tr><th>Strengths</th><th>Weaknesses</th></tr>
<tr><td>

There is an increased reporting and awareness of evaluation reports, both within the government and outside.
Corrective actions in the schemes based on evaluation studies are visible in the Plan document.
Donor agencies are now increasingly using the evaluation results for formulation of plans of assistance to specific sectors.

</td><td>

A large number of major programs/schemes continue to be financed despite some major weakness because either there has not been any evaluation at all or the non availability of evaluation reports in time.
There are no visible lessons learnt in improving economy and efficiency in implementation of most of the programs/schemes.

</td></tr>
<tr><th colspan="2">TASKS AHEAD</th></tr>
<tr><td colspan="2">

The demand on specified evaluation studies should emerge from policy makers in the budgetary process.
The economy aspects of evaluation studies must reflect in the budgetary allocation.

</td></tr>
</table>

4.3.8 Substantiating the assessment

The assessment made for each stage of PEM cycle in the preceding section of this chapter can well be substantiated with a large number of specific activities, programs, schemes being financed through the budgetary expenditure of the Central as well as state governments. A large number of official evaluation reports, academic and research studies and finally the CAG reports have specifically proved the weakness in the system of public expenditure management in India. The examples can be multiplied. **A positive development is that the Planning Commission has taken a serious view of these reports and have not only started incorporating these reports in the Plan documents but also have initiated corrective measures.**

Following are a few excerpts from the most authentic document on 'Mid-Term Appraisal of the Ninth Five Year Plan, 1992-97 (PC 2000, Oct.) from the Planning Commission, Government of India to illustrate the weaknesses of the PEM system as identified for different stages in the preceding sections of this Chapter.

Policy :

- **Policies and budgetary provisions, despite the rhetoric, have not been integrated so far.** They sometimes run on parallel tracks. On lesser-known reason of this isolation is that development and planning in India are associated with spending of money. That Planning = Expenditure = Development is the mindset behind such beliefs. Changes in policy or laws, are not seen as an integral part of the development process because these have no direct financial implications. **The Indian planner, unfortunately, has still to understand the difference between planning and budgeting.** (*emphasis added*) Planning Commission, 2000 Oct. p. 490.
- **The policy approach to agriculture, particularly in the 1990s, has been more to secure increased production through subsidies in inputs such as power, water and fertilizer, rather than through building new capital assets in irrigation and power.** This has reduced the pace and pattern of technological change in agriculture and effected TFP (total factor productivity) adversely….. The fiscal problems of the central and state governments suggest that the subsidies cannot continue to grow, and the stock of rural productive assets and technological basis for growth will be limited by the past pattern of spending, unless low cost options are pursued, which have a higher capital-output ratio. (*ibid,* page 56)

Plan/Programme/Activities:

Though a rigorous procedure has been in place for introducing new Centrally sponsored Scheme (CSS), **there is a proliferation of CSS which could not be kept**

in check. Following a direction from the National Development Council, several CSS schemes were sought to be transferred to the states. In February 1999 the Planning Commission prepared a list of such schemes with an outlay of Rs. 3,709 crore annually for handing them over to the states. But Central Ministries have been reluctant to fall in line, and as of July 2000 they have agreed to give up schemes worth only Rs. 163 crore and transfer them to the states. In the meanwhile several new CSS have been introduced in the last two years.... Schemes like 'National Reconstruction Corps' (1999) and 'Annapurna' (1999), which were brought in midway, duplicate ongoing schemes, yet they get introduced as new schemes on non-economic considerations. (*ibid*, page 485, 486)

Monitoring and Implementation

The reasons for poor implementation of Centrally Sponsored Schemes are many, such as:

- **There are too many schemes to be monitored.** The Department of Agriculture has for instance about 150 Centrally Sponsored Schemes. The number could be curtailed so that systems for effective monitoring can be developed.
- **There is unwillingness to accept poor performance,** for fear of being questioned by Parliament or adverse press publicity. In the process, shortcomings are concealed and independent evaluation is not encouraged. Since weaknesses are not highlighted, no corrective action is taken to set them right.
- **Capacity to do monitoring is limited, and often does not exist.** Thus there is neither will nor capability for the task.
- Since schemes are implemented by the states, sensitivity associated with centre-state relations often precludes the Centre from asking embarrassing questions or makes it go slow with monitoring state sector schemes, although these may have important bearing on the sector with which the Central Ministry is concerned.
- Uniformity of schemes all over the country from Mizoram to Kerala--without sufficient delegation to states to change the schemes to suit local conditions--leads to a situation where the **states even knowing that a scheme is not doing well become indifferent to its implementation.**

Many schemes assume a highly committed delivery machinery which will act as 'friend, philosopher and guide' of the people. Such rare individuals, if they existed in government, do not stay at a particular post for long to make a lasting impact (*ibid*, page 484). (emphasis added).

Evaluation

As a part of the project schedule, there is need to provide for evaluation, both concurrent and post-project, but such a need is yet to be recognised. In this respect, Externally Aided Projects are definitely on an advantage since the donor agencies do regular evaluation of the projects. Absence of such a mechanism in the case of other national projects makes it difficult to know the progress in various components and apply mid-term corrections, if need be, in physical and financial targets. (*ibid*, page 486)

From early 1960s/70s, schemes are being implemented without having any evaluation done to know their shortcomings or impact. While doling out money, due consideration is not given to the likely delivery of inputs. For example, money is invested in revival/modernization of sugar mills but after modernization the mills are in red, their net worth completely eroded. A major problem being faced by those mills, *i.e.* artificially high state-administered prices of sugar can, has not been addressed. (*ibid*, page 486)

Some of the weaknesses of the Public Expenditure Management System can also be illustrated through an evaluation report on the "Employment Assurance Scheme (EAS)" a few result of which are summarized in Appendix 4.1.

4.3.9 Some limitations of the assessment

The assessment of PEM in India attempted in section 2 of this chapter is strictly in the framework already used in the JBIC study for two other developing countries *i.e.* Pakistan and Philippines. It is based on a large number official reports and other studies which provide information on the expenditure management system in India. An earlier study on 'Management of Indian Economy - Systems and Process' by the present author and published by the OECF in 1995 was also found of use in the present study to the extent of indicating the systems aspects in various stages of PEM cycle. Finally a draft of this assessment was discussed with experts on the subject at a presentation made by this author at the JBIC Institute, for obtaining expert comments, before finalizing this part of the study. **Even so the assessment has a few limitations,** which need to be kept in view while considering the 'tasks ahead' indicated in the assessment.

(a) **The tasks ahead indicated in this assessment of PEM in India are general and macro in nature.** Also, these are limited to the stages in PEM cycle only.

It, however, needs to be recognized that identification of the tasks ahead is the first necessary stage towards improving a PEM system. Specific measures can be worked out only at a second stage when the suggestions are considered in depth for implementation - a task beyond the scope of

this study. Incidentally, a comprehensive and in-depth analysis of government finances is found in the report of the Eleventh Finance Commission (July 2000) where some specific measures have been indicated for restructuring the government finances in India. Some of the important specific suggestions relating to expenditure management made in the Report include :

(i) government may examine the feasibility of introducing a multi-year budgeting process,

(ii) introduce objective methods of preparing budget estimates so as to improve the quality of budget estimation,

(iii) stipulate a maximum time within which, reports of C&AG are scrutinized by Public Accounts Committee and examined by Parliament or Legislature, as the case may be,

(iv) review all expenditure classifications other than revenue and capital,

(v) fully computerize cash flow management, at all levels of government.

(vi) Another necessary reform in budgeting is, to do away with the dichotomy between 'plan' and 'non-plan' in expenditure. With the introduction of planning, budget heads have come to be divided under 'plan' and 'non-plan' and the distinction runs through all items of expenditure on revenue as well as capital accounts. Apart from creating problems in keeping the revenue deficits and thereby fiscal deficits in control, as pointed out earlier, the distinction has had a deleterious effect on the quality of public services. Essential maintenance has been neglected as they do not come under the plan and existing assets including schools and hospitals are starved of much needed support for their running. In recognition of these ill-effects of the plan/non-plan distinction in budgeting, the Union Finance Minister had observed in the budget speech for 1998-99:

> *The distinction between plan and non-plan expenditure in our budgetary system has created several problems. It has led to an excessive focus on so called plan expenditure with a corresponding neglect of items such as maintenance which is classified as non-plan. Various bodies, including the Finance Commission have advocated the elimination of the plan and non-plan distinction in the budget. I propose to constitute a Task Force, including representatives of Planning Commission, Finance Ministry, Comptroller and Auditor General of India and State Governments to examine these issues in a*

comprehensive manner and to make recommendations for a functionally viable and more focussed presentation of government expenditure in the budget.

(vii) In order to improve the efficiency of public expenditure we need to have better targeted, beneficiary oriented programs and an effective monitoring mechanism. It may be mentioned that the evaluation of public programs has so far been primarily expenditure oriented. However, expenditure is not an end by itself. Evaluation of performance, in terms of achievements, related to the objective is seldom done. This needs to be remedied.

(b) **The assessment is primarily focussed on Central government's expenditure management.** The assessment is largely based on the system and institutions relevant mainly to the Central government, except in case of audit.

Even though the statutory provisions for state government budgetary system is well defined and common, given the number of 26 state budgets, wide range of levels of implementation practices, and lack of specific information, it is rather not feasible to make a systematic common assessment of the type attempted here. Though not in the framework adopted here, an indicative partial assessment of state government budgets system could be had from the annual comprehensive study on State government budgets undertaken by the RBI, which includes an analysis of 'Fiscal Marksmanship' in state budgets. Fiscal marksmanship essentially reflects the degree of accuracy between 'estimates' and 'actuals' of the budget data. It shows the degree to which the budgetary forecasts that have been made are accurate. The deviation between budget estimates and actual outcome has been more pronounced particularly, in 1997-98, the latest year for which accounts data are available.

Table 4.3 State-wise Fiscal Marksmanship (Major States)

(Per cent deviation in actuals over Budgeted)

States	Revenue Expenditure			Capital Disbursements		
	1995-96	1996-97	1997-98	1995-96	1996-97	1997-98
Andhara Pradesh	-2.52	19.38	5.92	31.24	-27.22	24.1
Assam	-3.80	-21.86	-12.74	-7.72	-31.48	5.52
Bihar	0.55	-9.79	-13.32	-48.16	-12.43	-25.45
Gujarat	6.96	12.27	13.14	8.76	12.34	-7.26
Haryana	6.20	35.98	-18.87	-20.31	4.41	-7.83
Karnataka	-6.73	-4.12	-8.99	7.07	4.62	12.5
Kerala	0.85	-5.02	-6.30	16.87	-2.89	27.61
Madhya Pradesh	-5.64	5.71	-4.57	5.1	4.38	-2.09
Maharashtra	2.40	4.49	4.07	25.15	-1.84	12.96
Orissa	-8.16	-7.65	-9.61	-17.3	-11.59	-7.73
Rajasthan	4.30	6.97	-1.76	14.2	7.98	44.42
Tamil Nadu	10.09	7.91	-34.28	2.76	29.61	12.88
Uttar Pradesh	-2.69	-7.91	-13.73	-5.2	-13.09	-34.2
West Bengal	-8.30	1.04	-5.91	18.3	4.33	-23.27

Source : RBI, State Finances, January, 2000.

A comparative picture of fiscal marksmanship for the Central government budget would show that the level is only a shade better over the state governments and thus the assessment made in this study could broadly hold good for state budgets also. The averages of such deviations (Actuals/Budgeted) for the period from 1994-95 to 1998-99 are as follows:

	Percent deviation Actual/Budget
Total Expenditure	2.4
A. Revenue Expenditure	1.1
of which:	
(i) Interest payments	-1.7
(ii) Subsidies	10.2
(iii) Defense	2.3
B. Capital Expenditure	7.2
(a) Capital outlay	-6.5
(b)Loans and Advances	16.4

(RBI Bulletin, May 2000)

(c) **The assessment lacks quantification.** The assessment made in terms of strengths and weaknesses for different stages of the PEM cycle in India is qualitative in nature and it lacks any quantification

to enable an evaluate on in terms of degree of performance. This, however, could at best be a subjective task and may have resulted in undue biases. An indicative quantification of budget and financial management practices is, however, given in the next part of this chapter, which is based on the World Bank framework on PEM.

4.4 PEM in India : An Assessment in World Bank Framework

4.4.1 General Observations

A World Bank study (2000) on India contains some general observations on governance and budgetary process in India along with evaluation and specific suggestions. A few important general observations are:

- India fares about average among developing countries, on Governance though it ranks well below industrial countries.
- India's 'outcomes' tend to be worse than the evaluations of its governance process, particularly in public service delivery, which suggests implementation problems.
- India's ranking on its budgetary processes and efficiency, and equity of revenues and expenditures in international comparisons is fairly high. However, in terms of the more general category, of management of public finances, India-ranks much lower. An appraisal that is borne out by India's high fiscal deficit, where India ranks among the worst 10% of countries in the world.

4.4.2 Evaluation through Checklist

As noted earlier, the World Bank Handbook on Public Expenditure Management (1998) provides for a checklist of practices that are relevant to assessing a country's strengths and weaknesses in budgeting and financial management . Also provided in the handbook is a detailed diagnostic questionnaire covering various aspects including aggregate fiscal discipline, budget execution and monitoring, expenditure prioritization and allocative efficiency, technical efficiency in terms of autonomy and accountability.

Based on the checklist in the handbook a summary evaluation of the budget and financial management practices in India has been given in the World Bank (2000) Report on India which quantifies the stage of development of each practices on a scale of 1 to 10 with 1 as inadequate, 5 as adequate and 10 as excellent. This evaluation by the World Bank is given in table 4.4. Also given in the table is an

alternate evaluation which is based on evaluation made by three experts in India familiar with budgetary practices. The experts included an academician (Professor at the NIPFP), and two financial advisers in the Ministries of Government of India. The average of the three markings is given as an alternate evaluation. The evaluation results show:

Table 4.4 Summary Evaluation of Budget and Financial Management Practices

	1-Inadequate 5-Adequate 10-Excellent	
	(World Bank Evaluation)	**(Alternate Evaluation : Indian Experts)**
Budget :		
Comprehensive	**7**	**6**
Based on reliable data and estimates	2	7
Has medium-term perspective	1	6
Linked to macroeconomic policy	2	7
Links planning & resource allocation	7	6
Capital and recurrent expenditure well integrated	2	5
Links between policy and resources are transparent	4	7
Trade-offs within spending constraints	2	6
Effectively controls spending aggregates	1	7
Is implemented as initially authorized	5	8
Is adopted on a timely basis	3	9
Controls items of expenditure	3	8
Provides incentives for efficiency	1	3
Uses performance measures	1	3
Financial Management :		
Based on accounting standards	**7**	**8**
Efficient cash management	5	6
Timely disbursement of budgeted funds	3	7
Accountability for expenditure	1	7
Internal controls systems	3	7
Audit of expenditures (professional, timely reporting)	7	7
Budget/Accounting is consistent	8	9
Procurement is transparent and competitive	7	7

4.4.3 Output and Outcomes

Further, the World Bank study also has assessed the public financial management in India in terms of Output and Outcomes as given in the table below:

Table 4.5 Public Financial Management in India : Outputs and Outcomes

(World Bank Assessment)

	(i) Aggregate Fiscal Discipline	
	PFM Outputs	**PFM Outcomes**
Institutional Arrangements	• Medium term expenditure framework? **NO** • Hard Budget Constraint? **NO** • Comprehensive Budget? **LARGELY**	• Revenue/Expenditure target achieved? **NO**
Accountability	• Ex post reconsiliation of the expenditures? **YES** • Sanctions for agency over-or under spending? **NO**	• Limited agency overspending? **NO**
Transparency	• Publication of budget and fiscal results? **YES, PARTLY**	

	(ii) Strategic Prioritization	
	PFM Outputs	**PFM Outcomes**
Institutional Arrangements	• Budgetary planning consultative with stakeholders? **PARTLY?** • Strategic targets linked to allocations? **PARTLY** • Line agency allocation discretion? **NO**	• Expenditure matched to strategic goals? **NO**
Accountability	• Outcomes reported? SOME • *Ex post* evaluation of results? LIMITED (INSTEAD, *EX ANTE* CONTROL) • Sanctions applied? **NO**	• Clear responsibility for mismatch? **NO**
Transparency	• Adequate Stakeholder voice mechanisms? **NO**	• Outcome performance published? **SOME**

	(iii) Operational Effectiveness and Efficiency	
	PFM Outputs	**PFM Outcomes**
Institutional Arrangements	• Relative line agency autonomy? **NO**	• Efficient service Delivery? **NO**
Accountability	• Internal and External Audit? **YES** • Personnel policies performance based? **NO** • Service delivery standards? **SOME** • Customer satisfaction surveys? **FEW**	
Transparency	• Program performance published? **SOME** • Client voice mechanism? **FEW**	

4.4.4 Suggested Reform Programs

Given the above assessment the study (World Bank, 2000) has also listed specific suggestions for a reform program on Budgeting and Expenditure Management in India as follows:

Regarding aggregate fiscal discipline

- A multi-year expenditure framework;
- A budget procedure with revenue budgeting and revenue policy setting before expenditure budgeting;
- Removal of the Plan/Non-plan categorization as suggested by several experts;
- Clearly defined expenditure caps, if possible through a Constitutional amendment;
- Creation of a contingency fund under the control of the MoF (different from the Contingency Fund of India) from which genuine unforeseen expenditure increases can be met;
- A budget circular incorporating expenditure ceilings for departments;
- Introduction of zero-base budgeting as announced by the Finance Minister and eventual revision of Demands for Grants by a document giving past outputs and linking realistically costed current and projected outputs to multi-year expenditure estimates. Strict zero-base budgeting as introduced in the United States may not be appropriate in the Indian context especially for development programs not directly executed by the center. However, the principal of (i) linking past outcomes to current expenditure proposals and (ii) evaluating the social return and/or prioritization of expenditure proposals is important.
- Improved cash management to permit eventual emulation of "just in time" inventory management, through positive and negative incentives to line ministry FAs to improve disbursement forecasts;

Regarding strategic allocation of expenditures

- Effective individual accountability and sanctions (or rewards if merited) for overspending or overbudgeting and for underspending;
- Development and tracking of program-wise output performance indicators **in the budgets** as is currently done in Annual Reports of some departments and ministries;
- Positive incentives for efficiency improving reforms rather than pursuit of fortuitous savings;
- Enhanced public involvement of stakeholder groups earlier in the budget formulation and post-budget stages;

Regarding effective and efficient service delivery

- Improved control of disbursements to on-spending agencies through the use of contractual positive incentives and negative sanctions (rather than ex ante

controls); and a reporting system providing information on both financial expenditure and physical progress;

- Improved internal audit capabilities and strengthening the role of external oversight to enable long term pursuit of management improvements where weaknesses are identified by external audit review;
- Stepped up implementation of computerization of accounts down to the program implementation level;
- The introduction of client satisfaction surveys, conducted by independent central and local agencies for each government program and feedback from client surveys to ministry budget allocations.

Regarding implementation of the reform program

- Setting up of a high powered reform management body to oversee implementation and deal with teething problems.

4.5 Summary Conclusions

Removal of poverty is the ultimate objective, as it has been, for the economic policy of the Government of India. There is evidence to show that without a sustained higher growth rate, the objective of removal of poverty cannot be achieved. Macroeconomic stability is a necessary precondition for a sustained high level of growth rate of the economy. Continuing fiscal deficit particularly driven by the revenue deficit in the government budgets poses a real danger to macroeconomic stability. Public expenditure management (PEM) is the key instrument for correcting such fiscal imbalances. Also, an effective and responsive governance requires effective PEM.

Box 4.5
Good Governance and Development Outcomes

Development is an outcome of efficient institutions rather than the other way around. *Good Governance* has therefore entered the development lexicon, even though how to achieve good governance remains debatable. There cannot be two opinions that the quality of governance must be improved. Focus must be shifted from maximising the quantity of development funding to maximising of development outcomes and effectiveness of public service delivery. This will help in improving the perception of investors and donor agencies about the investment climate in the States. It will also contribute to increasing the revenue collecting ability of States.

--Planning Commission (2000, Oct.) Page 491-492.

An assessment of PEM in India made in this chapter brings out a large number of weaknesses notwithstanding the well established systems with some built in strengths. The assessment also identifies the major tasks ahead. Some other reviews of PEM have also made wide ranging suggestions for improving

expenditure management in India. What is now needed is a holistic approach to remove the identified weaknesses at each stage of the PEM cycle rather than tinkering with a few sub systems without linking them to the ultimate objectives of an effective, responsive and accountable governance, as well as, PEM. The major tasks ahead are:

(a) **Strengthen policy formulation system :** Medium term policies for the major budget supported programs should be formulated in advance before finalizing the budget proposals. Eleventh Finance Commission has also recommended that the government may examine the feasibility of introducing a multi-year budgeting process.

(b) **Develop cost consciousness for each major activity/program.** Activity-wise allocations in the budget need to be examined in more details to avoid incremental budgeting and bringing in cost consciousness. For the purpose, least cost options need to be explored in consultation with users, beneficiaries and target groups of the budget allocations.

(c) **Associate stakeholders, participants and beneficiaries with monitoring process.** The system of monitoring the implementation of programs is confined mainly to monitoring of expenditure. Effectiveness of implementation can be increased if participants and beneficiaries are associated with the monitoring process.

(d) **Develop appropriate management systems for expenditure control.** There has to be a multi-disciplinary management approach towards control and internal audit of expenditure. The internal audit system cannot be left to accounting personnel alone, as at present.

(e) **Lay greater emphasis on program audit, efficiency audit and performance audit.** The CAG audit focuses mainly on financial irregularities. The other aspects of efficient use of resources, performance and value for money remain weak in the reports.

(f) **Focus 3Es (Economy, Efficiency and Effectiveness) in evaluation studies.** The system of evaluation studies needs to be strengthened, for its coverage, regularity and time bound schedules along with a focus on 3Es.

(g) **Ensure timely feed back for evaluation results to policy makers.** Results of evaluation studies should reach the policy formulation stage of budgetary process well in advance, to avoid incremental budgeting despite poor outcomes of expenditure incurred earlier.

Apart from the above mentioned major tasks, there would emerge several micro-level systemic weaknesses which may need technical examination. A few

suggestions made by the Eleventh Finance Commission, in this context, deserve special attention. Review of all expenditure classifications other than revenue and capital, doing away with the dichotomy between 'plan' and 'non-plan', avoiding the practice of providing a 'token' provision resulting in thin spread of resources, etc. are some such tasks which can go a long-way in improving the PEM systems.

Finally, as already mentioned, the tasks ahead and suggestions available need to be examined, considered, and implemented in a comprehensive manner. Setting up of a high powered reform management body, to oversee implementation and deal with teething problems is included in the list of suggested reform program in the World Bank study. The Expenditure Reforms Commission set up in February 2000 could be assigned the task of considering and overseeing the implementation of reforms in public expenditure management in a comprehensive manner.

Appendix 4.1

Employment Assurance Scheme (EAS)

Launched on Gandhi Jayanti day (2nd October) in 1993, the Employment Assurance Scheme (EAS) was initially in operation in 1772 backward blocks. The blocks were identified in drought prone areas, deserts, tribal areas and hill region areas where the Revamped Public Distribution System (RPDS) was in operation. Gradually, EAS was extended to other blocks and by 1997-98 the scheme was being implemented in country's 5448 rural blocks in all. **This scheme has the highest level of allocation amongst all the five 'Major Rural Development Programmes' during the Ninth Plan. The Plan allocation for 1999-2000 was Rs. 24.32 billion accounting for 27.7 per cent of the total allocation (Rs.87.68 billion) for the five programs.**

As its primary objective, EAS is to create additional wage employment opportunities during a period of acute shortage through manual work for the rural poor. The secondary objective is the creation of durable community, social and economic assets for sustained employment and development. Though open to all rural poor, **the programme is expected to attract only unskilled people below the poverty line because it offers only the minimum wages.**

As experience showed, employment provided under EAS was meagre. The Third Report of 1995 of the Comptroller and Auditor General stated that on an average each person was provided 18 days and 16 days of employment during 1994-95 and 1995-96 respectively.

According to a comprehensive evaluation by the Programme Evaluation Organisation (PEO) of Planning Commission in 14 States, EAS is being executed through contractors in most States in violation of central guidelines; the norm of 60:40 for wage and material is not maintained; genuine muster rolls are not being maintained by the Gram Panchayats. Family cards have not been issued; the system of registration of job seekers with Gram Panchayats is not in vogue; and even though Central allocation seems to have been made on the basis of minimum national requirement, a vast majority of the Blocks did not get this allocation. This could be due to the inability of the States to contribute their matching share in the pooled fund for EAS.

As to EAS' impact, the study found that the estimated proportion of registered job seekers who actually got any employment was as low as 25 per cent in sample villages. The average number of days of employment per person per year was less than 53 as per official records. However, information gathered from the beneficiaries reveals that 69 per cent of them got less than 30 days of employment and another 17 per cent between 30 days and 50 days. The overall average for the sample States works out to 31 days.

Even in the matter of asset creation, the study finds that Central norms have not been followed. For example, none of the sample States has earmarked 40 per cent of funds for watershed development and 20 per cent for minor irrigation, link roads and buildings for schools and anganwadis. In Bihar, 69 per cent of EAS funds were allocated to activities like school buildings/anganwadis which are not labour-intensive. Similarly, in Gujarat, Haryana and West Bengal the unit cost of employment generation in school buildings/anganwadis is abnormally high (Rs 200 to Rs 300) It is difficult to justify allocation of funds to such activities under employment generation scheme. **No inventory of assets was kept and it was difficult to know whether the asset created was community asset or private one.**

A profile of the EAS beneficiaries shows that over 78 per cent belonged to daily wage earning class. To that extent the scheme appears to have been well-targeted. Although bulk of EAS beneficiaries were illiterate or below matriculation level, some skilled and semi-skilled workers were also among them. This is further supported by the wide variation in wage rates paid in some states (for instance, Rs 25-100 in Rajasthan, Rs 22-150 in Tamil Nadu and Rs 20-80 in Madhya Pradesh). This could also be a reflection of the involvement of contractors who may have shown their employees as EAS beneficiaries.

The PEO study concludes that EAS has not realized its objectives of generation of sustained and gainful employment, supplementing the income of rural wage-earning class in agricultural lean seasons and improving the well-being of rural poor. With universalisation of EAS and without an element of assurance of employment of 100 days in a year as initially envisaged, there is practically no difference between JGSY and EAS except that the former is being implemented through PRIs and the latter by the administrative apparatus. There is, therefore, need to have another look at EAS.

Several lacunae have come to notice in the design and implementation of EAS. First, bogus reporting. Field staff have learnt to report figures in the manner expected of them, that is, they must show that targets have been fully achieved irrespective of what the ground situation is. Collectors are under pressure to furnish utilization certificates so that states could draw the next installment from the Cetnre. Money is considered to have been spent once is allotted from district to panchayats, even when no physical expenditure has taken place.

Second, employment generation programs create incomes for the rural poor but leave no assets behind. Once such programs are withdrawn, the poor may again fall below the poverty line in the absence of family based assets.

Third, development of vital infrastructure like road, water supply, electricity, schools and the like is neither labour-intensive nor results in assets primarily for use by the poor.

Fourth, employment schemes provide massive funds for road and school construction, in which villagers become (temporary) state employees of the concerned departments and thus remain in a continued state of psychological dependence and expectation from the state.

Lastly, such programs have encouraged corruption, both at political and administrative levels.

Source : Planning Commission, (2000 Oct.), Mid-Term Appraisal of Ninth Five Year Plan (1997-2000).
(Page 144 and 145)

Chapter V
Decentralization in India : Developments and Issues

5.1 Introduction

Lack of peoples' participation in formulation and implementation of public expenditure programs for basic needs has been identified as a major weakness in achieving the ultimate objective of removal of poverty. There has, therefore, been no major dissension over the purpose and advantages of taking governance closer to people. And decentralization of functional and financial power has been considered to be the most powerful means of self governance at local level. What, however, under debate is that in practice there is no guarantee that decentralization would succeed. The path towards decentralization is not devoid of pitfalls.

Box 5:1
Rationale of Decentralized Local Government

Admittedly the most important rationale of decentralized local government is the provision of certain basic services and infrastructures of standard quality at the local level. No citizen should suffer because of her/his choice of location of residence. To deprive a citizen of adequate level of schooling, drinking water, primary health care and other basic services because of her location is an injustice. That even after more than fifty years of planning, the union and the state governments have woefully failed the people of India in this respect needs no documentation. At the same time the market mediated regime underway also cannot be trusted to promote territorial equity. The need for local government involvement is greater than ever before.

(*Oommen, M.A., 1999*)

In the context of public expenditure management in India, a limited purpose of this chapter is to identify the main issues responsible for weakening the effectiveness of the expenditure management system notwithstanding the significant developments towards strengthening the decentralization process particularly during the nineties. The focus thus is limited to fiscal decentralization rather than the larger issues of political and institutional developments. But before all that, a glimpse of international experience is considered desirable.

5.2 Decentralization : Concept and International Experience

The term decentralization encompasses a wide range of distinct processes: 'The main ones are administrative decentralization, or the transfer of state functions from higher to lower levels of government while retaining central control of budgets and policy making; fiscal decentralization, or the ceding of influence

over budgets and financial decisions from higher to lower levels; and devolution, or the transfer of resources and political authority to lower-level authorities that are largely independent of higher levels of government. Rarely does decentralization embrace all three" (WDR, 1997). May it be in any form or a combination thereof, the overall purpose of decentralization process is to take the government closer to the people.

It is important to recognize that decentralization is only a means to achieve multiple objectives like peoples participation, removal of poverty, improving public sector efficiency and not an end in itself. The achievements of these objectives would thus depend on how appropriately this 'means' is 'adopted' given the needs, dimensions, institutional capacity, and above all, the political conditions specific to a country. Based on international experience, the message in some recent reports (UNDP, 2000, WDR 2000-2001) on the pitfalls of decentralization is loud and clear as shown in a few highlights given below:

- One of the most serious pitfalls of decentralization occurs when power imbalances are large at the local level. Studies of Argentina indicate that sub-national governments can sometimes be less effective than Central governments at targeting poor areas. Similar problems are noted elsewhere in Latin America and South Asia.
- Studies of successful decentralization indicate the importance of creating administrative capacity. Many local governments lack the administrative capacity for large scale decentralization and need training in accounting, public administration, financial management, public communications and community relations.
- While certain degree of fiscal devolution is needed for effective decentralization, it carries the risk of exacerbating inequalities between regions.
- Decentralization can greatly enhance the states' capacity to accelerate local development and reduce poverty, but only if effectively designed.
- Central support is required to ensure that national policies are adhered to and to coordinate the inter-regional interests of different administrative units; as with highway charges and access to common water resources.

(*World Development Report, 2000-2001*).

- One of the most common concerns about decentralization is that it could merely buttress the heavy hand of local élites. If so, the prospects for poverty reduction are undoubtedly dimmed.
- One criticism of fiscal decentralization is that it often disadvantages the poor by compelling them to pay fees for basic education and health

services, or by compelling local authorities to raise taxes on the poor to finance these services.

- Badly planned decentralization can worsen regional inequalities. Left to their own devices, richer regions are likely to develop faster than poor ones. And a system of matching grants, intended by central government to motivate local government to raise funds, typically exacerbates regional disparities.
- If decentralization implies dumping responsibilities onto lower levels of government—"load shedding"—it can be done fairly quickly. But if it implies strengthening democracy—"empowering decentralization"—it will take some time, considerable resources and extensive capacity building.
- Widespread popular participation is vital to successful decentralization without it, the potential benefits of local information cannot be realized.
- To have the biggest impact, decentralization should go hand in hand with strengthening accountable local government and fostering popular participation.

(*UNDP, Poverty Report, 2000*)

5.3 Decentralization in India

India has a three tier structure of Government. The Central government, State governments, and local bodies *i.e. panchayats* and municipalities. The constitutional changes in 1992 (73rd and 74th amendments) now envisage the *panchayats* (rural local bodies) and municipalities (urban local bodies) as institutions of self government. These rural and local institutions have been in existence even before the constitutional amendments. But now, with these amendments it has become mandatory for the States to hold regular elections for these bodies under the supervision of State Election Commissions. Besides, detailed provisions have been made under which state legislature, by law, may entrust the local bodies with such powers, functions and responsibility so as to enable them to function as institutions of self government. Before a review of recent developments and issues a look at the main features of the Indian system may be of use.

5.3.1 Background

The concept of decentralization, the purposes and the institutional system for the same is not new to India. It was under the Directive Principles of the Constitution that Article 40 requires that "the State shall take steps to organize

village panchayats and endow them with such power and authority as may be necessary to enable them to function as units of self government". Many State governments over the period attempted to translate this Directive Principle into practice by enacting necessary legislation and creating Panchayat Raj Institutions (PRIs). However, such efforts were confined to a few states only. Also, repeat efforts and emphasis on decentralized planning in different five years plans had very little success (*see* Box 5.2).

Box : 5.2
Democratic Decentralization and Planning in India

The First Plan (1951-56) recognized the need for a desegregated planning exercise through a process of democratic decentralization incorporating the idea of a village plan and of District Development Councils. The Second Plan made some headway with the emergence of Community Development and the National Extension Program. However, micro-level planning did not go beyond identification of activities, as neither village nor district plans were prepared. The Balwant Rai Mehta Committee (1957) recommended the block as the unit of planning with the Panchayat Samitis as the executive body for planning. It also suggested the setting up of Village Panchayats, Taluk Development Boards and Zilla Parishads. The government accepted these recommendations and the State governments enacted appropriate legislation's to usher in a new era of PRIs. However, the PRIs worked well only in a few States like Gujarat, Maharashtra, Karnataka and West Bengal.

The Third Plan re-emphasized decentralized planning in many sectors, but the absence of a planning machinery resulted in poor planning. During the Fourth Plan, the emphasis shifted towards district planning. The Planning Commission also took interest in helping the States in initiating decentralized planning. Accordingly a scheme of strengthening regional/district planning units was initiated by the Planning Commission…….In 1977 the Ashok Mehta Committee was set up to examine the functioning of PRIs and to suggest measures for making decentralized planning effective. The Sixth, Seventh and Eighth Plans re-emphasized district planning within a multi-level planning framework. However, proper administrative arrangements were not made to facilitate this process; there was also a lack of technical expertise and an absence of financial devolution, both of which acted as impediments in the process of democratic decentralization.

[*Planning Commission . Ninth Five Year Plan (1997-2002). Vol. I, Page 252*]

5.3.2 The Constitutional and legal framework for local bodies

The 73rd and 74th amendments of the Constitution in 1992 have been a major step towards strengthening of local governments and operationalising the decentralization process. Provisions were made relating to (a) constitution and composition of the panchayats and municipalities (b) functional and fiscal powers of the Panchayats and Municipalities and (c) institutional arrangements for planning for economic and social development.

(a) For the constitution of the Panchayats and Municipalities, the Constitution provides that:

"there shall be constituted in every State, Panchayats at the village, intermediate and district levels in accordance with the provisions of this Part.— Panchayats at the intermediate level may not be constituted in a State having a population not exceeding 20 lakh" (Article 243 B).

"There shall be constituted in every State—

- a Nagar Panchayat for a transitional area, that is to say, an area in transition from a rural area to an urban area;
- a Municipal Council for a smaller urban area, and
- a Municipal Corporation for a larger urban area" (Article 243Q).

(b) Regarding functional and fiscal powers, now the Constitution contains two schedules, viz Schedule XI (243G) and Schedule XII (Article 243W) which comprise a list of functions considered appropriate for devolution to Panchayats and Municipalities. The list of functions is illustrative in nature (See Annex 5.1). The Constitution thus maintains the prerogative of the State in respect of determining the functional/spending responsibilities of the Panchayats and Municipalities.

The Constitution has provided for the setting up of a finance commission in every State, for the propose of reviewing the financial position of the Panchayats and Municipalities, and making recommendations to the Governor as to the principles which would govern :

- The distribution between the State and Panchayats, and the State and Municipalities of the net proceeds of the taxes, duties, toll and fees leviable by the State;
- The determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the Panchayats and Muncipalities.
- The grants-in-aid to the Panchayats and Municipalities from the Consolidated Fund of the State, and
- Any other measure that would improve the finances of the Panchayats and Municipalities.

(c) For institutional arrangements the Constitution now provides for the constitution of District Planning Committee (DPCs) and Metropolitan Planning Committees (MPCs). Articles providing for the constitution of such Committees are a significant step in the direction of initiating a process of planning from below. The DPCs are to be responsible for the consolidation of plans prepared by the Panchayats and the Municipalities, and preparation of a draft development plan for the district. The MPCs are to be responsible for the preparation of draft development plans for the metropolitan areas. The composition and

functions of DPCs and MPCs are to be determined by the legislature of the States.

5.3.3 Some Dimensional features of local bodies

The third tier of government in India consisting of panchayats for rural areas and municipalities for urban areas together exceed 250 thousand in number with different layers and compositions depending upon such factors as population, area, density etc. As per the latest information available from the Eleventh Finance Commission Report (EFC 2000) there were (as on 1.4.98) 2,47,033 rural local bodies and 3682 urban local bodies. Some indicative estimates of finances of these bodies are given in the later part of this chapter.

Table 5.1 Dimensions of the third tier of Government in India

(As on 1.4.1998)

	Number	
A. **Total Rural Local Bodies**		**247033**
Panchayats		238682
Village Level Panchayats	232278	
Intermediate Level Panchayats	5905	
District Level Panchayats	499	
Autonomous Councils (in ADC Areas)		83410
Village Councils	8310	
Block Advisory Committees	25	
Autonomous Development Councils	16	
B. **Total Urban Local Bodies**		**3682**
Municipal Corporations	96	
Municipalities	1494	
Nagar Panchayats	2092	

5.4 Developments and Issues

Developments in decentralization process particularly during 1990s have shown a highly diversified experience in terms of its effectiveness to achieve the objectives being pursued. "The overall evidence… indicates that decentralization has not advanced beyond the creation of democratically elected bodies at the level of Panchayats and Municipalities and notwithstanding the recommendations of the finance commissions of States, no worthwhile decentralization of power and responsibilities has occurred or in sight" (Mathur, O.P. 1999). A 'Report Card' prepared in the study by Mathur, O.P. and used by the World Bank Study (W.B, 2000) shows a dismal record of progress of decentralization in India as given in the matrix form below :

	Performance	Capacity	Institution Building
Policy Formulation	•Largely unassisted	• Inadequate	•Limited autonomy •Incomplete functional and Fiscal devolution •Wide inter-State differences
Accountability	•Unassisted except in Selected cities	• Negligible	•Inadequate or absent external accountability provisions
Service delivery and Revenue Collection	• Poor where assessed • Some improvement in	• Very Inadequate	•Overlapping jurisdictions Limited in selected cities and States

Given the dimensions of the developments in terms of implementation of the mandatory provisions in the constitutional amendments like periodic holding of elections, legislative amendments at state level, constitution of various committees at different levels, delegation and devolution from Centre and States to the local bodies it is much beyond the scope of this study even to summarize the major changes over the period. For the same reasons (dimensional aspects) any generalizations on progress or performance of the local bodies could only be misleading. While experiences and developments with decentralization in Kerala State are reportedly exemplary in terms of success story at one extreme, some field survey reports on the other extreme point out disastrous failure of local bodies in the State of Uttar Pradesh and absolute systemic failure of the process in the State of Bihar where even the mandatory process of decentralization has not been completed.

Box : 5.3
Extreme examples of success and failure of decentralization process in India

First, the success story: Decentralisation, as Kerala's People's Planning Campaign has shown, can lead to genuine empowerment of the disadvantaged groups, provided they are not only given the representation they deserve in the elected local bodies because of their numbers but also their participation in the gram sabhas and other lower level groups, formed as part of the planning exercise for prioritization, plan implementation and beneficiary selection is insisted upon and properly monitored.

According to the information now made available, the major focus of the productive schemes of the local bodies was on bringing additional area under cultivation, followed by the distribution of livestock, including poultry. The additional area brought under cultivation in the first three years is reported to be 3.16 lakh acres and the number of livestock distributed 21.43 lakh, of which poultry was 18.68 lakh. Under social welfare schemes the number of houses constructed under the local body plans was 3.06 lakh and the number of houses repaired was another 1.18 lakh. In addition, the number of toilets constructed during the same period was 4.13 lakh. No doubt these are impressive achievements in both the productive and social welfare sectors. It needs to be taken note also that while the share of the Scheduled Castes and Scheduled Tribes population in the area additionally brought under cultivation was 10.1 per cent, their share of the livestock distributed was 45.4 per cent. The share of these disadvantaged groups in new houses constructed was 38.25 per cent and in the number of houses repaired 49.2 per cent. Of the total number of toilets constructed under the local plans, the combined share of the SC and ST population was 20.7 per cent.

These figures suggest that while in the productive sector our disadvantaged groups got their due share keeping in mind their combined population ratio of 11.1 per cent, in the social welfare sector they have received significantly larger attention at the hands of the panchayati raj institutions.

(*Source :* Economic and Political Weekly, July 15-21, 2000. Editorial)
[Also see Annex 5.2 on 'The Kerala Experience' by Vijayanand, S.M. (2000)]

The extreme example of failure:

A Gram Panchayat in Hathras District (Uttar Pradesh)

The Gram Sabha meeting was not held since at the Panchayat elections. Some of the village elders from the poor section of Balmiki caste approached the Chairperson (Jatav caste) to provide a tap for drinking water in their areas as they were not allowed to use the village well at times. Their request was turned down due to shortage of funds. A local retired school teacher raised this issue in the presence of the District Magistrate and made a request to arrange a Gram Sabha meeting in 1996. On the orders from the official agency, the Chairperson convened a meeting and also mobilized support from his community. It led to wide scale violence in the village assembly deterring other groups to support the cause of Balmiki community. Besides, some from the Balmiki community were implicated in false police cases. The Balmiki community still awaits their tap connection.

[The above report is based on a filed survey undertaken by Kaushik P.D. as given by him in his paper on 'Information Technology : Decentralization and the Rural Poor in India,' published in Gangopadhyay, S and Wadhwa, W (2000).]

The Expenditure Finance Commission while analyzing the process of implementation of the 73rd and 74th amendments has come across several problem areas which need to be looked into to make decentralization process effective.

(a) Administrative and legal issues:

Notwithstanding the fact that all the States (except Arunachal Pradesh) have either enacted a new Panchayat/Municipal Act or have brought the existing legislation in conformity with the 73rd and 74th amendments there remain significant gaps in administrative measures taken, uncertainties of role assigned to the local bodies, and deviations from true spirit of amendments.

(i) **Schemes not yet transferred to local bodies.** The EFC found that the schemes relating to the subjects included in the Eleventh and Twelfth Schedules have not yet been transferred by the States to the local bodies. States' legislation merely enumerate the subjects indicated in the two schedules but do not specify the schemes that have to be implemented by these bodies as contemplated in articles 243G and 243W. Thus the funds and functionaries relating to these schemes remain under the control of the departments of the State governments.

(ii) **Planning Committees not made operational.** The District Planning Committees (DPCs) have not become operational in most States; Metropolitan Planning Committees have not been constituted in any State. On the other hand, in some States, DPCs have been entrusted with executive functions, by which they overshadow the local bodies.

(iii) **Extension of 73rd and 74th amendments either not complete or not in true spirits.** Provisions of the Central Act 1992, had excluded out of its purview Fifth Schedule areas falling in some 9 States. After the Parliament had passed an Extension Act in 1996 these States were to amend their existing Acts in consonance with the Extension Act within a year (by Dec. 24, 1997). Except Bihar all other States have amended their Acts. However, it has been noticed that these States have kept provisions in such a way so as to make the extension to scheduled areas meaningless because the powers have been retained by the state governments themselves. (see Mahi Pal, May 2000 for details). Further the Parliament has yet to pass the extension act for the sixth schedule areas.

(iv) **High degree of uncertainty in the role of local bodies.** A hierarchical structure of Panchayats has been contemplated in the States' legislation with the intermediate level panchayats supervising the village level panchayats and the district level panchayats supervising, advising and coordinating the activities of village level and intermediate level panchayats. However, the role of the three tiers of the panchayats has not been clearly delineated in the State legislation and the matter has usually been left to be decided by way of executive instructions.

(b) **Fiscal decentralization :**

The EFC Report (June, 2000), provides, for the first time, a State-wise as well as consolidated overview of the finances of the local bodies for the period from 1990-91 to 1997-98. Based on these data table 5.2 shows that:

For rural local bodies in 1997-98:

- Total expenditure was 1.38 per cent of GDP;
- Expenditure on core services i.e. water supply, street lighting, sanitation and roads was only about 7.4 per cent of the total expenditure;
- Own resources of the local bodies were only 3.2 per cent of the total expenditure incurred; and
- There was a financing gap to the extent of 0.10 per cent of GDP.

For Urban local bodies in 1997-98:

- Total expenditure was 10 per cent of GDP;
- Expenditure on core services was 66.9 per cent of the total expenditure;
- Own resources of urban local bodies were only 5 per cent of the total expenditure incurred by them; and
- There was a significant financing gap to the extent of 9.2 per cent of GDP.

Table 5.2 Finances of Local Bodies

	1990-91		1997-98	
	Rs. Crore	% of GDP	Rs. Crore	% of GDP
Rural Local Bodies				
(Panchayat Raj Institutions, All tiers)				
Total Expenditure	**7147**	**1.33**	**20931**	**1.38**
Expenditure on Core Services (Water supply, Street lighting, Sanitation and Roads)	417	0.08	1555	0.10
Other Expenditure	6730	1.26	19377	1.28
Total Revenue	**6614**	**1.24**	**19356**	**1.28**
Own Revenues	**370**	0.07	**677**	0.05
(i) Own Tax	238	0.04	377	0.02
(ii) Own-Non-Tax	132	0.02	300	0.02
Other Revenues	**6244**	**1.17**	**18679**	**1.23**
Urban Local Bodies				
(All levels)				
Total Expenditure	**24395**	**4.56**	**151308**	**10.00**
Expenditure on Core Services	9988	1.87	101224	6.68
Other Expenditure	14407	2.69	50085	3.30
Total Revenue	**3931**	**0.73**	**12179**	**0.80**
Own Revenues	**2736**	0.51	**7599**	0.50
(i) Own Tax	1935	0.36	5892	0.39
(ii) Own-Non-Tax	801	0.15	2127	0.14
Other Revenues	**1195**	**0.22**	**3608**	**0.30**

Source : (for basic data) Report of the Eleventh Finance Commission, June 2000.

From an overview of the finances of local bodies it would appear that :

(a) The financing gap for the rural local bodies is not yet significant. This could be primarily because the rural local bodies spend only what is made available to them by the State government. In any case these institutions would not have many sources of tax and non-tax revenue at the local level.

(b) The finance gap with the urban local bodies on the other hand is significant. This is mainly because while these institutions have the sole responsibility of providing core services in the urban areas they are administratively weak in realizing cost related user charges of these services. Also these institutions, thus increasingly depend on funds provided by the State government which in most cases remain under severe financial constraint.

It is clear that fiscal decentralization is the key to the sustainability of any decentralization effort. The noteworthy features of Kerala's financial devolution to local governments clearly demonstrate the importance of fiscal decentralization. In 1996, a land mark decision was taken by the Kerala Government to allot more than a third of the State's Plan Resources (i.e., invisible funds) to the local governments, with the PRIs getting an 85% share in accordance with the rural population around 90% of the Plan funds is given in a practically untied form to the local governments to prepare their own schemes and implement them within certain broad policy framework. (*see* Annex 5.1 for details).

A word of caution may be in order. Various aspects of decentralization and PRIs have been reviewed in 'Mid Term Appraisal of the Ninth Plan' recently published by the Planning Commission (Oct., 2000), Government of India. One of the conclusions based on field studies indicates an important shortcoming of the system as follows:

> "From these studies, it appears that though the ordinary village people feel optimistic about the potential of panchayats, they think that it has not brought the fruits of development to them. Corruption is singled out as the most important cause for the ineffective functioning of these institutions. Control which is exercised by the Sarpanch and Block Level officials over Village Panchayats and Gram Sabhas has not only buttressed corruption, but it has also led to pessimism that villagers on their own and at their level cannot change or improve things because of heavy dependence on elected functionaries and Block officials. The present system is, therefore, seen to have actually reinforced dominance and unequal access to power, besides rendering the villagers helpless and alienated." (Page 185).

The Eleventh Finance Commission did the whole exercise of analyzing the developments on fiscal decentralization for local bodies because for the first time, a

finance commission, in its terms of references, was required to make recommendations on the measures needed to augment the consolidated funds of the States to supplement the resources of the local bodies on the basis of the recommendations of the Sate Finance Commission (SFC). Also, the EFC was required to make its own assessment wherever SFCs have not reported or even constituted. It is in this process of assessment and recommending the measures that the EFC has found significant problems and issues confronting the smooth functioning of the fiscal decentralization from states to local bodies. State Finance Commission mechanism could be found of not much help to the EFC. Study reports sponsored by the EFC to two research institutions could not provide usable estimates of financial requirements of local bodies. Perhaps the most intriguing fact is that States' memoranda to EFC did not even give the position in regard to transfer of powers, authority and responsibility or the financial powers devolved on the local bodies to raise resources. The powers of taxation mentioned in the legislation have been made subject not only to the rules, notifications and orders to be issued by the State governments, but also to the procedures and limits to be prescribed. Finally, in quite a few States action is yet to be taken. Some of the important problem areas in fiscal decentralization as identified by the EFC are as follows:

(a) **SFCs mechanism is not working well.** The fact that EFC could not utilize the outcomes of SFC mechanism is an indication enough of a systemic failure. The EFC found that:

- There is no synchronization of the periods covered by the SFCs with that of the Finance Commission.
- Many SFC reports have not addressed the specific terms listed in articles 243I and 243Y, nor have they provided a clear idea of the powers, authority and responsibilities actually entrusted to the local bodies.
- In some States the action taken report (ATR) on the recommendations of the SFC is yet to be submitted to the state legislature, despite the fact that the reports have been available for about two to three years.
- Several important recommendations of the SFC, relating to sharing/transfer of resources, are often reported to be under consideration for months or even years.
- In some states, serving government officers are appointed as chairperson and members of the SFCs and that too in *ex-officio* capacities. This puts limitation on the ability of the SFC to act as an autonomous body to make recommendations in a free and independent manner, as has been envisaged in the Constitution.

Box 5.4
Deficiencies in State Finance Commission Reports

In real terms, no improvement in local resource base is likely as a result of the recommendations of SFCs. Moreover, the SFC reports have paid far less attention to issues of autonomy, financial management and auditing procedures. The main deficiency of the reports lies in the fact that the recommendations are not based on a clear statement of the spending responsibilities of local bodies. Indeed the absence of attention to the elementary principle, that expenditure assignment must precede any tax or revenue assignment, has made most of the SFC's recommendations suspect.

All PRIs have a poor fiscal base. While resource mobilization by the PRIs is generally limited, it is imperative to provide PRIs with revenue raising powers of their own in order to reduce their excessive dependence on the State and Central Governments. But till such time that they are financially dependent on funds from the State Governments, the State Budgets should specify the amount earmarked for district sector plans under Panchayati Raj as also their distribution among the three tiers. It is suggested that 30-40 percent of a State's Plan be devolved on local bodies as already done in the State of Kerala. In addition, a part of the finances should be in the form of untied funds so that the funds can be utilized as per the felt needs of the Panchayats. Training and capacity building of PRI functionaries is essential and devolution of financial resources must be accompanied by suitable strengthening of PRIs through transfer of departmental functionaries.

Planning Commission (2000, Oct.) page 176.

(b) **There is no significant change in the functional domain of Panchayats post 73rd amendment.** The study entrusted by the EFC to National Institute of Rural Development (NIRD) revealed that few States have been serious in vesting the panchayats with the necessary powers, funds and staff to enable them to perform the functions assigned to them under the statutes. Further, the States' legislation provide for levy and collection of certain taxes, fees and tolls but the rules relating to fixation of rate structure are not periodically done and reviewed.

(c) **Local bodies are merely performing agency functions.** The Central sector and Centrally sponsored schemes are mostly implemented through special agencies created at the district level. In some cases, the local bodies have been associated but they have no decisive role clearly assigned to them in the preparation and implementation of these schemes.

In consideration of the slow and half hearted implementation of the 73rd and 74th amendments in the Constitution for creating local bodies as self government, the EFC has made wide ranging recommendations both for administrative and legal changes as well as for proper utilization, accounting and audit of the expenditure of these bodies.

In the ultimate sense, however, it will all depend on the sincerity of purpose with the State governments to see that the local bodies do function as the 'self government' in its real effective form. **No one can help filling up the pitfalls if these are created by those who are supposed to fill them up. There are clear examples of success stories on decentralization like those of Kerala within the same framework as available to other states.** (*see* Annex 5.2 on Kerala experience) 'One must understand that empowering panchayats and local governments in any developing country is a critical economic and political issue. While the 'economics' part is fairly clear, political hurdles are enormous since hierarchies which promote 'panchayats', may not be interested in providing them with the required financial freedom. (*Marjit, S.* 1999).

***Annex* - 1.1**

Perspectives on Indian Economy : Highlights of Select Reports/Studies

For a synoptic view of overall assessment and perspectives on the Indian economy an attempt has been made to select a few important studies/reports out of the vast literature and present the main highlights from them. To keep the assessment and perspective unbiased and balanced, the studies/reports selected are from Government of India and the Reserve Bank of India, International Institutions (IMF, World Bank, ADB, UNDP and JBIC) and academic studies published by a few individual experts (with apology to all others).

1. Government of India : Planning Commission

The Ninth Five Year Plan (1997-2002) document is the most comprehensive study available from the Planning Commission, Government of India to ascertain the assessment and perspectives on the Indian economy. The Plan was approved (in Feb., 2000) by the National Development Council-the highest body on economic development headed by the Prime Minister with members of Planning Commission, Cabinet Ministers and Chief Ministers of the States as members. The document provides specific objectives of the Planned economic progress of the country for a medium term and also for the long-term.

'As we look back over the past 50 years of our development as an independent nation, we can take justifiable pride in having successfully reversed the worst inequities of our colonial heritage and building a nation of considerable economic strength in a framework of democracy and federalism. We cannot, however, overlook our shortcomings or to the magnitude of the challenges that lie ahead of us. Despite all our achievements, one third of our citizens still live below a modestly defined poverty line.'

(Excerpt from Prime Minister's 'foreword' to the Ninth Plan Document, Vol. I, Feb. 2000)

The focus of the Ninth Plan can be described as : "Growth with Social Justice and Equity".

The specific objectives of the Ninth Plan as approved by the National Development Council are as follows:

- Priority to agriculture and rural development with a view to generating adequate productive employment and eradication of poverty;
- Accelerating the growth rate of the economy with stable prices;

- Ensuring food and nutritional security for all, particularly the vulnerable sections of society;
- Providing the **basic minimum services** of safe drinking water, primary health care facilities, universal primary education, shelter and connectivity to all in a time bound manner;
- Containing the growth rate of population;
- Ensuring **environmental sustainability** of the development process through social mobilization and participation of people at all levels;
- **Empowerment of women** and socially disadvantaged groups such as Scheduled Castes, Scheduled Tribes and Other Backward Classes and Minorities as agents of socio-economic change and development;
- Promoting and developing **people's participatory institutions** like Panchayati Raj institutions, cooperatives and self-help groups;
- Strengthening efforts to build self-reliance.

(Ninth Five Year Plan-1997-2002, Vol. I)

2. <u>Government of India : Finance Minister</u>

In his budget speech (2000-01) the Finance Minister, Government of India, declared the next 10 years as 'India's decade of development' and to achieve this objective listed the elements of the strategy as follows:

A broad-based industrial recovery is under way. Despite lower growth of agriculture due to inclement weather, overall economic growth this year is expected to be nearly 6%. The infrastructure sector is performing much better. For the first time in 17 years the inflation rate has stayed below 4% for 42 consecutive weeks.

The next 10 years will be Indian's decade of development. To achieve this objective our strategy must encompass the following elements:

- Strengthen the foundations of growth of our rural economy, especially agriculture and allied activities.
- Nurture the revolutionary potential of the **new knowledge-based industries such as infotech,** biotechnology and pharmaceuticals.
- Strengthen and modernize traditional industries such as textiles, leather, agro processing and the SSI sector.
- Mount a sustained **assault on infrastructure bottlenecks** in power, roads, ports, telecom, railways and airways.
- Accord the highest priority to **human resource development** through programs and policies in education, health and other social services, with special emphasis on the poorest and weakest sections of society.

- Strengthen our role in the world economy through rapid growth of exports, **higher foreign investment** and prudent external debt management.
- Establish a credible framework of **fiscal discipline,** without which the other elements of our strategy can fail.

3. Government of India : Finance Ministry

Just before the presentation of the Union Budget, the Ministry of Finance presents an annual 'Economic Survey' which besides covering all the important sectoral developments in the economy during the year under review, also brings out critical issues, challenges and priorities for the macroeconomic policy. Some of the highlights of the assessment and challenges given in the Economic Survey 1999-2000 are as follows:

- To sustain and accelerate the growth of our economy and employment, while ensuring low inflation, our economic policies must combine **fiscal discipline** with rapid economic reforms wherever necessary.
- More **effective management of public finances** continues to be the central challenge facing all levels of government in India.
- Many of our administrative practices and methods have not changed since colonial times. We need to introduce urgently modern management practices in departments which provide well-defined services such as Posts or have well defined objectives like tax collection.
- Many people feel that our legal system is creaking, if not collapsing, under the burden of too many laws and too little enforcement.
- Laws and institutions constitute the "software" of the state and society. Their reform and effective operation will be crucially important for successful economic performance in the new millennium.
- Confronted by the continuing challenges of globalization the central lesson of the nineties is to persevere with the **thrust of our economic reforms.** This includes continued liberalization of our foreign trade, reduction of customs tariffs, clear and decisive policies to encourage foreign direct investment, continued prudence on external debt, carefully calibrated expansion of convertibility on capital account and continued reliance on a market-determined exchange rate policy.

4. Reserve Bank of India : Currency and Finance Report

Unlike in the past, for the first time, the Annual 'Report on Currency and Finance, 1998-99' from the RBI is essentially a research document focusing on the theme namely 'the structural transformation of the Indian Economy' keeping the time frame of analysis the 'eighties and the 'nineties.

The report thus provides an analytical assessment of the economy with recent developments in the backdrop of 'eighties and also 'the perspectives' on the Indian economy. A few highlights from the first chapter on 'The perspectives' are as follows:

- The Indian economy, as it moves into the twenty-first century, is poised to further the institutional reforms that have been initiated in a structured manner in the early 'nineties, for purposes of enhancing the prospects of higher growth with enduring stability.
- The policy orientations in the **last eight years** or so have given considerable **resilience and dynamism to the economy,** enabling it to realize, more effectively, the gains from allocative efficiency.
- **The Indian experience is, in several respects, fascinating.** The adoption of development planning in the early 'fifties was considered as unique. It was also appealing. Over time, however, the experiment with planning has been rendered ineffective by the introduction of a plethora of controls and licences. The resultant inefficiencies, distortions and rent seeking activities had to be, therefore, addressed by elimination of controls, freeing prices and building in appropriate incentives.
- By the early 'eighties, it became evident that gradual liberalization and opening up of the economy would need to be introduced through a process of 'learning by doing'. Accordingly, deregulation was initiated by relaxing the energy barriers and the restrictive clauses in the MRTP Act, and by allowing expansion of capacities. Modernization of industries through acquisition and upgradation of technology was encouraged. Import restrictions, especially on capital goods, were reduced. In the area of domestic financial sector, the yield on long-term Government securities was raised, and measures to develop the money market in India and to introduce new instruments were initiated.
- It is important to recognize that development planning has failed to deliver to the expected extent because of absence of incentives and because of the inadequacy of supportive institutions. The economy had become vulnerable to external payment crisis by the beginning of the 'nineties, partly due to the presence of the external factor, viz., the Gulf War, and partly owing to the unsustainable fundamentals. The relatively high rate of growth in the second half of the 'eighties proved to be fragile; in the context of the sharp increase in the external current account deficit (CAD) and the steep rise in gross fiscal deficit of the Central Government, respectively, to 3.2 per cent and 8.3 per cent of GDP in 1990-91. The foreign exchange reserves declined to a mere US $ 975 million on July 12, 1991 (barely sufficient to cover the country's imports for a week).

- The crisis was also reflected in the sharp downgrading of India's credit rating, the curtailment of foreign private lending and the acceleration of inflation. The correction to this situation required the application of a relatively comprehensive macroeconomic and structural adjustment policies alongwith a shift in the development strategy in favour of market orientation and provision of appropriate incentives. The underlying thrust of such a regime shift is to provide an environment that enables both growth and stability to move hand in hand on s sustained basis.
- **The experience of the 'nineties *vis-à-vis* that of the eighties shows that there has been a marked structural transformation of the Indian economy.**
- The 'nineties brought to the fore a number of challenges. Apart from the need to containing fiscal deficit, there are issues relating to sustainable trade position, the strategies to promote capital flows keeping in view their implications for domestic monetary management and exchange rates, the sustainability of external debt, and the nature and kinds of strategies need to pursue legal and institutional reforms, and modern technologies, particularly those affecting the payments and settlement systems in a synchronous manner.
- The Indian economy has undergone a gradual transformation during the post-independence period, the pace of such transformation, however, being relatively rapid since the last decade.
- With the Indian economy shifting to a high growth path during the eighties, it was evident that the economy has emerged from a phase of stagnation, which had set in since the mid-sixties.

5. Reserve Bank of India : Monetary Policy background

Another first time from the RBI is a report on 'Macroeconomic and Monetary Developments in 1999-2000' issued alongwith the statement on Monetary and Credit Policy for the first half of the financial year 2000-2001, on 27th April, 2000. This brief review of macroeconomic provided an insight in the recent developments. A few highlights are a follows:

The recent trends in real GDP growth highlight three distinct though inter-related developments in the real economy.

- **First, there has been a significant decline in the overall saving and investment rates in the economy since they peaked in 1995-96,** largely on account of a sharp decline in public saving.
  - While the gross domestic saving rate declined from 25.5 per cent of GDP in 1995-96 to 22.3 per cent in 1998-99, the gross domestic capital formation rate fell from 27.2 per cent to 23.4 per cent during this period. The public saving rate declined from 2.0 per cent in 1995-96 to near zero in 1998-99.

While household saving rate remained flat at 18.5 per cent, between 1995-96 and 1998-99, the private corporate saving rate moved down from 5.0 per cent to 3.8 per cent.

  - Available indicators imply a mixed prospect in the saving front for 1999-2000. The rates of expansion of both currency and aggregate deposits in 1999-2000 have been lower than those in the previous year. On the positive side, the household saving is expected to get a boost from the revival of equity market and a substantial increase in small savings (gross) and provident fund collections.
  - The private corporate saving is expected to improve in 1999-2000 given the early trends in profit after tax. On the other hand, the saving performance of the public sector may exhibit a further deterioration as revealed by the large increase in the revenue deficit of the central government in the revised estimates of 1999-2000. The advance estimates of GDP growth for 1999-2000 has been placed at 5.9 per cent. Implicit in this estimate would be an investment rate of 22 to 24 per cent that would be consistent with the trend value of the incremental capital-output ratio (ICOR).

- **Secondly, growth impulses in recent years seem to have emerged from productivity growth in the economy.** The underlying permanent component of ICOR is estimated to move down from 4.1 in 1995-96 to 3.9 in 1998-99. There has also been evidence of significant improvement in total factor productivity in the economy during 1990s.
- **Thirdly, cyclical factors, both in the demand and supply sides have played a relatively large role in the growth experience of recent years.** While supply cycles reflected fluctuations in agricultural growth, demand cycles have largely followed the trends in consumption and investment of the private and public sectors. Private consumption demand witnessed a decline from 72.1 per cent of GDP in 1980-81 to 63.7 per cent of GDP in 1995-96 and further to 63.3 per cent of GDP in 1998-99. Public consumption, on the other hand, has remained steady at around 10 to 12 per cent of GDP in 1980s and 1990s. Investment demand has fallen sharply in the public sector from over 10 per cent of GDP in 1980s to around 6 to 7 per cent in the second half of 1990s which was only partly corrected by increase in the private investment demand (from around 10 to 14 per cent of GDP in 1980s to 15 to 18 per cent in the second half of 1990s).
- These structural and cyclical factors in the growth dynamics have implications for monetary policy in terms of their impact on the potential and actual output. While the developments in the potential output have a bearing on the medium to long term stance of monetary policy, the monetary policy would itself matter

to the growth outcomes in the short-run through credit, interest rate, exchange rate and other mechanisms.

6. World Bank

The World Bank report on 'India: Policies to Reduce Poverty and Accelerate Sustainable Development', January 2000, is a pilot in the World Bank's new approach to country economic reports, embodying the Bank's Comprehensive Development Framework. The new approach to economic reports provides a medium-term perspective and the economy's potential vulnerabilities, including those in the short run. A few highlights of the report on overall assessment and perspectives on the Indian economy are as follows:

- **India's trend growth of 5.7% p.a. since 1980 is the highest outside Southeast and East Asia among large developing countries.** However, despite this relatively high growth, poverty incidence is still 34% and India's economic structure remains relatively unchanged.
- By comparison, even after the Southeast Asian crisis, Korea, Thailand and Indonesia have substantially higher per capita incomes and social indicators, and considerably lower poverty than India, although the countries had similar per capita incomes in the 1960s.
- The experience of Southeast Asia suggests that India needs sustained, higher, more labor-using, outward-oriented growth, coupled with improved social service delivery, in order to reduce poverty.
- A rapid reduction in India's poverty and increased growth will depend on a **second wave of reform,** as all recent governments have recognized. Reducing poverty and increasing development will depend on a comprehensive framework that improves access of the poor to education and health services, improves infrastructure, and provides good governance, transparency, a sound legal and judiciary system, a strong financial system, and human and environmental sustainability. Sustained development will also critically depend upon continued **sound macroeconomic policy,** namely:
    - Greater openness to trade, to encourage more efficient resource use and increase labor demand, and
    - Sounder public finance, namely reduced subsidies and deficits and the realignment of government away from non-core public sector activities and consumption spending and towards more and better infrastructure and basic social services.

India and High Growth East Asia : A statistical Comparison

	GDP Per Capita 1997			National GDP		Openess/a		Investment Rate/b		Literacy Rate/c	
	PPPS $	Current $	1996/ 1970	1996/ 1970 Growth Rates p.a.	1997/ 1977 Growth	1970 Rates p.a.	1997	1970	1996	1970 (Female)	1997 (Female)
India	1510	451	3.4	4.7	5.2	7.2	17.8	14.6	22.9	33.6 (18.1)	62.0 (50.0)
China	3120	745	5.9/c	10.5/d	10.4/e	11.2/e	35.4	28.3/f	33.8	51.7 (35.8)	82.9 (74.5)
Indonesia	3490	1079	5.6	6.9	6.4	22.9	44.1	13.6	31.8	56.3 (44.0)	85.0 79.5)
Korea	13580	9623	8.1	8.4	7.8	32.2	63.6	23.0	35.0	86.6 (79.8)	97.2 95.5)
Malaysia	8190	4544	6.3	7.3	7.1	77.8	159.7	17.7	42.4	58.3 (46.1)	85.6 (81.)
Thailand	6690	1959	6.5	7.5	7.3	28.4	77.3	23.7	35.6	80.0 (72.7)	94.7 (92.8)

a. Openess equals total trade (exports+imports) as share of GDP.
b. Gross fixed investment as a share of GDP.
c. Figures in the brackets are female literacy rates.
d. Data pertains to 1978-1996.
e. Data pertains to 1978-1997.
f. Data pertains to 1979.
Source : IMF, International Financial Statistics; World Bank, World Development Indicators.

- **Although India's growth has been among the fastest in the world and poverty has fallen in the last twenty years, the poor still number over 300 million, more than in all of Sub-Saharan Africa.** And, despite the growth, little has changed structurally: trade remains a much smaller percentage of GDP. East Asian countries including China, almost 73% of the people living in rural areas, and social indicators, despite improvement, still low. India's human development and per capita consumption has not risen nearly as fast as in East Asia, even taking into account East Asia's recent crisis.
- **A Second Wave of Reforms** will be needed to achieve this poverty-reducing growth and banish the risk of a slowdown including macroeconomic, structural policy reform, governance and institutional concerns.

7. <u>International Monetary Fund (IMF)</u>

The 'World Economic Outlook', published twice a year presents IMF staff economists' analysis of global economic developments during the near and medium term. The May, 2000 'Outlook', contains a 'box writeup' on 'India: Reinvigorating the Reform Process' wherein in the backdrop of an incisive analysis of the Indian economy over a period the perspective is also presented. A few highlights are as follows:

- **India has been among the fastest-growing economies in the world over the last two decades, and has achieved trend improvements in growth, literacy, mortality, and poverty rates.** In recent years, deft handling of monetary policy has helped India to successfully weather the Asian crisis, while maintaining low inflation and a comfortable external position. Yet despite these gains, poverty rates remain high, with more than a third of the population still living below the official poverty line. This uneven progress raises questions about the impact of the economic and structural reforms implemented since the mid 1980s on growth in India, and what more can be done to make greater inroads into poverty reduction.
- In the three decades following independence in 1947, growth in India was stifled by a high degree of government planning and regulation, with per capita GDP rising by only 1.5 per cent per annum. Industrial controls were pervasive, and restrictions on private credit, the role of the public enterprise sector, and subsidy programs increased throughout the period. Strict controls on foreign direct investment, in import licensing system, and from the 1970s-high tariff rates further limited the economy's growth potential.

Expenditure and Sectoral Components of Growth[1]

(Average annual percent unless otherwise noted)

	1951-79	1980-90	1992-96	1997-99[2]
Real per capita GDP growth[3]	1.5	3.8	4.7	4.1
Real GDP growth[3]	3.7	5.9	6.7	5.8
Contribution to growth,				
by expenditure item:				
Private consumption	2.4	3.8	3.9	2.5
Public consumption	0.4	0.8	0.5	1.4
Gross fixed investment	0.8	1.5	1.9	1.2
Private investment	…	0.8	1.8	0.9
Public investment	…	0.6	0.1	0.3
Net exports[4]	…	0.1	0.1	0.6
Contribution to growth,				
by sectors:				
Public	1.1	1.7	2.8	5.2
Private	2.2	4.2	3.8	0.7
Contribution to growth,				
by sectors:				
Agriculture	1.1	1.6	1.4	0.5
Industry	1.0	1.7	2.0	1.5
Services	1.4	2.5	3.2	3.8
ICORs, by sector:[5]				
Overall	…	4.2	4.1	4.8
Agriculture	…	2.0	1.5	2.6
Industry	…	5.7	6.8	10.7
Services	…	4.0	2.9	2.1

Source : Central Statistical Organization (CSO), National Accounts Statistics.

[1]Averages computed over fiscal years beginning in April.

[2]1999 figures on GDP and sectoral production are CSO Advance Estimates; annual population growth assumed constant at 1.7 percent; average contribution of expenditure categories and private and public production computed over 1997-1998.

[3]Measured at market prices; base year is 1980 for data until 1993, and 1993 thereafter.

[4]Includes statistical discrepancy.

[5]The incremental capital output ratio (ICOR) is the ratio of the investment rate to the GDP growth rate; a falling ICOR over time therefore indicates improved capital productivity.

Explaining India's Relative Growth Performance

	Average Value (percent)		Estimated Difference in Contribution to Growth Rates[1]
	India	East Asia	(percentage points)
Factors contributing to growth during 1970-95			
Investment/GDP	21.9	29.6	-1.2
Net FDI/GDP	0.1	2.5	-0.8
Trade/GDP	4.5	113.5	-1.1
Government consumption/ GDP	10.3	10.4	0.0
Secondary school enrollment Rate	35.2	50.5	-0.3
CPI inflation rate	8.8	8.4	0.0
Convergence effect and Other factors	…	…	0.2
Real per capita GDP growth (1970-95 average)	2.4	5.7	-3.3

Source : P. Kongsamut and A. Vamvkidis, "Economic Growth," Chapter 2 in Philippines: Toward Sustainable and Rapid Growth, IMF Occasional Paper No. 187 (Washington: International Monetary Fund, 2000).

[1]Calculated as the estimated coefficient times the difference in the independent variable value (India less East Asia). Reported differences in growth rates of real per capita GDP are actual.

- **Faster growth would require durable fiscal consolidation to** raise national saving and crowd-in private investment spending; further liberalization of foreign trade and investment flows; and additional reforms to labor markets and in the agricultural, industrial, and financial sectors to promote greater efficiency and export competitiveness. These reforms need to include removal of domestic pricing distortions, improvements to bankruptcy procedures, and an easing of restrictions on firm and farm size and regulations that make it difficult to shed labor (and therefore impede job creation). Fiscal priorities also need to be redirected toward investment in human and physical capital.

8. United Nations (UN)

In June 2000, UN has brought out a Report on 'India: Common Country Assessment'. The Common Country Assessment (CCA) is the first step towards developing the 'United Nations Development Assistance Framework' (UNDAF) - a strategic framework that enables the UN system to act with a common vision, purpose and approach to accelerate human development. Preparation of the UNDAF in India was validated by the Triennial Comprehensive Policy Review resolution of the General

Assembly passed in 1998. The Framework is being developed in collaboration with the Government of India.

The CCA assesses the country's development situation in the context of national development priorities. A few highlights of the assessment of Indian economy contained in the CDA are as follows:

- **India has achieved considerable success along several dimensions of human development over the past 50 years.** Distinctly visible are the significant expansion and diversification of production, made possible by the application of modern science and technology and the introduction of modern management. Between 1950-51 and 1997-98, for instance, the index of agricultural production increased nearly four fold, the index of industrial production went up from 7.9 to 137.6, and electricity generation increased from 5.1 billion kwh to 421 billion kwh. Between 1960-98, wheat production went up from 11 million tonnes to 66 million tonnes, and the production of rice increased from 35 million to 82 million tonnes. All this has contributed to a steady and impressive growth in India's GDP. With the exception of 4 years, the country has recorded a positive growth rate in its GDP every years since 1950. Between 1950-51 and 1980-81,over 30 years, India's GDP grew at an annul average rate of 3.6%.
- However, after 1981, and particularly after the mid 1980, India's GDP began to grow much faster. Between 1980-81 and 1990-91, it grew on average by 5.7% per annum. Annum growth in GDP fell sharply to 0.8% in the crisis year of 1991-92, but revived quickly to around 5% per annum in the two subsequent years before reaching a high of 7.7% in each of three successive years. GDP growth rates fell again to 5% in 1997-98 and improved marginally to 6% in 1998-99.
- **India's growth record in recent years has been particularly impressive given that it has been able to avert the fiscal crisis that many East Asian economies experienced over the past few years.** India has been able to record a steady growth in its per capita income as well. Between 1950-81, the annual average rate of growth in per capita income was around 1.2%, but since then, there has been a significant change. Between 1980-91, per capita Net National Product grew on average by 3.1% every year. The financial crisis of the early 1990s saw a slowing down in the growth of per capita income, but there has been quick recovery. Per capita NNP has grown on average by 5.2% every year between 1993-98.
- Achievements have also been recorded in many spheres of social development. Life expectancy at birth has gone up from 32 years at the time of Independence to 61 years in 1998.

- India has put in place an extensive system of public health services. Table 1 shows the expansion in health services between 1951-97. Remarkable progress has been achieved in immunizing children, and in the control and eradication of guineaworm. Since the 1960s, infant mortality has been halved to 71 deaths per 1000 live births in 1998.

<table>
<tr><th>Achievements</th><th>Shortfalls</th></tr>
<tr><td colspan="2">Health</td></tr>
<tr><td>• Life expectancy at birth has doubled to 61 years between 1950-97.
• Infant mortality has been halved between 1960-98 to 71 deaths per 1000 live births.
• Guineaworm has been almost eradicated.
• Significant gains have been made in the control of communicable diseases, and in the eradication of polio.
• An extensive public health and medical system has been put in place.</td><td>• Close to 2 million children annually die before reaching the age of one - and most of these deaths are avoidable.
• Maternal mortality remains high - 437 deaths per 100,000 live births. Maternal mortality accounts for 20% of the world's death from pregnancy related causes.
• Only 35% of children between 12-23 months were found to be fully immunized in 1992-93.
• Quality of public health care leaves much to be desired.</td></tr>
<tr><td colspan="2">Education</td></tr>
<tr><td>• Literacy rates have gone up from 18% to 52% between 1951-91.
• Significant gains have been made in the field of higher education - in medicine, technology and management.
• Some 95% of villages have a primary school within walking distance of one kilometer.</td><td>• Some 69 million children between 6-14 years of age are out of school.
• Against the Constitutional requirement of ensuring free and compulsory education for 8 years, the average years of schooling is only 2 years.
• Discrimination on the ground of caste, class and gender continues to deny children equal access to good quality basic education.</td></tr>
<tr><td colspan="2">Water and sanitation</td></tr>
<tr><td>• Some 90% of urban population have access to safe drinking water.
• Nearly 87% of rural population have access to safe drinking water.</td><td>• Water contamination by arsenic, fluoride and other chemicals pose a serious threat.
• Indiscriminate drilling has led to rapid depletion of water in many parts.
• 20% of rural population have access to latrines.</td></tr>
<tr><td colspan="2">Income poverty</td></tr>
<tr><td>• Between 1973-74 and 1993-94, the proportion of rural population below the poverty line has come down from 56.4% to 37.3%.
• Between 1973-74 and 1993-94, the proportion of urban population below the poverty line fell from 49% to 32.4%.</td><td>• There were 321 million people below the income poverty line in 1973-74. By 1993-94, the number had come down to 320 million.
• In 1993-94, there were 244 million people in rural areas below the income poverty line.</td></tr>
<tr><td colspan="2">Food and nutritional security</td></tr>
<tr><td>• The yield per hectare of wheat has gone up from 11 million tonnes to 65.9 million tonnes between 1960-98.
• Between 1951-98, per capita food availability went up from 395 grams per day to 484 grams.
• The country has built up a reserve stock of foodgrains-around 20 million tonnes in 1999.</td><td>• Some 53% of children below the age of five remain moderately and severely malnourished (under-weight).
• Nearly 75 million children below the age of five year malnourished-the largest number in the world.</td></tr>
<tr><td colspan="2">Gender</td></tr>
<tr><td>• Constitutional Amendments have ensured that one-third of all seats in local elections are reserved for women.
• The singular mean age at marriage for women has gone up from 18.4 years in 1981 to 20 years in 1992-93.
• Total Fertility Rate has come down from 4.9 in 1982 to 3.4 in 1992-93.</td><td>• The female-to-male population ratio remains adverse-and has been worsening.
• Instances of female feticide and infanticide are regularly reported.
• Women constitute less than 10% of elected Lok Sabha (Lower House of Parliament) members.
• Female illiteracy rates remain unacceptably high.</td></tr>
</table>

9. <u>Asian Development Bank (ADB)</u>

ADB brings out an Annual Report "Asian Development Outlook". The 'Outlook 2000' contains a review of the Indian economy along with the challenges being faced. A few highlights are:

- The recovery is being sustained, and the new government passed several important reform bills at the beginning of its term. However, the unfinished agenda of economic reform remains substantial. In particular, while reforms undertaken so far clearly have helped promote economic growth, progress has been less impressive in developing better social opportunities for the poor.
- Dependence on the private sector and markets does not mean that the government has no role. Reorienting its contribution to the economy is crucial, and government can help create conditions for accelerated growth.
- Infrastructure bottlenecks are likely to constrain the achievement of a higher growth rate of 7 per cent and above.
- The poor state of human resource development is an even more serious constraint to sustainable development.
- Restructuring public sector enterprises through disinvestment or privatization must be accelerated.
- **The economic reforms undertaken have yielded good results,** but progress has been less impressive in terms of better social opportunities for the poor.
- **The government needs to spend more in education and health,** but not only because investments in human capital are instrumental for economic growth.

10. <u>OECF (Now JBIC)</u>

In its Annual Report 1999 OECF (now JBIC) had made the following important observations regarding India :

- After the economic crisis caused by the Gulf Crisis in 1991, the Government of India had launched economic reforms including making up the budget deficit, deregulation, liberalization in trade and investment, and reforms in financial sector, those which **rewarded with good results in some extent.**
- **In India, the need to improve economic infrastructure such as electric power, which constitutes the greatest impediment to economic growth, remain as high as ever.** In addition, there is going to be an increasing demand for confessional funds allocated specifically in the social and environmental sector, such as water supply and sewerage, agricultural and rural development, primary education, and medical treatment and health care, etc. furthermore, in view of the needs to consider global environmental problems like global warming, it will be essential to make every effort to minimize the impact on

the environment when promoting the improvement of economic infrastructure, particularly in the transportation and power and energy sectors.

11. <u>Vijay Kelkar :</u>

In an article (EPW, August 14, 1999) on 'India's Emerging Economic Challenges', Vijay Kelkar (ex-Finance Secretary, Government of India) provides a review of the strategic policy failures which landed the Indian economy, till very recently, in a low productivity, low growth impasse and a discussion of the critical areas to focus on in the next phase of economic reforms. A few highlights are as follows:

- **In the last few years, the Indian economy has been a sea of tranquillity in the turbulent world economy, especially in Asian region.** In fact, in the year 1998 India achieved one of the highest growth rates in the world and this year the growth rate is expected to be higher than last year. Equally, in terms of other macro-economic indicators, such as the rate if inflation or exchange rate stability, once again the performance of the Indian economy in recent years has been quite outstanding. The rate of inflation is less than 4 per cent and exchange rates have been relatively stable. There is, in fact, some evidence that during the nineties the growth rate in India has shown some acceleration. However, there are a number of weaknesses which we need to overcome to meet the objective of rapidly removing poverty.
- Seen in the context of the contemporary experience of other economies of Asia, such as China, Japan or South Korea, our performance is far short.
- **When a satellite is put into orbit, it require high velocity to ensure exit from the earth's gravitational force; similarly, if our economy is to exit from the gravitational pull of poverty, it requires an exit velocity of double-digit growth rate over the next two decades.**
- **At present we are among the bottom 20 of the all the countries in terms of Human Development Index. In the year 2020 we should be among the first 20.** This is possible and it is entirely up to us to build the necessary consensus for accelerated reform and implement it.

12. <u>Nirupam Bajpai and Jeffrey D Sachs</u>

Based on the ongoing analysis of India's economy at the Centre for International Development (CID) in the Kennedy School of Government at Harvard University, USA as well as discussion that the authors benefited from during a trip to India earlier this year, Nirupam Bajpai and Jeffrey D Sachs in an article (EPW, April 15, 2000) on 'India's Decade of Development' have summarized ten crucial initiative of reform to make the

first decade of the 21st century a true 'Decade of Development' for India. *These relate to (I) Universal literacy, (ii) Aggressive public health complain, (iii) Enhanced family planning policies, (iv) Completion of economic reform agenda, (v) Political Decentralization, (vi) Enhanced global role for India, (vii) Commitment to IT backbone, (viii) Strengthening of economic/cultural/financial/ investment/scientific ties to overseas Indian communities, (ix) Strengthening Science and Technology in India's development policies, and (x) Major commitment to Indian higher education. Some of the highlights are:*

- **We concur that India has a chance for a tremendous breakthrough in economic development this decade.** We suggest at least two broad goals that the government of India may like to set for itself :
  - *First,* by the year 2010, the per capita income of India would be doubled. Income doubling within a decade requires annual growth in per capita income of 7 per cent per annum.
  - *Second,* by the year 2010, there would be universalisation of education until Class VIII, with a special effort for girls and disadvantaged groups.
- Additional targets could well be set regarding health conditions and access to basic services, such as sanitation, clean water, telecoms, power, and so on, particularly in rural India.
- To make the first decade of the 21st Century a true 'Decade of Development' will require a broad-based program of economic and social actions. These actions will have to be broad-based, requiring new approaches and legislative reforms in many areas of public policy. **The Decade of Development cannot rest on an unstable fiscal base. Unless substantial fiscal consolidation is achieved, in our view, continued fiscal deficits pose India's greatest risk to future destabilization.**
  - The government needs to promote exports through greater emphasis on export processing zones, the elimination of product reservation for small-scale industry, the encouragement of the IT sector, the elimination of administrative barriers to foreign direct investment, and the elimination of tax and tariff structures that are anti-export biased.
  - India could have achieved what China has achieved in export growth, but India failed in basic policy strategy.
  - Service-sector export based on information technology (IT) is another areas where the government's policy could do much more to spur export growth. India is becoming one of the most important players of the world in the IT sector and it is the fastest growing foreign exchange earner for India. We believe that the government could do more for this industry, not through

direct subsidies necessarily, but actually through liberalization of telecom, allowing for lower priced telecommunication services, by allowing new entry of major international players in telecom.

- **Economic reforms by themselves are not sufficient to achieve India's development goals. A growing body of economic evidence suggests that social progress** - such as increased life expectancy, reduced disease burdens, lower fertility rates, and improved educational attainments - are at least as important as the narrower economic policies in meeting goals of higher economic policies growth and raising living standards. Thus, social goals are crucial not only in and of themselves, but also for what they contribute to economic dynamism.

13. Martin Ravallion

A recent special article on 'What is Needed for a More Pro-Poor Growth Process in India?' by Martin Ravallion published in EPW, March 25, 2000, synthesizes some recent research findings that help answer the question as the what conditions are required for more pro-poor growth in the future.

A few conclusions:

- Agriculture growth reduces rural poverty directly, and it foster the conditions for pro-poor growth in the (urban and rural) non-form sector.
- **Without higher and more stable agricultural growth, it will be hard to restore India's momentum in poverty reduction.**
- Agriculture, infrastructure and social spending (especially in lagging rural areas) will need to get high priority before the poor will be able to participate fully in India's post-reform economic growth. The conditions for assuring more pro-poor growth may not develop very quickly, but there is no time like the present to start.

14. T.N. Srinivasan

In a recent (Oxford, 2000) Volume on 'Eight Lectures on India's Economic Reforms', T. N. Srinivasan (Samual C. Park, Jr. Professor of Economics and Chair, Department of Economics at Yale University) has reviewed :

- The reforms undertaken in major sectors of the Indian economy including agriculture, industry, foreign trade and investment, infrastructure, education and health, and financial markets. Their relevance for the overall objective of poverty eradication is also examined.
- Srinivasan concludes that **with further expansion of reforms and India's integration with the World economy, rapid and sustained growth is achievable.**

15. Jean Dreze and Amartya Sen

In the book on 'India : Economic Development and Social opportunity', Oxford (1995), the authors have emphasized:

- The need to take the debates on economic policy well beyond the issue of economic reforms in their present form.
- The Authors have argued for the necessity of asking—and addressing—a very different set of questions, rather than confining the analysis to examining different answers to the old familiar questions. **The central issue,** they have argued, **is to expand the social opportunities open to the people.** In so far as these opportunities are compromised—directly or indirectly—by counterproductive regulations and controls, by restrictions on economic initiatives, by the stifling of competition and its efficiency-generating advantages, and so on, the removal of these hindrances must be seen as extremely important.
- Debates on such questions as the details of tax concessions to be given to multinationals, or whether Indians should drink Coca Cola, tend to 'crowd out' the time that is left to discuss the abysmal situation of basic education and elementary health care, or the persistence of debilitating social inequalities, or other issues that have a crucial bearing on the well-being and freedom of the population.

16. C. Rangarajan

In a collection of his essays on 'Perspectives of Indian Economy' (2000, UBS), c. Rangarajan (Ex-Governor, RBI and present Governor of Andhra Pradesh) has included an essay on Indian Economy : The Years Ahead' in which with a detailed historical perspective the medium-term prospects are given as follows:

- Over the medium term, the broad economic parameters do point to the feasibility of the economy growing around 7 per cent per annum. With the domestic savings rate ranging between 25 per cent and 26 per cent and even with a modest current account deficit of 2 per cent of the GDP, a growth rate of 7 per cent is possible, with the ICOR remaining more or less at 4. With an improvement in the savings rate and better efficiency in the use of capital, it may be possible to even improve on this growth rate. Perhaps even to grow at 7 per cent comfortably, an improvement in the savings rate is required. This can be achieved if the fiscal deficit is brought under control and the public savings rate rises. **All these broad parameters only indicate that the necessary conditions exist for achieving a 7 per cent rate of growth.**

In a more recent article (EPW, April 15, 2000) on 'State, Market and the Economy Dr. Rangarajan has reviewed critical issues in the ongoing debate on

perhaps the most important topic that of state v/s market and has suggested as follows:

- The serious question which we have to address is not one of either state of market, but one of how much state intervention, what kind and by what means.
- **The crucial factor for determining the mix is that of comparative efficiency.** It is necessary to create a matrix of activities and the kind of intervention and determine for each activity what form of intervention is best. **The matrix can take the following form:**

Activities Intervention	Manu-factures	Physical Infrastructure	Social Infrastructure Services	Financial and other
Market				
State				
(a) Direct investment				
(b) Regulatory				
(c) Indicative				
(d) Unbundling				

17. <u>Dr. Y. V. Reddy</u>

In a recent (June 2000, RBI Bulletin) article on Pro-Poor Growth : New Realities and Emerging Questions' Dr. Y. V. Reddy, Deputy Governor, RBI has brought out an innovative thinking and suggested a new approach towards India's problem of eradication of poverty.

- **The Approach :** In the ultimate analysis, markets, however, efficient they are, are not democratic institutions in the strictest sense, since customer's vote is proportionate to his/her purchasing power. **Secondly,** labour is different from capital since the owner of capital can withhold if he/she thinks that the return is not adequate while labour cannot withhold because it will then not be able to survive. He or she has to work to live. **Thirdly,** the poor can give according to their ability but if such abilities cease to have markets, they cannot get what they need even if the need is minimal. **Fourth, resource-transfer to the rich is described as 'incentives' while income-transfer to the poor is described as a 'subsidy' - commonly perceived to be a derogatory term.** Finally, pro-poor oriented growth is thus possible when intellectual community and policy makers treat markets with the suspicion that they deserve **and the poor with the respect that they need.**
- **A suggestion** : Indeed, it may be useful to explore a ***Poverty Alleviation Forum (PAF)*** with close involvement of corporates, technology-leaders, financial intermediaries, and non-Governmental organizations or self-help groups, say

under the aegis of an international organisation such as the ADB. The main objective of such a forum should be to arrive at a consensus on managing globalisation, while ensuring not merely financial stability, but also poverty-alleviation.

And finally,

- Indian Economy is to grow in close cooperation with Japanese Economy.

- Japanese Prime Minister Yoshiro Mori, during his recent visit to India on 21st August, 2000 had the following to say in a press interview in Bangalore, India :

  > ***"I understand that India is an advanced nation in the IT sector and I intend to create opportunities to forge close cooperation between Japan and India through both the government and the private sector."***

  --Times of India, 22nd August, 2000.

- Earlier and not long ago, on March 29, 2000 in Mumbai, India, Dr. Eisuke Sakakibara, former Vice Minister of Finance for International Affairs, Japan, in his Exim Bank Commencement Day Annual Lecture, 2000 on "Asia in the 21st Century" The Role of India and Japan had observed the following :

  > ***"India and Japan could play a catalytic and strategic role in spreading and enhancing IT revolution and globalization in Asia, as well as to defend the region from negative aspects of the revolution. I think that the time has come for India and Japan to make strenuous efforts to quickly improve and expand our bilateral relationship and to take the leadership role in promoting regional cooperation in greater Asia."***

***Annex* - 1.2**

An Overview of Policy Recommendations of the Country Framework Report for India, under the Auspices of the World Bank Group's Infrastructure Action Program, with funding from the World Bank and the Japanese government

(*World Bank, 2000)*

There has been some progress since the infrastructure sectors were opened to private investment. But a deepening of reforms will be required if the private sector is to make a full contribution to meeting India's infrastructure needs.

Telecommunications

Strengthen the regulator's role

- Amend legislation so that TRAI has clear authority over interconnection and all tariffs for service provision in the sector.
- Develop clear policy guidelines that the Telecom Regulatory Authority of India (TRAI) can observe when making rulings to reduce the scope for ad hoc, after-the-fact intervention by the central government.
- Strengthen TRAI's role in influencing opening of sector and introduction of new service providers by giving it a formal role in the licensing process and the introduction of new service providers.

Open telecommunications markets

- Liberalise long-distance voice and data services without delay.
- Establish standard qualification requirements for opening fixed services and allowing qualified new players to enter.
- For long-distance and local fixed services, set license fees at low levels that recover the costs of regulation alone.
- Initiate the liberalisation of international services.
- Introduce new entrants to cellular, concomitant with the proposed migration of existing license holders to a revenue-sharing regime.
- Lift the restriction on Internet telephony--because it is difficult to enforce, hinders competition in the sector, and prevents consumers and service providers from benefiting from technology convergence.

Clarify universal service obligations

- Assess what genuinely constitutes non-commercial service.
- Reimburse the Department of Telecommunications through the New Telecom Policy fund proposed to encourage expansion into noneconomic areas. Base this reimbursement on the excess costs that the department is

incurring to meet its universal service obligations, not on its cellular license fee.

Allocate the spectrum efficiently

- Relocate defence and security use from parts of the commercially attractive bands and provide suitable compensation. Consider auctioning the spectrum, particularly in areas where there are constraints on its availability.

Power

Privatise the power sector

- Make distribution the priority for privatisation. Corporatisation of SEBs while a necessary starting point, is unlikely to produce the conditions required for improving performance and stopping the theft of power.
- Introduce comprehensive legislation that transfers state electricity board assets to successor companies, outlines the new industry structure, and creates a regulator with appropriate powers as the starting point for privatisation.

Create strong regulatory agencies to ensure that tariffs reflect costs

- Create these regulatory agencies through legislation rather than government notification.
- Grant a wide range of powers to regulatory agencies through this legislation, include licensing, resolving disputes among service providers, and regulating their quality of service, in addition to setting tariffs.
- Curtail the scope for ad hoc policy interference through the legislation.

Encourage power reform through central government support

- Require beneficiary states to undertake these reforms through further support from the central government to private power projects—for example, from the Power Trading Corporation.

Urban Water and Sewer Systems

Introduce private participation into urban water systems

- For sustainable improvement in performance, allow full management control to the private sector (including the authority to hire and fire workers and the ability to provide incentives for good performance).
- Phase in price increases over time to match improvements in water availability and better quality—and to allow a transition from the current low prices.
- Include targeted government support to finance revenue gap, with explicit targets for reducing them over time, or provide capital investments to match private sector resources.
- Provide a policy framework so that informal water providers can continue to provide services to the poor.

- Address water resource and allocation issues, particularly in water-deficient areas.

Establish a regulatory framework

- Ensure the continuity and stability of the contractual environment, to aid private participation in the water sector.
- Give to an independent agency the role of overseeing concessions to insulate tariff and investment decisions from political interference.
- Allow municipalities to grant contracts and licenses, but give power of enforcement and monitoring to a start regulatory agency.

Institute Central government policies to compare performance of water systems and enhance fiscal support for municipalities

- Develop a benchmarking scheme to help stimulate public debate by comparing the technical and financial performance of water systems in towns across India.
- Enhance fiscal support for municipalities attempting to reform water distribution.

Road

Monitor and gradually reduce public support for private road projects

- Review the need for certain forms of public sector support for roads, such as covering senior debt in the event of a concessionaire default, following the first phase of successful concessions. In addition, develop public sector support mechanisms that are well targeted and easy for the government to monitor.

Establish incentive structures and demand risk in road concessions

- Consider establishing a system for the government to award projects on the basis of the lowest present value of gross revenues at a concession auction. The concessioning authority would set toll and discount rates, and the concession would not have a fixed term but would end when the concessionaire ears what it bid.
- Establish a measurable value of the concession to simplify issues related to compensation for early termination.

Consider other countries' approaches to public support for privately funded road projects

- *Shadow tolls.* A capacity payment is made as long as the concessionaire complies with certain key technical or social parameters. The capacity payment can be sized to cover a certain proportion of the project's fixed costs. Or it can be a variable payment based on actual usage by vehicle type (the greater the weight on the variable payment, the lower the government's exposure to demand risk).

- *Toll road utility.* Project financing is converted into corporate financing once several projects are operating successfully.

Ports

Restructure the ports sector

- Develop a new institutional structure for the sector, separating policy, regulatory, and commercial functions clearly and providing a nexus for central and local interests.

Include the following elements in this new structure

- *Corporatized Port Trusts*—with private and public operating companies conducting commercial activities related to ship services and cargo traffic management and handling.
- *National Ports Council*—to determine national port policy and strategic planning objectives, and define main sector regulations to be enforced by the Port Authorities. The council would comprise representatives from the Ministry of Surface Transportation (MoST), the Ministry of Railways, and the Ministry of Environment and Forests (MOEF), mayors of port cities, and Port Authority managers.
- *Port Authorities*—autonomous public institutions that enforce navigation safety measures and environmental protection regulations, monitor concessions, lease contracts governing private sector activities in the port area, and market the port facilities to attract new investors.

Improve interministerial coordination

- Improve cooperation between such actors as Indian Railways, the Container Corporation of India, and the Central Warehousing Corporation.
- Improve the interface between railways and ports, possible using agreements at Jawaharlal Nehru as a model, to eliminate long delays in cargo transfer.

Address labor practices at the major ports

- Realign the workforce consistently with modern traffic and cargo handling requirements.
- Allow private operators to adjust their workforce to actual operational requirements over time if the private sector is called in before this issue is resolved.
- Provide retraining, voluntary retirement, indemnity payments for voluntary departure, and a temporary workers' pool as needed.

Establish efficient award criteria for concessions

- When competition in the market is strong, the government would take bids on the highest price paid for the assets or shares of the enterprise being privatised, the highest concession fee (one-time), or the highest net present

value of discounted revenue streams over the concession period to accrue to the government.

- When competition in the market is weak or nonexistent, the government would be alert to the risk of rent-seeking behaviour, and therefore take bids on the basis of the lowest tariff charged to consumers.

Airports

Undertake a wide-ranging privatisation of operations at existing airports, in addition to concessioning out Greenfield sites to the private sector for development.

Shift the functions of the Airports Authority of India away from operations and focus on its policy, planning, and statutory functions

Create a separate independent authority to handle economic regulation for the sector :

- Define the authority's powers clearly to ensure that it concentrates on area where competition is restricted. This would include oversight of the terms and conditions of leases and concessions.
- Continue to have the Directorate General of Civil Aviation handle technical and safety aspects.

Developing Infrastructure Regulatory Bodies

Establish regulatory independence through clearly defined provisions in legislation

- Clearly separate the policy role and reduce the scope for ad hoc policy interventions by government in the decisions of regulatory agencies.

Place the creation of an independent regulator within a broader restructuring of the sector

Fund regulators from sources outside the regular government budget

- Consider establishing funding for regulatory agencies through a small charge on regulated companies.
- Provide for scrutiny of the regulators' budgets by the legislature and by auditors to ensure accountability.

Consider establishing multisector regulatory agencies at the state level

Developing a Genuine Market for Long-Term Debt

Institute pensions and insurance reform

- Pass the Insurance Regulatory Authority Bill, which will allow competition in the insurance industry.
- Phase out guaranteed returns on provident funds to ensure that the absence of a guaranteed rate of return will not be detrimental to participant interests and to encourage investment in infrastructure.

- Establish fully funded pension schemes to increase national savings and the demand for long-term debt, making more funds available for infrastructure.

Make the debt market work better

- Simplify taxes to reduce distortions. Remove the stamp tax on secondary debt market trades to allow the establishment of a dematerialised settlement system for fixed-income instruments.
- Regulate the debt private placement market to provide adequate protection to institutional investors.
- Institute reforms to promote securitization.
- Institute legal reforms to allow for securitization without perfection of the security, facilitate special purpose vehicles, and permit provident funds and insurers to invest in securitized instruments and transactions.
- Develop appropriate accounting standards and clarify the status (under the Income Tax Act) of a special purpose vehicle structured as a trust.
- Simplify and harmonise the Reserve Bank of India's debt auction procedures.

Improving Efficiency and Transparency in Contracting Infrastructure Projects to the Private Sector

Consider establishing a one-stop shop for contracting

- Establish a single state government body responsible for contracting and obtaining necessary clearances and for interacting with private developers and investors.
- Ensure that the body coordinates effectively with public sector agencies, including the state electricity board, the Public Woks Department, and municipal bodies that provide water services.

Report and Value contingent liabilities

Great liquid funds that will allow public agencies to meet liabilities as they arise, rather than wait for the next annual budget cycle

Audit public support for private infrastructure projects

- Have one public sector agency undertake project design and contracting, negotiating, and providing documentation on why award decisions were made.
- Supplement the skills of central government units with the skills of professional advisers, including lawyers, investment bankers, and accountants.
- Work toward establishing capabilities to audit the award of public-private infrastructure project to assure the public that the government has achieved value for its money.

Annex - 2.1

Main Features of Budgetary Process in India

In the case of Union budget, Article 112 of the Constitution states that "the President shall in respect of every financial year cause to be laid before both the Houses of the Parliament a statement of the estimated receipts and expenditure of the Government of India for that year, in this part referred to as the Annual Financial Statement." Accordingly, an Annual Financial Statement (AFS), along with other supplementary documents commonly known as Union Budget, is placed before the Parliament by the Union Finance Minister every year. The financial year in India being 1st April to 31st March, the budget is presented on the last day of February, *i.e.*, a month before the financial year begins.

The Budget formulation process for the ensuing financial year (April-March) starts in the month of September of the current year when the Budget Division in the Department of Economic Affairs, Ministry of Finance, issues a 'budget circular' seeking statement of budget estimates from various Ministries and other organizations concerned. Specific performance are enclosed with the 'budget circular' along with the time frame within which the information is to be sent to the Budget Division.

Simultaneously, the Planning Commission also addresses letters to different Central Ministries and State Governments seeking their annual plan proposals. The Planning Commission through a process of detailed discussions finalizes the plan allocations for different Ministries in which the budget support component is clearly specified so as to fix the budgetary outgo for the plan schemes of the Central Ministries/Departments. In the case of states, the Planning Commission after detailed reviews and discussions finalizes the magnitudes of central assistance to be extended to the states which is an outgo from the Union Budget. Special attention is given to the budgetary support to be given to Central Ministries and assistance given to the states for programs/projects which are financed through external assistance. Thus, necessary plan allocations as well as central assistance allocation for externally aided projects is provided for as far as possible. For the purpose, there is a continuous interaction between the External Finance Division of the Department of Economic Affairs and the Planning Commission.

Expenditure Estimates : The process of preparation of expenditure estimates starts from the issue of the budget circular. The financial advisers (FAs) forward this circular to the Ministry/Department with which they are associated for obtaining the required information. The ministries in turn collect estimates from organizations under their control or prepare the same for their

own activities. These are scrutinized by the budget. units of the ministries and submitted to the FAs. The FAs review and examine these estimates before sending the same in the form of their recommendations to the Budget Division in the Ministry of Finance. These recommendations classified under separate 'demand for grants' in details up to the object head and labeled as statement of budget estimates (SBEs), are discussed by the Secretary (Expenditure) with each FA in a series of meetings where the ministry's budget division is also represented. After these discussions the budget division conveys budget ceilings to each FA for revising all the estimates within the ceilings and sending the SBEs in the final form. The final SBEs are to be sent to the budget division in two stages. In the first stage, the SBEs include (i) revised non-plan expenditure for the current year and budget estimate for the next year, and (ii) revised plan expenditure for the current year. At the second stage of SBEs, FAs send to the budget division budge estimates for plan expenditure for the next year as approved by the Planning Commission. Meanwhile, the Controller of Aid Accounts & Audit (CAA&A) also sends the estimates on external debt, repayment of external loans and other payments.

Revenue Estimates : The budget division obtains revenue estimates from a large number of organisations. Estimates on central taxes and duties are obtained from the Revenue Department in the Ministry of Finance. The Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) provide revised estimates on direct and indirect tax revenues respectively, initially for the current year and later the budget estimates for the next year after several interactions depending on proposals under consideration at various stages. The Chief Controllers of Accounts (CCAs) and Accountants General (AGs) of Union Territory (UT) administrations send to the budget division estimates of taxes, duties etc. for the UTs concerned. Chief Controller of Accounts (CCAs) of different ministries send to the Budget Division their estimates on various types of receipts (non-tax) including those from public accounts after getting the same approved from obtained by the budget division directly from the State Accountants General (SAGs). For external aid receipts the CAA&A prepares the estimates after obtaining information from different credit units of the external finance division of the Department of Economic affairs, and sends the same to the budget division. Finally, the budget division obtains from the RBI estimates on possibilities as well as sources of market borrowings which may be required by the government. This process continues over a long period from October till the time of giving a final shape to the budget as the various alternatives to fill the gap between receipts and disbursements are to be worked out till the end.

Flow of Estimates : The various estimates on receipts and expenditure keep flowing in the budget division from October till the budget is given a final shape towards the end of the February. In the process there are to and for movements also for several estimates amongst the different units of the Ministry of Finance and also amongst the Budget Division of Ministry of Finance, Planning Commission, different ministries, state governments and other organizations of which RBI is most important. apart from the receipt estimates which are finalized only in the middle of February, it is on the plan expenditure of the central ministries, central assistance to the states and resources of the central public sector enterprises that the changes in the estimates continue over the period owing to discussions at various levels and in different stages. The annual plan discussions in the Planning Commission with the central ministries and the states continue, at times, till the end of January and it is only after finalization of these estimates that the FAs of different ministries can send final SBEs for central plan expenditure to the budget. In working out these estimates Planning Commission associates the plan finance division of the Department of Expenditure, the external finance division of the Department of Economic Affairs, etc.

An Overview : With different flows of estimates, overall estimates of resources and expenditure continue to be made by the budget division. From December onwards the broad estimates are reviewed, discussed and simulated under the overall guidance and supervision of the Additional Secretary (Budget), who obtains guidance from Secretary (Expenditure), Secretary (Economic Affairs), Chief Economic Adviser, Secretary (Revenue) and the Finance Secretary. This group receives an overall guidance from the Finance Minister. Meanwhile, the Finance Minister invites a group of leading economists, representatives of industry and trade, labour and trade unions, consumer organizations, small scale sector and science and technology sector, for pre-budget discussions and receives their suggestions for the budget. The Finance Minister also consult the members of the Consultative Committee of Parliament for the Ministry of Finance.

After the presentation of the budget in the Parliament, the Parliamentary Standing Committee reviews the budget proposals, the budget proposals are debated in the Parliament and various bills are passed to approve the budget.

(*Source : Mathur, K.B.L., (1995) Management of Indian Economy - Systems and Processes. OECF, New Delhi Office.)*

Annex - 3.1

Assessment of Tax Structure and Administration

	Pre-reform	Recent years	Recent to pre-reform Index (Over 100 implies improvement in recent years)*
I. Performance			
Tax Structure			
Revenue adequacy : Level (Tax/NAGDP)	14.08	12.00	88
Trend (NAGDP buoyancy)	0.93	0.88	95
Revenue stability (CV of buoyancy)	0.23	0.31	54
Vertical balance: (ratio of centre's revenue adequacy to states')	1.24	1.24	100
Economic neutrality 1 (rates)			
Personal income tax	16.80	11.71	143
Corporation tax	35.43	27.34	130
Excise duties	9.31	8.38	111
Import duties	41	27	143
Aggregate score			
Economic neutrality 2 (concessions)			
Income tax: Individuals	3.98	2.24	178
Companies	11.17	7.43	150
Import Duties:	21.5	27.8	77
Aggregate score	19.7	29.6	150
Equity (share of direct taxes)			
Simplicity	Laws are simpler#		#
Certainty (business survey; 1=Very Good; 6 = Very Bad)	3.77	3.61	104
Sectoral balance	Exclusion of agriculture continues Unchanged		100
Tax Administration			
Administrative effectiveness:			
Income tax compliance	39.4	49.0	124
Collection arrears (% of collections)	36.8**	46.5	77
Administrative efficiency			
Business Survey (1=Very Good; 6 = Very Bad)	NA	3.1	NA
Business survey (Index of ease of dealing with tax departments in 1998-99 compared to three years ago)	100	102.2	102.2
Collection cost to society per rupee of revenue##	NA	NA	NA
Administrative corruption			
Business survey (% paying bribes "sometimes", "frequently", "usually" or "always" to income tax or customs officials)	NA	74	NA

Source : World Bank. India Policies to Reduce Poverty and Accelerate Sustainable Development, January 31, 2000.

* : The index is the ratio of recent pre-reform indicators or its inverse, so that a higher value represents improvements. The ratio is calculated before rounding.

** : Pertains to the period 1992-93 to 1994-95. Pre-reforms figures are not readily available.

\# : While adequate quantitative data are not available, this is suggested by the number of tax (second) appeals and judicial references declining over the period for which data are available.

\## : Collection cost given in the Central Budget amount to under 2% of tax collection. However, these figures are incomplete and underestimate true costs as elaborated on in the background note.

(a) Profitability of Central Public Sector Undertakings

(Rs. Billion)

		1990-91	1991-92	1996-97	1997-98
1.	Number of units	236	237	238	236
2.	Paid-up capital	432.4	457.0	624.3	657.6
3.	Net Worth	588.7	603.3	1138.9	1324.4
4.	Capital employed	1020.8	1179.9	2015.0	2230.5
5.	Gross profit	111.0	136.7	306.1	360.9
6.	Pre-tax profits	35.0	40.0	152.1	193.8
7.	Profit after tax (PAT)	22.7	23.6	99.9	137.2
8.	%Gross Margin to Capita employed	17.9	18.8	22.2	23.6
9.	%Gross profit to Capital employed	10.9	11.6	15.2	16.2
10.	%Pre-tax profit to Capital employed	3.4	3.4	7.5	8.7
11.	%PAT to Net Worth	3.9	3.9	8.8	10.4

Source : Economic Survey, 1999-2000

(b) Finances of Central Public Enterprises

(Rs. Billion)

	1990-91	1991-92	1998-99 RE	1999-00 BE
Net Internal Resources (NIR)	107.2	120.1	335.1	386.1
of which :				
Petroleum	27.2	26.3	101.8	107.6
Telecommunications	24.9	26.6	126.6	145.9
Plan Expenditure	280.5	294.2	578.0	681.6
of which :				
Petroleum	42.7	41.4	123.8	121.2
Telecommunications	31.1	36.5	134.9	167.9
Overall Balance	-173.3	-174.1	-242.8	-295.5
Financing:	173.3	174.1	242.8	295.5
External (net)	25.5	18.5	43.7	54.5
Domestic	147.8	155.6	199.1	241.0
Budget Support	76.0	69.2	75.8	86.4
Loans	24.8	27.4	21.6	28.8
Equity	51.2	41.8	54.2	57.5
Bonds	49.3	57.2	89.2	109.8
Other	22.5	29.2	34.1	44.9
Memo(%):				
CPE deficit/GDP[1]	-3.0	-2.6	-1.3	-1.5
CPE deficit/GDP[2]	-2.6	-2.2	-1.2	-1.3
Plan Exp./GDP	4.8	4.4	3.2	3.4
NIR/GDP	1.9	1.8	1.9	1.9
Budget Support (plan+non-plan)/GDP	1.5	1.2	0.5	0.5
Share of Petroleum and Telecom in Plan Exp.	26.3	26.5	44.8	42.4
Share of Petroleum and Telecom in NIR	48.6	44.1	68.1	65.7
Non-Plan loans to CPEs (Rs. Billion)	10.7	7.6	18.5	17.4

[1]Refers to the deficit of all Central Public Enterprises.

[2]Refers to the CPE deficit excluding Petroleum and Telecom.

Note: RE=Revised Estimate; BE=Budget Estimate.

Source : World Bank. India Policies to Reduce Poverty and Accelerate Sustainable Development, January 31, 2000.

***Annex* - 3.3**

Reform Measures relating to Government Securities Market

Elements of Reform	Pre-Reform Measures	Reform Measures	Current Status	Comments/Outlook
1. Policy	• Absence of internal debt management policy. • Automatic monestisation of budget deficit through a system of ad-hoc T-Bills at interest rate of 4.6 per cent. • System of Tap T-Bills at 4.6 per cent.	• Active debt management policy. • Abolition of system of ad-hoc T-Bills (since April 1, 1997) and introduction of system of ways and means advances (WMA) within agreed limits at Bank rates. Maximum period of overdraft at Bank rate plus 2 percentage points. • Tap T-Bills replaced by 14-Day Intermediate T-Bills (since April 1, 1997).	• Limit of WMA for the first half of 1998-99 fixed at Rs. 11,000 crore and for the second half at Rs. 7,000 crores. • Monitoring Group of Cash and Debt Market constituted with RBI and debt officials.	• Limits of WMA to be reviewed further. • No overdraft will be permitted beyond 10 days after March 31, 1999.
2. Dated Government Securities	• Dated Securities sold at low preannounce coupon rate. • Long-Dated Securities of 20-30 yers were being issued. • Instrument used was plain vanilla fixed coupon security.	• Securities sold through auction process (June 1992). • Discriminatory type of auction (June, 1992). • Maturity of security usually not more than 10 years. • Variety of instruments used such as zero-coupon bonds, floating rate bonds, partly paid stock, capital indexed bonds, etc • Notified amount preannounce in respect of each auction (Oct. 1998). • A portion of the notified amount underwritten by Primary Dealers (PDs) (since June 1997). This replaced the system of commission introduced in July 1996.	• Securities generally sold through discriminatory auction process. • Securities also sold at market related preannounce coupon rate and also on tap, depending on prevailing conditions.	• Can consider new instruments. • Aim to move to totally market clearing yields at auctions.

3. Treasury Bills	• 14-day Tap T-Bills at a coupon of 4.6 per cent. • 182-Day T- Bills.	• Tap T-Bills replaced by 14 Day Intermediate T-Bills (April 1, 1997). • A variety of T-Bills exist - 14 - Day, 91-day and 364-Day, 182-Day T-Bills withdrawn. • T-Bills sold through auction basis (since April 1992). • Notified amounts pre-announced. • Non-competitive bids (allowed in respect of 14-Day and 91-Day T-Bills) kept outside notified amounts. • T-Bills auction underwritten by PDs.	• T-Bills sold through actions. • 14-Day and 91-Day T-Bills auctions held every Friday and 364-Day auctions every alternate Wednesdays. • Discriminatory auctions used in respect of 14-day and 364-day T-Bills and uniform type auction in respect of 91-Day T-Bills. • Notified amount varied depending on prevailing market conditions.	• Announced intention to introduce 28-day T-Bills and reintroduce 182-day T-Bills. • Could sell through uniform or discriminatory auctions depending on experience gained.
4. Institutional Development	• No specialized institution.	• Securities Trading Corporation of India Ltd. Promoted by RBI (July 1994) to develop trading in Government Securities. • A system of Primary Dealers (March 1995) and Satellite Dealers (December 1996) have been established to activate primary and secondary markets and retail Government Securities.	• RBI has diluted most of its holdings in STCI and is a minority shareholder. • STCI has acquired PD status.	•
5. Primary Dealers	• Did not exist	• Initially six PDs licensed (March 1996). • PDs given bidding commitments. • PDs have access to call money market both as borrowers and lenders (March 1996) and can raise funds through issue of CP, by way of loans from banks and from the intercorporate market (September 1996).	• Recently, seven new PDs have been given in-principle approval (October 1998). • Individual PDs cannot underwrite more than 30 per cent of the notified amount. • PDs have formed an SRO called Primary	• Consider increasing the number of PDs. • Increase the proportion of underwriting to 100 per cent of notified amount. • Consider introducing when-issued market.

		• PDs underwrite 50 per cent of notified amounts in auction (August 1998).	Dealers Association.	
6. Satellite Dealers	• Did not exist	• Nine SDs registered initially (Nov. 1997). • Two in-principle approval given to banks (Nov. 1997). • SDs do not have access to call/notice money market.	• Four out of nine SDs have graduated as PDs. • SDs permitted to issue CP (June 1998).	• Consider increasing the number of SDs.
7. Settlement System	• Through Subsidized General Ledger Accounts maintained in the Public Debt Office of RBI. • Banks, FIs, PFs holding SGL account • Manual Accounting and no Delivery Versus Payment.	• Through SGL accounts maintained in PDO of RBI. • Computerized environment with DVP system for settlement. • Participants given two SGL accounts, one for own transactions and the other for constituents. • PFs asked to close SGL accounts with RBI and encouraged to open constituent accounts with banks, etc.	• DVP system in operation. • Banks/FIs/PDs/NSE/NSDL/SHCIL have SGL and current account with RBI.	• To move to real time gross settlement system. • To integrate SGL and current account.
8. Secondary Market Trading	• Transactions conducted over telephone. • Transactions routed through brokers. • Tax deducted at source (TDS) in respect of income from secondary market transactions.	• Transactions continue to be conducted over telephone. • Transactions are usually directly between counterparts. • If routed through brokers they must be through a recognized stock exchange. • Individual broker limits fixed for banks. Any increase in broker limits needs ratification by bank Boards. • TDS abolished.	• PDs, foreign banks and new private sector banks are usually active in the secondary markets. • PDs are expected to give active two way quotes.	• Electronic Dealing System being put in place. • Ease in individual broker limits may be considered.

9. Inter-Bank Repos	• Freely done	• Heavily restricted. • Banks and PDs can borrow and lend through repos (June 1994.) • Mutual funds/other select holders can lend through repos (April 1997). • Minimum period of repo reduced to 1 day (October 1998).	• Banks and PDs can lend and borrow through repos. • Non-bank participants who are lenders in call money market can lend through repos. • Minimum period of repos is one day.	• It is proposed to make the interbank call money market purely interbank. The sequencing will require all non-bank participants to allow access to the repo market in Government and Non-Government debt in dematerialized form. • Encourage dematerialization of Non-Government debt. • Introduce different form of repos. • Introduce code of conduct for market practices and standardized contracts for repos.
10. RBI Repos	•	• RBI conducts 3/4/14 days repos. • Repos conducted both on auction basis and fixed rate volume tender (Nov. 1997).	• Currently RBI conducts 3/4 day repos on fixed rate volume tender basis.	• 1 day repo being contemplated and will be conducted as and when necessary.
11. Foreign Investment		• NRI/Overseas Corporate Bodies/Foreign Institutional Investors can operate Dated Securities in primary and secondary markets. • Since May 1998, FIIs permitted investment in T-Bills also in both primary and secondary markets.	•	•

Source : Reddy Y.V., Financial Sector Reform: Review and Prospects. Keynote Address at the Conference on "Growth, Governance and empowerment : The future of India's Economy at University of California, Santa Cruz on Nov., 20, 1998, published in RBI Bulletin, January 1999.

***Annex* - 3.4**

BILL NO. 220 OF 2000

THE FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT BILL, 2000

A

BILL

to provide for the responsibility of the Central Government to ensure inter-generational equity in fiscal management and long-term macro-economic stability by achieving sufficient revenue surplus, eliminating fiscal deficit and removing fiscal impediments in the effective conduct of monetary policy and prudential debt management consistent with fiscal sustainability through limits on the Central Government borrowings, debt and deficits, greater transparency in fiscal operations of the Central Government and conducting fiscal policy in a medium-term framework and for matters connected therewith or incidental thereto.

BE it enacted by Parliament in the Fifty-first Year of the Republic of India as follows:—

Short title, extent and commencement

1. (*1*) This Act may be called the Fiscal Responsibility and Budget management Act, 2000.

(*2*) It extends to the whole of India.

(*3*) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint in this behalf.

Definitions.

2. In this Act, unless the context otherwise requires, —

(*a*) "annual budget" means the annual financial statement laid before both Houses of Parliament under article 112 of the Constitution;

(*b*) "fiscal deficit" means the excess of—

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

(ii) "total expenditure from the Consolidated Fund of India (including loans but excluding repayment of debt) over tax and non-tax revenue receipts (including external grants) and non-debt capital receipts during a financial year which

represents the borrowing requirements, net of repayment of debt, of the Central Government during the financial year;

(*c*) "fiscal indicators" means the measures such as numerical ceilings and proportions to gross domestic product, as may be prescribed, for evaluation of the fiscal position of the Central Government;

(*d*) "Reserve Bank" means the Reserve Bank of India constituted under sub-section (1) of section 3 of the Reserve Bank of India Act, 1934;'

(*e*) "revenue deficit" means the difference between revenue expenditure and revenue receipts which indicates increase in liabilities of the Central Government without corresponding increase in assets of that Government;

(*f*) "prescribed" means prescribed by rules made under this Act;

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

Fiscal policy statements to be laid before Parliament.

3. (*1*) This Central Government shall lay in each financial year before both Houses of parliament the following statements of fiscal policy alongwith the annual budget, namely: —

(a) the Medium-term Fiscal Policy Statement;

(b) The Fiscal Policy Strategy Statement;

(c) The Macro-economic Framework Statement.

(*2*) The Medium-term Fiscal Policy Statement shall set forth a three-year rolling target for prescribed fiscal indicators with specification of underlying assumptions.

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

(*i*) the balance between revenue receipts and revenue expenditures;

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

(*4*) In Fiscal Policy Strategy Statement shall, *inter alia,* contain—

(*a*) the policies of the Central Government for the ensuring financial year relating to taxation, expenditure, market borrowings and other liabilities, lending and investments, pricing of administered goods and services, securities and description of other activities, such as, underwriting and guarantees which have potential budgetary implications;

(*b*) the strategic priorities of the Central Government for the ensuing financial year in the fiscal area;

(*c*) the key fiscal measures and rationale for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administered pricing and borrowings;

(*d*) an evaluation as to how the current policies of the Central Government are in conformity with the fiscal management principles set out in section 4 and the objectives set out in the Medium-term Fiscal Policy Statement.

(5) The medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Marco-economic Framework Statement referred to in sub-section (*1*) shall be in such form as may be prescribed.

Fiscal Management principles.

4. (*1*) The Central Government shall take appropriate measures to eliminate the revenue deficit and fiscal deficit and build up adequate revenue surplus.

(*2*) In particular, and without prejudice to the generality of the foregoing provision, the Central Government shall—

(*a*) reduce revenue deficit by an amount equivalent to one-half per cent. Or more of the estimated gross domestic product at the end of each financial year beginning on the 1st day of April, 2001;

(*b*) reduce revenue deficit to nil within a period of five financial years beginning from the initial financial year on the 1st day of April, 2001 and ending on the 31st day of March, 2006;

(*c*) build up surplus amount of revenue and utilise such amount for discharging liabilities in excess of assets;

(*d*) reduce fiscal deficit by an amount equivalent to one-half per cent. Or more of the estimated gross domestic product at the end of each financial year beginning on the 1st day of April, 2001;

(*e*) reduce fiscal deficit for a financial year to not more than two per cent. Of the estimated gross domestic product for that year, within a period of five financial years beginning from the initial financial year on the 1st day of April, 2001 and ending on the 31st day of March, 2006:

(*f*) not give guarantee for any amount exceeding one-half per cent. of the estimated gross domestic product in any financial year;

(*g*) ensure within a period of ten financial years, beginning from the initial financial year on the 1st day of April, 2001, and

ending on the 31st day of March, 2011, that the total liabilities (including external debt at current exchange rate) at the end of a financial year, do not exceed fifty per cent. of the estimated gross domestic product for that year.

Providing that revenue deficit and fiscal deficit may exceed the limits specified under this sub-section due to ground or grounds of unforeseen demands on the finances of the Central Government due to national security or national calamity:

Provided further that the ground or grounds specified in the first proviso shall be placed before both Houses of parliament, as soon as may be, after such deficit amount exceeded the aforesaid limits;

Borrowing from Reserve Bank.

5. (*1*) The Central Government shall not borrow from the Reserve Bank.

(*2*) Notwithstanding anything contained in sub-section (*1*), the Central Government may borrow from the Reserve Bank by way of advances to meet temporary excess of cash disbursement over cash receipts in any financial year in accordance with agreements which may be entered into that Government with the Reserve Bank:

Provided that any advances made by the Reserve Bank to meet temporary excess cash disbursement over cash receipts in any financial year shall be repayable in accordance with the provisions contained in sub-section (5) of section 17 of the Reserve Bank of India Act, 1934.

(*3*) Notwithstanding anything contained in sub-section (*1*), the Reserve Bank may subscribe to the primary issues of the Central Government securities during the financial year beginning on the 1st day of April, 2001 and subsequent two financial years.

(*4*) Notwithstanding anything contained in sub-section (*1*), the Reserve Bank may buy and sell the Central Government securities in the secondary market.

Measures for fiscal transparency

6. (*1*) The Central Government shall take suitable measures to ensure greater transparency in its fiscal operations in public interest and minimize as far as practicable, secrecy in the preparation of the annual budget.

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

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

(*b*) as far as practicable, and consistent with protection of public interest, the contingent liabilities created by way of guarantees including guarantees to finance exchange risk on any transactions, all claims and commitments made by the Central Government having potential budgetary implications, including revenue demands raised but not realized and liability in respect of major works and contracts.

Measures to enforce compliance.

7. (*1*) The Minister incharge of the Ministry of Finance, shall review, every quarter, the trends in receipts and expenditure in relation to the budget and place before both the Houses of Parliament the outcome of such reviews.

(*2*) Whenever there is either shortfall in revenue or excess of expenditure over pre-specified levels during any period in a financial year, the Central Government shall proportionately curtail the sums authorized to be paid and applied from and out of the Consolidated fund of India under any Act to provide for the appropriation of such sums :

(*3*) The Minister incharge of the Ministry of Finance, shall make a statement in both the Houses of Parliament explaining –

(*a*) any deviation in meeting the obligations cast on the Central Government under this Act;

(*b*) whether such deviation is substantial and relates to the actual or the potential budgetary outcomes; and

(*c*) the remedial measures the Central Government proposes to take.

Power to make rules.

8. (*1*) The Central Government may, by notification in the Official Gazette, make rules for carrying out the provisions of this Act.

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

(*a*) the fiscal indicators to be prescribed for the purpose of sub-section (2) of section 3 and clause (a) and sub-section (2) of section 6;

(*b*) the forms of the Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-economic Frame Work Statement referred to in sub-section (5) of section 3;

(*c*) the form of statement under sub-section (*2*) of section 6; and

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

Rules to be laid before each House of Parliament.

9. Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive session, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified from or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

Protection of action taken in good faith.

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

Application of other laws not barred.

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

Power to remove difficulties.

12. (*1*) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may be, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear be necessary for removing the difficulty;

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

(*2*) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

***Annex* - 3.5**

Excerpts from the Report on the Committee on Fiscal Responsibility Legislation

(Ministry of Finance, Dept. of Economic Affairs, 2000)

Trends in Central Government's finances

1. Fiscal consolidation has been one of the main elements of economic reforms adopted since July 1991. However, Government finances continue to be a matter of serious concern, as may be seen from the movements of key fiscal indicators, viz., revenue deficit, fiscal deficit, primary deficit and primary revenue balance (Table 1). The persistence of large fiscal deficit and primary deficit has resulted in a large debt stock (Table 2). More significantly, revenue deficit, which surfaced in 1979-80, became a permanent feature in the Indian fiscal system. Persistence of revenue deficit emanating from growing interest burden has resulted in a vicious circle of deficit and debt (Table 3 and 4). Apart from growing and persistent fiscal imbalances which have raised the issue of fiscal sustainability and macro-economic stability, the integrity of the budget has been questioned on account of large variations from the original estimates in the Budget. Such variations have been persisting and growing.

2. If the present fiscal scenario continues, the future seems to be a matter of serious concern. Assuming that GDP grows at 12 per cent in nominal terms and at 7 per cent in real terms, domestic debt grows at 15 per cent, revenue receipts, revenue expenditure, and capital expenditure grow at 13.5 per cent, 11.1 per cent and 13.2 per cent, respectively (the same as the level of 2000-01); the revenue deficit and fiscal deficit would be around 2.4 per cent and 4.5 per cent of GDP, respectively, at the end of fiscal 2005-06. The interest payments wold be 5.9 per cent of GDP and primary deficit and primary revenue balance would be 1.4 per cent and 3.5 per cent, respectively and domestic debt to GDP ratio would be around 59 per cent. A tentative calculation further shows that if the revenue receipts and revenue expenditures would increase at the rate of 2000-01 level, i.e., 13.5 per cent and 11.1 per cent, respectively, the zeroing of revenue deficit would be possible only in fiscal 2012-13., This scenario implies severe fiscal stress and calls for bold fiscal measures either in terms of large mobilization of non-debt resources or through expenditure compression.

3. The continuation of fiscal stress as mentioned above underscores the need for steeper fiscal correction and consolidation along with an emphasis on stricter fiscal adjustment. This implies containing fiscal deficit and, more importantly,

revenue deficit to moderate levels in order to ensure that interest payments do not result in preempting greater part of revenue receipts. Reduction of fiscal deficit would in turn result in reduction in the debt to GDP ratio over the medium term. This would be facilitated, if adequate surplus could be generated in the primary balance both in revenue account and overall account of the budget. In particular, in the medium term, there is a need to have an adequate surplus in the non-interest revenue account which would meet the interest obligation. In addition, there is also a need to ensure adequate return on a sustained basis in respect of borrowings deployed for capital expenditure so that revenue budget would be benefited over time from higher productivity in the country.

Table 1 Trends in Deficit Indicators Relative to GDP

(in per cent)

Year	RD	GFDI	GFD2	PD1	PD2	PRB1	PRB2	MD
1970-75*	-0.29	3.16	2.78	1.85	1.46	-1.60	-0.44	1.08
1975-80*	-0.29	4.27	3.81	2.63	2.17	-1.94	-0.73	0.87
1980-85*	1.02	5.75	5.13	3.73	3.10	-1.01	0.33	2.03
1985-90*	2.37	7.55	6.57	4.44	3.47	-0.73	0.91	2.10
1990-91	3.19	7.66	6.46	3.97	2.77	-0.50	0.99	2.53
1991-96*	2.80	5.60	4.87	1.49	0.75	-1.31	0.29	0.65
1996-97	2.32	4.73	3.98	0.51	-0.24	-1.90	-0.33	0.14
1997-98	2.97	5.69	4.68	1.49	0.48	-1.23	0.39	0.66
1998-99	3.82	6.39	5.10	2.01	0.72	-0.56	1.13	0.17
1999-00	3.78	6.99	5.60	2.29	0.90	-0.92	0.84	N.A.
2000-01	3.55	6.57	5.10	2.03	0.46	-1.09	0.59	N.A.
1996-01*	3.29	6.07	4.89	1.67	0.46	-1.14	0.52	

Notes :

(-)	Minus represents surplus. The GDP figures have been revised taking into account the base as 1993-94 with a link factor of 1.08878.
*	Annual Averages.
RD	Revenue Deficit.
GFD1	Gross Fiscal Deficit (including small savings loans to States)
GFD2	Gross Fiscal Deficit (excluding small savings loans to States)
PD1	Primary Deficit (including small savings loans to States)
PD2	Primary Deficit (excluding small savings loans to States)
PRB1	Primary Revenue Balance (Revenue balance – Interest payments)
PRB2	Primary Revenue Balance (Revenue balance – Net Interest payments)
MD	Monetised Deficit

Table 2 Vicious Circle of Deficit, Debt and Expenditure

(in per cent)

Year	RD/GFD2	OD/Y	IP/Y	RE/Y	TE/Y
1970-75*	-10.43	42.50	1.23	7.39	12.90
1975-80*	-7.61	43.60	1.31	8.95	15.18
1980-85*	19.88	45.21	1.70	9.83	15.78
1985-90*	36.07	56.36	2.83	12.59	18.82
1990-91	49.38	53.97	3.69	12.62	18.08
1991-96*	57.49	52.27	4.11	11.98	15.77
1996-97	58.29	47.93	4.22	11.27	14.28
1997-98	63.46	49.78	4.20	11.53	14.84
1998-99	74.90	50.12	4.38	12.22	15.70
1999-00	67.50	53.01	4.70	13.01	15.62
2000-01	69.61	54.07	4.64	12.88	15.51
1996-01*	67.28	50.98	4.43	12.18	15.19

Notes :

(-)	Minus represents surplus. The GDP figures have been revised taking into account the base as 1993-94 with a link factor of 1.08878.
*	Annual averages.
RD	Revenue Deficit.
OD	Total Outstanding Debt (Gross)
IP	Interest Payments
RE	Revenue Expenditure
TE	Total Expenditure
Y	Revised GDP at current market prices

Table 3 Evolution of Debt

(in per cent)

Year	OD/Y	DOD/Y	EOD/Y	NAG/Y	EOD*/Y	EOD**/Y	OD*/Y	OD**/Y
1980-85*	45.21	35.12	10.09	-1.23	@	@	@	@
1985-90*	56.36	46.19	10.17	-8.82	@	@	@	@
1990-91	53.97	48.59	5.38	-12.50	12.92	24.29	61.51	72.88
1991-96*	52.27	47.54	4.73	-15.85	14.99	27.92	62.53	75.46
1996-97	47.93	44.08	3.85	-17.18	12.11	22.75	56.19	66.83
1997-98	49.78	46.24	3.54	-19.14	10.93	21.48	57.17	67.72
1998-99	50.12	46.91	3.21	-19.92	10.05	20.95	56.96	67.86
1999-00	53.01	50.04	2.97	-23.28	9.89	21.44	59.93	71.48
2000-01	54.07	51.47	2.60	-25.98	N.A.	N.A.	N.A.	N.A.
1996-01*	50.98	47.17	3.81	-21.06	N.A.	N.A.	N.A.	N.A.

Notes :

*	annual averages, NA Not Available (-) Minus represents net liabilities. The GDP figures have been revised taking into account the base as 1993-94 with a link factor of 1.0878.
OD	Total Gross Debt
DOD	Total Domestic Debt
EOD	External Debt at Historical Exchange rates
NAG	Net Assets(+) or Net Liabilities(-)
EOD*	Government External Debt at Current Exchange Rate
EOD**	Total External Debt at Current Exchange Rate
OD*	Total Gross Debt Corresponding to EOD*
OD**	Total Gross Debt Corresponding to EOD**
Y	Revised GDP

Table 4 Interest Burden

(in per cent)

Year	IP/Y	IP/RR	IP/RE	NIP/Y	PRB/IP
1970-75*	1.31	17.20-	17.88	0.16	122.71
1975-80*	1.64	17.79	18.33	0.44	120.58
1980-85*	2.02	22.94	20.56	0.68	50.52
1985-90*	3.10	30.17	24.64	1.90	23.11
1990-91	3.69	39.12	29.24	2.19	13.66
1991-96*	4.11	44.94	34.33	2.50	32.04
1996-97	4.22	47.10	37.42	2.65	45.10
1997-98	4.20	49.02	36.39	2.58	29.23
1998-99	4.38	52.09	35.82	2.69	12.81
1999-00	4.70	50.93	36.13	2.95	19.57
2000-01	4.64	49.72	36.03	2.96	23.54
1996-01*	4.43	49.77	36.36	2.77	26.05

Notes :

*	Annual Averages.
	The GDP figures have been revised taking into account the base as 1993-94 with a link facor of 1.0878.
IP	Interest Payments
RR	Revenue Receipts
NIP	Net Interest Payment (Interest payment minus interest receipts)
PRB	Primary Revenue Balance (Revenue balance minus Interest payments)
Y	Revised GDP at current market prices
RE	Revenue Expenditure

Table 5 Twenty five countries with High Central Budgetary Deficit

	1989	1990	1991	1992	1993	1994	1995	1996	1997
LEBANON	…	…	…	…	-7.75	-17.19	-18.36	-20.55	-25.80
ALBANIA	…	…	…	…	…	…	-8.87	-12.34	-12.01
MALTA	-4.65	-5.18	-5.05	-3.11	-2.93	-3.65	-2.69	-7.73	-9.83
MONGOLIA	…	…	…	-6.00	-16.67	-9.18	-6.80	-8.46	-8.73
REPUBLIC OF CONGO	…	…	…	-14.13	-12.62	-13.23	-8.19	-1.90	-08.64
GREECE	-21.32	-23.12	-15.04	-5-90	-9.75	-10.82	-9.44	-8.57	-8.45
TURKEY	-3.41	-3.00	-5.22	-4.31	-6.64	-3.89	-3.99	-8.65	-8.44
PAKISTAN	-6.98	-4.92	-6.91	-7.47	-8.87	-7.21	-6.57	-7.91	-7.72
BAHRAIN	-8.43	-6.84	-4.24	-6.91	-0.11	-3.19	-6.66	-2.73	-6.05
INDIA	-7.75	-7.79	-5.55	-5.40	-7.13	-5.69	-5.10	-4.91	-5.72
BURUNDI	…	…	-3.31	-7.13	-3.99	-3.22	-3.01	-7.81	-5.50
CYPRUS	-2.92	-5.35	-6.85	-4.76	-2.38	-1.42	-1.00	-3.44	-5.33
ZIMBABWE	-6.35	-5.29	-7.12	-11.22	-6.23	-3.72	-9.38	-6.07	-5.09
SRI LANKA	-8.65	-7.82	-9.45	-5.39	-6.42	-8.54	-8.27	-7.80	-4.49
MAURITIUS	-1.52	-0.44	…	-0.77	0.04	-0.28	-1.24	-4.24	-4.21
ROMANIA	8.22	0.94	1.94	-4.68	-0.47	-2.51	-2.96	-4.02	-3.89
NEPAL	-7.75	-5.66	-6.49	-5.72	-5.20	-3.41	-3.17	-3.91	-3.72
COLOMBIA	-1.90	3.93	2.55	-1.89	-0.54	-1.37	-2.30	-3.63	-3.63
FRANCE	-1.93	-2.10	-1.26	-3.91	-5.68	-5.58	-6.56	-5.25	-3.50
SOUTH AFRICA	-0.22	-4.06	-4.06	-8.72	-9.13	-5.59	-5.42	-5.18	-3.36
ITALY	-10.47	-10.18	-9.80	-10.78	-10.26	-10.43	-7.52	-7.00	-3.05

Source : Tables 1 to 4 are based on data taken or derived from the Central Government Budget documents, pre-budget Economic Survey documents, RBI's Annual Reports as well RBI's Reports on Currency & Finance. Table 5 is based on Government Finance Statistics for Central Budgetary Deficit and the World Economic Outlook for GDP published by the International Monetary Fund.

Country Experiences

A number of countries have experimented with medium-term fiscal adjustment for making a credible reduction in fiscal deficit and debt – GDP ratio, often backed by rule-based fiscal policy framework. The rules have varied from Constitutional and legal arrangements within the countries to agreements between countries. Following is a summary account of the international experience in this regard.

European Union—Under Maastricht Treaty (1991), most EU countries have recognized and implemented two separate limits for overall borrowings : one based on the debt during a year, i.e., the 'Public Deficit' representing net borrowings of the general Government, and the other based on the debt stock representing the gross debt at nominal value outstanding at the end of every financial year. The Treaty seeks to place a limit of 3 per cent for the ratio between Public Deficit and the Gross Domestic product (GDP) at market prices and a limit of 60 per cent for the ratio between Public Debt and GDP at market prices. (At an annual nominal GDP growth rate of 5 per cent, assuming 3 per cent real growth and 2 per cent inflation, in the long run, observance of a fiscal deficit limitof 3 per cent of GDP will result in a public debt of 60 per cent of GDP.) Only indirect central bank credit to the government (defined as the acquisition of government securities by the central bank from a third party) is permitted and that too has to be entirely at the discretion of the bank. Most EU countries now refer to the Maastricht criteria as their primary aggregate fiscal goal. These have served as a particular incentive for fiscal consolidation in countries with significantly higher deficit and debt levels than the Maastricht criteria. There can reasonably be debate about the durability of this mechanism and the aptness of the targets so far chosen but fiscal rectitude has generally entered the objective functions of the EU and potential EU countries, to a degree not seen before.

United States of America – USA had for two centuries since independence followed a policy (not statutory) of balanced budget. It was only in 1980s that the US government incurred huge budget deficits because of reduction in taxes accompanied by a significant increase in expenditure. The Balanced Budget and Emerging Deficit Control Act (Gramm-Rudman Hollings Acts of 1985 and 1987) required a steady decline in the federal government's deficit to zero level within a stipulated time frame. The Omnibus Budget Reconciliation Acts of 1990 and 1993, and the Balanced Budget Act of 1997 have been the main legislative framework in USA. The latest budgetary rules have been successful in controlling discretionary spending by setting caps on government investment and consumption. If the annual appropriation exceeds the caps, the law invokes an automatic sequestration, which means any excess discretionary spending over the specified

limits is subject to sequestration, by a uniform percentage across activities (The Budget Enforcement Act of 1990). While the caps have been amended annually, real discretionary spending has fallen every year since 1991. With the policy of moving towards balanced budget (or zero deficit) by year 2002, the total debt to GDP ratio is expected to come down to about 60 per cent in 2002, from 68 per cent in 1995.

New Zealand – The recent reforms of economic policy and public sector management in New Zealand have attracted attention internationally. In particular, the financial management regime that has been put in place since June 1994 under the Fiscal Responsibility Act has resulted in major advances in transparency and accountability of fiscal policy decisions. The Act specifies requirements for information and policy decisions through open budgetary processes, while establishing statutory accountability for the government. The Act also specifies principles of responsible fiscal management and transparency on key budget parameters and other aggregate fiscal reports, with the intention that any fiscal strategy proposed by the government should be amendable to evaluation in relation to specified criteria. The important mechanism operating here is that governments have to explain the policy rationale behind five crucial fiscal indicators. The fact that they have to do this repeatedly builds in commitment. The Act enunciates five principles for responsible fiscal management : (i) reducing total debt to prudent levels by achieving operating surpluses every year until prudent level of debt has been obtained; (ii) maintaining total debt at a prudent level by ensuring that average operating expenses do not exceed operating revenue; (iii) achieving and maintaining levels of net worth that provide a buffer against adverse future events; (iv) prudent management of fiscal risks; (v) pursuit of policies consistent with a reasonable degree of predictability about the level and stability of tax rules.

Australia – Budget Honesty Act, 1998 aims to increase transparency in fiscal policy making and fiscal results. A notable feature it shares with the New Zealand approach is the requirement to publish a set of fiscal updates prior to all elections to prevent governments from withholding information on the true fiscal position. This produces a number of desirable features including sharing a common economic and fiscal outlook in the debate and preventing a newly elected government from being “shocked” at the state of finances.

Germany – The golden rule, embodied in Article 115 of the Constitution, specifies that over the cycle the Government will borrow only to invest and not to fund current expenses (including depreciation and maintenance). The balanced budget rule is stipulated in the Constitution and confirmed in the respective budget laws for both the federal and sub-national governments. In any year,

government borrowings must not exceed government investment expenditure, except in circumstances of a "macroeconomic disequilibrium."

United Kingdom – U.K.'s Code for Fiscal Stability has a number of features that are quite similar to the New Zealand law. This code includes adherence to "the golden rule," targeted debt, and real operating expenditure levels. The United Kingdom's golden rule differs from the German one by allowing deficits to exceed investment in any specific year as long as the rule is fulfilled over the course of the economic cycle. On the other hand, it is stricter by referring explicitly to net instead of gross investment. Further, U.K. follows a traditional prohibition on the central bank credits to the government.

Japan – While the fiscal deficit and debt to GDP ratio in Japan is high from international standards and a law enacted in 1997 intended to promote fiscal restraint was suspended in 1998 to provide fiscal stimulus to deal with recessionary conditions, its debt management has certain salutary features. The Japanese golden rule is institutionalized by the virtual separation of government "deficit bonds' from government "construction bonds" and the aim of limiting government borrowing to construction bonds only in the medium term, implied redemption in 60- years through a system akin to sinking fund contributions and the use of postal savings for supporting a public investment program generating income surpluses.

The advantages of a golden rule followed by several countries are twofold: it puts a limit on the scope for government borrowings without preventing beneficial government investment from being undertaken. The underlying idea of the rule is that government investment generates a future stream of income and/or services that justifies the allocation of some of the expenditure to the future. However, a golden rule does not rule out government borrowing to finance even investment projects with low economic or social returns.

Switzerland – The Swiss government has proposed that its fiscal consolidation target be enshrined in the Constitution. The new Constitutional clause would set the authorized deficits for coming years. Should these objectives not be achieved, a mandatory procedure would be set in train, requiring savings to be made based on financial priorities. It has still to be presented for approval by the parliament, the cantons and a public referendum.

Netherland – The structural deficit ceiling, which was introduced as a policy norm in 1961, was abandoned in 1974. Under a more recent approach, introduced in 1995, the Netherlands is pursuing a similar rule to meet the EU deficit reference value.

Indonesia – The Guidelines for State Policy (1966) prohibit deficit spending and mandate strict adherence to balanced budget policy under which public expenditure should not exceed the government's domestic budgetary revenue and

foreign aid flows. The same applies to provincial and municipal governments. The definition of foreign aid as a form of revenue rather than a means of financing a deficit has permitted the government to accept substantial volumes of foreign borrowing to fund public sector development projects. In practice, therefore, Indonesian government does not issue domestic bonds in the market. The balanced-budget strictures have been relaxed to a certain extent in the recent years following a proposal that the government would have to be able to pursue a more effective counter cyclical fiscal policy if it permitted budgetary surpluses or deficits to be recorded in individual years as long as a broad balance is maintained over a period of, say, five years.

Kenya – Significant amendments to the Central Bank of Kenya Act, 1966 have been introduced by the Amendment Act, 1997. The principal object of the bank has been redefined to make it focus on formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. The scope of the government to get direct advances from the central bank has been considerably narrowed down.

South Africa – Public Finance Management Act, 1999 incorporates many salutary features of responsible fiscal management such as budget disclosure of intentions regarding borrowing and other forms of pubic liability during current and future financial years, provision of giving projections of multi-year budget to Parliament with key macro-economic projections, borrowing power limited to budgeted deficit, Ministers' responsibility regarding guarantees, to be defrayed in the first instance from the funds budgeted for the department issuing the guarantee, percentage limits for re-appropriations and unbudgeted expenditure etc.

The fiscal rules for select countries highlighting targets, effective period, statutory instrument, government level and penalty for non-compliance are set out below.

selected countries – fiscal policy rules[4]

Countries	Target or Ceiling	Effective Period	Statutory Instrument	Government Level	Penalty for Non-Compliance
Netherlands	Structural Deficit Limit	1961-74	Government Policy	Central Government	Reputational
European Union Members	Medium-term Overall balance yearly deficit Limit (3 per Cent of GDP)	Since 1997	International treaty (Stage 3 of EMU)	General Government	Reputational Financial (from 1999)
United States	Yearly Overall Balance	Proposal	Constitutional amendment	Federal Government	Judicial
Costa Rica	Yearly deficit Limit (1 per cent of GDP	proposal	Constitutional amendment	Public sector	Judicial
Switzerland	Cyclically Adjusted balance	Proposal	Constitutional amendment	Federal Government	Reputational
New Zeland	Medium-term Operating Balance	Since 1994	Legal provision	Public sector	Reputational
Germany	Yearly Current Balance	Since 1949	Constitutional amendment	Federal and sub-national Governments	Judicial
Japan	Yearly current Balance	1946-75 and proposed From 2003	Legal provision	Central Government	Judicial
United States	Yearly current Balance	Various	Constitutional amendments	Subnational Governments	Judicial
Canada	Overall balance Or deficit limit	Since 1993	Legal provision	Subnational Governments	Judicial
Indonesia	No domestic borrowing	Since 1967	Government policy	General Government	Reputational
European Union Members	No borrowing from Central bank.	Since 1994	International Treaty (Stage 2 of EMU)	General Government	Judicial
Argentina, Canada, Chile, Ecuador, Hungary, Japan, Peru, United States	No borrowing from Central bank.	Various	Various	General Government	Judicial
Brazil, Egypt, Morocco, Philippines, Slovak Republic	Borrowing from Central bank limited as fixed proportion of last year's revenue	Various	Various	General Government	Judicial or reputational
European Union members	Gross debt limit (60 per cent of GDP)	Since 1997	International treaty (Stage 3 of EMU)	General Government	Judicial

[4] George Kopits and Steven Symansky, "Fiscal Policy Rules", IMF Occasional Paper 1998.

REQUIREMENTS OF A MINIMUM STANDARD OF FISCAL TRANSPARENCY

Clarity of Roles and Responsibilities

* General Government should be defined as in the *System of National Accounts* (SNA, 1993) or the IMF Manual on Government Finance Statistics, (GFS, 1986).
* Government equity holding should be identified.
* Extrabudgetary activities should be subject to Government review and priority setting as part of the budget process.
* Significant quasi-fiscal activities of the central bank, Public Financial Institutions (PFIs), and Non-Financial Public Enterprises (NFPEs) should be identified.
* A budget law or administrative framework, covering budgetary as well as extrabudgetary activities and specifying fiscal management responsibilities should be in place.
* Taxation should be under the authority of law and the administrative application of tax laws should be subject to procedural safeguards.

Public Availability of Information

* Extrabudgetary activities should be covered in budget documents and accounting reports.
* Original and revised budget estimates for the two years preceding the budget should be included in budget documents.
* Budget documents should include statements of the main Central Government contingent liabilities and tax expenditures, and a statement of significant quasi-fiscal activities of the Central bank, PFIs and NFPEs.
* The level and composition of Central Government debt should be reported annually with a lag of no more than six months.
* A statement of fiscal reporting practices should be published.
* Advance release date calendars should be announced for the year ahead showing no later than release dates for annual reports and a range of dates for more frequent reports.

Open Budget Preparation, Execution and Reporting

* A fiscal and economic outlook paper should be presented with the budget, including a statement of fiscal policy objectives and priorities, a summary of economic prospects and a qualitative assessment of fiscal sustainability.
* A statement should be made of the medium-term macro economic framework for the budget, including the macro economic forecasts on which the budget is based. Key forecasting assumption should also be reported.

* A statement of fiscal risks should be presented with the budget documents, covering the impact of variations in assumptions on fiscal forecasts, contingent liabilities and the other main uncertainties about the costs of certain programs.
* All general government activities should be covered by the budget and accounts classification. Transactions should be recorded on a gross basis and a classification by economic, functional and administrative categories should be derived.
* The classification system should identify administrative responsibility for the collection and use of public funds.
* The overall balance should be reported in budget documents, with an analytical table showing its derivation from budget estimates.
* A statement of accounting standards should be presented with the budget.
* GDDS standards for periodicity and timeliness of Central Government reports (each quarter within a quarter) should be followed.
* Final Central Government accounts should reflect high standards of coverage and reliability, should be reconciled with budget appropriations, and should be audited by an independent external auditor. Audited accounts should be prepared within 12 months of the end of the fiscal year.

Independent Assurances of Integrity

* Mechanisms should be in place to ensure that external audit findings are reported to the legislature and that remedial action is taken.
* Standards of external audit practice should be consistent with international standards.
* Working methods and assumptions used in producing macro economic forecasts should be made publicly available.

Source : IMF Code of Good Practices of Fiscal Transparency to be adopted by member countries on voluntary basis.

major fiscal indicators

Deficit Indicators

1	Revenue Deficit (RD)	The revenue deficit denotes the difference between revenue receipts and revenue expenditure signifies disserving of the Government.
2	Monetised Deficit (MD)	The magnetized deficit is the increase in the net RBI credit to the Central Government, which is the sum of increases in the RBI's holdings of (i) Central Government dated securities, (ii) Treasury Bills, (iii) rupee coins and (iv) Loans and Advances from RBI to the Centre since April 1, 1997 adjusted for changes is the Centre's cash balances with RBI. Signifies extend of monetisation of GFD.
3	Gross Fiscal Deficit (GFD)	The gross fiscal deficit is the excess of total expenditure including loans, net of recovery, over revenue receipts (including external grants) and non-debt capital receipts. Measures the net borrowing requirements of the Government.
4	Net fiscal Deficit (NFD)	The net fiscal deficit is the difference between gross fiscal deficit and net lending. Measures the net borrowing requirement in the absence of the lending operations of the Government.
5	Gross Primary Deficit (GPD)	The gross primary deficit is the difference between the gross fiscal deficit and interest payments. Measures the borrowing requirement in the absence of the debt service burden of past borrowings of the Government.
6	Net Primary Deficit (NPD)	The net primary deficit denotes net fiscal deficit minus net interest payments.
7	Government Sector Fiscal Deficit (GSFD)	Government sector fiscal deficit is the deficit of Central and State Government net of inter-governmental transactions.

Debt and Sustainability Indicators

1	Debt	Public debt and other liabilities which include small savings, provident funds, reserve funds, deposits etc.
2	Combined Central & State Debt	Total liabilities of the Centre and the States net of loans and advances given by the Centre to the States.
3	Interest burden	Interest payments as ratio to revenue receipts.
4	Nominal interest rate on government debt	Relatively higher interest rate exceeding GDP growth rate has implications for debt stability.
5	Debt/GDP ratio	higher debt/GDP ratio puts strain on government finances and affects future sustainability of fiscal policy.
6	Contingent liabilities	Guarantees issued by governments for various purposes. These may include credit guarantees, interest payment guarantees or exchange risk guarantees.

Indicators of Fiscal Stress

1	Ratio of Revenue Receipts to GDP	Lower ratio adds to stress
2	Ratio of Tax Revenue to GDP	Lower ratio adds to stress
3	Ratio of Non-Tax revenue to GDP	Lower ratio adds to stress
4	Ratio of Direct Tax to GDP	Lower ratio adds to stress
5	Ratio of Indirect tax to GDP	Lower ratio adds to stress
6	Revenue Expenditure as proportion to GDP	High ratio indicates fiscal stress
7	Capital Expenditure of GDP	Lower ratio indicates fiscal stress
8	Ratio of Interest Payments to Revenue Expenditure/Total Expenditure/Revenue Receipts	High ratio indicates inflexibility of budget
9	Non-developmental expenditures as proportion to revenue receipts, total expenditures and GDP	High ratio indicates poor allocative efficiency of budget

Annex 4.1

Dimensions of Public Expenditure Management

Categories of Objectives 1	Broad Content 2	Techniques Utilized for Achieving Objectives 3	Comments 4
Economic and financial Macroeconomic stability	Determination of aggregate spending, size of deficit/surplus and its financing or utilization.	Specification of overall macroeconomic policies and design of fiscal policy; involves the application of macroeconomic financial planning techniques; techniques of medium-term planning are also extensively utilized.	This provides the annual policy framework and a link with monetary policy. The determination of aggregate spending could involve a two-tier approach - one for the appropriations which may be on an obligation or accrual basis, and a cash-based approach to total spending.
Effective budgeting	Matching outlays with resources; determining intensity of allocation of resources among functions and within functions, among programs and activities.	Rolling expenditure planning; prioritization; planning-programming-budgeting; fundamental expenditure reviews; zero-base budgeting; target-based budgeting; below-base budgeting; line-item review; development plans; output budgeting system; accrual-based budgeting system.	Techniques shown in column 3 are generally applied independently of each other. In any event, there are several features that are common to these techniques. The actual techniques used in a year depend very much on the economic setting and the goals of fiscal policy. In most developing countries, a combination of line-item reviews and development plans, and ad hoc budget-cutting measurements are in operation.
Management aspects Financial discipline	Budget outcome to be congruent with estimate.	System of time-slice-based release of budget authority; cash management techniques; intrayear reporting and monitoring; development of online systems to track day-to-day developments; provision of year-end flexibility.	The management aspects specified here work within the overall policy framework indicated above.
Efficiency gains	Achieving economy and efficiency in expenditure.	Specification of cost standards; specification of fiscal dividend; performance budget system; activity-based costing system; improved competitive tendering procedures.	The intent is to secure efficient implementation of programs and projects, and delivery of services.
Program and Project management utilization of resources	Managers to have operational flexibility to fulfill objectives within specified budgetary resources.	Performance budgeting; management contracts; new management philosophy; value-for-money audit; evaluation.	These techniques may be applied in tasks oriented agencies.

Categories of Objectives 1	Broad Content 2	Techniques Utilized for Achieving Objectives 3	Comments 4
Financial disclosure	Provision of accurate information on the status of government finances to policymakers, managers, and the public.	Accrual-based accounting; decision-related information; specification of accounting standards.	Governments have a responsibility to provide unbiased information at regular intervals.
Public interest requirements Transparency	Clear decision-making procedures.	Improved budget documentation that shows the objectives and features of programs and projects; preparation of annual reports of agencies; dissemination of key financial information; complete annual accounts.	In general, transparency has often been viewed as limited to the requirements of the legislature; it has, however, broader requirements vis-à-vis the public. The emphasis on transparency and accountability could contribute to the pursuit of defense mechanisms in the executive wing. This could be overcome in the long-run through the rigorous implementation of standards for transparency and accountability.
Accountability	Provision of goods and services within specified quality, cost, and time schedules.	Performance budgeting system; accountability and performance-oriented service contracts; annual review or evaluation; value-for-money audit.	Accountability is not merely for the money spent, but for results; the emphasis is not merely to be critical of the existing systems and procedures but to facilitate the evolution of alternative systems of delivery of goods and services.
Client orientation	Government systems and procedures should be designed to serve the needs of the client groups.	Internal evaluation; group surveys of clientele views.	The public is the final judge of the quality and quantity of services provided by the government, either directly or indirectly. The operational processes of each agency should be so designed as to facilitate interaction with the public.
Political aspects Political acceptability	Community's approval for all the above facets is vital for the implementation of policies.	Legislative approval; market approval; donor approval (where foreign aid is an important part of the budget); broad support from other layers of government.	Government financial management has a significant impact on the community. It's voices come in a variety of forms and should not be viewed as being limited to the legislature only.
Citizen participation	To provide opportunities to the community to participate in certain spheres of economic management.	Serving on the tender or contract committee; serving in the evaluation machinery; and serving in the advisory and related policy councils.	In several ways, this is an area that remains to be developed fully. Association of citizens to look at issues that transcend the financial aspects, and those associated with the street-level bureaucracy, has distinct advantages in paving the way for social control of public finances.

Source : Premchand A (2000).

Annex - 5.1

List of Functions for devolution to Panchayats and Municipalities

Eleventh Schedule

(Article 243G)

1. Agriculture, including agricultural extension.
2. Land improvement, implementation of land reforms, land consolidation and soil conservation.
3. Minor irrigation, water management and watershed development.
4. Animal husbandry, dairying and poultry.
5. Fisheries.
6. Social forestry and farm forestry
7. Minor forest produce.
8. Small scale industries, including food processing industries.
9. Khadi, village and cottage industries.
10. Rural housing.
11. Drinking water.
12. Fuel and fodder.
13. Roads, culverts, bridges, ferries, waterways and other means of communication.
14. Rural electrification, including distribution of electricity.
15. Non-conventional energy sources.
16. Poverty alleviation program.
17. Education, including primary and secondary schools.
18. Technical training and vocational education.
19. Adult and non-formal education.
20. Libraries.
21. Cultural activities.
22. Markets and fairs
23. Health and sanitation, including hospitals, primary health centres and dispensaries.
24. Family welfare.
25. Women and child development.
26. Social welfare including welfare of the handicapped and mentally retarded.
27. Welfare of the weaker sections, and in particular, of the Scheduled Castes and the Scheduled Tribes.
28. Public distribution system.
29. Maintenance of community assets.

Twelfth Schedule

(Article 243 W)

1. Urban planning including town planning.
2. Regulation of land-use and construction of buildings.
3. Planning for economic and social development.
4. Roads and bridges.
5. Water supply for domestic, industrial and commercial purposes.
6. Public health, sanitation conservancy and solid waste management.
7. Fire services.
8. Urban forestry, protection of the environment and promotion of ecological aspects.
9. Safeguarding the interests of weaker sections of society, including the handicapped and mentally retarded.
10. Slum improvement and upgradation.
11. Urban Poverty alleviation.
12. Provision of urban amenities and facilities such as parks, gardens, playgrounds.
13. Promotion of cultural educational and aesthetic aspects.
14. Burials and burial grounds: cremations, cremation grounds and electric crematoriums.
15. Cattle pounds; prevention of cruelty to animals.
16. Vital statistics including registration of births and deaths.
17. Public amenities including street lighting, parking lots, bus stops and public conveniences.
18. Regulation of slaughter houses and tanneries.

Annex 5.2

Excerpts from the Study on
DECENTRALIZATION - THE KERALA EXPERIENCE
By Vijayanand, S.M
Presented in 'India States' Reform Forum 2000', (Nov. 2000)
(www.statesforum.ogr)

Kerala has embarked on a trajectory of rapid decentralization. The State has moved ahead at good pace with the transfer of not only functions and responsibilities but also the authority to carry them out along with resources, both human and financial. Though historically Kerala had not achieved anything significant in decentralized development, after the 73rd and 74th Constitutional Amendments, it has carried out certain pioneering reforms worthy of attention and study. The reforms carried out in the State to decentralize governance particularly in the developmental field have been very fundamental. It cannot be dubbed as a political fad or as a tokenist gesture; it is no populist gimmick either. It is an earnest attempt to set up genuine institutions of local self government as envisaged in the Constitution.

** ** ** **

THE DECENTRALIZATION PROCESS.

A. Background.

There are certain peculiar Socio-political features, which need to be clarified for a clear understanding of Panchayati Raj in Kerala. First is the relative size of the three tiers. The Grama Panchayats (991 Nos) are very large in size – their distribution according to population (1991 census) is as follows:

Below 10,000	-	15
10,000 to 20,000	-	288
20,000 to 30,000	-	426
30,000 to 40,000	-	180
40,000 to 50,000	-	60
50,000 to 60,000	-	18
60,000 to 70,000	-	1
Above 70,000	-	2

(The largest 20 Grama Panchayats have now been bifurcated).

This has several implications. It provides the natural "right size" for several development services, especially viable service areas for Primary Health Centres, Veterinary Hospitals, Krishi Bhavans and so on. Of course it makes it difficult for direct participation by people of the whole village and this problem can be surmounted only by limiting it to the ward level -–i.e. the electoral constituency of a Grama Panchayat Member. With large village Panchayats and relatively compact Districts (14 Nos), it becomes difficult to earmark exclusive functions for Block Panchayats (152 Nos.) which they alone can perform better than others.

Next is the rural-urban continuum, which exists in the settlement pattern in Kerala. This is reflected in the functional responsibilities of rural and urban local bodies. PRIs especially the Village Panchayats have several civic and regulatory functions and the municipal bodies have several developmental and welfare functions.

Another feature is the influence of the political milieu. All elections are fought on party basis and there is considerable polarization in the political composition of local governments. This had led to the policy decision to treat PRIs as non-hierarchical – i.e., the District Panchayat has no control over Block or Village Panchayats. This arrangement while it keeps the system free of political squabbles, strengthens local government autonomy and instills a sense of responsibility, creates operational problems in monitoring, reporting, financial supervision, passing down of information and even in integration of plans across tiers.

B. The Strategy of Decentralization.

Kerala has followed an unorthodox strategy of decentralization. It reverse the traditional paradigm of gradualist transfer of powers to local governments in accordance with perceived improvement in their capacities to exercise them. It opted for a big bang approach by transferring functions, authority and resources in one fell blow and then attempting to build the capacity of local governments to perform efficiently. This methodology first transferred powers and then set up umpiring systems; it devolved funds and then structured procedures and systems. It facilitated learning by doing and at the same time was backed up by a system, which responded quickly to the ups and downs of the process. In a sense this reversal of the conventional sequence, placed an

onus on Government to ensure that the right environment was created for the local governments to function well. At the same time the local governments were pushed by the new responsibilities to carry out their responsibilities to the best of their ability. Hind-sight proves that it was a very wise move strategically, as it is well nigh impossible to transfer power in degrees.

To operationalise decentralization, Kerala chose the path of participatory local level planning as the entry point. This succeeded to a considerable extent in harnessing public action in favour of decentralization. In order to push the system and force the process a campaign approach was followed for decentralized planning - known as the 'People's Planning Campaign'. This campaign created a powerful demand factor for decentralization to be guided along the right path. To a large degree the campaign has succeeded in setting the agenda for decentralization.

C. Steps in Decentralization.

(1) Creation of legal entitlements and defining of the functional domain: The Kerala Panchayat Raj Act was passed by the legislature and brought into effect in May 1994. Based on the initial experience in decentralization, it was radically restructured in March 1999, significantly fortifying the decentralization process. The 11th Schedule of the Indian Constitution actually does not define the functional sphere of local governments. It is only a suggestive list of developmental subjects in which the local governments could have a role in planning for economic development and social justice and in the implementation of such plans. Unlike many State Acts, Kerala has attempted to define the functional areas of the different tiers of PRIs as precisely as possible. It was guided by the principles for transfer of functions laid down by the Committee on Decentralization of Powers. In areas related to infrastructure and management of public institutions, the functional differentiation is sharp and clear, but in productive sectors it is difficult to clearly earmark functions separately for each tier. Only through experience can the natural functional area in such sectors get marked. There is a clear recognition that there is a role-range for local governments – Agent, Adviser, Manager, Partner and Actor – with the objective being to reduce the agency role and expand the autonomous Actor role. The Kerala Act classifies functions as mandatory functions, general functions and sector-wise functions.

Another path breaking exercise in broadening the legal entitlements of local governments was the amendment carried out in March 2000 to 35 State legislations. These amendments which aimed at creating the necessary legal frame work for the smooth functioning of the local governments essentially transformed them into the third tier of governance through the far reaching legislative recognition of the fact that local governments are not creatures of one or two acts but they are partners of government in carrying out various developmental functions and have a legitimate space in all enactments related to their area of functioning.

(2) **Transfer of Institutions and Staff**. Various institutions, offices and staff of government were transferred to the local governments and this was done in two major instalments - the first was in September 1995 before the first general elections to the newly set up local governments and the second was in July 2000, just before the second general elections.

The local governments have operational control over the staff transferred to them. They can assign duties and supervise, review and inspect performance. They can also impose minor punishments on the staff if it is so needed to enforce discipline.

The local governments cannot create new posts. They have to go by the normative staff pattern laid down by government. Since recruitment to all posts in the State is done by the Public Service Commission, neither the government nor the local governments have a say in this. However interim filling up of vacancies till Public Service Commission recruits join duty can be done by the local governments.

The quantum and quality of decentralization as delineated in laws and prescribed in government orders can be gauged from the following statements:

(1) In the Health sector all institutions other than medical colleges and big regional specialty hospitals have been placed under the control of the local governments.

(2) In the Education sector, in rural areas the high schools have been transferred to the District Panchayats and the primary and upper primary schools have been transferred to Village Panchayats; in urban areas, all schools have been transferred to the urban local bodies.

(3) The entire responsibility of poverty alleviation has gone to the local governments; all the centrally sponsored anti-poverty programs are planned and implemented through them.

(4) As regards Social welfare, barring statutory functions relating to juvenile justice, the entire functions have gone to local governments. The ICDS is fully implemented by Village Panchayats and Urban Local Bodies. Care of the disabled, to a substantial degree has become a local government responsibility.

(5) In the Agriculture and allied sectors, the following have become the de facto and de jure local government functions.

a) Agricultural extension including farmer oriented support for increasing production and productivity.
b) Watershed management and minor irrigation.
c) Dairy development.
d) Animal Husbandry including veterinary care.
e) Inland fisheries.

(6) Barring highways and major district roads, connectivity has become local government responsibility.

(7) The whole of sanitation and almost the entire rural water supply have moved over to local governments.

(8) Promotion of tiny, cottage and small industries is mostly with the local governments.

(9) All the welfare pensions are administered by the local governments.

The above list more than proves that in terms of governance, interfacing the citizen nearly two-thirds is with the local governments.

(3) **Transfer of financial resources**. Prior to 1995 also the Village Panchayats used to get Government Grant-in-aid. This was not regular or assured and there was a lot of discretion in the allotment of such grants. With the acceptance of the recommendations of the First State Finance Commission the grants-in-aid became more defined and their devolution was systematized through a formula. But the total amount recommended by the State Finance Commission to be devolved to the Panchayat Raj Institutions did not amount to much. However, in 1996 a land mark decision was taken to allot more than a third of the State's Plan Resources (i.e., investible funds) to the local governments, with the PRIs getting an

85% share in accordance with the rural population. The noteworthy features of Kerala's financial devolution to local governments are listed below:

1. The quantum of Plan funds earmarked for local governments is the highest in the country.

2. Around 90% of the Plan funds is given in a practically untied form to the local governments to prepare their own schemes and implement them within certain broad policy framework, which stipulates that at least 40% of the funds should be invested in productive sectors, not more than 30% should be invested on roads and at least 10% should be earmarked for gender sensitive schemes and which has fixed a consensual upper ceiling for subsidies in different categories of schemes.

3. The entire Plan grant is investible. This can be called "pure money", as it does not carry any staff salaries or other administrative costs. (Normally at the State level 20 to 25% of the plan is taken away by such commitments.)

4. All the Plan grants due to local governments are separately budgeted in a document given as Annexure IV of the State Budget. Since it is passed by the Legislature it is non-divertible for other purposes by the executive.

5. Contrary to universal practice, it is the Village Panchayats which get the bulk of the Grants with nearly 70% of the rural share going to them and the District and Block Panchayats only sharing the remaining 30% more or less equally.

6. Every single rupee devolved to local governments whether under Plan or other categories is given as per a transparent formula and there is no room for patronage or partisanship in allocation of resources to local governments.

7. A flow of funds procedure has been designed. The funds flow in four instalments. A local government has to spend at least 75% of its allocation during a year failing which the shortfall would be reduced from the next year's allotment.

(4) **Operationalising decentralised participatory planning.** The People's Planning Campaign has succeeded in providing a concrete methodology for participatory planning for local level development. The roots of the methodology can be traced back to an experiment carried in Kalliassery Panchayat of Kannur District in the early 90s. In 1996 it was modified and adapted for large-scale application. The salient features of this methodology are described below, stage by stage.

1) Needs identification: Through a meeting of Grama Sabha, i.e., the ward or the electoral constituency of a village panchayat member, the felt needs of the community are identified. There is a period of environment creation to mobilize maximum participation in the Grama Sabha. Statistics reveal that about 10 – 12 % of the rural population has participated in the Grama Sabhas held as part of the People's Planning Campaign. The Grama Sabha meetings are held in a semi structured manner with plenary sessions and sub group sessions dealing with specific developmental issues. The decisions are minuted and forwarded to the Panchayats. Each Grama Sabha is chaired by the elected member and has an official as its Co-ordinator

2) Situation analysis: Based on the demands emanating from the first special Grama Sabha and based on developmental data, both primary and secondary, exhaustive Development Reports have been prepared and printed in the case of every Panchayat Raj Institution in the State. These reports describe the status in each sector of development with reference to available data, analyse the problems and point out the directions for further development. This is an one-time exercise and the Reports will be revised before the next five year plan.

3) Strategy setting: Based on the Grama Sabha feed back and the Development Report, a one day seminar is held at the PRI level in which participation of experts, elected members, representatives nominated by Grama Sabhas, practitioners from among the public is ensured. The development seminars suggest the broad priorities and general strategies of developmental projects to be taken up for a particular year.

4) Projectisation: The ideas thrown up by the above three stages are translated in the form of projects by Task Forces at the PRI level. For each PRI there are about 12 Task Forces dealing with different sectors

of development. Each Task Force is headed by an elected member and is convened by the concerned government official. The Vice Chairman of the Task Force is normally a non-government expert in the sector. The projects are prepared in the suggested format outlining the objectives, describing the benefits, explaining the funding and detailing the mode of execution and phasing of the project.

5) Plan finalization: From among the projects, based on the allocation communicated, the concerned PRI finalizes its plan for the year and this plan is submitted to the District Planning Committees (DPCs) through the Expert Committees. The Panchayat is free to take up any project, irrespective of its cost, subject of course to the resources actually available and within the sectoral limits.

6) Plan vetting: The Expert Committees at the Block or the District level vet the projects for their technical viability and conformity with the mandatory government guidelines on planning and costing and forward them to the DPC. They cannot change priorities or projects; they can only ask for rectification.

7) Plan approval: The DPC gives the formal approval to the plans after which the PRI can start implementation. It is to be noted that the DPC also cannot change the priority of a PRI. It can only ensure that government guidelines are followed. Administrative approval for implementation is given project-wise by the PRI. Every PRI has unlimited powers of Administrative sanctions subject only to the limits of its Financial resources.

(5) Setting up Appropriate Administrative Support Systems. A remarkable feature of Kerala's decentralization has been the achievement of the State Government in having created a sub set of laws and procedures to facilitate the smooth functioning of PRIs. A fact often not realized is that for day to day exercise of powers and functions, mere provisions in the Act would not be sufficient. They have to be fleshed out with appropriate rules, which constitute the subordinate legislation, and more important, to make the system dynamic, government orders, manuals and circulars would have to be infused into this system to provide the life blood. Since the deep structure of various governmental procedures are attuned for a centralized functioning, it is necessary to radically alter them to bring about a sub system, which in keeping with the spirit of decentralized governance. It is

all the more necessary because of the fact that almost the whole of the developmental sphere of government is governed not by legislation but by executive decisions expressed in the form of government orders, manuals, guide lines, circulars and clarifications. Kerala has been able to realize this practical point and has succeeded in considerable measure in laying the foundation for new systems. Some of the important administrative measures worth mentioning, are summarized below:

- In a fundamental shift from the existing method of execution of public works a set of rules for execution of public works by Panchayati Raj Institutions was issued. It provides for community contracting of works through committees of beneficiaries along with stringent provisions to guard against 'benami' contractors masquerading as convenors or nominees of beneficiary committees. The rules provide for compulsory transparency with all records relating to a public work right from preliminary estimates, up to final bills and payment vouchers being declared as public documents for any one to peruse or take copies. The rules also insist on preparation of a summary of the estimate in layman's language and exhibition of this summary as well as details of execution at the work site. In addition the process of technical approval is sought to be demystified so that government could, through an executive order bestow powers of technical sanction on institutions as well as Committees of government or non-government professionals. This radical feature provides for easy access to technical expertise. In pursuance of these rules the government have embarked on a program of creating a separate public works manual for local governments with updated specifications and standards and more accountable and people-friendly methods of preparation of estimates and taking measurements of public works. This ambitious program when it is carried to its logical conclusion is expected to revolutionize the execution of public works by reducing chances of corruption and facilitating social audit.

    - Another innovation is the setting up of Expert Committees. Originally a Volunteer Technical Corps (VTC) was set up as part of the People's Planning Campaign at Block and District levels. This consisted of experts in various fields who responded to the call of Government to render voluntary professional services in the cause of local level development. These VTCs were converted into Block Level Expert Committees (BLEC) and District Level Expert Committees (DLEC) by adding to its membership through the nomination of professionals from Government. These Expert Committees are given a three-fold role. *Firstly* they are expected to provide technical advice to the PRIs.

Secondly they are empowered to technically vet the projects of PRIs before they are sent to the District Planning Committee for approval. Here the Expert Committees function as the Technical Advisory Groups of the DPC. However these Expert Committees are not empowered to change the priority of a PRI; they can only insist on following of technical standards, proper costing and phasing of various programs. The *third* function of the Expert Committee is to provide technical sanction for works, which require such approval. In this role they function as the Technical Support Group of the PRIs. For technical sanction, sub groups consisting of at least three Experts are formed in which as far as possible the Government professional is the conveyor and the non-government professional is the Chairperson. This system of technical approval is faster, cheaper and more transparent. It has debureaucratised and demystified the process of giving technical sanction. In the case of PRIs without engineers, the members of these Expert Committees are allowed to perform the engineering support functions subject to the payment of a small fee not exceeding $2^1/_2$ % of the estimate of a work for the full range of functions. This outsourcing of technical services has been institutionalized.

- In order to improve the quality of implementation and to facilitate speedy execution of public works a system of accrediting non-government organizations for carrying out public works has been introduced. Accordingly, five NGOs have been accredited including a 75 year old Labour Co-operative Society. Local Governments can directly approach any of these NGOs and get their works executed without going through the tendering process. Incidentally three of the NGOs accredited specialize in appropriate building technologies, attempting to use cost effective local materials and man power. Also a scheme of Apprentice Engineers have been introduced which allows fresh graduates from Engineering Colleges as well as diploma holders from Polytechnics to lend their services to Village Panchayats for a period of one year and in return gain hands on experience in designing and supervising public works projects.

- Another major area of local government functioning is selection of beneficiaries for various individual and group oriented development programs, particularly relating to anti poverty and minimum needs programs for people below poverty line. Without infringing on the basic autonomy of Panchayat Raj Institutions, the Government have

prescribed a due process for beneficiary selection. The key elements of this process are fixing of definite and transparent eligibility criteria for each scheme as well as prioritization criteria among those eligible for such scheme. The prioritization criteria have to be given weightages in the form of points or marks. These criteria have to be published and application forms invited after widespread publicity. In fact full-page advertisements are issued by Government alerting the people about impending beneficiary selection and exhorting them to approach the PRIs. Each application received has to be acknowledged. Thereafter it has to be enquired into either through officials or preferably through a committee of officials and non-officials and marks awarded for each criterion and totaled. A draft priority list based on these marks has to be prepared and taken to the Grama Sabha in which the applicants from that particular ward also participate. The marks have to be justified in the Grama Sabha and altered if decided by the Grama Sabha. Once the Grama Sabha approves the list, the priority cannot be changed by the Panchayat. In order to ensure equitable distribution of benefits among the different wards of a Village Panchayat, ward-wise physical target is prepared in proportion to eligible applicants. Even for selection of beneficiaries to schemes sponsored by Block Panchayats and District Panchayats it is the Grama Panchayat which is to perform the function through its Grama Sabhas in the manner prescribed above. All records relating to selection of beneficiaries have again been declared as public documents. This insistence of due process has considerably reduced patronage and nepotism in the selection of beneficiaries.

- Over a period of time in the absence of genuine democratic institutions at the District level or levels below, various agencies have been set up for various schemes. They are all nominated power centres of one kind or the other and exercise functions and take decisions in areas related to the subject under the control of local governments. Government of Kerala has realized that such parallel systems are detrimental to the growth of genuine PRIs and a conscious decision has been taken to abolish such institutions. In pursuance of this decision the DRDA and Development Authorities in the non-Corporation areas have been disbanded. An exercise is being undertaken to dismantle Fish Farmers Development Agencies (FFDA) and Brackish Water Fish Farmers Development Agencies (BWFFDA) also.

- An interesting administrative feature is the role of the District Collector. The Collector has practically no role in the developmental sphere and has no control whatsoever over the PRIs. But he is the chief co-ordinator of decentralized planning and implementation, playing a critical role in providing support services in monitoring and in trouble shooting. The experience and expertise of Collectors are harnessed to the full without in any way affecting the independence of PRIs.

- A very successful administrative innovation is the functioning of the Co-ordination Committee which is a high power Committee constituted by the Council of Ministers to which its powers have been delegated for taking most of the policy decisions in respect of decentralization. This Committee is chaired by the Minister for Local Self Government and has as its members the Secretaries in charge of Local Self Government, SC/ST Development, Planning and Finance Departments, Members of the State Planning Board in charge of Resources and Decentralized Planning and the Heads of Panchayat, Municipalities, Rural Development Departments. This Committee which meets every week has been a great success in providing online response to issues arising out of the decentralization process by virtue of its empowered nature. It has helped in taking quick policy decisions and issue of critical government orders and circulars to remove bottlenecks.

- There is a system of identifying beacon Grama Panchayats and conferring Grama Shree Awards based on certain criteria of performance. These Panchayats are encouraged through incentive grants. Similarly Panachayats which have shown best practices in various developmental fields are given a nodal role in providing training to elected members and officials of sister Grama Panchayats, by inviting them to the Panchayat and sharing their experience.

- Some of the administrative reform measures which have been approved and are under operationalisation are listed below:

i. A Committee has been set up to prepare new modern manuals dealing with budgeting, accounting and auditing of local governments. Another Committee has been set up to prepare a detailed manual for procurement of goods and services by the local governments.

ii. A detailed government order outlining the rights of citizen vis-à-vis local governments, is under preparation and is to be given to every family. This

is expected to be a powerful tool of empowerment in a literate society. Similarly a government order on the rights of elected members is also to be prepared.

iii. Manuals for effective management of institutions transferred to local Governments are under preparation.

iv. Information Kerala Mission has been launched with the objective of introducing information technology in local governments. Every Village Panchayat is expected to be networked by mid 2001.

(6) Capacity Building. A huge capacity building exercise has been attempted right from the beginning. In the first year a cascading system of training was introduced to enable quick outreach to the cutting edge level. About 600 Key Resource Persons (KRPs) were identified at the State level both from Government and outside representing various disciplines. These persons were utilized to train practically every elected member of local governments as well as key officials. At the district level about 10,000 District Resource Persons (DRPs) and at the local government level about 100,000 Local Resource Persons (LRPs) were selected. All the DRPs and LRPs and a good number of KRPs were selected by the Local Governments themselves from government officials, professionals and activists. The massive training program ensured that at the level of the Village Panchayat, there would be nearly 100 persons sensitized on the objectives and methodology of decentralized planning. These Resource Persons took active part in spearheading the campaign as well as intervening in critical stages of the Plan preparation and implementation cycle.

In order to fortify and simplify the training system in the second year, handbooks on various development sectors were prepared by expert panels and circulated widely among the local governments and Resource persons. These handbooks outline the problems and possibilities of the sector and contain model projects, which can be adapted according to local needs. Sixteen such handbooks were prepared.

Now the focus is on strengthening the capacity of the Task Forces on various sectors. Institutions like Medical College, Agricultural University, Centre for Water Resource Development and Management (CWRDM) etc., are being utilized to provide high quality technical training to members of Task Forces in their respective disciplines. In addition, local governments which have evolved successful models are now utilized to train fellow local governments by exposing them to the models evolved.

All these training programs are getting consolidated and institutionalized around the Kerala Institute of Local Administration, one of the few institutions of that kind existing in the country. It was set up by pooling the funds of various Village Panchayats and Municipal bodies and this institute is perceived as one owned by the local governments and has excellent credibility in reaching out to them. The experience from the training programs is being utilized to strengthen the Kerala Institute of Local Administration which is expected to grow into a national centre of excellence for capacity building for local governments.

(7) Accountability Mechanisms.

(a) Institutions: There is a conscious decision by Government to give up direct control over local governments and to set up independent institutions to deal with various aspects of local government functioning. The institutions which have been created and which are in the offing are listed below:

i) **The State Election Commission**. The Election Commission has been given powers which go beyond those required for the conduct of elections. It is empowered to delimit Wards which were formerly done by the executive and it has been given powers to disqualify defectors.

ii) **The State Finance Commission**. This has been given the mandate as required by the Constitution. The first SFC was constituted in 1994 and the second SFC in 1999.

iii) **Ombudsman for Local Governments**. This is a high power institution (it is the name given to an institution rather than an individual as is the conventional practice) consisting of seven members – a High Court Judge, two District Judges, two Secretaries to Government and two eminent public men selected in consultation with the Leader of Opposition. This institution has been given vast powers to check malfeasance in local governments in the discharge of developmental functions.

iv) **Appellate Tribunals**. These are to be constituted at the Regional/District level to take care of appeals by citizens against decisions of the local government taken in the exercise of their regulatory role like issue of licences, grant of permits etc.

v) **Audit Commission**. Though this has not yet been legislated a policy decision has been taken to set up an Audit Commission which would be independent of governmental control and which would function on the lines of Comptroller and Auditor General of India and would be able to set its own standards of audit.

vi) **State Development Council.** This is headed by the Chief Minister and consists of the entire Cabinet, Leader of opposition, Vice-Chairman of the State Planning Board, the Chief Secretary, all the District Panchayat Presidents who are also Chairperson of District Planning Committee and representatives of other tiers of local governments. This institution is expected to take the lead in policy formulation and in sorting out operation issues.

(b) Conventional Accountability Systems. The conventional systems of accountability have both been newly brought in or the existing practices reinvigorated. Some of the important ones are summarized below:

i. The fund flow is through treasuries and the accounts are maintained in Treasury Personal Deposit Accounts. Every receipt and payment is recorded and a system of certification is relied on for release of funds.

ii. Local Government decides the "implementing officer" for each project and thereafter the funds for that project are transferred to the implementing officer who is to implement the project as approved by the local government expend funds under the close supervision of the local government and report to it regularly. He can withdraw funds only on the specific authorization of the local government. This achieves a double purpose - the involvement of the officer ensures observance of the due process and the supervision of local governments provides social control.

iii. Traditionally audit of local governments in Kerala have been performed by the Local Fund Audit Department controlled by the Finance Department of the State. With decentralization surplus staff of the Panchayat, Rural Development, and Municipalities Departments at the District level have been formed into Performance Audit Teams whose function is to carry out periodical concurrent audit mainly with the objective of enabling proper maintenance of accounts and adherence to basic

procedures rather than post facto fault-finding. In cases of complaint, Government resorts to making requests for special audit by the Accountant General.

iv. The local governments are inspected by the Finance Inspection Wing, the Vigilance Department on sample basis or on receipt of serious complaints. With decentralization a Technical Audit Team has been set up to randomly check the quality of public works and sort out disputes between local governments and engineering staff.

v. A Grievance Enquiry Committee has been constituted at the District and State level to enquire into complaints and if serious faults are noticed they are referred to the Ombudsman.

(c) New Accountability Mechanisms.

With the new empowerment of local governments, certain new procedures and systems to ensure accountability have come into being. They are described below:

(i) The Government frequently launches IEC Campaigns of a non-propagandist nature bringing to the notice of the citizen his rights and duties vis-à-vis local governments. This is done through full page advertisements in major newspapers. In a State where newspaper readership, is extremely high this has good effect.

(ii) All local governments follow the council system of decision making. No individual or group is given the power to decide. Everything can be decided only by the full Committee of a local government. The meetings of local governments are open and can be attended by members of the public as well as the Press.

(iii) Grama Sabhas have been strengthened and given powers to select beneficiaries as well as the right to know every item of expenditure in the Village Panchayat.

(iv) The 12 Task Forces each headed by a Member of the Local Government having both official as well as non-official experts in the sector, function as Monitoring Committees. They carry out field visits and inspections to verify that the projects are properly carried out.

(v) The Expert Committees described earlier make sure that basic technical standards are maintained and that costs are reasonably fixed.

(vi) The due process in beneficiary selection prescribed by a Government Order has made it legally enforceable.

(vii) The broad frame work of formulation of schemes provides the rational boundaries to autonomy and acts as a check on run-away misutilisation of funds.

(viii) The right to information has been enshrined in the Panchayat Raj and Municipality Acts making all documents relating to public works and other items of expenditure public documents available to anyone for scrutiny. Information Boards have been set up in each Ward where information on developmental matters are exhibited regularly.

NEW INITIATIVES

In order to consolidate the gains of the formative years and to sort out the problems, the following initiatives are in the offing.

(1) Strengthen Grama Sabhas further through action research projects in which NGOs and eminent citizens are involved. This to bring about greater participation of all sections of society especially the better-off ones and encourage more in-depth discussions on local development issues and detailed social audit

(2) Upscale the Social Audit systems now tried out in selected local governments and make social auditing an integral part of local government system. This is to facilitate greater control from below.

(3) Move from annual planning to five year planning to ensure more sustainable developmental schemes. This is to reduce the tendency to spread the resources thin and help develop a strategic vision of development.

(4) Attempt to attract institutional finance for local development effort. This will help curb the tendency to give high subsidies in individual beneficiary-oriented projects and motivate taking

up of commercially viable projects or projects which have a revenue stream from user equity and user charges.

(5) Restructure the existing Kerala Urban Development Finance Corporation (KUDFC) and making it into financing agency for all local governments with a special responsibility to develop viable projects for institutional funding.

(6) Prepare a shelf of B.O.T/B.O.O. projects for willing local governments to pick up.

(7) Provide an incentive stream to Village Panchayats from the Plan grant to raise local resources.

(8) Develop modern but simple systems for budgeting, accounting and auditing and prepare elaborate self-speaking manuals on these aspects. This is to inculcate greater financial discipline.

(9) Design a new Public Works Manual incorporating appropriate standards and specifications as well as methods of estimation. This is to allow flexibility and simplicity for community contracting and demystify the process of preparing cost estimates of public work. A major threat to decentralization is the scope for corruption inherent in archaic and arbitrary procedures of estimate preparation and measurement of work done. Moreover, innovative methods of competitive bidding and contracting out of works need to be introduced into the system.

(10) Network local governments through computers, initially for Plan monitoring and later for other purposes for increased accountability and for easing the workload.

(11) Move on to electronic budgeting linked to computerized treasuries. This is to reduce the tendency to divert funds.

(12) Publish Citizen's Charters for each local government. This is to focus on quality of services, that is, on the software of governance.

(13) Lay down a Code of Conduct for elected representatives and officials. This to define expectations of behavioral norms and ethical standards and demarcate the domains of professional freedom and political control.

(14) Adopt modern office management methods.

(15) Focus on management of institutions and delivery of services, moving away from mere implementation of public works and beneficiary oriented programs. For this simple but detailed

management manuals are to be prepared for each kind of institution/office.

(16) Promote community management of assets created, starting with water supply.

(17) Publish citizen entitlements as well as elected representative entitlements and reach them to every family and every elected member.

(18) Allow beacon panchayats full freedom from existing rules and procedures for a fixed period. This is to document best practices and adopt them into the system for replication.

(19) Create a cadre of development professionals to serve as chief executives of local governments. This is to get over the problems of co-ordination particularly at the Village Panchayat level.

The Achievements

The experience of the first few years of decentralization has proved that in providing basic minimum needs infrastructure like housing, water supply, sanitation and connectivity, the Local Governments have performed creditably. The speed and extent of coverage as well as efficiency in implementation in respect of provision of minimum needs has been superior to that of Government. The details of local government achievement in poverty related programs in the last three years are summarized below:

A. Asset distributions for economic development (Major items)

1.	Cattle	2,74,572 Nos.(Of which 86792 under Special Component Plan (SCP) for Scheduled Castes & 10520 under Tribal Sub Plan (TSP) to Scheduled Tribes.
2.	Cattle sheds	74,636 Nos. (11,570 SCP/ 1047 TSP)
3.	Poultry	18,67,517 (310653 SCP/ 24305 TSP)
4.	Sewing Machines	53,472 (15766 SCP/ 732 TSP)

B. Basic Needs.

1	House Plots	15099 (10079 - SCP 7115 - TSP)
2	New Houses	3,06,288 Nos. (103040 SCP/ 14133 TSP)
3.	Upgradation of Houses	1,18,019 (51511 - SCP 6634 - TSP)
4.	Wiring of houses	10,07,717 (41138 SCP 4577 TSP0
5.	Toilets	4,13, 174 (80941 - SCP 9567-TSP)
6.	Drinking Water Wells	87, 591 (19,637 SCP 1647 TSP)
7.	Drinking Water Taps	32,503 (6432 SCP 1131 TSP)
8.	Additional space created in schools	93,548 sq.mts.
9.	Additional space created in hospitals	90,021 sq.mts.
10.	Additional space created in public markets	56,328 sq.mts
11.	Roads upgraded	17,188 kms.

Next to minimum needs, the local governments have done reasonably well in natural resource management particularly in utilization of water resources for productive purposes. As regards the productive sector there have only been isolated successes where agricultural production and productivity have been increased manifold.

However in providing services like health and education, success stories have been relatively less in number. Of course outreach of health services as well as remedial coaching for laggard students has definitely improved and the infrastructure for health and education has rapidly been upgraded. But management of professionals and other staff to provide better quality services requires further effort.

On the whole an encouraging feature is the fact that in most of the sectors relating to poverty reduction there have been viable models evolved by individual local governments. A major challenge would be to upscale and replicate them. It is pertinent to note that funds spent on poverty reduction program by local governments significantly exceeds earlier investments. This is suggestive of the higher priority given to anti poverty programs by local governments. The spread of this investment is also much wider and generally more equitable.

Another significant area relating to poverty reduction where the local governments have performed well is the implementation of social security schemes like pensions. The coverage has improved and the targeting has been fairly satisfactory.

The good governance aspect of decentralization particularly transparency as well as the opportunities for participation have improved the quality of anti poverty programs formulated and implemented by local governments. There is considerably less leakage and definitely the identification of beneficiaries is better.

What holds the biggest promise for poverty reduction is the attempt to develop a network of self help groups of families below the poverty line (BPL), each represented by a woman. Essentially, it is based on a community based identification of BPL families on non monetary indicators which are transparent and which are reflective of social perceptions of poverty. Identified families are organized into Neighborhood Groups (NHGs) of 20 - 25 members who are federated into an organization called Area Development Society (ADS) at the Panchayat Ward/Grama Sabha level and further networked into a registered NGO of poor women called the Community Development Society (CDS) at the level of the Village Panchayat. This experiment which has been tried out in the most backward district of Malappuram has now been expanded to cover one-third of the Village Panchayats in the State. **[Incidentally this system of poverty reduction has been awarded the Gold Medal by the Commonwealth Association of Public Management (CAPAM) from among international best practices in Public Management for the year 2000].**

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