

# 15. State Finance

Attainment of fiscal consolidation through revenue augmentation and expenditure management is the main reform priority of the State. The State had turned the corner in fiscal sphere following the introduction of Medium Term Fiscal Reform Programme and Enactment of Tamil Nadu Fiscal Responsibility Act, 2003 in consonance with the enactment of the Fiscal Responsibility and Budget Management Act, 2003 and the Fiscal Responsibility and Budgetary Management Rules, 2004 of Government of India. Dwindling revenue deficits on Revenue Account, a leading indicator, mirrors a better financial discipline in the State. The pro-active measures taken by the Government such as medium term fiscal reforms programme, debt swap scheme and lowering of interest on Central loans to State had enabled the State to achieve durable fiscal consolidation and fiscal empowerment.

## **Budget 2003-04 - Major Highlights:**

The occurrence of droughts on the farm front for third year in succession had impinged on the fiscal scenario in large measure in that it affected the purchasing power of the farmers which, in turn, reduced the demand for manufactured goods and services. Overall deficit of rainfall was to the tune of (-)25.4 per cent in 2002. Government had implemented a number of drought relief measures in 2003-04 such as special 'Food for Work' Programme to mitigate the severity of the drought situations in the affected districts.

The Budget for 2003-04 aimed at accelerating the growth of primary sector and giving impetus to manufacturing sector and to encourage IT and IT-enabled services, BPO, etc. Development strategies set out by the Government are detailed below:

- Reinvigorating the primary sector;
- Special thrust to the manufacturing sector with the implementation of second generation reforms;
- Accelerated infrastructure development with a special focus on the Chennai Metro area;
- Special emphasis on the development of IT and tourism for generation of new employment opportunities;
- Renewed emphasis on human resources development and
- Building a comprehensive social safety net and social security cover for the poor and needy.

As a part of development strategy a '*clean village campaign*' with special focus for the disposal of village level waste had been launched and a sum of Rs.75 lakhs was proposed for the campaign to reward the village. The State was enabled to levy tax on telephone rents. Government had decided to provide direct subsidy to small and marginal farmers and hut dwellers. Rationalisation and modification of electricity tax was expected to bring an additional revenue of Rs.80 crores during the year. Emission control measures had also been introduced by levying a new '*Green tax*' on all classes of old motor vehicles.

To accelerate the process of registration, the project **STAR** (Simplified and Transparent Administration of Registration) an IT-enabled service as a part of E-governance had been launched to make the public-Government interface simple, fast and hassle-free. The State had formulated a disinvestment policy in line with the Government of India to tone up all the public sector undertakings and cooperative sector enterprises in the secondary sector as a process of restructuring. The VRS scheme had also been implemented for Government employees in the State.

## Budget for 2004-05 - Salient Features:

The budget for 2004-05 was pro-poor in that it provided a social safety net for the disadvantaged sections of the population besides aiming at increased overall productivity, equitable distribution of income and thrust to development of agriculture, industry and social sectors.

The Budget aimed at crop diversification with new value addition, efficient use of water, precision farming, capital investment in agriculture creation of new irrigation potential and all-embracing rural infrastructural upgradation on the farm front. The Budget focused on quality power supply, taxation reforms, labour reforms, impetus to information technology, e-governance initiative and realization of Millennium Development Goals. Since drought was very severe, the Government had taken pragmatic drought relief measures to cushion against the worst effects of the severe drought. The Budget also gave thrust to the Chennai Water Supply Augmentation Project (New Veeranam Project) with a budgetary support of Rs.720 crores.

A new programme called "*Namadhu Gramam*" was launched with the objective of ensuring all round development of villages in Tamil Nadu. This programme ensured specific improvements in areas such as drinking water, sanitation, drainage, health, women empowerment, nutrition, cleanliness and hygiene, elementary education, environmental improvement, management of water resource, village roads and street lights.

For empowerment and poverty reduction the budget laid emphasis on livelihood security, nutrition security, shelter security, health security, etc. Thrust was given to housing for the poor, development of rural roads, rural electrification, etc. As a part of development of highways, the '*Golden Quadrilateral Project*' connecting the four metropolitan cities including Chennai had progressed rapidly. The work on North-South Corridor connecting Kanyakumari with Kashmir was also inaugurated. The focus of the budget 2004-05 is directed towards adding new generation capacity and improving distribution efficiency in the power sector with the supply of quality electrical energy without any load shedding.

In order to make secondary sector a vibrant one, key reforms were unveiled by a New Industrial Policy 2003. They were provision of quality infrastructure, quality energy supply, simplification of procedures and deregulation reforms in State level taxation, labour forms and technological modernisation and application.

Each MLA is entitled to take up works to the tune of Rs.82 lakhs every year. Prioritization in taking up the works is delineated below.

<u>Activity</u>	<u>Amount (Rs. lakhs)</u>
Drinking water supply works	: 15.00
Namadhu Gramam Thittam	: 15.00
Construction of BC/MBC Hostels	: 5.00
Construction of SC/ST Hostels	: 5.00
Village Panchayat Roads including Cement Roads and Street Lights	: 10.00
Untied Outlay	: 32.00
	-----
	82 .00
	-----

On education front, the Government's goal is to attain the ambition of 'Universalisation of Primary Education' through implementation of the Centrally-sponsored

Sarva Shiksha Abhiyan. This objective is sought to be achieved through having a primary school within a radius of 1 km for every habitation in the State, augmenting capacity-building, improving infrastructural facilities and effective monitoring of the implementation of the Sarva Shiksha Abhiyan. On health front the State had already attained the goal of population stabilization i.e. Total Fertility Rate of 2.1 on par with the performance of Kerala.

On fiscal front, the State has attained fiscal consolidation. It is noteworthy that there was a substantial improvement in the quantum of mobilisation of resources under Revenue Accounts and compression of public expenditure.

#### **Accounts 2003-04 and RE 2004-05 - An Overview:**

There was a huge imbalance between rigidity in collection of resources and rising expenditure on the Revenue Account, which resulted in fiscal instability and stress. But this tight fiscal scenario had eased because of the proactive measures taken by the State in the form of expenditure compression and increased marshalling of resources through better fiscal consolidation. The Revised Estimate of Budget 2004-05 shows that the revenue expenditure exceeded the revenue receipts by Rs.168739 lakhs. Revenue receipts stood at Rs.2704942 lakhs whereas Revenue expenditure was put at Rs.2873679 lakhs in 2004-05 (RE). The overall Revenue deficit had increased from Rs.156524 lakhs in 2003-04 to Rs.168739 lakhs in 2004-05. The overall total transactions (net) ended in a closing deficit of Rs.20817 lakhs in 2004-05 compared to Rs.7905 lakhs in the preceding year.

**Table -1: Overall Budget**

(Rs. in lakhs)

Sl. No.	Details	2001-02 Accounts	2002-03 Accounts	2003-04 Accounts	2004-05 Revised
<b>I.</b>	<b>Consolidated fund</b>				
<b>A.</b>	<b>Revenue account</b>				
1.	Receipts	1881803	2083674	2370571	2704942
2.	Disbursement	2155697	2568770	2527095	2873679
3.	Surplus or Deficit	-273894	-485096	-156524	-168739
<b>B.</b>	<b>Capital Account</b>				
1.	Receipts	1348725	1880264	1143345	1381629
2.	Disbursement	1204248	1344223	1026801	1278196
3.	Surplus or Deficit	144477	536041	116944	103433
<b>I.</b>	<b>Consolidated fund (net)</b>	<b>-129417</b>	<b>50945</b>	<b>-39580</b>	<b>-65306</b>
<b>II.</b>	<b>Contingency fund (net)</b>	<b>61</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>III.</b>	<b>Public Account (net)</b>	<b>115031</b>	<b>-42210</b>	<b>31675</b>	<b>44489</b>
<b>IV.</b>	<b>Total transactions (net)</b>	<b>-14325</b>	<b>8735</b>	<b>-7905</b>	<b>-20817</b>

Source: Annual Financial Statement.

The Capital Account shows a surplus fund of Rs.103433 lakhs in 2004-05 (RE) against Rs.116944 lakhs in 2003-04 (Accounts). An ideal situation is that there should be Revenue Account surplus which balances the Capital Account receipts. It means that funds are being saved from current expenditure to invest in capital works such as roads, buildings, irrigation projects, etc. Contrary to this ideal situation, there have been Revenue Account deficit and Capital Account surplus implying current consumption requirements are being met from borrowing.

#### **Revenue Account 2003-04 and 2004-05 (Revised Estimates):**

##### **Revenue Receipts:**

Buoyancy in State's tax revenue is predicated by increase in per capita income, urbanisation, performance of manufacturing and service sectors, effective tax-collecting machinery, fool-proof tax system, tax effort, etc. The total Revenue receipts of Rs.2704942

lakhs of the State had flowed by way of the devolution of funds from Central taxes, State's own tax revenue and Non-tax revenue comprising State's own non-tax revenue and grants-in-aid from the Centre. Of the total tax revenue of Rs.2280748 lakhs, State's tax revenue accounted for 82.32 per cent (Rs.1877472 lakhs) and share of Central taxes comprising Income Tax, Union Excise and additional Excise Duties accounted for 17.68 per cent (Rs.403276 lakhs). Of the State's own tax revenue mobilised by the State, the major portion of revenue emanated from General Sales Tax (60%), followed by State Excise Duties (13%), Stamps and Registration (7.9%), Central Sales Tax (7%) and taxes on vehicles (5.5%). Out of the total non-tax revenue of Rs.424194 lakhs, State's own non-tax revenue stood at Rs.209643 lakhs (49.42%) and grants-in-aid from the Centre Rs.214551 lakhs (50.58%).

**Table - 2 : Receipts on Revenue Account by Principal Heads**

(Rs. lakhs)

Sl. No.	Details	2001-02 Accounts	2002-03 Accounts	2003-04 Accounts	2004-05 Revised
I	<b>Tax revenue (A+B)</b>	<b>1587977</b>	<b>1738928</b>	<b>1948917</b>	<b>2280748</b>
A.	<b>Share of Central Taxes</b>	<b>279742</b>	<b>295107</b>	<b>339700</b>	<b>403276</b>
1.	Income Tax	53484	51399	57295	70717
2.	Union excise and additional excise duties	226258	243708	282405	332559
B.	<b>States Own Tax Revenue</b>	<b>1308235</b>	<b>1443821</b>	<b>1609217</b>	<b>1877472</b>
1.	Agricultural Income Tax	202	163	125	35
2.	Land Revenue	5047	840	1750	2144
3.	Urban Land Tax	1411	1269	1203	1472
4.	Stamps & Regn. Fee	113789	107912	131640	148722
5.	State Excise Duties	205822	211361	165710	236000
6.	General Sales Tax	683888	866093	986804	1134825
7.	Central Sales Tax	154672	92867	113659	130708
8.	Taxes on Vehicles	64843	74562	93429	102772
9.	Electricity Duties	25975	13518	22800	23000
10.	Entertainment Tax	8800	8158	10697	6022
11.	Betting Tax	749	437	713	612
12.	Luxury Tax	6498	7397	4401	4388
13.	Sugarcane Cess	1009	643	471	569
14.	Taxes on Goods & Passengers	28265	48952	61094	70259
15.	Share of Net Proceeds Assigned to States	1472	2183	2161	2507
16.	Service Tax	5793	7467	12559	18839
17.	Deduct - Refunds	0	0	0	-5400
II.	<b>Non tax revenue (A+B)</b>	<b>293826</b>	<b>344746</b>	<b>421654</b>	<b>424194</b>
A.	<b>State's Own Non Tax Revenue</b>	<b>155672</b>	<b>186062</b>	<b>209379</b>	<b>209643</b>
1.	Interest Receipts & Dividend and Profits	53542	59470	55974	56543
2.	General Services	32609	38796	34103	27104
3.	Social Services	23600	26158	476 70	47045
4.	Economic Services	45921	61638	71632	78950
B.	<b>Grants-in-Aid from the Centre</b>	<b>138154</b>	<b>158684</b>	<b>21227 5</b>	<b>214551</b>
	<b>Total Revenue Receipts (I&amp;II)</b>	<b>1881803</b>	<b>2083674</b>	<b>2370571</b>	<b>2704942</b>

Source: Budget Memorandum.

### Revenue Expenditure:

Development and non-development component of the Revenue expenditure was in the ratio of 51:49. Within development expenditure .. out of the total expenditure of Rs.1477710 lakhs social services accounted for 65.8 per cent and economic services 34.2 per cent. General services constituted 89 per cent and compensation and assignments to PRI 11 per cent within non-development expenditure of Rs.1395969 lakhs. Under general services,debt services formed 42 per cent administrative services 16.7 per cent and pension and miscellaneous service expenditure 33.2 per cent in 2004-05. With the increase in the number of retirees, the un-funded pension liabilities had increased over the years.

**Table - 3 : Expenditure on Revenue Account by Principal Heads**

(Rs. lakhs)

Sl. No.	Details	2001-02 Accounts	2002-03 Accounts	2003-04 Account	2004-05 Revised
<b>I.</b>	<b>Development expenditure (A+B)</b>	<b>1191944</b>	<b>1423567</b>	<b>1320518</b>	<b>1477710</b>
<b>A.</b>	<b>Social Services</b>	<b>767706</b>	<b>797404</b>	<b>859777</b>	<b>972179</b>
1.	Education, Art & Culture, Sports	429287	414533	417506	455620
2.	Medical and Public Health	96663	94997	99846	114632
3.	Family Welfare	21776	23791	20450	20023
4.	Water Supply and Sanitation	16293	21630	25284	20180
5.	Housing	2845	6173	12129	9998
6.	Urban Development	13294	16550	18257	12006
7.	Labour and Employment	10492	11462	14505	10361
8.	Welfare of SC, ST and OBC	47485	50513	54859	61244
9.	Social Security and Welfare	68960	62660	83642	92746
10.	Nutrition	46305	52763	67898	68900
11.	Relief on Account of Natural Calamities	12607	37732	40854	100715
12.	Other social services, Information & Publicity	1699	4600	4546	5756
<b>B.</b>	<b>Economic Services</b>	<b>424238</b>	<b>626163</b>	<b>460741</b>	<b>506531</b>
1.	General Economic Services	162470	133411	90428	95291
2.	Agriculture and Allied Services	123885	114351	110209	121746
3.	Rural Development	47112	60894	90530	60797
4.	Special Area Programme	1588	1574	1524	1633
5.	Irrigation and Flood Control	41635	48610	53774	54071
6.	Energy	3463	200227	44010	84444
7.	Industry and Minerals	17049	30030	22511	27400
8.	Transport	26441	36759	45124	59439
9.	Science, Technology and Environment	595	307	2630	620
<b>II.</b>	<b>Non-development Expenditure (A+B)</b>	<b>963753</b>	<b>1145203</b>	<b>1206578</b>	<b>1395969</b>
<b>A.</b>	<b>General Services</b>	<b>892096</b>	<b>989491</b>	<b>1058911</b>	<b>1242117</b>
1.	Organs of State	27293	19094	18984	26529
2.	Fiscal Services	32729	36735	53385	72014
3.	Debt Services	351337	413341	469959	523451
4.	Administrative Services	165491	173009	1792 58	207989
5.	Pension and Miscellaneous General Services	315246	3473 12	337324	412135
<b>B.</b>	<b>Compensation &amp; Assignments to Local Bodies and Panchayat Raj</b>	<b>71657</b>	<b>155712</b>	<b>147667</b>	<b>153852</b>
	<b>Total Revenue Expenditure (I+II)</b>	<b>2155697</b>	<b>2568770</b>	<b>2527096</b>	<b>2873679</b>

*Source: Annual Financial Statement.***Capital Receipts:**

Capital receipt was at Rs.7917096 lakhs during 2004-05 (RE) against Rs.6435705 lakhs during 2003-04. A major portion of the capital receipt within consolidated fund came from public debt (17.45%) of which internal debt alone accounted for 89 per cent and loans and advances from Government of India accounted for 11 %. Gross capital disbursements were at Rs.7769175 lakhs in 2004-05 (RE) compared to Rs.6287086 lakhs in 2003-04 the increase being 23.57 per cent.

**Table - 4 : Capital Budget**

(Rs. lakhs)

Sl. No.	Details	2001-02 Accounts	2002-03 Accounts	2003-04 Accounts	2004-05 Revised
<b>A.</b>	<b>Receipts</b>				
<b>I.</b>	<b>Consolidated fund</b>	<b>1381159</b>	<b>1923533</b>	<b>1200801</b>	<b>1442097</b>
1.	Public debt	1348725	1880264	1143345	1381629
	i. Internal debt	1257494	1788306	1041046	1223632
	ii. Loans and advances from GOI	91231	91958	102299	157997
2.	Loans and advances repaid to State Government	32434	43269	57455	60468
II.	Contingency fund	0	0	0	0
<b>III.</b>	<b>Public account</b>	<b>2129012</b>	<b>2763808</b>	<b>5234904</b>	<b>6474999</b>
1.	Small savings, Provident fund etc.	286310	289515	268758	331411
2.	Reserve fund	19638	-15932	73654	163142
3.	Deposits and advances	691463	811254	874253	812680
4.	Suspense and miscellaneous	664170	1252702	3652866	4 812031
5.	Remittances	467431	426269	365373	355735
<b>IV.</b>	<b>Gross capital receipts (I+II+III)</b>	<b>3510171</b>	<b>4687341</b>	<b>6435705</b>	<b>7917096</b>
<b>B.</b>	<b>Disbursements</b>				
<b>I.</b>	<b>Consolidated fund (1+2+3)</b>	<b>1236682</b>	<b>1387492</b>	<b>1083857</b>	<b>1338664</b>
1.	Capital expenditure outside the revenue account	177791	162754	<b>358990</b>	360761
2.	Public debt	1004204	1155073	623810	901691
	i. Internal debt	945228	994398	307726	612183
	ii. Repayment of loans and advances to GOI	58976	160675	316083	389508
3.	Loans and advances of the State Government	54687	69665	101057	76212
4.	Appropriation to Contingency fund	0	0	0	0
<b>II.</b>	<b>Contingency fund</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>III.</b>	<b>Public account</b>	<b>2013980</b>	<b>2806018</b>	<b>5203229</b>	<b>6430511</b>
1.	Small savings, Provident fund etc.	230251	260626	242543	279114
2.	Reserve fund	21587	43267	67818	172371
3.	Deposits and advances	638679	907994	873024	806416
4.	Suspense and miscellaneous	648740	1163291	3665761	4817311
5.	Remittances	474723	430840	354083	355299
<b>IV.</b>	<b>Gross Capital Disbursements (I+II+III)</b>	<b>3250662</b>	<b>4193510</b>	<b>6287086</b>	<b>7769175</b>

Source: Annual Financial Statement.

### Capital Expenditure:

Accelerating capital expenditure is both a necessary and sufficient condition to spur economic development. Major items of capital expenditure are - roads, irrigation, machinery and equipment, share capital investment, health and education etc. The capital expenditure had increased from Rs.358990 lakhs in 2003-04 to Rs.360762 lakhs in 2004-05 displaying a growth of 0.49 per cent. Of the total capital expenditure of Rs.360762 lakhs in 2004-05 (RE), 94.19 per cent was met towards developmental activities and 5.81 per cent towards non-developmental activities.

The structure of capital expenditure shows that of the total expenditure of Rs.360762 lakhs in 2004-05, 58.86 per cent had been spent on economic services, followed by social services 35.34 per cent and general services 5.80 per cent. The composition of expenditure has deteriorated, with capital expenditure squeezed out by growing revenue expenditure. It may be mentioned that a sharp reduction in Revenue deficits is imperative so that the wherewithal available for capital formation would be substantial. Ultimately, process of

capital deepening and widening would be substantial with the result, productive capacity of the economy would expand.

**Table - 5: Capital Expenditure**

(Rs. lakhs)

Sl. No.	Details	2001-02 Accounts	2002-03 Accounts	2003-04 Accounts	2004-05 Revised
<b>I.</b>	<b>Development Expenditure (A+B)</b>	<b>162728</b>	<b>145409</b>	<b>333752</b>	<b>339812</b>
<b>A.</b>	<b>Social Services</b>	<b>66600</b>	<b>61606</b>	<b>151225</b>	<b>127482</b>
1.	Education, Sports, Art & culture	693	1359	7907	8654
2.	Medical, Public Health & Family Welfare	3527	4837	6591	8556
3.	Water supply, Sanitation, Housing & Urban development	61384	53836	128083	99447
4.	Welfare of SC,ST & OBC	941	1434	7517	9612
5.	Social welfare & nutrition	7	27	542	252
6.	Other Social Services	48	113	585	962
<b>B.</b>	<b>Economic Services</b>	<b>96128</b>	<b>83803</b>	<b>182527</b>	<b>212330</b>
1.	Agriculture & Allied Services	10410	9811	9767	11002
2.	Rural Development	3360	165	65	40656
3.	Special Area Programme	1153	1495	1391	1339
4.	Irrigation & Flood Control	30201	30301	24529	29737
5.	Industry & minerals	73	1981	-86	271
6.	Energy	10000	2500	20000	2500
7.	Transport	40875	37463	123094	125372
8.	General economic services	56	87	3766	1453
<b>II.</b>	<b>Non-development expenditure</b>	<b>15063</b>	<b>17345</b>	<b>25238</b>	<b>20950</b>
	<b>Total capital expenditure (I+II)</b>	<b>177791</b>	<b>162754</b>	<b>358990</b>	<b>360762</b>

Source: Annual financial statement ..

### Tax Effort:

Tax effort, defined as a percentage of tax mobilisation to State Income, is a good indicator of efficiency with which the Government mop up resources for development purposes. Owing to fiscal correction, the State occupies a top slot in tax effort. That the ratio of State's own tax revenue to the State Income was at 9.86 in the Revised Estimates for 2004-05 is among the highest in the country. This is due to effective implementation of Medium Term Fiscal Plan and a slew of fiscal measures taken by the State.

### Devolution of Resources from GOI:

The yardsticks adopted for horizontal distribution of resources from the divisible pool of the Central taxes are:

- 50 per cent on per capita income on a distance basis;
- 25 per cent based on population;
- 10 per cent based on geographical area;
- 7.5 per cent based on tax effort and
- 7.5 per cent based on fiscal discipline.

The relative share of Tamil Nadu in the divisible pool of Central taxes had decreased from 6.637 per cent to 5.385 per cent which is a sizeable reduction of 18.86 per cent according to the recommendations of 11<sup>th</sup> Finance Commission.

The recommendations of the 11<sup>th</sup> Finance Commission acted against the interests of the State. The best-performing States had been penalised in terms of diminished share in total devolution of funds from the Centre.

The 12<sup>th</sup> Finance Commission has recommended a rise in the total share of all States in the divisible pool of Central taxes from 29.5 per cent to 30.5 per cent. Tamil Nadu's share would be 5.305 per cent of the total divisible pool based on the recommendation of the 12<sup>th</sup> Finance Commission on principles of devolution for the period 2005-0-2010, as accepted by the GOI. Major recommendations of the 12<sup>th</sup> Finance Commission are presented in *Annexure -I*.

### **Subsidy:**

Subsidy is a negative tax intended to activate the production process through providing sufficient cushion to weaker sections or sick activities and services or both. Subsidies are classified into Merit I, Merit II and non-merit categories, based on the perceived desirability in the provision of public services. The State is aiming at eliminating the non-merit subsidies and focusing on progressively raising the user charges. At present the budgetary provision for Public Distribution System, education, agriculture, power, etc. has exceeded Rs.2000 crore-mark. Subsidy reforms are directed towards:

- Reduction of their uses;
- Making them of finite duration;
- Using for meritorious economic activities;
- Making them transparent;
- Better targeting of subsidies for the poor and
- Administering them through final goods with a view to maximizing the reach the access towards the target population at a minimum cost.

### **Forecast of Medium Term Fiscal Plan:**

Gross Fiscal Deposit (GFD), a comprehensive indicator of fiscal health, indicates the total fund requirements of the State to meet the growing expenditure. It remains the soft underbelly of the State's fiscal system. A combination of factors results in heavy Revenue Account deficits. They are rising expenditure on salary, unfunded pension, interest payments, rising subsidy payments (both on merit and non-merit goods and services and direct and indirect) and stagnation in Tax-GSDP ratio. Revenue Account receipts need to be surplus so that we can fall back on it. As this situation is very remote, Government have to borrow money from public through open market loan, Government of India and financial Institutions. This kind of financial operations give rise to mounting interest payments and debt servicing. To get over this hump, the State had taken pro-active reform measures by adopting a holistic approach on fiscal front. All these concerted efforts had yielded desired results in the form of substantial improvement in revenue augmentation. Table below throws light on how the fiscal stress has eased in the State last three years.

**Table - 6: Recent Fiscal Situation**

(Rs. in crores)

Accounting Year	2001-02	2002-03	2003-04	2004-05 Revised
Revenue Deficit	2739*	4851#	1565	1687
Fiscal Deficit	4739	6742	5591@	5452
	(Percentage)			
Revenue Deficit over Total Revenue Receipts	14.56*	23.28#	60.60	6.24
Revenue Deficit over Fiscal Deficit (%)	57.80*	71.95#	27.99@	30.95
Fiscal Deficit over Gross State Domestic Product (%)	3.30	4.36	3.28@	2.90
Interest payments over Total Revenue Receipts (%)	18.67	19.84	19.82	18.43
Capital Expenditure (Rs. in crores)	1777.91	1627.54	3589.90@	3607.62

Source: Finance Accounts by CAG and Annual Financial Statement 2005-06.

(\* - The revenue deficit in 2001-02 was artificially compressed because the State Government was unable to clear all its expenditure commitments before the close of the financial year).

(# The revenue deficit in 2002-03 is high due to the conversion of arrears owed by TNEB to Central utilities amounting to Rs.1962.14 crores as a subsidy to the TNEB. Correspondingly the debt of the Government goes up as the Government has to discharge these liabilities. Excluding this, the revenue deficit over Total Revenue Receipts in 2002-03 is 13.86%).

(@ - The fiscal deficit in 2003-04 includes adjustment of prior period capital expenditure amounting to Rs.1423.38 crores met from bonds raised by TIDCO. Correspondingly the debt of the Government goes up as the Government has to discharge this liability. Excluding this, the fiscal deficit over GSDP in 2003-04 is 2.44% and revenue deficit over fiscal deficit in 2003-04 is 37.56%).

(\$ The fiscal deficit in B.E. 2005-06 includes adjustment of prior period capital expenditure amounting to Rs.232.30 crores met from off budget borrowings. Correspondingly the debt of the Government goes up as the Government has to discharge this liability. Excluding this, the fiscal deficit over GSDP in B.E. 2005-06 is 2.86% and revenue deficit over fiscal deficit is 22.95%).

The above table indicates that more than 50 per cent of the gross fiscal deficit was accounted for by the Revenue deficit in 2001-02. Thus, the quality of expenditure had deteriorated as revealed by the proportion of revenue deficit to fiscal deficit. However, the Revenue Deficit over GFD had come down from all time high 72 per cent in 2002-03 to 30.95 per cent in 2004-05 and the ratio of GFD over SGDP dipped from 4.36 per cent in 2002-03 to 2.90 per cent in 2004-05. The consistent increase in net borrowings had magnified the magnitude of GFD.

The goal of Fiscal Responsibility Act 2003 is to reduce the ratio of Revenue Deficit to total Revenue Receipts to less than five per cent by 31.3.2008. The deficit over GSDP is forecast to be on the decrease, as indicated below:

**Table - 7 : Gross Fiscal Deficit**

(Rs.in Crores)

Year	Size of Gross Fiscal Deficit	Gross Fiscal Deficit as % of GSDP
2003-04 (Projection)	(-) 7397.28	(-) 4.46
2003-04 (Actual)	(-)6441.24	(-)3.78
2004-05 (Projection)	(-)8245.80	(-)4.60
2004-05 (RE)	(-)7478.00	(-)3.97
2005-06 (Projection)	(-)7090.85	(-)3.64
2005-06 (BE)	(-)8944.32	(-) 4.19
2006-07 (Projection)	(-)8202.84	(-)3.52
2007-08 (Projection)	(-) 6801.31	(-)2.67
2008-09 (Projection)	(-)6491.12	(-) 2.33

Source: Budget Speech, 2005-06.

### State-wise Gross Fiscal Deficit:

Tamil Nadu is no exception in having Gross Fiscal Deficits. Table below presents data on share of each State in aggregate GFD of Rs.1409542 crores. The share of Tamil Nadu in total GFD stood at 5.46 per cent in 2003-04.

**Table - 8 : State-wise Analysis of Fiscal Deficit**

(Rs. in crores)

Sl. No.	Name of the State	2001-02 Accounts	2002-03 Accounts	2003-04 Revised Estimate
1.	Andhra Pradesh	6722.0	7625.3	7425.9
2.	Assam	1448.2	927.7	3083.8
3.	Bihar	608.4	2184.7	4107.2
4.	Chhattisgarh	1060.8	972.6	1932.9
5.	Delhi	2826.8	2396.4	3250.1
6.	Goa	446.1	412.0	525.5
7.	Gujarat	6509.8	6080.3	9897.5
8.	Haryana	2739.5	1471.0	1347.9
9.	Jharkhand	1642.7	862.0	1658.1
10.	Karnataka	5869.9	5281.3	5564.1
11.	Kerala	3269.4	4993.6	5653.8
12.	Madhya Pradesh	3649.4	4062.3	8488.7
13.	Maharashtra	10897.8	14289.9	19476.7
14.	Orissa	3964.2	2817.0	5495
15.	Punjab	4959.0	4298.3	5868.6
16.	Rajasthan	5748.4	6114.0	7929.6
17.	<b>Tamil Nadu</b>	<b>4738.8</b>	<b>6742.4</b>	<b>7696.4</b>
18.	Uttar Pradesh	9898.1	9496.9	20413.9
19.	Uttaranchal	424.2	888.8	2501.8
20.	West Bengal	11804.1	10564.7	13318.3
	<b>Total (all States)</b>	<b>95993.6</b>	<b>99525.6</b>	<b>140954.2</b>

Source: Public Finances, CMIE, November 2004.

For overcoming the incidence of GFD of the State Governments, the States are advised to make use of the GOI's Debt Swap Scheme supplemented by the Medium Term Fiscal Reform Programme. This scheme aims at liquidating high cost loans given by the GOI to the States. Those States participating in this scheme can retire high cost GOI loans and advances through allocation of additional market borrowings.

### Measures to Overcome the Financial Crisis:

In order to bring down GFD, the State aims at enhancing revenue buoyancy, containing revenue expenditure and streamlining the functioning of Public Sector Undertakings. Medium-term Fiscal Reforms Programme sets targets for broad fiscal indicators in the medium term covering fiscal consolidation, power sector reforms and budgetary reforms, etc.

### Enactment of Tamil Nadu Fiscal Responsibility Bill:

Salient features of the Bill are:

- A concerted effort is needed in expenditure control, revenue augmentation and debt relief.
- On debt relief, grant component of the Centre could be increased by reducing the loans to the States.
- The distinction between plan and non-plan spending should be abolished.

- A restraint should be put up on hiring and revising pay scales, which would lead to a fall in wage bill by 0.2 per cent of GSDP annually.
- Pension bill as a ratio of GDP should also be kept constant in the next five years.

### **Continuation of Reform Process on Power Sector:**

Electricity is an important infrastructure of the economy. Therefore, apart from the tariff reform, the power sector reforms also focuses on the following areas:

- Elimination of inefficiencies in the system and wastages in the entire value chain.
- Minimum capacity addition to be made every year.
- Providing electricity to unelectrified households.
- Improving quality and reliability of supply.

### **Streamlining Working of State PSUs:**

The government is a major stakeholder in public sector undertakings. In many cases, it has provided large budgetary support to the loss-making enterprises. This budgetary support is slowly draining the resources of the Government. But the bad-performing PSUs especially, the manufacturing sector in the recent past have caused additional burden on State's finances. *Suitable PSU reforms such as disinvestment, winding up and restructuring* are being initiated by the State in order to convert the viable PSUs into efficient and profitable entities.

### **Introduction of VAT<sup>1</sup>:**

The VAT system has gained much currency all over the world. The value added system of taxation integrates the taxation structure of goods (and services) in a manner that mitigates the cascading effects of taxation of commodities on the final product and eventually facilitates the establishment of a national common market for goods and services.

With the implementation of VAT, the rates of sales tax are to be fixed at a single rate, '*revenue neutral rate*'<sup>2</sup> throughout the country. Therefore, for the end consumer, there is a single rate of tax for the final product. There would be broadly 2 tax rates under the system, 4 per cent for industrial inputs and items of daily and common use (250 essential products are covered under this) and 12.5 per cent rate for all other goods (217 items are covered under this). Another 41 items including petrol, diesel, aviation turbine fuel and newspapers would be exempted from VAT while gold and silver would attract only one per cent.

The proposed VAT is a multi-point destination-based system of taxation. Tax will be levied on value addition at each stage of transaction in the production / distribution chain. Some other striking features of VAT are:

- Uniform schedule of rates of VAT for all States. This would make the tax system simple and uniform and prevent unhealthy tax competition among states;
- The provision of input tax credit would help in preventing cascading effect of tax;
- The provision of self-assessment by dealers would reduce harassment. Small traders with turn over up to Rs.5 lakhs would be exempt from the provisions of VAT and
- The zero-rating of exports would increase the competitiveness of Indian exports.

---

<sup>1</sup> Value Added Tax: Tax on account of product's final value added at each stage of production. That is the value added to, or created in a commodity by the manufacturing or marketing process exclusive of the cost of materials, supplying, packaging or overhead.

<sup>2</sup> Revenue neutral rate is the rate at which the State feel comfortable that there would be no loss of revenue.

Sales tax / VAT is basically a State subject. The Central Government will be playing the role of a facilitator for successful implementation of this reform measure. One of the concerns expressed by States in adopting VAT relates to the possible loss of revenue in the initial years. The Central Government agreed to compensate the estimated loss on the basis of an agreed formula, on account of the introduction of VAT. The loss would be minimized to the extent of 100 per cent of the loss in the first year, 75 per cent of the loss in the second year and 50 per cent of the loss in the third year of introduction of VAT on a tapering basis.

An Empowerment Committee (of State Finance Ministers) has been constituted by the Ministry of Finance, Government of India. This has formulated the design and introduction of State-level VAT. The Committee has come up with a White Paper on State-level Value Added Tax on January 17, 2005. The salient features of the White Paper on the issues concerning VAT are presented in Box below:

<b>Box</b> <b>White Paper on State-level VAT</b>
<ul style="list-style-type: none"><li>➤ Introduction of VAT would help to avoid cascading nature of sales tax.</li><li>➤ Present multiple rates and taxes can converge into a few rates and a single VAT.</li><li>➤ Transparency in the system of tax administration through simple self-assessments and departmental audit.</li><li>➤ Rationalisation of taxes to result in lower tax burden and higher tax revenues.</li><li>➤ To avoid tax competition, the design of State VAT needs to be harmonized even as the distinctive needs of individual States are recognised.</li><li>➤ State VAT to have two basic rates of 4 per cent and 12.5 per cent and to cover 550 commodities. About 270 commodities will be under 4 per cent rate.</li><li>➤ 46 items, comprising of natural and unprocessed products in unorganised sector, items legally barren from taxation and items having social implications, are exempt from VAT.</li><li>➤ Gold and silver ornaments subject to a special VAT rate of 1 per cent and other commodities to attract a general VAT rate of 12.5 per cent.</li></ul>

Despite its advantages, difficulties constraining the implementation of the VAT are as follows:

- States would levy a multiplicity of taxes including entry tax, octopi and import duty on goods originating elsewhere.
- Manufacturing States would export taxes across State borders.
- There is likely to be procedural delays and delays in reimbursement, if VAT is handled through paper work and forms.
- There is no clarity as to whether manufacturing and services are to be treated identically and
- Availability of fool-proof data base.

Tamil Nadu has deferred the implementation of VAT considering the likely revenue loss.

### **Introduction of Zero Base Budgeting<sup>3</sup> (ZBB):**

Zero-base budgeting is a technique designed to revitalise budgeting. It is a management tool which provides a systematic method for evaluating all operations and programmes, current or new, allows for budget reductions and expansions in a rational

---

<sup>3</sup> Zero-base Budgeting: A Budgeting technique that requires items to be justified anew "from the ground up" without regard to how much has been spent on them in the past.

manner and allows re-allocation of sources from low to high priority programmes. It is simply an extension of the Cost-Benefit analysis method to the area of the corporate budgeting. Under this system those schemes and programmes which have outlived their utility and less profitable services would be axed.

Introduction of ZBB enables the Government to allocate resources according to priority of the programmes / schemes. It ensures that every scheme undertaken by the Government is essential and is being performed in the best possible way. No arbitrary acts or increase in Budget Estimates are made. It helps in identifying areas of wasteful expenditure and, if desired, it can also be used for suggesting alternative courses of action.

The zero-base budgeting is now being adopted to review all Departments to identify fruitless schemes and surplus staff so that the scarce resources may be used more efficiently. The ZBB involves enormous amount of data, time and cost. It needs properly trained managerial personnel to do the required job.

### **Recovery of User Charges:**

State's own non-tax revenue was at Rs.209643 lakhs in 2004-05 against Rs.209379 lakhs in 2003-04, the increase being meagre at 0.0012 percent. The increase in revenue from economic services and interest receipts and dividends indicates a meagre percentage increase due to reduction in revenue from general services and social services. It had ultimately reduced the resources available for meeting Revenue expenditure. The ratio of pension and miscellaneous general services to revenue expenditure also increased from 13.3 percent in 2003-04 to 14.3 percent in 2004-05. Appropriate recovery of user charges will ease the fiscal strain and stress to a great extent.

### **Annual Plan 2003-04 and 2004-05:**

The Plan expenditure in 2004-05 (RE) was at Rs.8001.00 crores. The expenditure was Rs.723.34 crores (9.04%) for power sector, Rs.1358.08 crores for transport (16.97%), Rs.409.79 crores for agriculture and allied activities (6.25%) out of the total Plan expenditure of Rs.8001 crores in 2004-05 (RE). Thus the focus areas are social sector, road infrastructure and power sector.

**Table -9: Annual Plan 2003-04 and 2004-05**

(Rs. in crores)			
<b>Sl. No.</b>	<b>Sector</b>	<b>2003-04 Accounts</b>	<b>2004-05 Revised</b>
1	Agriculture & Allied Activities	454.02	409.79
2	Rural Development	849.18	903.07
3	Irrigation & Flood Control	346.58	365.69
4	Energy	1261.33	723.34
5	Industry & Minerals	277.85	435.69
6	Transport	641.95	1358.08
7	Science, Technology & Environment	2.95	3.16
8	General Economic Services	34.80	114.83
9	Education	248.17	359.41
10	Health	171.23	221.66
11	Social and community services	2544.57	2862.79
12	Co-operation	157.40	113.64
13	General Services	98.27	129.85
<b>Total</b>		<b>7088.31</b>	<b>8001.00</b>

*Source: Annual Plan 2004-05 - Tamil Nadu - State Planning Commission..*

The multi-pronged development strategy includes diversification of agricultural practices, Slum Development Programme, Development of Western Ghats and Coastal Areas, development of two million hectares of waste land, perspective planning for improvement of urban facilities etc. The State requested full Central assistance for mid-day meal scheme for pre-school and school children, National Slum Development Programme, Special Infrastructure Development Programme for Chennai Metropolitan areas.

### **Economic-cum-Functional Classification of Budgetary Transactions:**

This exercise is intended to see to what extent the Government has contributed towards the gross capital formation, investment, transfer of resources to the rest of the economy. Function-wise expenditure can also be understood. It has an interlocking system of accounting. These measures of economic magnitude are the important pieces of information to chalk out Plan for the future.

A look at the Economic-cum-Functional Classification for 2003-04 reveals that total budgetary resources stood at Rs.30526 crores. Horizontally seen, total current expenditure is at 72.61 per cent and total capital expenditure at 27.39 per cent. Seen vertically, a sum of Rs.30526 crores is split into education (22.12%), general administration (12.11%), economic services (15.38%) and other services (32.16%). It is obviously seen that in what direction the public resources have been prioritised and what is the Government's growth strategy. This pieces of information could not be got from the raw Budgetary Documents and Demands for various Departments.

### **Summing-up:**

For the Government the priority areas which are at the top of the development agenda are: upscaling of technology, agriculture, water, education, health, employment, urban renewal and infrastructure. The State is playing a pivotal role of a facilitator providing an enabling environment instead of a direct provider of services. It also refrains itself from hiking the tax rates for commodities of mass consumption on the premise that the incidence of taxation and marginal sacrifices falls on the poor in larger measure. The State has become a magnet for attracting new Foreign Direct Investment and the Diaspora in areas of building economic infrastructure through provision of a level playing field Public-private partnership is solicited in undertaking crucial activities including Information Technology, Business Process outsourcing and IT-enabled services.

---

4.

Foreign Direct Investment is beneficial to the recipient country in the following ways: It triggers technology spillovers, assist capital formation , contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development. FDI influences a total factor productivity and efficiency of resources in the recipient economy. Technology transfers through FDI generate positive externalities in the host country.

## ANNEXURE

### Recommendations of the Twelfth Finance Commission

#### Restructuring public finances

- Centre and States to improve the combined tax-GDP ratio to 17.6 % by 2009-10.
- Combined debt-GDP ratio, with external debt measured at historical exchange rates, to be brought down to 75 % by 2009-10.
- Fiscal deficit to GDP targets for the Centre and States to be fixed at 3%.
- Revenue deficit of the Centre and States to be brought down to zero by 2008-09.
- Interest payments relative to revenue receipts to be brought down to 28 % and 15 % in the case of the Centre and States, respectively.
- States to follow a recruitment policy in a manner so that the total salary bill, relative to revenue expenditure, net of interest payments, does not exceed 35%.
- Each State to enact a fiscal responsibility legislation providing for elimination of revenue deficit by 2008-09 and reducing fiscal deficit to 3% of State Domestic Product.
- The system of on-lending to be brought to an end over time. The long term goal should be to bring down debt-GDP ratio to 28 % each for the Centre and the States.

#### Sharing of Union Tax Revenues

- The share of States in the net proceeds of shareable Central taxes fixed at 30%, treating additional excise duties in lieu of sales tax as part of the general pool of Central taxes, Share of States to come down to 29.5%, when States are allowed to levy sales tax on sugar, textiles and tobacco.
- In case of any legislation enacted in respect of service tax, after the notification of the eighty eighth amendment to the Constitution, revenue accruing to a State should not be less than the share that would accrue to it, had the entire service tax proceeds been part of the shareable pool.
- The indicative amount of overall transfers to States to be fixed at 38% of the Centre's gross revenue receipts.

#### Local bodies

- A grant of Rs.20,000 crore for the Panchayati Raj institutions and Rs.5,000 crore for urban local bodies to be given to States for the period 2005-10.
- Priority to be given to expenditure on operation and maintenance (O&M) costs of water supply and sanitation, while utilising the grants for the Panchayats. At least 50 percent of the grants recommended for urban local bodies to be earmarked for the scheme of solid waste management through public-private partnership.

#### Calamity relief

- The scheme of Calamity Relief Fund (CRF) to continue in its present form with contributions from the Centre and States in the ratio of 75:25. The size of the Fund worked out at Rs.21,333 crores for the period 2005-10.
- The outgo from the Fund to be replenished by way of collection of National Calamity Contingent Duty and levy of special surcharges.
- The definition of natural calamity to include landslides, avalanches, could burst and pest attacks.

- Provision for disaster preparedness and mitigation to be part of State Plans and not calamity relief.

### **Grants-in-aid to States**

- The present system of Central assistance for State Plans, comprising grant and loan components, to be done away with, and the Centre should confine itself to extending plan grants and leaving it to States to decide their borrowings.
- Non-plan revenue deficit grants of Rs.56,856 crore recommended to 15 States for the period 2005-10. Grants amounting to Rs.10172 crore recommended for the education sector to eight States. Grants amounting to Rs.5887 crore recommended for the health sector for seven States. Grants to education and health sectors are additionalities over and the above the normal expenditure to be incurred by States.
- A grant of Rs.15,000 crore recommended for roads and bridges, which is in addition to the normal expenditure of States.
- Grants recommended for maintenance of public buildings, forests, heritage conservation and specific needs of States are Rs.500 crores, Rs.1000 crores, Rs.625 crores and Rs.7100 crores, respectively.

### **Fiscal Reform Facility**

- With the recommended scheme of debt relief in place, fiscal reform facility not to continue over the period 2005-10.

### **Debt relief and Corrective Measures**

- Central loans to States contracted till March, 2004 and outstanding on March 31, 2005 amounting to Rs.1,28,795 crores to be consolidated and rescheduled for a fresh term of 20 years, and an interest rate of 7.5 per cent to be charged on them. This is subject to enactment of fiscal responsibility legislation by a State.
- A debt write-off scheme linked to reduction of revenue deficit to States to be introduced. Under this scheme repayments due from 2005-06 to 2009-10 on Central loans contracted upto March 31, 2004 will be eligible for write-off.
- Central Government not to act as an intermediary for future lending to States, except in the case of weak States which are unable to raise funds from the market.
- External assistance to be transferred to States on the same terms and conditions as attached to such assistance by external funding agencies.
- All the States to set up sinking funds for amortization of all loans.
- States to set up guarantee redemption funds through earmarked guarantee fees.

### **Others**

- The Centre should share 'profit petroleum' from New Exploration and Licensing Policy (NELP) areas in the ratio of 50:50 with States where mineral oil and natural gas are produced. No sharing of profits in respect of nomination fields and non-NELP blocks.
- Every State to set up a high level committee to monitor the utilisation of grants recommended by the TFC.
- Centre to gradually move towards accrual basis of accounting.