Fiscal Reforms and Finances of Government of Andhra Pradesh

R. Sudarsana Rao

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Introduction

The Indian constitution entrusted the states with functions both expensive and expansive such as agriculture, irrigation, roads and buildings, rural development, education, medical and public health, and law and order, along with some revenue powers, mostly inelastic in nature. Since the advent of Five Year Plans, these expenditure commitments have been increasing phenomenally. For instance, the states' share of current expenditure in the combined current expenditure of the centre and states was about 58 percent in 1999-2000. The share of the states in the combined non-developmental expenditure was about 35 percent in 1990-91, which rose to 43 percent in 1999-2000. It is quite interesting to observe that the rise in the states' share was even more pronounced in the case of developmental expenditure – from 59 percent to 72 percent during the same period. It is to be noted that while the centre's total expenditure in the combined total expenditure has declined from 57 percent in 1990-91 to 46.5 percent in 1999-2000, the decline implied a corresponding increase in the states' share from 43 percent to 53.5 percent. This amply demonstrates the crucial role played by the states' expenditure in the Indian union. This growth of expenditure needed to be accompanied by commensurate revenue efforts, but has been lacking for a long time in most of the states. Moreover, the expenditures need to be targeted at the twin objectives of economic growth and welfare of the people. In order to achieve higher levels of economic growth, larger investments have to be made for the development of both physical and social infrastructure. Public investments are not only required for their direct impact on growth, but also to attract private investments that contribute to economic

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growth of the state. Further, the benefits of accelerated growth need to be percolated to the larger sections of people, so that the welfare objective is achieved in terms of reduction in both income poverty and human poverty. However, the development of infrastructure depends not only upon the availability of adequate fiscal resources in the state concerned but also development-oriented expenditure policies of the Government. But almost all the states now face acute fiscal crisis owing to their economic policies, especially on account of their competitive populism coupled with laxity in taxation. The fiscal situation has further deteriorated with poor cost-recovery measures. The ever-increasing commitment of states' expenditure on interest payments, which have resulted from rising interest rates as well as increasing indebtedness caused by accumulated losses and consequent budgetary support to public enterprises, particularly in the power sector, and the spurt in pension expenditure have also contributed to fiscal problems. This turn of events is reflected in the appearance of large fiscal and revenue deficits in most states during mid-nineties. Moreover, the number of fiscal transfers, especially shared tax revenue has declined considerably in several states consequent upon the economic reforms initiated by the union government, since 1991. All these factors have led to substantial decline in public investment in infrastructure, the worst hit being the social sector, in several states. In order to remedy the situation, several major states which were hesitant and lagging behind the central government in adopting the fiscal reforms have now come forward to initiate economic reforms with multiple goals to achieve. In fact, it has been felt that "reform at the state level is critical for stabilising the fiscal economy, accelerating (economic) growth and improving access to and the quality of social services"(Fardoust and Lahiri, 2003). Moreover, it has been well recognised that reforms at the central government level cannot be successful and will not yield the desired results without complementary reforms at the states' level. Hence, the much needed encouragement from the union government with financial incentives to states to initiate reforms without further delays. In these circumstances, several states felt that the implementation of economic reforms, especially fiscal reforms is almost inevitable rather than a matter of choice. Consequently, most of the major states have adopted some fiscal reform measures during the nineties. Andhra Pradesh has been one of the front-runners in implementing reforms since 1995-96, at a time when several major states were still skeptical about initiating reforms.

The Case of Andhra Pradesh

Andhra Pradesh is one of the major states in India endowed with rich natural resources having large potential for economic growth and development. It is the fifth largest state in the country covering a geographical area of 274.40 lakh hectares with a population of about 7.56 crore, being the fifth populous state in the country. It has often been asserted that its development is still below its potential in spite of its endowment of natural resources (Sarma, 2002). While the growth of GSDP in Andhra Pradesh in 1980s was marginally higher or nearly the same compared with the GDP of the nation, there has been no improvement in the growth rate of GSDP during the 1990s while the GDP of the nation did record an improvement. However, there is an improvement in the per capita SDP during the 90s compared to 80s, though it has always been lower than the all-India level of per capita income (Hanumantha Rao, 2003). These facts underline the importance of further developments in infrastructure services in order to accelerate the economic growth and per capita income.

The revenue and expenditure policies of successive governments in the state were such that there was surplus on its revenue account in 1980-81, 1981-82, and 1982-83 but subsequently it experienced fiscal and revenue deficits, affecting capital expenditures and the development of infrastructure, resulting in stifling of economic growth. During the late 1980s and mid-90s the non-plan, non-developmental expenditure has increased phenomenally, which led to huge fiscal and revenue deficits. The frequent changes in the political parties in power since 1983-84 have influenced the revenue mobilisation and expenditure policies of the state, resulting in changes in the composition, pattern, direction, and growth of both revenue and expenditure. In other words, both economic and political factors over a period of time are responsible for leading the state government to a fiscal crisis. As a response to this situation, the government initiated several fiscal reforms in the state since 1995-96. In continuation of the fiscal reforms initiated especially since July-August 1996 and in the light of the feedback on the draft *Fiscal Reforms Strategy Paper* released in February 2001, the government prepared a Medium Term Fiscal Framework (MTFF) covering the period 2001-02 to 2005-06. The state is also covered by the *Fiscal Reforms Facility* of the Government of India as recommended by the Eleventh Finance Commission. The Government of Andhra Pradesh also has undertaken a *Medium Term Fiscal Reforms Programme* by revising the targets already set for the MTFF. The state has undertaken a number of measures relating to revenue mobilisation, expenditure restructuring, debt and deficits and several sectoral reforms with a view to achieve the set goals. Though it takes some time to reap the full benefits of the reform process, still it is pertinent to analyse and assess the usefulness or otherwise of the reforms already initiated. Such an analysis will provide insights either to deepen, revise or redesign the reform process in future. Therefore, a modest attempt is made in this paper to address the following:

- analyse the important reasons for the fiscal crisis that necessitated the introduction of reforms in the state;
- discuss the fiscal reforms initiated in the state including reforms in the power sector and public enterprises;
- briefly discuss the implementation of the *Medium Term Fiscal Reform Programme;* and
- make suggestions useful for future reform policy.

Data Sources and Methodology

This paper covers the period 1980-81 to 2003-04. The fiscal situation that prevailed during 1980-81 to 1995-96 has been presented to explain the resource crunch experienced by the state in 1995-96 that necessitated urgent fiscal reforms. The analysis is largely based on information and findings of earlier studies on the subject pertaining to the state. The year 1995-96 has been chosen as the beginning of fiscal reforms while 2003-04 is the last year for which least revised estimates are available. The data are obtained from the Reserve Bank of India Bulletins, Budget Documents, Economic Surveys, Annual Fiscal Framework 1996, 2001-02, 2002-03, 2003-04, Strategy Paper (January 2001), budget speeches, Government of Andhra Pradesh, Reports of the CMIE besides other documents of the Government of India and World Bank. Simple analytical tools have been used to analyse the information obtained from these sources. The paper is presented in four sections. The first section deals with an analysis of the important reasons for introducing fiscal reforms. Section II presents an analysis of the details of the reforms undertaken and their progress. Section III attempts a broad evaluation of the implementation of the *Medium Term Programme* under *Fiscal Reform Facility*. Some suggestions and future fiscal initiatives are outlined in the fourth section.

Section - I

Important Reasons to Undertake Fiscal Reforms

Revenue Performance

The revenue receipts of the state witnessed considerable expansion during the period 1980-81 to 1984-85. The total revenue receipts of the state as a proportion of GSDP increased from 15.44 percent in 1980-81 to 16.90 percent in 1984-85. But this proportion subsequently declined from 16.04 percent in 1990-91 to 12.75 percent in 1994-95 and further to 12.37 percent in 1995-96 (Chart-1). Similarly, own tax revenues showed an expansionary trend during the period 1980-81 to 1984-85. The ratio of own tax revenue in GSDP increased from 7.11 percent in 1980-81 to 8.64 percent in 1984-85 which then declined to 7.94 percent and 5.16 percent in 1990-91 and 1995-96 respectively, as the proportion of almost all the state taxes, including sales tax revenue declined substantially mainly because of too many concessions, exemptions, and administrative bottlenecks that cropped up in the tax structure since the latter half of 1980s. Moreover, the revenue from share in central taxes declined from 3.44 percent in 1990-91 to 2.73 percent in 1994-95 due to a significant decrease in the revenues from union excise duties consequent upon economic reforms, and then recovered a little to 3.21 percent in 1995-96.

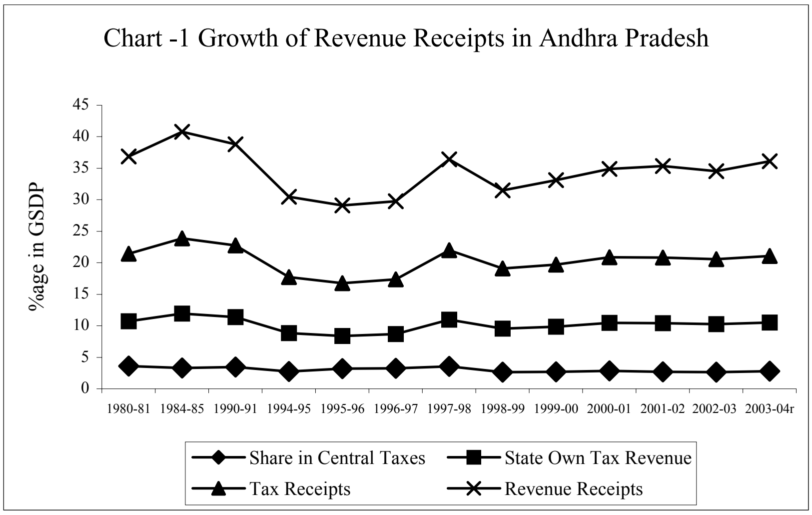
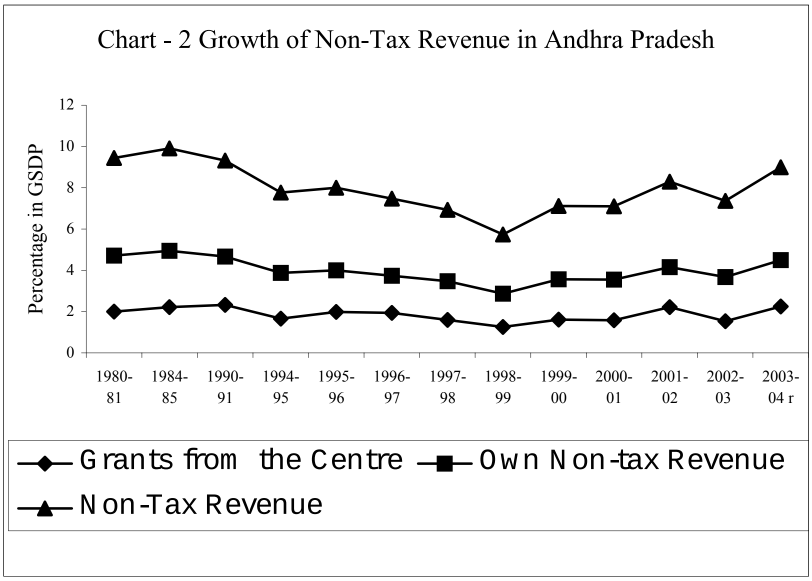


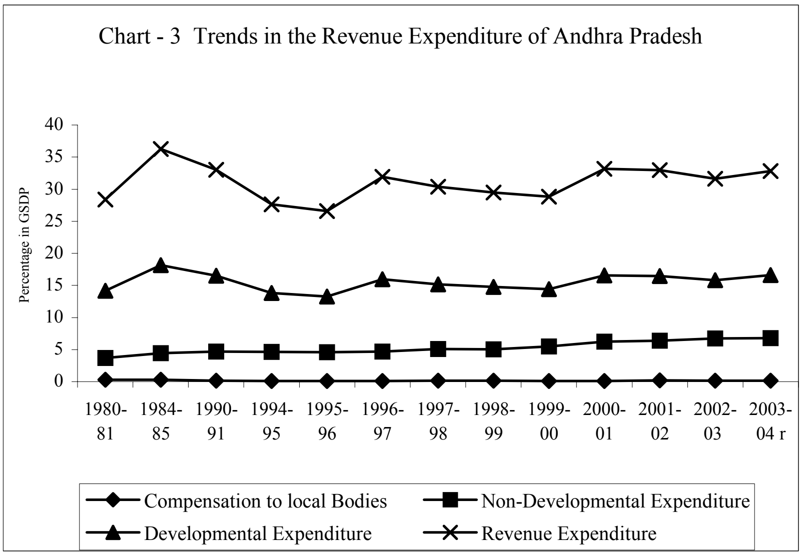
Chart -1 Growth of Revenue Receipts in Andhra Pradesh
%age in GSDP
45
40
35
30
25
20
15
10
5
0
1980-81
1984-85
1990-91
1994-95
1995-96
1996-97
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04r
Share in Central Taxes
State Own Tax Revenue
Tax Receipts
Revenue Receipts

Similarly, revenue from non-tax sources as a proportion of GSDP also declined during the same period. For instance, it increased from 4.72 percent in 1980-81 to 4.95 percent in 1984-85 and declined during the latter years to reach 4.0 percent in 1995-96. The decline may be attributed to the decline in both own non-tax revenue as well as in grants from the centre. It may be observed from chart–2 that between the period 1990-91 and 1995-96 the percentage decline is more in the central grants compared to own non-tax revenues. The decline in the revenue from interest receipts and social services is the main reason for the decline in own non-tax revenues during the period.



Increasing Revenue Expenditure

Public expenditure needs to grow as the economy grows in order to provide the required public services at adequate levels. In other words, growth in expenditure needs to follow the growth in the GSDP. Moreover, the composition of expenditure – the relative proportion of revenue and capital expenditure – is also important as the growth of an economy very much depends upon the size and growth of capital expenditure. The pattern and composition of expenditure underwent a substantial change between 1980-81 and 1995-96 during which the proportion of revenue expenditure was not only very high but also increased substantially, minimising the role of capital expenditure. For instance, the revenue expenditure as a proportion of total expenditure increased from 78 percent in 1980-81 to 86 percent in 1995-96. Similarly, the revenue expenditure as a proportion of GSDP shows an increasing trend until 1990-91 but has then declined to 13.29 percent in 1995-96 from 14.18 percent in 1980-81 (Chart-3). It is a matter of concern that the capital expenditure as a proportion of GSDP has declined from 3.98 percent in 1980-81 to just 2.10 percent in 1995-96 (Chart-4). The growth of revenue expenditure in the total expenditure has been mainly due to the introduction of new welfare schemes and expansion of the already existing schemes, increased salary bill and pension commitment, increasing number of loss making public sector enterprises and the resultant budgetary support. The changes in the political parties in power in the state during this period brought a sea-change in the public policies wherein the composition and direction of the public expenditure was changed for the worse, although the need was for restructuring and reorientation in order to have a developmental impact that would lead to accelerated economic growth of the state.



Growth of Establishment Costs

The state government incurs expenditure on salaries, wages, and pensions of its employees, judiciary, aided educational institutions and local bodies besides the state public sector undertakings (PSUs), universities and cooperatives. The expenditure on salaries of employees of municipalities, universities and PSUs etc. are paid out of the budget support from the government and from their own resources. But the burden of the state government has been increasing over the years, as most of these institutions have not been generating enough own resources to meet their establishment costs. The increase in the establishment costs is mostly on account of an increase in the number of employees, pay revisions in every five/ten years as the case may be and the hike in dearness allowance which is indexed to inflation. While the employees of the state government and local bodies constituted about 69 percent of total public sector employment, the rest of the employees in the PSU, universities and cooperatives constituted about 31 percent in 1993. The number of employees grew by about 19 percent between 1988 and 1993. In fact there was a notable increase of 4 lakh employees between 1981 and 1993 in the state. Consequently, the establishment expenditure in terms of pay and allowances, wages, salary grants, pensions etc., have increased remarkably. It may be seen from table-1 that the establishment costs as a percentage of state's own revenue have increased from 77 percent in 1984-85 to 96 percent in 1995-96. It is observed that there is considerable redundancy and surplus staff in practically all the departments and institutions, which called for reform to reduce establishment costs. The observation of the *Staff Review Committee* appointed by the state government that there is 40 percent surplus staff in the irrigation department reflects the intensity of the problem and suggests need for reform.

Table 1: Establishment Expenditure of the Government of Andhra Pradesh

(Rs. crore)

	Pay and allowances (including traveling allowances)	Wages	Grants-in-aid for salaries	Pen-sions	Total expen diture	Establi-shment costs as % of states own revenue
1984-85	574	14	375	117	1080	76.9
1989-90	1152	9	96	269	1525	86.5
1994-95	2197	14	1588	780	4580	88.5
1995-96	2351	14	1553	928	4845	95.6

Source: Compiled from Strategy Paper on Fiscal Reforms, GoAP, February 2001.

Bulging Expenditure on Subsidies

The government has been providing a numerous of subsidies through its various budgets. The subsidies may be explicit or implicit. While the subsidies given for food (rice), power, housing, and other public enterprises are explicit subsidies, subsidies given to wards irrigation, education, health etc., are implicit subsidies. Of all the explicit subsidies, subsidy for rice is the most popular and sought after in the state.

The subsidised rice programme was started in 1983 as one of the electoral promises of the then ruling party and has since undergone several changes. Initially rice was given at Rs. 2 a Kg, and 5 kg per person and a maximum of 20 kg per family through fair price shops. Though the issue price was raised subsequently to Rs.3.50, it was again revised downwards to Rs. 2 in December 1994, increasing the maximum quota given to a household. The total subsidy on rice was Rs.137 crore in 1984-85 constituting 7 percent of total revenue receipts. This has since increased to Rs.1,143 crore constituting 12 percent of the total revenue receipts. The rice subsidy in 1995-96 was so huge that it was about half of the total budgetary allocations to education and health put together. With such a huge amount of subsidy, the Rs.2 per kilo rice scheme was the largest subsidised programme among the states in India (Government of Andhra Pradesh, 1996).

Another important explicit subsidy in the state has been the power subsidy. This subsidy was given to the erstwhile AP State Electricity Board (APSEB) to compensate for its losses and also to enable the board to ensure a 3 percent return on net capital invested in the power sector. The government gave a subsidy of about Rs. 944 crore and Rs 1,259 crore in 1994-95 and 1995-96 indicating the need for applying corrective measures not only to reduce the fiscal impact on government but also to provide uninterrupted power of adequate quality in the state.

Besides power subsidy, the government provides implicit subsidies to irrigation, housing, education, health, and public enterprises in various forms. Almost all these subsidies are not well targeted and the cost recovery has been very poor impacting adversely on the state budget. For instance, the cost recovery varies from 20-25 percent with regard to irrigation, about 1 to 10 percent in housing, 6 to 8 percent in health and only below 1 percent in higher and technical education (World Bank, 1997). The poor cost-recovery measures coupled with the subsidy given to power sector has led to draining of fiscal resources of the state government causing fiscal distress which ought to be reformed and remedied.

Loss Making Public Enterprises

The state government has established different forms of public enterprises not only to provide public services to its citizens but also to produce goods on commercial and profitable lines. The activities of these enterprises encompass promotional, developmental, trading, marketing, manufacturing and service sectors. The number of State Level Public Enterprises (SLPEs) have increased over the plan period. There were about 39 SLPEs by 1995-96. Government participates by providing equity investment, loans and also by giving guarantees to the loans undertaken by the SLPEs. But most of the SLPEs have been incurring losses and have been running on budgetary support. Their performance was pathetic in that the return on investments was meagre. For instance, the return in terms of dividend on its investments was only 0.3 percent in 1993-94 and the accumulated losses of SLPEs were as high as Rs. 913 crore, which constituted almost 12 percent of the revenue receipts of the state. These accumulated losses have further increased by 1995-96 thus aggravating the fiscal stress of the state government. Clearly, the situation was ripe for reforms in public enterprises in the state.

Declining Investments

The rising costs of establishment, increased commitments of subsidies and of other welfare programmes have crowded out the resources for physical and social infrastructure and for non-wage operation and maintenance (O &M). The capital expenditure (total of capital outlay and net lending) as a proportion of total expenditure declined sharply from 21.92 percent in 1980-81 to 13.65 percent in 1995-96. As a proportion of GSDP, it declined from 3.98 percent in 1980-81 to 2.10 percent in 1995-96. Though the state government subsequently made efforts to push up investment in infrastructure areas mainly through externally aided projects, the after effects of the resource crunch in 1994-95 and 1995-96 severely limited the rise in investments. The resource crunch also led to smaller resource allocation in the social service sectors as well as the expenditure on non-wage O & M, the least protected item in the expenditure budget. For instance, the expenditure on education and health as a proportion to GSDP fell from 3.18 percent and 1.84 percent respectively in 1980-81 to 0.71 percent and 0.34 percent in 1995-96. This indicates the need – despite increased private participation in these sectors – to reorient and restructure the public expenditure in order to have a long-term growth inducing expenditure pattern.

Low Standard of Human Development

Human development is critical for long term and sustainable economic growth. Andhra Pradesh is one of the states lagging behind several others in the country as far as education and health standards are concerned. The literacy levels are far less than the national average; one of the lowest among the major states in the country. For instance, male and female literacy in Andhra Pradesh was 55 and 33 percent in 1991 while the national average was 64 and 39 percent respectively. The gross enrolment ratio for primary schooling is also lower and the dropout ratio higher than several other comparable states including the southern states. About 30 lakh children of school-going age are out of school. Government expenditure on education was not only low but also declining. For instance, education expenditure as a proportion of total expenditure declined from 16.41 percent in 1984-85 to 15.26 in 1994-95, and to14.02 percent in 1995-96; as a proportion of GSDP it declined from 3.5 percent in 1984-85 to 2.46 percent in 1994-95 and to 2.16 percent in 1995-96. Moreover, the relative importance of primary education has been declining which needs to be remedied.

Though the usual health indicators such as crude birth rate, crude death rate and infant mortality rate are either similar or close to the national average, Andhra Pradesh lags behind several major states including the southern states in certain other aspects. Incidence of communicable diseases has been rising in the rural areas and non-communicable diseases were also assuming prominence, which need policy interventions. Of course, private health sector in the state compared to the government sector is large and fast growing, however, concentrating on diagnostic and curative services. In contrast, the health care provided by the government is more of preventive nature, but obviously inadequate. Budgetary allocations for health sector are far less than needed by any standard. Health care was allocated 7.81 percent of the total expenditure in 1984-85 which declined to about 5.05 percent in 1994-95 while the same as a proportion of GSDP declined from 1.67 percent in 1984-85 to about 0.82 percent in 1994-95. It is pertinent to note that almost 70 percent of the expenditure on health at the secondary hospital level has been spent for salary and wages leaving only a small part for non-wage recurring expenditure. While salaries and wages are expected to account for a large part of revenue expenditures on social services, there is a minimum level of other expenditures that need to be made, keeping in view the complementarities between wage and non-wage expenditures. It is to be noted that the non-wage recurring expenditure at the secondary level declined by 10 percent during 1991-92 to 1994-95, which needs correction.

The Resource Crunch

The Government of Andhra Pradesh, like several other state governments, experienced severe fiscal stress in 1994-95 and 1995-96. The state, which enjoyed revenue surpluses in 1980-81, 1981-82 and 1982-83, was reeling under revenue deficits in all the subsequent years until 1995-96. As a result of unabated growth of expenditure with revenue receipts falling short, budgetary deficits emerged. Fiscal and revenue deficits as a proportion of GSDP were at 3 percent and 0.93 percent respectively in 1995-96. These were not large by themselves, but indicated the emergence of the vicious cycle of deficits—greater borrowing—rising interest burden—higher deficits. The borrowings increased from Rs.266 crore in 1980-81 to Rs.2,563 crore in 1995-96. The outstanding debt also increased from Rs. 1,781 crore in 1980-81 to Rs.15,164 crore in 1995-96. Besides, almost 31 percent of the borrowed funds were utilised for current expenditures crowding out capital outlays to that extent. The growing debt burden was evident from the increase in per capita outstanding debt, average effective interest rate and per capita interest payments which increased from Rs.336, Rs.4.58 and Rs.15 respectively in 1980-81 to 2115, 11.8 and 213 respectively in 1995-96. Between 1984-85 and 1996-97, interest payments have increased by 12 times reflecting the increased recourse of the government to debt financing and the increasing cost of debt. Plan outlays came down in 1995-96 mainly due to the non-release of the promised level of central assistance, smaller market borrowings allocated by the Planning Commission and a sharp decline in the resources of the State Electricity Board. Moreover, revenues from taxes like sales tax, and stamp duty and registration fees were well below the budgetary projections. Consequently the government experienced severe resource crunch even in 1994-95, so that it had to rely on overdrafts on a number of days to maintain the cash balance, as may be seen in table-2. The government which did not utilise overdrafts in 1992-93 and 1993-94 at all had to rely on overdrafts for 16 days in 1994-95 and 30 days in 1995-96. In the context of its faltering finances, the state decided to initiate reforms at its level without further delay.

Table 2: Overdrafts by the Government of Andhra Pradesh

	Item	1992-93	1993-94	1994-95	1995-96
1)	Number of Days on which Minimum cash Balance was Maintaining				
A	Without obtaining any advances	365	36	308	245
B	By obtaining Ways and Means Advances	-	-	41	91
2)	Number of Days on which overdraft was taken	-	-	16	30
		365	365	365	366*

Source: CAG Report, various issues, Andhra Pradesh

- 1996 was a leap year and hence had 366 days.

Section - II

Fiscal Reforms in Andhra Pradesh 1995-96 – 2003-04

In view of the persistent and growing budgetary deficits leading to fiscal crisis and growing levels of public debt, the state government initiated several reforms after 1995-96, more specifically since July-August 1996, the important ones being:

- augmentation of own revenues;
- reprioritisation and restructuring of expenditure;
- better management of expenditure and budgetary practices;
- development of infrastructure;

- reforming the power sector and other state level public enterprises (SLPEs); and
- improving governance and transparency in the fiscal mechanism.

An attempt is made below to analyse important aspects of fiscal reforms implemented by the government with the specific objectives listed above, expected to have direct impact on state finances in most cases. The others, like reform in public enterprises, particularly power sector reforms, were expected to have an indirect impact on state finances.

The government embarked upon the reforms process on the basis of recommendations made in the reports of the Chelliah Committee (1994), the World Bank (1995), Sarma (1995) and the Hiten Bhaya Committee (1995). The vision 2020 document also envisaged the development of plans with short term, medium term, and long term goals. Furthermore, the government released several strategy papers, and Annual Fiscal Framework (MTFF) in Feb. 2001 while implementing the fiscal reforms. These fiscal reforms can be assessed under the broad heads of: i) augmentation of own revenues; ii) expenditure reforms; iii) power sector reforms; iv) reforms in public enterprises; and v) others. Under the last head 'Others', issues such as governance, decentralisation having indirect bearing on state finances are discussed.

Augmentation of Own Revenues

Augmentation of own revenues can be through augmenting own tax revenues and own non-tax revenues. Own taxes consisted of 53 percent of total tax revenue in 2001-02. The own tax revenue predominantly consists of revenue from indirect taxes in combination with negligible amount of revenue from direct taxes. For instance, as much as 92 percent of own tax revenue comes from indirect taxes. The important individual indirect taxes that contribute to own tax revenue are sales tax (67 percent), state excises (14 percent), stamp duties and registration fees (7 percent), and motor vehicles tax (8 percent). Entertainment tax is also an important indirect tax in the state but the net proceeds are given to local bodies. The proportion of revenue from other indirect taxes is negligible. The individual indirect taxes comprising sales tax, stamps and registration tax, motor vehicle tax and state excises put together contributed 96 percent of total indirect tax revenues in 2001-02. Direct taxes, such as land revenue and agricultural income tax, contributed only around 8 percent of the total own tax revenue. In view of their importance in state finances, the analysis is confined to individual indirect taxes such as sales tax, state excises, stamps and registration and motor vehicle tax followed by an analysis of non-tax revenues.

Sales Tax

As stated above, sales tax is the most important tax for the state government but has been riddled with the problem of multiplicity of rates, too many slabs and commodity groups besides a plethora of exemptions and concessions, and requires a thorough reform. The state government has already implemented almost all the recommendations made by the Chelliah Committee (1994). It has abolished the turnover tax, additional tax, surcharge and introduced the trade margin VAT for dealers trading at the second and subsequent points of sale of 19 groups of the commodities. Andhra Pradesh is one of the major states that has introduced the agreed floor rates of sales tax, since January 2000. It has also withdrawn the tax incentives hitherto provided to industries in order to discourage the rate war among the states to attract the industrial investments. Moreover, the tax slab rates and the commodity grouping have been thoroughly rationalised. The Department of Commercial Taxes all over the state has been computerised to improve the administration and efficiency of the tax system. As far as the implementation of VAT at the state level is concerned, Andhra Pradesh has been one of the best prepared states to launch the same and prepared a draft VAT law and also completed preparation for establishment of large VAT taxpayers units (LTUs). Out of the forty four check posts in operation earlier, twelve were inter-state check posts and thirty-two were internal check posts. While the government abolished all the check posts initially, the internal check posts had to be restored later. Also, the turnover tax abolished earlier was restored. The reforms initiated with regard to sales tax yielded good results as the revenue from this tax as a proportion of GSDP increased from 3.70 percent in 1995-96 to 5.21 percent in 2003-04. As there has been some rollback of reform measures, it remains to be seen whether the improvement in revenue performance can be sustained.

State Excise Duty

Prohibition was in force in 1995-96 when the need for reforms was felt. In view of the fiscal pressure and government's realisation of the difficulties in implementing total prohibition, it was partially withdrawn since August 1996. More reforms are necessary in this second most important own tax revenue with regard to systematic changes and further simplification of the administrative procedures including broadening of the base. The government has now fully withdrawn prohibition and has also liberalised the policy of licensing for sales outlets and bars, which further increased the buoyancy of revenue in the subsequent years. As a result, the excise revenue has increased from 0.10 percent in GSDP in 1995-96 to 1.05 percent in 2003-04.

Stamp Duties and Registration Fees

The objective of stamp duties and registration fees are totally different. The aim of stamp duty is to collect revenue. Registration fees controls and regulates the transaction of property rights. Both *ad valorem* and specific methods of taxation are in vogue. The differential rates prescribed for property valuation and utilised to determine the value of the tax base used to be revised at irregular intervals till 1995. This system was revised in 1997. Accordingly, the annual revision of market value for urban areas is scheduled from first August every year and for rural areas the same is fixed with effect from first April of every alternative year. The government's revision of market value guidelines for sale registrations and for the General Power of Attorney (GPAs) has become indeed effective for augmenting revenue. The registration fees have been cut down by half in order to lessen the burden on the registering public which may also enhance the tax compliance. In order to reduce the high level of evasion, the Committee of State Finance Ministers on Stamp Duty Reform recommended that the duties of states should be brought in the range of 5 to 10 percent in the short run, and 6 to 8 percent over the medium range. The government made a policy that the photographs of both the parties should be affixed on the sale deeds with effect from May, 2002 by which the bogus transactions could be controlled. The introduction of Computer-aided Administration of Registration Department (CARD), office computerisation and rationalisation of procedures and concessions yielded good results and improved the tax yields. Revenue from this source as a proportion of GSDP increased from 0.41 percent in 1995-96 to 0.57 percent in 2003-04.

Motor Vehicles Tax

Motor vehicles tax (MVT) is more important than stamp duty and registration from the point of view of revenue right from the beginning since the revenue of MVT as a proportion of GSDP has been higher than that of stamp duty and registration. The proportion of revenue from motor vehicles tax in GSDP was as high as 0.69 percent in 1984-85 which declined during the latter period. This is mainly because of large scale exemptions and concessions provided by the government to different types of private operators. The revenue loss may be partly attributed to the differential tax rates of motor vehicles tax and illegal operations of the private vehicle owners in the state. The government's efforts to increase revenue realisation by better administration and enforcement yielded good results though a lot more can be done with regard to this revenue.

Taxes on Professions, Trades and Callings

The state is empowered to levy a tax on professions, trades, callings and employments as per the state list of the seventh schedule of the Indian constitution. The maximum amount of tax, fixed at Rs. 250 per annum originally, has been revised in 1988 to Rs. 2,500 per annum through an amendment of the constitution. There are about 20 categories of professions with certain sub-categories within them, which are subject to profession tax. However, the revenue from this tax has been less than its potential as several potential taxpayers especially the self-employed are not brought into the tax net. Moreover, the state government does not have the benefit of the revenue from this tax as 95 percent of net revenue is assigned to the local bodies on the basis of origin principle. An increase in revenue from this will improve the financial position of the local bodies reducing their fiscal dependence on the state government for financial resources.

Table 3: Buoyancy Coefficients of Revenue

Item	Buoyancy coefficients with respect to GSDP 1993-94 to 2002-03	
	With state excise revenue	Without state excise revenue
Total revenue	1.09	1.07
Tax revenue	1.15	1.13
Own tax revenue	1.27	1.25
Own revenue	1.20	1.17

Source: Budget Documents of GoAP, and Economic Survey 2002-03, GoAP.

As a whole, tax revenues have recorded buoyancies above unity during the reform period. Buoyancy coefficients of important aggregate revenue variables for the period 1993-94 to 2002-03 have been estimated with state excise revenue and without it. In both the cases, own tax revenues obtained the highest coefficient indicating the good effort of the state on the tax front. Also an attempt is made to compare, in a broad way, the tax effort of the state in relation to per capita GSDP for the year 2001-02. Own tax revenue, own non-tax revenue, own revenue and per capita GSDP of the major fifteen states and their respective ranks are presented in table 4. It may be observed from the table that Andhra Pradesh revenue ratios in GSDP are higher than the all-states ratios even though its per capita GSDP is less than the all-states average. The state obtained rank 6 with regard to own revenue and own tax revenue and rank 5 with regard to own non-tax revenue while having rank 8 in per capita GSDP. It may also be inferred from the table that the state's tax performance is better than states like Maharashtra, Gujarat, Punjab, and West Bengal. The government needs to gear up its administration to collect the huge amount of Rs. 2,231 crore of the tax arrears in 2001-02 of which Rs. 1,981 crore are in sales tax (Report of the CAG, GoAP 2001-02).

Table 4: States' Own Revenues as a Ratio of GSDP – 2001-02

S.N.	State	Own tax revenue	Own non-tax revenue	Own revenue	Per capita GSDP (Rupees) At current prices
1	Andhra Pradesh	7.71 (6)	1.94 (5)	9.66 (6)	19528 (8)
2	Assam	4.84 (13)	1.64 (8)	6.48 (13)	12163 (12)
3	Bihar	4.63 (14)	0.92 (13)	5.55 (14)	6052 (15)
4	Gujarat	7.40 (7)	3.01 (2)	10.41 (3)	25303 (4)
5	Haryana	8.32 (3)	2.79 (3)	11.11 (1)	27925 (2)
6	Karnataka	9.02 (1)	1.00 (11)	10.02 (5)	20624 (7)
7	Kerala	7.79 (5)	0.71 (14)	8.50 (8)	23324 (6)
8	Madhya Pradesh	5.78 (10)	1.97 (4)	7.76 (10)	13305 (11)
9	Maharastra	7.85 (4)	1.72 (6)	9.56 (7)	27755 (3)
10	Orissa	5.71 (11)	1.60 (9)	7.31 (11)	11710 (13)
11	Punjab	6.82 (8)	4.18 (1)	11.00 (2)	28877 (1)
12	Rajasthan	6.34 (9)	1.68 (7)	8.02 (9)	15650 (10)
13	Tamil Nadu	8.77 (2)	1.05 (10)	9.82 (4)	23806 (5)
14	Uttar Pradesh	5.55 (12)	0.95 (12)	6.50 (!2)	11125 (14)
15	West Bengal	4.19 (15)	0.50 (15)	4.69 (15)	19314 (9)
16	All States	6.07	1.51	7.58	20193

Source: CMIE, Public Finance, November 2003.
Note: Figures in brackets indicate ranks of the states.

Non-Tax Revenues

Non-tax revenue consists of own non-tax revenues and grants-in-aid from the central government for various purposes. Own non-tax revenues of the state consist primarily of interest receipts and dividends from different types of public sector undertakings. More than half of the own non-tax revenues accrue from this source. The remaining own non-tax revenue comes from user charges relating to general, social, and economic services provided by the government departments. Own non-tax revenues of the state as a proportion of GSDP exhibit a decline since late 1980s (chart-2). It may be observed that the proportion of receipts from economic services have been higher than the proportion of receipts from social and general services throughout the period though the proportion never exceeded 1 percent in GSDP.

The government has initiated several cost recovery measures and user charges with regard to various departments and has allowed the departments concerned to retain the amount to provide incentives as well as to improve the delivery systems of the services. The retention system of user charges should allow the users themselves to have the benefits of the amount they pay. The cost recovery and user charges are more evident in the departments of irrigation, transport, police and hospitals wherein the concerned authorities are empowered to collect and plough back the user charges they collect. The Water Users Associations (WUAs), which were established to maintain and improve the efficiency of the irrigation systems, and the *Vana Samrakshana Samithies* (VSS) have been vested with the authority to utilise a share of the collected fees and proceeds of minor forest produce respectively. As a result of these measures, own non-tax revenue as a proportion of GSDP shows improvement since 1997-98 over the ratio of 1996-97 though the ratio has not reached the level that prevailed before 1995-96. Non-tax revenue as a proportion of GSDP declined in 1996-97, 1997-98, and 1998-99 from the 1995-96 level but showed an improvement since 1999-2000. The increase in the ratio in 2001-02 is due more to an increase in the grants-in-aid than an increase in the own non-tax revenues implying the need for further reforms to augment own non-tax revenues in the state.

Reforms in Expenditure

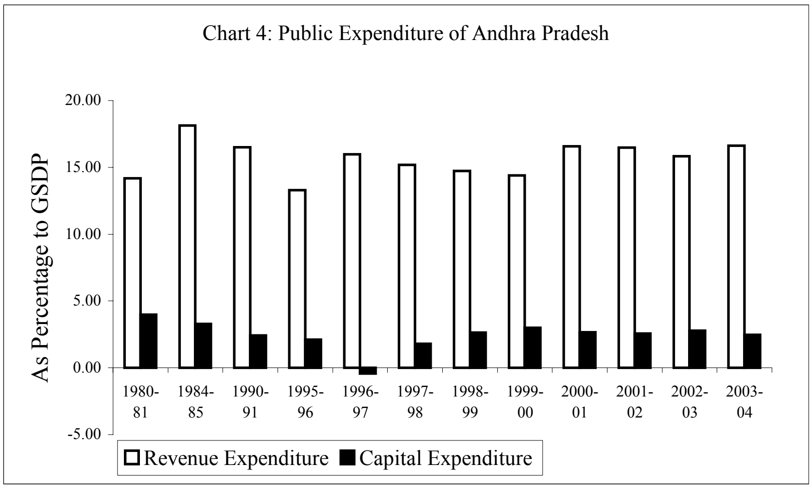
The most important element of reforms in expenditure is restructuring public expenditure in such a way as to increase the developmental impact of expenditure and simultaneously reducing unproductive revenue expenditure through a policy of reprioritisation of the expenditure items. In concrete terms, these would imply reducing the establishment costs, rationalisation of subsidies, revamping welfare schemes, reforming the SLPEs and simultaneously increasing expenditure on infrastructure, both physical and social, as well as expenditure on operation and maintenance of public assets.

Public expenditure can be categorised as revenue and capital expenditure, Plan and non-Plan expenditure, and developmental and non-developmental expenditure. While revenue expenditure includes expenditure on maintenance of the government machinery and its assets, which includes items like establishment costs, interest payments, subsidies, and pensions and gratuity, capital expenditure means expenditure used for creation of assets. It is to be noted that in general, higher the size and growth of capital expenditure, higher would be the growth prospects of the economy. The same classification is used in the present analysis as the other two types automatically fall in one of these categories of expenditure.

Growth of Expenditure

Revenue Expenditure

As the structure of public finances in an economy is defined by the level and composition of public expenditure and the method of its financing, an analysis of the growth of revenue and capital expenditure assumes importance. Revenue expenditure, which was Rs. 1,161 crore in 1980-81, increased to Rs. 30,315 crore in 2003-04 (revised estimate) registering an increase of 2,511 percent. The proportion of revenue expenditure in GSDP during 1980-81 to 2003-04 is presented in chart-3. Revenue expenditure was 16.51 percent of GSDP in 1990-91, but shows a declining trend since 1995-96 indicating some compression of public expenditure due to fiscal reforms. It again shows an increasing trend from 2000-01 onwards. The ratios relating to revenue expenditure show comparatively greater increase than those relating to capital expenditure. Revenue expenditure as a proportion of total expenditure has increased from 78 percent in 1980-81 to 83 percent in 1999-2000 and further to 87 percent in 2003-04. This reveals the undue growth of revenue expenditure at the cost of the growth of capital expenditure in the state. These trends may be observed in chart 4.



Major Items of Revenue Expenditure

The large size and fast growth of non-Plan non-developmental expenditure in the revenue account is mainly due to certain items of expenditure, such as, pay and allowances (including salary grants), pensions and gratuity, and interest payments as shown in table 5. The indices for these expenditure items have been calculated and presented in the table. It may be seen from the table that the index of salary expenditure has increased to 905 in 1995-96 and has further increased by 2032 in 2003-04. This is mainly due to the fast growth of public sector employment until 1995-96 and the revision of scales of pay thereafter, imposing a heavy burden on the government budget. Of course, this is not a unique experience of Andhra Pradesh as several other states have had similar experiences. For example, the expenditure on administrative services in Maharashtra, which was just about 10 percent of revenue expenditure for more than a decade and a half (from 1980-81 to 1997-98), shot up to 25 percent in 1998-99 mainly owing to the impact of the Fifth Pay Commission (Godbole, 2003). Moreover, the impact of revision of pay scales is much more severe on the states than on the centre as the share of salary expenditure is higher (Rao, 2002). The pay revision created a fiscal crisis of unprecedented dimension for the state government (Kurian, 1999) and Andhra Pradesh was no exception.

Table 5: Indices of Select Items of Non-Developmental Expenditure

Year	Pay & Allowances (including salary grants)		Pensions/ Gratuity		Interest payments		Revenue expenditure	
	Rs. crore	Ind-ex	Rs. crore	Ind-ex	Rs. crore	Ind-ex	Rs. crore	Ind-ex
1980-81	433	100	38	100	82	100	1161	100
1991-92	2608	602	441	1161	695	848	6452	556
1994-95	3799	877	780	2053	1256	1532	9514	819
1995-96	3917	905	928	2442	1529	1865	10614	914
1996-97	4394	1015	1004	2642	1839	2243	14392	1240
1997-98	4939	1141	1139	2997	2153	2626	14544	1253
1998-99	5628	1300	1373	3613	2644	3224	16944	1459
1999-00	6981	1612	1626	4279	3161	3855	18038	1554
2000-01	7612.11	1758	2378	6258	3793	4626	23070	1987
2001-02	7791.87	1800	2321	6108	4584	5590	24725	2130
2002-03	8371.06	1933	2364	6221	6131	7477	26057	2244
2003-04 r.e.	8799.3*	2032	2426	6384	6919	8438	30315	2611

Source: Same as Table 1.
Note: r.e indicates revised estimates.
***:** relates to Budget Estimates

Similarly, the expenditure commitments on pension and gratuity have also spurted, the index of this expenditure being 6,826 in 2002-03 mainly due to the large scale retirements and also owing to revision of pension alongwith the revision of scales of pay of the employees. Again the situation is more or less similar in several states and possibly more serious in some other major states than in Andhra Pradesh. On top of this, the expenditure on interest payments has increased phenomenally registering an index of 8,438 in 2003-04. The spurt in expenditure on interest payments is a consequence of not only a continuous increase in the volume of borrowings but also the change in the nature of borrowings, rising interest rates, and reduction in the size of low cost borrowings from the public account. It is pertinent to note that while revenue expenditure registered a growth in index of 2,611, gratuity and pensions and interest payments registered an index of 6,384 and 8,438 respectively over the period 1980-81 and 2003-04. Though the expenditure on rice subsidy – another element of revenue expenditures – was large prior to 1996, it has been successfully lowered.

Table 6: Pension Payments of Major States in 2002-03 (b. e.)

(Rupees in crore)

State	Pension
Andhra Pradesh	2560
Bihar	2038
Gujarat	1435
Karnataka	1943
Kerala	1820
Maharastra	2307
Orissa	1451
Rajasthan	2028
Tamil Nadu	3176
Uttar Pradesh	2662
West Bengal	2095
All States	30396

Source: The Economic Times, Feb.27th 2004.

Reducing Establishment Costs

With a view to reducing the salary bill, several measures were initiated to check the growth of employment in the public sector. An *Act* emphasising upon prior approval for making fresh appointments was passed and the government appointed the *Gangopadhyay Committee* to assess the available positions in the government, identify redundant staff, and recommend for their redeployment. The committee identified a large amount of redundancy, e.g., 40 percent in the irrigation department. The government followed an attrition policy (by which it reduced 0.9 percent of employment every year since 1996-97) besides the policy of voluntary retirement and redeployment among different government departments. The overall size of the civil services was reduced by 2.6 percent through attrition (Strategy Paper, 2001). As a result, the growth of government employees was less than one percent on an average per annum in the post reform period compared to 3.4 percent per annum, prior to 1996-97. The downsising policy has been extended to the aided institutions as well. However, the government allowed fresh recruitment in the human development departments of education, health, and police, besides the limited recruitment of backlog posts for SC and ST categories. The abovementioned measures helped the government to keep the salary bill under control, thereby compressing the revenue expenditure in the state. For instance, the expenditure on salaries and pensions as a percentage of states' own revenue declined from 68.17 percent in 2000-01 to 62.18 percent in 2002-03 (r.e) (Annual Fiscal Framework, 2003-04).

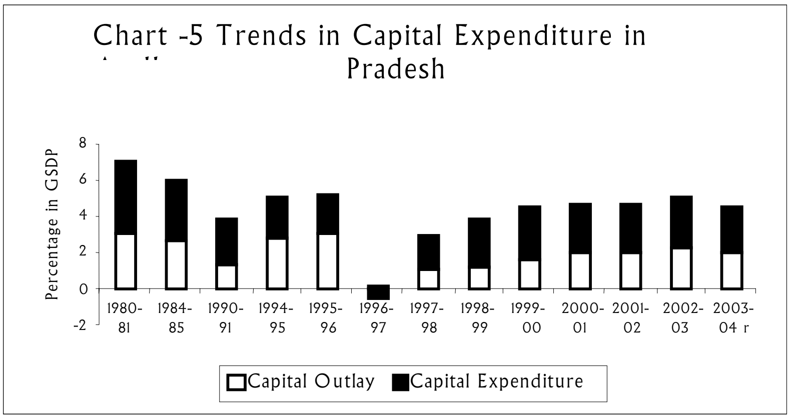
Though the government successfully contained the salary bill, the pension commitment has been on the increase mainly due to the extension of the pension benefit to the local bodies and other aided institutions besides the revision of pensions. Efforts have been made to adopt pension reforms by devising appropriate strategies to contain the future pension commitment, but the immediate impact on the pension bill is likely to be small.

Rice Subsidy

The rice subsidy, which was a huge burden to the government, has been reduced both by revising the issue price from Rs. 2 to Rs.3.50 per kg and by weeding out bogus cards on a large scale. The rice subsidy as a proportion of the total revenue expenditure has come down except in the year 1999-2000. The subsidy expenditure increased suddenly in 1999-2000 due to steep price increase in the issue price of Food Corporation of India and the consequent absorption of the full impact by the government. In fact

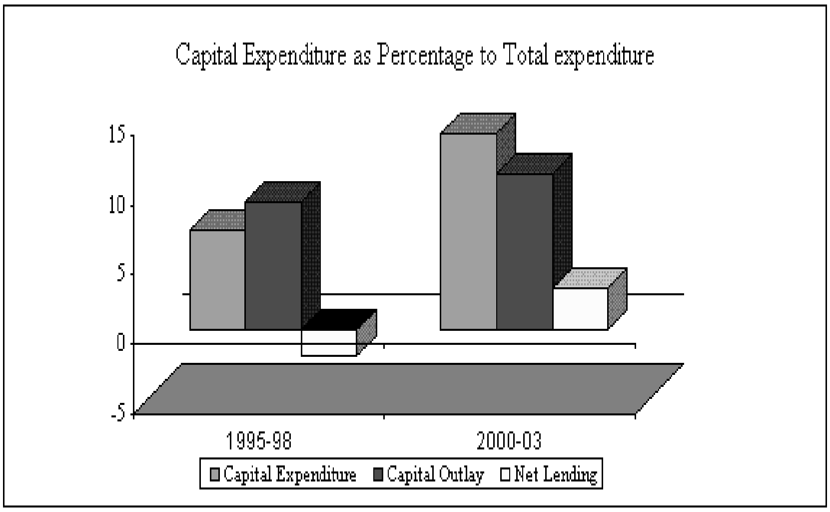
Rs.100 crore were expected to be saved in expenditure on rice subsidy during 2002-03 on account of efficiency brought about in the public distribution system, based on issue of food coupons to draw monthly entitlements. Further streamlining and weeding out of bogus cards would further reduce the financial commitment.

Capital Expenditure



The unabated increase in revenue expenditure has resulted in the reduction of capital expenditure. The proportion of capital expenditure in GSDP during 1980-81 to 2003-04 (r.e) is presented in chart 5. It may be observed from the chart that the capital expenditure-GSDP ratio declined to 2.10 percent by 1995-96 from 3.98 and 3.29 percent in 1980-81 and 1984-85 respectively. The negative ratio of capital expenditure in 1996-97 is due to a decline in net lending which is one of the components of capital expenditure, the other being capital outlay. The negative net lending in 1995-96 and 1996-97 is owing to the waiver off of government loans to APSEB and also due to the conversion of government loans to APSEB into equity. The sudden fall in capital outlay during 1996-97 is due to the conversion of Rs. 907 crore of equity of APSEB as subsidy by the government. The proportion of capital expenditure has increased gradually during the reform period to reach 2.99 percent in 1999-2000 but subsequently declined. The capital outlay which declined to an all time low of 0.15 percent in 1995-96, gradually increased and reached 2.31 percent in 2002-03. Chart–6 shows the average capital expenditure and its constituents during the initial and the concluding period of reforms with a view to making a comparison. A substantial increase in capital expenditure may be observed. The increase in capital expenditure is mainly due to the allocations for the development of social sector and infrastructure. Of the three categories—general services, social services and economic services — the share of economic services, though the largest throughout the period, declined gradually while the share of general services and the social services increased considerably. The increased expenditure on social services has been mainly caused by the enhanced outlays on primary education, primary health and rural water supply schemes. It is pertinent here to note that the proportion of plan expenditure in the total expenditure has been on the rise continuously from 19.74 percent in 2000-01 to 21.29 percent in 2001-02 and to 26.24 percent in 2002-03; this is perhaps a good omen for economic development.

Chart-6



Infrastructure Development

Infrastructure (in the conventional sense) needs to be developed by enhancing the capital expenditure as it has high correlation with economic development. The government constituted an Infrastructure Development Fund in 2001-02 by allocating Rs. 82 crore to meet the critical counterpart investments to encourage public-private partnerships. It has enacted an Infrastructure Development Enabling Act (IDEA) besides making huge investments in irrigation and power, roads, communications, transport, ports and airports and information technology. Besides domestic resources, the government of Andhra Pradesh mobilised foreign investments to develop infrastructure especially in the area of power, ports, and information technology. However, the spread of investments in the state during the reform period especially in roads, communications, and IT has been subjected to criticism that a large chunk of resources mobilised for infrastructural development has been invested in and around the city of Hyderabad only ignoring the considerations of balanced regional development. For example, seven flyovers have been constructed in Hyderabad at an estimated cost of Rs. 52 crore and a few more are in progress, but in some parts of the state roads are awaiting normal maintenance. On the positive side, while developing economic infrastructure, the government simultaneously encouraged development of social infrastructure as well.

Increased Allocations for the Social Sector

Adequate allocation to the vital sectors within social services of health and education in general and primary education and primary health in particular, was a priority area of the fiscal reform programme. The allocations to social sector have increased in recent years. As a result, the expenditure on social services as a proportion of GSDP has been 5 to 6 percent except in 1998-99, the capital expenditure shows a discernible improvement during the period 1995-96 to 2002-03. Similarly, education and health expenditure as a proportion of GSDP shows quite an improvement. The thrust of the reforms have been to achieve the target of universal primary education and improving the primary health care especially in the rural areas. The government made efforts to improve the service reach to remote areas and communities as far as primary education and primary health care are concerned.

The government has increased budgetary allocation on primary education to achieve universal elementary education by 2005, the key strategy being improved access to schools (providing 98 percent of the rural habitations with primary schools within a distance of 1 km). A massive recruitment drive of school teachers and construction of thousands of primary school buildings have been taken up under different programmes especially under the *A.P. Economic Restructuring Project*. Moreover, the government enacted a law—*A.P School Education Community Perception Act* 1998—to encourage community participation in order to improve both the spread and quality of education. School committees are constituted in every village which would plan, manage and promote education by engaging *Vidya* volunteers. In order to encourage primary education among specific social groups and to discourage dropouts, the government implemented programmes like ‘Back to School’. As the financial resources earmarked for primary education are transferred to these committees accountability and transparency of this amount of public expenditure has increased.

With regard to primary health, especially in the rural areas, the investments are scaled up to ensure that all primary health centres (PHCs) have their own buildings, providing the staff necessary equipment and also with adequate drugs and consumables. Besides, several referred hospitals have been upgraded under the *A.P First Referral Health Systems Project*. While the increased budgetary allocations have helped in the construction of new buildings and renovation of old buildings of the PHCs, provision of adequate drugs and consumables is still a dream in the rural areas. It is pertinent to increase the allocations further in order to achieve the goals envisaged in *Vision 2020* with regard to education and health. Moreover, it is necessary to increase the capital component compared to the salary component of the allocation for these two vital sectors.

Operation and Maintenance Expenditure

The government allocated more funds for the non-salary operation and maintenance in view of its importance in the economy. Consequently it has increased from 0.5 percent of GSDP in 1995-96 to 1.7 percent in 2000-01 and was estimated to go up to 1.8 percent of GSDP in 2002-03. This may be attributed as a significant outcome of the fiscal reforms in the state. However, the purpose of increased allocation would not be served unless the funds are purposefully and properly utilised.

Treasury Reforms

Several reforms have been introduced in the treasury to enhance fiscal discipline and transparency in financial transactions. While the government has computerised the pensions and salaries of government employees, and the same are being paid through banks, it has also introduced Treasury Audit System (TAS) to counter check any irregular payments. It also introduced Integrated Finance Information System (IFIS) to capture detailed information on a daily basis and has standardised the accounting system in all the treasuries throughout the state. Relational Data Base Management System (RDBMS) software known as 'e- *Khajana*' has been introduced in all treasuries besides implementing several measures to improve the performance and accountability in all the treasuries and sub-treasuries in the state.

Budgetary Reforms and Expenditure Efficiency

As part of fiscal reforms, the government changed several budgetary practices and introduced new procedures. It made available the budget document, for the first time, in electronic form on the internet and also in a compact disc. Several attempts have been made to demystify and simplify the budget and overlapping of schemes has been avoided by merging similar schemes into generic programmes integrating the respective heads of account by which precious and scarce resources could be conserved. Experience has shown that heavy rush of expenditure in the last couple of months, especially in March, impairs the quality and questions the accountability of public spending. A new cash management system has been formulated which assures compliance with the budget and consistency with seasonality. With assured budget releases, the government departments concerned are now in a position to plan their schemes and execute them. The performance of each department is to be reviewed half-yearly, which facilitates better cash management and provides a broad link to the ensuring budget preparation. All these measures are supposed to enhance the expenditure efficiency and avoid rush of expenditure. But there still exists extraordinary rush of expenditure in the last months of the financial year. It may be seen from table 7 that instead of spreading the expenditure evenly in all the four quarters, 39 percent was spent during the last quarter in 2001-02. It is also interesting to observe that 22 percent of the total expenditure has been spent only during March 2002 in spite of several reforms initiated with regard to cash management and release of funds.

Table 7: Year -End Rush of Expenditure

Quarter ended	Expenditure (Rs. crore)	Percentage to total expenditure
30th June 2001	4259.49	15.31
30th bSep.2001	6806.29	24.47
31st Dec. 2001	5787.50	20.81
31st March 2002	10964.00	39.41
Total Expenditure	27817.29	
Expenditure during March 2002	6172.08	22.19

Source: CAG Report of A.P, 2001-02.

Reforming the Public Sector Units

The government appointed an implementation committee to suggest appropriate measures for restructuring, privatisation, downsising or closure of the public as well as cooperative enterprises. The committee recommended that the reform process be split into two phases. Accordingly, the government privatised 8 units, closed 6 while downsising and restructuring or divesting 5 units during the first phase, namely, 1999-2001. The reforms during the first phase encompassed cooperatives and public enterprises including some important corporations like the Andhra Pradesh State Agro-Industries Development Corporation, Andhra Pradesh State Irrigation Development Corporation and A.P Meat Development Corporation. Under the second phase, the government intended to initiate reforms relating to 68 units during 2001-05, but actually the reform process had started in April 2002 to be over by 2006. The target of reforming 22 units out of 68 has already been achieved by 2003-04. The 68 identified units under the second phase include cooperative sugar mills, spinning mills besides the APSRTC and the AP Seeds Corporation. Consequent upon the reforms in SLPEs, a large number of employees have opted for or have already availed of voluntary retirement scheme (VRS) and the government successfully counseled, retrained, or redeployed the employees as shown in table 8. The VRS has also been implemented in those units which are not identified for privatisation or closure in order to improve operational efficiency, financial health, and cost effectiveness of these units. The government has incurred an outgo of Rs.323.44 crore on account of VRS schemes. The bulk of the proceeds that are augmented through reforms would be used for settling the outstanding liabilities of the enterprises concerned.

Table 8: VRS to SLPE Employees from 1999

Item	Number
Number of employees opted / availed VRS	22269
Amount disbursed under VRS (Crs)	323.44
Employees counselled	8600
Employees retrained	4819
Employees redeployed	1748

Source: Department of Public Enterprises, GoAP. Hyderabad.

The Fiscal Impact

Reforms in public enterprises will have an important fiscal impact on the finances of the state government. The estimated gross fiscal impact of 54 units is shown in table 9. It may be observed from the table that the companies/cooperatives and the Listed companies put together enjoyed budgetary support of Rs.1,283 crore during the pre-reform (1996-2001) scenario. The budgetary support would have increased to Rs. 2,512 crore during 2001-05 in the absence of reforms. The table also shows the estimated savings under the reform programme, an amount of Rs.1,332 crore. This indicates the fiscal importance of reforms in public enterprises in the state. Moreover, the resources that are freed from these inefficient units can be used for the development of the social sector. It has been estimated[i] that the resources available to the state government by implementing the first phase of the enterprises reform project could be utilised either for creation of 9.16 lakh new jobs or for implementing a mega water supply scheme worth Rs. 886 crore or 11 thousand new primary schools, 7,333 kms of metalled road or setting up of 4,400 primary health centres or 44 new medical colleges or for resettlement of 2,200 households in slums (FIA study). However, the government needs to take into consideration the amount of social welfare generated by these units. For example, a large public sector undertaking like the Road Transport Corporation, with its wide network and huge investment may not be easy to replace in terms of the several social objectives it has been serving. A manufacturing or trading enterprise which is not rendering any social welfare to the community and incurring financial losses continuously is a better bet for reform.

Table 9: Gross Fiscal Impact of Public Enterprises on State Finances

Nature and Number of Public Enterprises	48 Companies/ Cooperatives	6 Joint Stock Listed Companies	Total Amount (Rs. In crs.)
Budgetary support (1996-2001) Pre-reform scenario	1259	24	1283
(2001-2005)No reform scenario	2483	29	2512
Estimated savings under reforms	1308	24.16	1332

Source: Department of Public Enterprises, GoAP, Hyderabad.

The Power Sector

The power sector reform is crucial to fiscal reforms due to its heavy dependence on budgetary support. The gross budget support to this sector, including interest payments on outstanding power sector liabilities totals over 2 percent of GSDP (Memorandum to Third Finance Commission, 2003). The power sector was financially comfortable until 1991-92 (Rao and Dev, 2003). The financial position deteriorated slowly since 1992-93 with losses accumulating for a variety of reasons like increase in the cost of inputs, steep increase in the growth of consumption of subsidised segments like agriculture and domestic compared to industry and business, shift of industrial consumers from the grid to captive generation, growing interest burden, borrowing for unremunerative purposes, non-revision of tariffs from time to time and on top of all a significant fall in the hydro-thermal mix in generation. In order to financially bail out the APSEB and in line with the general economic reform process, the government implemented the *Hiten Bhaiya Committee* recommendations. Andhra Pradesh is one of the major states that has implemented a wide range of comprehensive reform measures in the power sector. The government enacted *A.P. Electricity Reform Act 1998* and accordingly has unbundled the APSEB into two separate companies – AP Transmission Company (APTRANSCO) and A.P. Generation Company (APGENCO) with effect from February, 1999. The government also established an independent regulatory commission known as Andhra Pradesh Electricity Regulatory Commission (APERC) in March 1999, which is solely responsible for electricity generation and transmission licenses and also for regulation of tariffs.

Since the government initiated power reforms, several international funding agencies from Japan, UK, China, Germany, and Canada besides the World Bank came forward for the construction of power projects, improving the distribution system and otherwise to participate in the power restructuring programme. The World Bank agreed to extend a loan of $1billion in five tranches under the Adaptable Program of Lending (APL) for strengthening the transmission and distribution network of APTRANSCO. Four separate distribution companies (DISCOMS) have been established in April, 2000 which are responsible for distribution of power in the state. The APERC has so far given five tariff orders for 2000-01, 2001-02, 2002-03, 2003-04 and 2004-05 besides directing enumeration of agricultural pump sets in order to estimate the agricultural consumption. Agricultural consumption in Andhra Pradesh is one of the highest among several major states especially among the southern states at 43 percent of the total sales, being also higher than the developed state of Maharashtra and the power reforms pioneering the state of Orissa. The consumption share of domestic, the other subsidised segment, is also relatively high.

The APERC issued directives to ensure that metering is completed so as to have better data on the agricultural sales and transmission and distribution (T&D) losses. As a result of several measures initiated to reduce the T&D losses, they have been reduced from 38 percent of the energy availability in 1999-2000 to about 24 percent by March 2004 (Budget Speech, 2004), but needs further reduction. In order to bring down the commercial losses due to theft and malpractice, an anti-theft law has been passed in September, 2000. Even though several reform measures have been initiated to reduce the T&D losses and increase the efficiency, and even after the new tariff orders have been issued, the commercial losses persist. The APTRANSCO proposed in April, 2000 to cover the losses in the following manner: 22 percent by tariff hikes, 14 percent through efficiency gains and 63 percent through government subsidies. The ERC increased the tariff on agriculture consumption through its orders, but the agriculture tariff contribution is still too low. For instance, according to the tariff order 2004-05 of APERC, the revenue from agriculture is Rs.409 crore while the total subsidy amounts to 1442 crore for 2004-05. This suggests an increase in the agriculture tariff along with other hitherto subsidised segments. Otherwise, the financial impact on the state budget in terms of subsidies (Rs.1,666 crore in 2000-01 and Rs.1,500 crore in 2003-04) would continue unabated. The reform process in the power sector needs to be continued as envisaged in the business plan for power sector, 1998 in order to attain the target of phasing out budgetary support by 2005-06. Private participation, which is at present comparatively low in this vital sector, needs further encouragement to fulfil the targets of reform. While private participation is low, the power plants which were started under the private sector have been facing the problem of scarcity of inputs (natural gas) which needs urgent attention by the government. The decision of the government to provide free power[1] to agricultural irrigation pump sets will further intensify the adverse fiscal impact on the state budgets.

Governance

Governance plays an important role in implementing policy initiatives, both financial and non-financial. Moreover, governance issues have an implicit relationship with improving compliance and reducing compliance costs (Howes, Lahiri, and Stern, 2003). It is opined that "without good governance and effective institutions, the money for development either would not be available or when available would not be of much utility for appropriate application. They create the necessary conditions and a genuine environment for people to participate in the development process, to exploit the economic opportunities on an equal basis to create wealth for them." (Budget Speech, Andhra Pradesh, 1999-2000).

In Andhra Pradesh, after the onset of economic reforms, improved governance has been conceived in two ways. Governance at different stages of the delivery systems in the state has been geared up by application of information technology and also by establishing decentralised institutions. Improved governance results in not only improved delivery systems and better expenditure management, making the spending agencies more accountable, but also helps in better realisation of tax and non-tax revenues.

Information Technology

Under the broad framework of economic reforms and also to push them further, the government of Andhra Pradesh made significant strides in harnessing information technology (IT) for a variety of purposes besides providing a SMART (Simple, Moral, Accountable, Responsive, and Transparent) government. The government made huge investments and provided various kinds of fiscal and non-fiscal incentives to attract investments in this sector, which has been recognised as one of the engines of growth in the *Vision, 2020*. As a result, the cumulative investment in the IT sector increased from Rs. 605 crore in 1997-98 to Rs. 2,350 crore in 2001-02. The software exports from the state also increased from Rs.284 crore to Rs. 2,500 crore during the same period. This has had its impact on the finances of the state. Most importantly, the huge investments in this sector definitely crowd out public investments in other sectors of the economy. That is the reason why private partnership and BOOT (Build, Own, Operate and Transfer) type of investments are requisite in the IT sector.

Increased levels of utilisation of IT by the government in diverse fields have gained Andhra Pradesh a place on the IT map of the world. IT applications like APSWAN (Andhra Pradesh State-wide Area Network), E-Seva (Electronic Citizen Services), FAST (Fully Automated Services of the Transport Department), CARD (Computer-Aided Administration of Registration Department), Civic Urban Information Management System or *Saukaryam* in Visakhapatnam, OLTP (Outline Transaction Processing System), IFIS (Integrated Financial Information System) and the E-procurement have helped in providing different services to the people across the state besides making a fiscal impact in terms of realisation of more revenues, conservation of resources, better expenditure management, transparency in financial transaction. However, it is to be noted that the IT application in government departments is more or less confined to urban areas, that too, covering a small segment of the total population.

Decentralised Governance

The government has provided a new thrust to governance by encouraging participatory development in the place of centralised planning process. It launched a people's participatory development programme christened as *Janmabhoomi*. In the eighteen rounds of this programme since 1997, several public works have been undertaken in accordance with the felt needs of the local people and area. Thus the earmarked funds are utilised more effectively by creating needed assets besides the voluntary contribution of both human and financial resources. However, there has been criticism against this programme that the resources of the program have been harnessed by the influential cadre of the ruling party besides wastage of public funds for undue publicity. The funds would have been of more use, had they been more broad-based, actively involving the mandatory institutions at the grass root level like *Gram Panchayats*. In order to better utilise the funds earmarked for the development of irrigation, survey and maintenance of the existing watersheds, water users' association (WUAs) have been formed. The WUAs have been permitted to plough back the water charges collected in their respective jurisdiction for their own utilisation. In general the WUAs have emerged successful in the job of effective utilisation of the earmarked funds with some exceptions here and there. Similarly, education committees, hospital committees etc. have emerged, though not as effective as the WUAs, as effective institutions in making the line departments accountable and transparent with regard to the utilisation of earmarked funds. However, the local government units, which are formally responsible for planning and implementing rural development and other programmes, have in the process been relegated to the background and have turned into passive agencies, against the true spirit of local self governance.

Guarantees and Funds for Contingent liabilities

In addition to its own debt, government gives guarantees to loans undertaken by public enterprises, including cooperatives.

Though no guarantee has ever been invoked against the government until 2000, financial assistance in the form of loans and equity has been provided to the public enterprises enabling them to discharge their liabilities. In fact a realistic assessment of indebtedness of the state government needs to take into account these contingent liabilities which were as much as 10 percent of GSDP by March 2000, declining marginally to 9.9 percent in 2001-02. Of the total guarantees in 2001-02, power sector guarantees constituted 70 percent, mainly on account of extending guarantees to pension trusts to an extent of Rs. 4,000 crore. In fact, the government could successfully contain the non-power sector guarantees. Consequently, the guarantees as a proportion of GSDP have been projected to decline from 9.9 percent in 2001-02 to 8.73 and 8.61 percent in 2002-03 and 2003-04 respectively. The government also decided to enforce strictly the requirement of scrutiny of the proposal, assess risk, and demand adequate compliance of financial discipline by the enterprises besides mandatory payment of guarantee fees.

The government made serious efforts in recent years to meet the contingent liabilities of guarantees in future, by establishing a sinking fund in 1999-2000 with an initial contribution of Rs. 60.4 crore. By 2001-02, it had contributed a sum of Rs. 229 crore to the fund, to be operated by the Reserve Bank of India on behalf of the state. Similarly, a guarantee redemption fund has been instituted with an initial fund of Rs.12.1 crore. In addition, it is proposed to contribute 1 percent of outstanding guarantee fees to be collected from the borrowing agency. Though such an orderly institutional arrangement is appreciable, the deposit amounts are quite meagre in view of the huge amount of outstanding guarantees and the risk involved in the event of default.

Section - III

Medium Term Fiscal Framework

The government launched a medium term fiscal framework (MTFF) through a strategy paper on fiscal reforms published in February 2001, to help plan fiscal policies. The main objectives of MTFF are: to ensure that public expenditures are stable and sustainable and do not lead to fiscal crisis; and to improve the efficiency of allocation decisions and also to protect high priority public expenditures such as social expenditure, expenditure on operation and maintenance, and infrastructure investments. The MTFF aims at establishing overall affordability of government expenditure within reasonable revenue forecasts simultaneously envisaging a broad path for protecting the priority expenditures. It also proposes to identify important fiscal policies necessary to reverse the growing debt problem. The important facets of MTFF are i) resource mobilisation; ii) expenditure compression; and iii) fiscal sustainability.

In addition to the proposed revenue mobilisation efforts along with the restructuring and reprioritisation of expenditure, the state is also covered by the fiscal reforms facility of the Government of India as recommended by the Eleventh Finance Commission. The government has undertaken the task of implementing the MTFRP. The MTFRP envisages a fiscal correction programme more explicitly, covering tax reforms, reforms in user charges, expenditure compression, power sector reforms, public sector restructuring, and budgetary reforms. Under the MTFRP, states which implement monitorible fiscal reforms are entitled for funds from the incentive fund of Rs. 10,607 crore during the period 2000-05. Andhra Pradesh is one of the twenty-two states until 30 September 2003, to adopt this programme. The release of funds from the incentive fund is based on a single monitorible fiscal criterion. According to MTFRP, each state is expected to reduce a minimum of 5 percentage points in the revenue deficit as a proportion of their total revenue receipts each year till 2004-05 over the base year (1999-2000). States having revenue surpluses can show an annual improvement of 3 percentage points in the balance from current revenue (BCR) as a percentage of their non-plan revenue receipts to be eligible for funds from the incentive fund. The Government of Andhra Pradesh has been implementing most of the reforms under the MTFRP. A comparison of important fiscal indicators of state finances between the base year 1999-2000 and the subsequent years of 2000-04 is given below. It may be observed from table 10 that the state's own revenues and own tax revenues as proportions of total revenue receipts show small increases in 2000-01 over the base year, but declined in the following year. However, they show considerable increase in the year 2002-03. The revised estimates of 2003-04 and the average of 2000-04 also show a decline in the ratios compared to the base year 1999-2000. The non-Plan revenue expenditure as a ratio of total revenue receipts shows a decline in almost all the years over the base year except in 2000-01 implying the positive impact of the reforms in compressing this kind of expenditure. A steady increase may be noticed in interest payments and public debt as percentages of total revenue receipts in all the years as well as in the average, over and above the base year percentage, indicating the growing burden of debt and debt servicing.

Revenue deficit as a percentage of total revenue receipts, the single monitorable indicator as suggested by the Eleventh Finance Commission, may be seen in table 10. It is evident from the table that instead of a decline in the percentage, the percentage increased by 11.12 in 2000-01 over the base year indicating further deterioration in fiscal management. However, the percentage shows a decline by 5.28 percentage points in 2001-02 indicating an improvement over the year 2000-01 which remained more or

Table 10: Some Fiscal Indicators Including Single Monitorable Indicator of Andhra Pradesh

(percentages)

Year	1999-00	2000-01	2001-02	2002-03	2003-04 r.e	Ave. 2000-04
SOR/TRR	68.14	68.27	66.36	70.20	66.57	67.85
OTR/TRR	53.61	54.18	53.00	54.85	51.58	53.40
RD/TRR	7.34	18.46	13.18	13.28	10.60	13.88
IP/TRR	18.45	19.48	20.98	26.65	25.24	23.09
NPRE/TRR	91.78	96.70	90.89	90.29	84.49	90.59
Debt/TRR	173.25	183.06	194.52	207.09	195.08	201.35

Source: Budget Documents, GoAP, Hyderabad.

Note: SOR = State Own Revenue, OTR = Own Tax Revenue, RD = Revenue Deficit, IP = Interest Payments, NPRE = Non-Plan Revenue Expenditure, TRR = Total Revenue Receipts

less the same in 2002-03. Improvement in terms of reduction in the ratio may be observed in 2003-04 (r.e) over the 2000-01 value, but the fact remains that the ratio was higher than the base year ratio in all subsequent years, suggesting the need for serious reform initiatives. The single monitorible indicator may be simple to apply but may not allow an objective assessment of fiscal consolidation. This is mainly because of the size of the indicator in the base year. To elaborate, a state with a large deficit in the base year finds it easy to comply with this measure. For a state with smaller deficit, it may be difficult to reduce the percentage by 5 points every year. However, this measure helps in broadly measuring the fiscal improvement or deterioration in the state compared to the base year.

In order to analyse the impact of fiscal reforms, an average percentage of select fiscal indicators for three different periods— pre-reform, initial period of reform and the MTFF period—has been computed and presented in table 11. It may be observed from the table that almost all the revenue variables show improvement between the initial period and the MTFF period. But at the same time, fiscal deterioration may be witnessed in terms of debt, deficit, and interest variables implying persistent fiscal imbalances.

Table 11

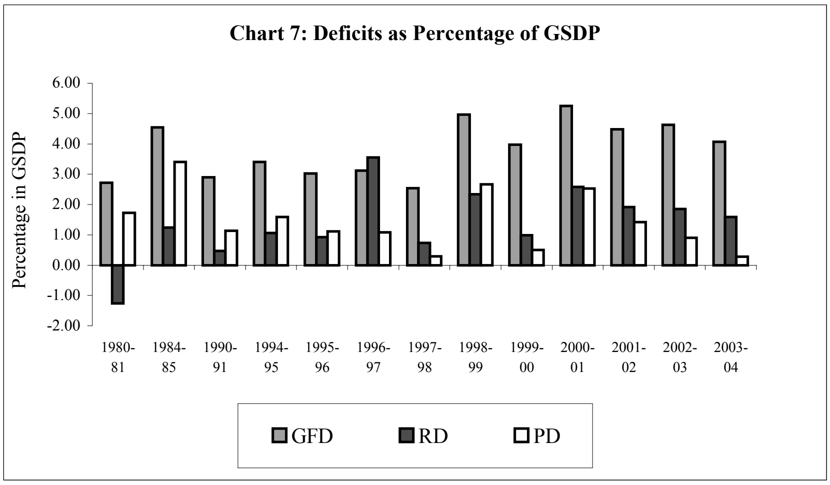
Average percentage of Important Fiscal Indicators in GSDP.

Item	Pre-Reform	Reform Period	
		Initial Period	MTFF Period
	1992-95	1995-98	2000-03
Total Revenue	14.1	13.1	14.2
Tax Revenue	9.7	9.4	10.4
State Own Tax Revenue	6.7	6.1	7.7
Own Revenue	9.7	7.2	10.3
Share in Central Taxes	3.0	3.4	2.7
Non-Tax Revenue	4.4	3.7	3.8
State Own Non Tax Revenue	2.3	1.9	2.0
Grants	2.1	1.8	1.8
Interest Payments	1.8	2.1	3.2
Pensions	1.0	1.1	1.6
Administrative Services	1.2	1.1	1.1
Total Capital Outlay	2.4	1.4	1.6
Net Lending	0.6	-0.2	0.6
Capital Expenditure	3.0	1.1	2.7
Gross Fiscal Deficit	3.4	2.9	4.8
Revenue Deficit	0.4	1.7	2.1
Primary deficit	1.5	0.8	1.5
Central transfers	5.1	5.2	4.5
Outstanding debt	19.4	19.6	28.2

Source: RBI Bulletins, Various Issues.
CMIE Public Finance, Nov. 2003.
Budget Documents, GOAP.

Fiscal Imbalance

The fiscal health of a government is revealed by the fiscal balance or deficits on its budgets. The deleterious effects of the twin deficits – gross fiscal deficit (GFD) and revenue deficit (RD) – are well known (Rangarajan, 2004, Government of Andhra Pradesh, 1996). In Andhra Pradesh, as in several other states of India, the twin deficits have been on the increase. The gross fiscal deficit and revenue deficit as a proportion in GSDP covering the period 1980-81 to 2003-04 are presented in chart 7. The gross fiscal deficit which was only 2.72 percent in 1980-81, increased to 4.54 percent and 4.90 percent in 1984-85 and 1986-87 respectively, and then declined in the subsequent years. But it has been more than 3 percent since 1995-96. In fact, it was as high as 4.96 percent in 1998-99. This may be due to the increased allocations on social and community services and pay revision of government staff without commensurate reduction in the non-development expenditure in the post-reform period, given the level of revenue receipts. The gross fiscal deficit was as high as 4.63 percent in 2002-03.



With regard to revenue deficits, the state used to maintain revenue surpluses until 1982-83, but since then it has been reeling under revenue deficits, except for year or two. In fact, the revenue deficit was as high as 3.55 percent in 1996-97 mainly because of a sharp decline in the current revenues with increased expenditure commitments. Even after the reforms, the fiscal and revenue deficits are 4.07 percent and 1.59 percent in 2003-04 (r.e) respectively. However, substantial reduction is discernible in the primary deficit which stands testimony to the government's efforts in reducing non-interest expenditure during the reform period. The primary deficit was 2.7 percent in 1998-99, but has declined to 0.9 percent in 2002-03. While the projected target of the primary deficit for the year is 0.5 percent, the revised estimate is only 0.3 percent in 2003-04.

Composition and Growth of Debt

The state government's debt at present consists of internal debt, special securities issued to the national Small Savings Fund (NSSF), loans and advances from the centre and small savings and provident fund etc. Internal debt comprises market borrowings, and loans from banks and financial institutions. The special securities issued to NSSF which are now treated as part of internal debt of the states since 1999-2000, were earlier a part of the central loans. The loans and advances from the centre are still the most important constituent of states' debt, though their relative importance has declined in recent times. The central loans constituted about 40 percent of the total states' debt in 2001-02. In Andhra Pradesh, central loans constituted about 76 percent in 1980-81 which declined to about 56 percent during 90's and further declined to 39 percent in 2002-03. The internal debt component in turn has increased substantially since the second half of the nineties.

The state has been using borrowings to fill the budgetary gaps. The fast growth of public debt can be observed in per capita terms. The per capita debt has increased from Rs. 336 in 1980-81 to Rs. 5,526 in 2001-02. The outstanding debt as a percentage of GSDP presented in table 12 shows that debt in the state has increased from 21.74 percent in 1980-81 to 31.57 percent in 2003-04. Several reasons like the larger plan loans for developmental purposes, non-plan loans from the centre, debt financing of large number of welfare schemes, pay revisions and huge pension commitments, increasing interest payments, investments in loss-making public sector enterprises especially the power sector can be attributed to the growth of debt. Besides, the government has borrowed on a large scale from international organisations and institutions in the form of structural adjustment loans (SAL), external aided projects (EAP). For instance, about 19 externally aided projects have been funded to the tune of Rs. 12,877 crore as loans and grants by the World Bank (10 projects) International Fund for

Agricultural Development, Overseas Economic Cooperation Fund, Netherlands etc. Similarly, funds have been raised by public enterprises, especially by the power sector, to which the government gives guarantees. Moreover, servicing of the debt itself has contributed to the rapid growth of public debt. This is mainly because the interest rates on the central loans and other kinds of loans have risen, leading to higher debt servicing costs. For example, the effective rate of interest has increased from 5.4 percent in 1980-81 to 13.0 percent in 1999-2000. At present (2003-04), it stands at 13.8 percent. These developments have caused a burden to the exchequer by draining out its revenue resources. Interest payments as a proportion of revenue receipts was only 6.46 percent in 1980-81, but has increased markedly to 25.24 percent in 2003-04 implying that more than a quarter of the revenue receipts are being spent on interest payments alone. In order to provide some relief to the debt ridden states, the government of India introduced a debt swapping scheme[2] under which the states can repay the high-cost.

Table 12: Indicators of Outstanding Debt Burden

Year	Debt as percentage of GSDP	Interest Payment as percentage of Revenue Receipts	Effective Rate of Interest
1980-81	21.74	6.46	5.4
1984-85	21.91	6.71	6.1
1990-91	20.21	11.02	10.2
1994-95	18.87	14.30	11.4
1999-00	23.25	18.45	13.0
2000-01	25.62	19.48	13.0
2001-02	28.31	20.98	12.9
2002-03	30.41	26.65	14.4
2003-04 r.e.	31.57	25.24	13.8

Source: Budget Documents, GoAP, various issues.

debt with relatively low-cost small savings collections It has been estimated (Moorthy, 2004) that savings under this scheme to the states would be to the extent of 2.58 percent of interest payments and will help to reduce the revenue deficits of the states. The Government of Andhra Pradesh has used the facility to the extent of Rs. 3,696 crore in 2002-03 and planned further swapping as well. However, the relief provided by debt swapping is positive but too small an amount in view of the huge stock of outstanding debt. The enormity of the problem of debt stock and the increasing cost of serving of debt is such that the average rate of growth of public debt has been 16.42 percent, 19.40 percent and 19.71 percent during 1990-93, 1997-2000 and 2000-03 respectively, exceeding the growth rate of revenue receipts (14.98 percent, 10.44 percent and 11.26 percent). It is to be noted that the growth rate of revenue receipts exceeded the rate of growth of public debt during 1980-83. While several other states face similar problems, including southern states of Kerala and Tamil Nadu and reforming states like Gujarat, Maharashtra and West Bengal, this does not lessen the difficulties for Andhra Pradesh in any way. One important additional reason for worry is that a sizeable part of the borrowed resources is being utilised to meet revenue deficits. For instance, as much as 43 percent of the borrowed funds have been used to meet revenue needs in Andhra Pradesh in 2002-03, which requires correctives to maintain debt at sustainable levels.

Section - IV

Further Reforms Needed

The foregoing analysis presented in this paper discussed the major reasons for launching the fiscal reform process, its implementation and the resultant effects on state finances. The fiscal reforms have brought about desirable changes in the initial years in terms of a compositional shift in expenditure, augmentation of own revenues and fiscal consolidation. For example, the proportion of expenditure allocations to social services has increased during the reform period. But the human development ratios[4] of public expenditure such as social allocation ratio (SAR), social priority ratio (SPR) and human priority ratio (HPR) of Andhra Pradesh in 1999-2000 are still below the UNDP norms. Similarly the reprioritisation of expenditure has not accorded due priority to sectors like agriculture and irrigation. For instance, the expenditure on agriculture and allied activities as a proportion of total expenditure in 2001-02 was only 2.63 percent which is less than all other states, except Assam. A state in which agriculture is still the dominant sector by several counts needs to increase expenditure on productivity related activities in agriculture. This is very much necessary to achieve the Average Annual Growth Rates as envisaged in *Vision 2020*.

Table 13: Average Annual Growth Rate Targets –VISION 2020

Year	GSDP	Agriculture	Industry	Services

2000-2005	8.6	6.1	9.7	9.5
2005-2010	10.9	6.9	11.6	12.6
2010-2015	12.4	6.3	13.8	14.0
2015-2020	14.0	5.7	14.6	15.5

Besides raising public investment in agriculture, it also requires huge investments for the development of infrastructure in view of its high correlation with the level of economic development. Large investment in the infrastructure sector is a pre-requisite for the state to move on to a higher growth path, and such investments will not be possible without further reforms.

On the revenue front, the reforms yielded good results in terms of additional own tax and non-tax revenues. But several problems such as tax evasion, corruption, tax arrears and augmentation of tax bases are still pending, which need further correction. Though there is some improvement in the cost recovery measures and user charges, there remains much more to be done, especially with regard to the returns to government investments in public sector enterprises, and the continued huge subsidies to the power sector demand further reforms. In spite of increased own revenues, the dip in central resource transfers combined with increasing revenue expenditure and enhanced investments in infrastructure have resulted in growing fiscal and revenue deficits. The government successfully achieved or was very close to the revised MTFF targets with regard to several important fiscal indicators as shown below. This raises hopes that it would achieve the objective of fiscal balance and fiscal consolidation. In order to achieve primary balance by 2005-06, revenue surplus and fiscal deficit below 3 percent by 2006-07, and for keeping the debt at a sustainable level, it requires the reform process to br intensified and continue more vigorously. Any attempts to reverse the reforms would lead to fiscal deterioration.

Table 14: Revised Targets of Medium Term Fiscal Framework 2002-07

Item	2003-04		2004-05		2005-06	2006-07
	Target	Actual	Target	Actual	Target	Target
Revenue	13.6	15.0	13.5	15.9	13.8	14.0
State's Own Revenue	9.1	10.0	9.2	10.5	9.3	9.6
Capital Outlay	2.6	2.0	2.3	3.1	2.4	2.5
Primary Surplus (+) Deficit (-)	-0.5	-0.3	-0.4		0.1	0.9
Revenue	-1.6	-1.6	-1.1	-1.0	-0.2	0.4

Surplus (+) Deficit (-)						
Fiscal Surplus (+) Deficit (-)	-4.3	-4.1	-4.1	-3.7	-3.6	-2.7
Debt	32.0	31.6	33.3	32.8	33.3	34.6

Future Fiscal Initiatives

In this section, some suggestions regarding reforms that the government can initiate in future are made. Though fiscal consolidation is the responsibility of the state, policy decisions and fiscal devolution often influence the fiscal policies of state governments. Therefore, it is necessary to mention the fiscal initiatives of the central government that help in the fiscal efforts of the state government by providing an enabling environment to achieve the goal of fiscal consolidation. The central government in its Budget 2004-05 made the following proposals that should provide fiscal relief to the states in the years to come.

- empowering states through devolution of larger resources;
- enlarging the scope of debt swap scheme;
- increasing the open market loans;
- passing on external loans on a back-to-back basis; and
- further reduction of interest rate to 9 percent on central loans with effect from 1-4-2004.

In addition, it can empower the states to impose tax on certain identified services, which will enhance the tax base of the state, by making necessary amendments in the constitution. Taking advantage of the new deal offered by the centre, the state needs to take its own initiatives within its purview.

On the revenue front, in view of the adequate buoyancy of own tax revenues and in the absence of much scope for increasing the existing tax rates of several individual taxes, it is necessary that the government should adopt state VAT from 1-4-2005. In fact, Andhra Pradesh is one of the better prepared states to implement VAT (the *Draft Act* was also prepared). With regard to stamp duty and registration fees and state excise, further computerisation, better administration, transparency and special monitoring is bound to yield more revenue. With regard to motor vehicles tax, the government can consider extending the one time tax system to vehicles hitherto not covered. Here also better administration and enforcement will yield good results. Moreover, further efforts are needed to improve the cost recovery measures to augment non-tax revenues.

On the expenditure side, a further reprioritisation and a compositional shift needs to take place wherein more resources are channeled for both physical and social infrastructure development and to non-wage O & M expenditure. A further rationalisation of both rice and non-rice subsidies followed by additional budgetary allocations to sectors such as agriculture and irrigation need to be made. The policy of encouraging private investments – both domestic and foreign – and public-private partnerships [Build, Operate and Transfer (BOT)] in the infrastructure area, especially in the power sector, needs adequate focus. The government should not introduce new schemes without a detailed study of its resource requirements and the sources of their mobilisation.

Reforms in the public sector enterprises, especially the power sector, needs further fillip to make the power sector self-reliant and competitive. In this context, mention may be made of adopting a more enduring, comprehensive, rational and a viable policy of power supply to agriculture and other subsidised segments in view of its crucial impact on the state finances.

The reforms relating to treasury, budgets, governance issues etc. should be intensified as they have an important bearing on the efficiency and productivity of public revenues and expenditures. Moreover, these issues will have their own impact on the implementation mechanisms, institutions and the delivery systems and hence should not be ignored. As soon as it assumed office in May 2004, the new government sent negative signals for the reform process by providing free power to farmers, withdrawing the user charges in hospitals etc. though it has categorically stated that the reforms would continue. Of course, it remains to be seen how the new government would pull the cart of fiscal reforms and attain the objective of fiscal balance and fiscal consolidation. Further, it is the responsibility of the present government to emulate states like Punjab and Karnataka to bring in the *Fiscal Responsibility and Budget Management Act* to ensure fiscal discipline in the state.

Endnotes

1. The Congress government which assumed office in May 2004 provided free power to farmers with effect from April 1, 2004 and allocated an additional subsidy amount of Rs.437.59 crore during 2004-05. The government also waived outstanding arrears of agricultural power consumers, an amount of Rs. 1,244 crore, as a relief measure.

2. *Debt Swap Scheme* has been introduced by the central government to enable the states to prepay their high cost debt bearing coupons in excess of 13 percent with market borrowings and small savings receipts at prevailing interest rates over a period of 3 years ending 2004-05.

3. Interest ratio is calculated as interest payments less interest receipts divided by total revenue receipts less interest payments (CAG of India).

4. The social allocation ratio is measured by taking the percentage of public expenditure on social services in total public expenditure. The social priority ratio is the percentage of social expenditure allocated to human priority concern. Human priority ratio is the expenditure on social priority concerns as a proportion of NSDP. The social priority concerns here refer to expenditure on elementary education, primary health, water supply, sanitation, and nutrition.

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