# Living under Fiscal Rules: Fiscal Management Response and Resource Allocation Choices for State of Odisha

No. 264
01-May-2019

Pratap Ranjan Jena

National Institute of Public Finance and Policy
New Delhi

# Living under Fiscal Rules
# Fiscal Management Response and Resource Allocation Choices for State of Odisha

**Pratap Ranjan Jena**

## Abstract

The paper assesses the remarkable success story of State of Odisha in making fiscal correction after adopting the fiscal rules and the policy responses. The degree of correction was one of the highest among the Indian States. The tradeoff between fiscal restraint and the development priorities assumes significance as a relatively economically weak State like Odisha maintained a very low-deficit regime by limiting the public spending for a long time. The paper highlights that while fiscal discipline improves the ability of the Government to prioritize among policy choices and improve operational management, strict imposition of self-restraint and large adjustments may lead to distortions. After a decade of controlled fiscal management, as the State has started opening up by expanding the public spending, the shrinking fiscal space, slow growth of internal revenue, and high dependence on Central funds present new challenges. The paper examines the institutional reforms in this context to address emerging fiscal architecture.

**Keywords:** Sub-national fiscal policy, fiscal federal system, Fiscal rules, Budgeting system, Medium term perspective

**JEL Classification Codes:** H61, H72, H77, E61

# 1. Introduction

Fiscal rules in the form of fiscal responsibility and budget management act (FRBM Act) remained at the core of the fiscal management system at both national and sub-national levels in India. The FRBM Act adopted by the Central Government in 2003 and later by State Governments in 2005-06 proved to be strong anchor for budget making and public policy. The fiscal outcomes for the Central Government during post FRBM Act shows that initial success in achieving the fiscal targets got disrupted due to the global financial crisis of 2008-09 and since then there has been movements towards overarching macroeconomic stabilization process and overcoming the fiscal vulnerability (Economic Survey 2017-18, GoI). The timeline to achieve FRBM target was extended several times by the Central Government (Report of the CAG, 2016). The State Governments, however, hold better record of adhering to the fiscal targets. The States have traversed a long way from the late nineties and early 2000s when fiscal reforms were undertaken to stave off the imbalance and mounting debt burden (Rao and Jena, 2009).

Fiscal stability improves the ability of the Government to prioritize among policy choices and improve operational management keeping value for money in consideration. Given the extent of functional responsibilities of the State Governments spanning across social and economic services, this becomes more crucial. Lack of fiscal discipline and budget credibility may jeopardize the choices in terms of policy objectives and resource discrepancy (World Bank, 1998). However, a strict imposition of self-restraint and large adjustments may lead to distortions in taxation and investments by the Government (Ana Corbacho and Teresa Ter-Minassian, 2013). The fiscal policy needs to respond to emerging socio-economic issues and development requirement.

Significant changes happened in the fiscal architecture relating to the Central transfers to the sub-national Governments in India in recent years. The end of five-year development plan and the Planning Commission posed new challenges for the States to reorganize budget-planning process. The central transfers now consist of more of untied fund in the form of tax devolutions following the recommendations of the Fourteenth Finance Commission. Consequent upon the enhancement of the share of the States in the central taxes, Central assistance to State Plan has been discontinued. The change in composition of Central transfers had their impact on policy responses and fiscal management practices of the States.

The change in composition of Central transfers has not been a smooth affair. While the States received higher tax devolution, the loss of plan grants required reorganization of the spending pattern. The choices to fund the existing plan schemes from the untied tax devolution or redesigning the spending priorities created interruptions and some uncertainties in fund flows to various programs and projects. Although the routing of CSS funds through State budgets started in 2014-15, uncertainties and unpredictability regarding the flow of funds from CSS persisted.

Describing the fiscal consolidation path of the State of Odisha, a relatively poorer State, assumes significance to understand the tradeoff between fiscal restraint and the development priorities. Odisha holds an impressive record of adherence to the fiscal rules since its adoption. The impact of FRBM Act to chart out a path to reduce deficit and stabilize debt burden, control over growth of expenditure, relatively better tax performance, and growing central transfers are significant factors that facilitated the fiscal consolidation in the State. While analyzing these broad views, the paper also examines the process and its impact. The paper also assesses the desired fiscal management principles contained in the FRBM Act of the State to achieve the fiscal targets and institutional improvements.

## 2. Macroeconomic Outlook

In the context of fiscal policy and budgeting of the State Governments, the contribution of various sectors to the State economy and possible revenue implication is important for which examining the macroeconomic outlook of a State becomes relevant. A stable growth process helps developing sound fiscal strategy and ensures predictability of flow of funds in the budget implementation process. The ability of the Government to assess fiscal impact of potential changes in economic circumstances helps developing robust fiscal forecasts. The theme of higher economic growth offering opportunities and lifting people out of poverty remain critical for a State like Odisha[1].

Since all the fiscal targets are expressed as ratios to the State GSDP under the FRBM Act, its trend becomes crucial parameter in assessing the fiscal targets[2]. The Central Government fixes the borrowing limit of the State by assuming a GSDP growth rate, which is usually based on the assumptions made by the Central Finance Commission. The borrowing limit in recent years is linked with the fiscal deficit limit stipulated the FRBM Act.

After the change in the methodology and in the base of the GDP series to 2011-12, it is is available since 2011-12. The back series, which was earlier in 2004-05 base, has not been firmed up yet following the new series. The GSDP numbers, starting from 2011-12 is referred here to understand the trend and the sector contributions. However, the average annual growth rate of GSDP at constant prices for Odisha from 2004-05 to 2011-12 based on old series works out to ne 7.65 percent and the same for the years from 2011-12 to 2017-18 works out to be 7.02 percent. While conclusion cannot be drawn on the performance, the two average growth numbers show continuity. The State had improved its growth trend over the years and shown the ability to sustain it. The growth process also had its impact on poverty eradication and human development (World Bank, 2007).

The GSDP growth, at constant prices, seems to have fluctuated during 2012-13 to 2014-15, reaching a low of 1.80 percent in 2014-15 after clicking a high of 9.26 percent the previous year (Table 1). As per the Economic Survey (2017-18) of Odisha, significant fall in the value of minerals and basic manufacturing products like iron and petroleum goods prices, which constitute a large share of the GSVA, was the major reason for this slump. Since the fiscal year

[1]In Jagdish Bhagwati and Arvind Panagariya, 2013, Why Growth Matters; The authors argue forcefully that economic growth, led by markets overseen and encouraged by liberal state policies would help the poor.
[2] The Stat GSDP is used as assumed base for the taxes, for which tax buoyancy is estimated to assess the resource mobilization effort. Thus, in the fiscal forecast process, the trend of State GSDP assumes significance.

2015-16, the GSDP of Odisha has regained the momentum and achieved higher growth rate. The volatility in the growth of agriculture with negative growth rates in the years like 2013-14, 2015-16, and 2017-18, has pulled down the share of agriculture sharply.

**Table 1**
**Key Aggregates of State Domestic Product (Constant Prices)**

| Item | Growth over previous year (in %) | | | | | |
|---|---|---|---|---|---|---|
| | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** |
| Gross State Value Added | 5.31 | 8.90 | 1.30 | 7.49 | 10.14 | 6.64 |
| Taxes on Products | 5.19 | 5.68 | 6.25 | 5.42 | 9.69 | 10.11 |
| Less Subsidies on Products | 3.81 | -6.77 | -0.92 | -18.23 | -1.02 | -2.07 |
| **Gross State Domestic Product** | **5.36** | **9.26** | **1.80** | **8.17** | **10.39** | **7.14** |
| Consumption of Fixed Capital | 1.13 | 21.09 | 6.00 | 6.75 | 9.07 | 7.27 |
| Net State Value Added | 5.89 | 7.29 | 0.60 | 7.60 | 10.31 | 6.54 |
| Net State Domestic Product | 5.91 | 7.78 | 1.21 | 8.38 | 10.58 | 7.12 |
| **Growth rate of economic activities** | | | | | | |
| Agriculture and Allied | 15.85 | -4.16 | 7.84 | -13.52 | 19.65 | -4.70 |
| Industry | -0.46 | 15.07 | -6.66 | 11.02 | 4.75 | 5.45 |
| Services | 7.41 | 7.79 | 7.75 | 8.11 | 10.74 | 12.42 |

***Source:*** Central Statistical Office, GoI

The decline of relative share of agriculture since 2011-12 has been a key feature of State economy (Table 2). The sector contribution to the GSDP shows that, the relative share of manufacturing has declined from 30.10 percent in 2011-2 to 26.32 percent in 2017-18. The annual growth of manufacturing also depicts volatility with couple of negative growth points. It was the service sector, which has shown a higher growth in terms of its relative share from 36.75 percent in 2011-12 to 41.15 percent in 2017-18. The lack of growth in agriculture and industry affects the ability of the State Government in creating employment inside the State and the ambitious GST collection is affected due to lack growth in the latter.

**Table 2**

**Composition of GSDP (Constant Prices)**

| Economic Activity | Percentage Share | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
| Agriculture, Forestry and Fishing | 17.03 | 18.73 | 16.43 | 17.41 | 13.91 | 15.08 | 13.42 |
| Mining and Quarrying | 11.47 | 10.67 | 11.65 | 10.54 | 12.73 | 12.67 | 12.39 |
| **Primary** | 28.50 | 29.40 | 28.08 | 27.94 | 26.64 | 27.75 | 25.81 |
| Manufacturing | 17.82 | 16.38 | 18.17 | 16.16 | 17.27 | 16.45 | 16.16 |
| Electricity, Gas, Water Supply & Others | 3.36 | 3.80 | 3.71 | 3.40 | 3.85 | 3.50 | 3.58 |
| Construction | 8.92 | 8.26 | 8.07 | 7.90 | 7.06 | 6.79 | 6.58 |
| **Secondary** | 30.10 | 28.43 | 29.95 | 27.46 | 28.18 | 26.74 | 26.32 |
| Trade, Repair, Hotels and Restaurants | 8.81 | 9.34 | 9.23 | 9.80 | 9.60 | 9.77 | 9.94 |
| Transport, Storage, Communication | 5.83 | 6.20 | 6.17 | 6.80 | 6.95 | 7.21 | 7.58 |
| Financial Services | 3.45 | 3.69 | 3.49 | 3.76 | 3.79 | 3.77 | 3.90 |
| Real estate | 7.39 | 7.28 | 7.11 | 7.40 | 7.52 | 7.23 | 7.23 |
| Public Administration and Defense | 3.74 | 3.79 | 4.70 | 4.95 | 4.95 | 4.81 | 5.95 |
| Other Services | 7.53 | 7.16 | 6.26 | 6.41 | 6.27 | 6.44 | 6.56 |
| **Tertiary** | 36.75 | 37.46 | 36.96 | 39.12 | 39.10 | 39.22 | 41.15 |

Source: Central Statistical Office, GoI

## 3. Overview of State Finances: Overcoming Restrictions to Expand the Spending Plans

Odisha has been feted as being a remarkable success story for achieving strong fiscal correction after facing the fiscal stress during late nineties and early 2000s (World Bank, 2007). While Odisha was not alone in the fiscal mire, the degree of correction was one of the highest among the Indian States. Over-expansion of government activities, loss incurring public enterprises, growing public sector salaries due to revision, and rising pension and interest payments were some of the reasons that bedeviled the fiscal management at the sub-national level (White Paper, GoO, 2001). The adoption of FRBM Act was one of the major landmarks in the fiscal reforms efforts that started in response to the crisis. The fiscal consolidation was expected to open up opportunities for budgetary reforms, expenditure planning and resource management.

The State achieved more than 8 percentage point improvement in the revenue and fiscal deficit in 2008-09 over 2001-02. The analysis of the various sources of improvements shown in Table 3 shows that enhanced revenue receipts helped the fiscal correction, with central transfers playing a key role. Total revenue receipt relative to GSDP increased by about 3.35 percentage points, where the increase in central transfers (1.74 percentage points) was higher than the rise in own revenue (1.6 percentage points). However, it was the reduction in expenditure, which played key role in the fiscal management during this period. Compression in revenue expenditure in 2008-09 over 2001-02 is quite substantial, which is of the order of 5.27 percentage points relative to GSDP. Reduction in interest payment due to lowering of average cost of debt and the decline in non-development general service contributed to revenue expenditure compression. The State Government could reduce its outstanding debt burden by a half from 51.40 per cent to GSDP in 2001-02 to 27.27 percent in 2008-09, a reduction of 24.13 percentage points relative to GSDP.

**Table 3**
**Fiscal Improvement since 2001-02**

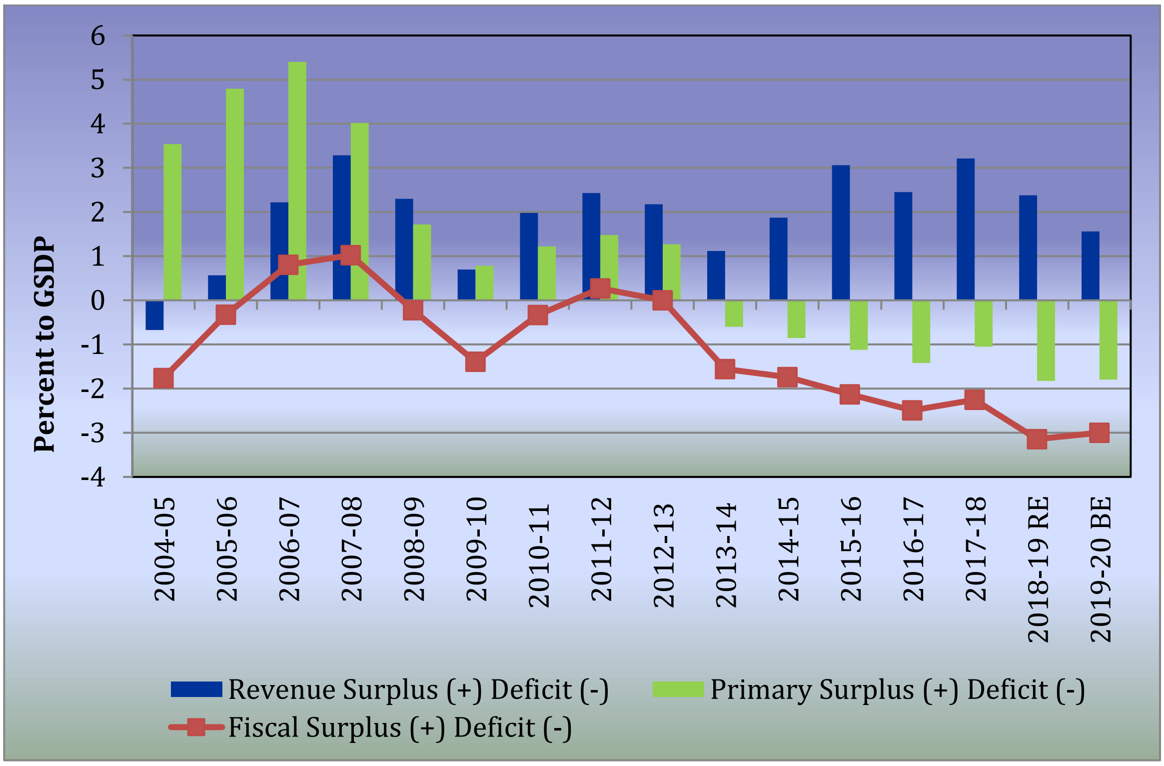
| | Percent to GSDP | | Percentage Points Improvement |
|---|---|---|---|
| | 2001-02 | 2008-09 | |
| **Total Revenue Receipts** | **15.07** | **18.42** | **3.35** |
| Own Tax Revenues | 5.28 | 5.98 | 0.71 |
| Own Non-Tax Revenues | 1.48 | 2.38 | 0.90 |
| Central Transfers | 8.32 | 10.06 | 1.74 |
| Tax Devolution | 5.67 | 6.20 | 0.53 |
| Grants | 2.65 | 3.86 | 1.21 |
| **Revenue Expenditure** | **21.13** | **15.86** | **-5.27** |
| Interest Payment | 6.06 | 2.16 | -3.90 |
| General Services | 10.87 | 5.50 | -5.37 |
| Social Services | 6.97 | 6.20 | -0.77 |
| Economic Services | 3.29 | 4.15 | 0.86 |
| Capital Expenditure | 2.43 | 2.81 | 0.38 |
| **Revenue Deficit** | **6.06** | **-2.56** | **8.62** |
| **Fiscal Deficit** | **8.49** | **0.44** | **8.05** |
| **Primary Deficit** | **2.42** | **-1.73** | **4.15** |
| **Outstanding Debt** | **51.40** | **27.27** | **24.13** |

***Source:*** Finance accounts, relevant years
**Note:** Improvements in deficit figures are shown as reduction in deficit in 2008-09 over 2001-02. The positive figures in deficit indicate the level of reduction.

The improved fiscal outcomes since after adopting FRBM Act shows that the maintained a low deficit regime, way below the specified targets, for almost a decade. During the period from 2005-06 and 2012-13, there were four year in which the State achieved fiscal surplus and in others abysmally low level of deficit - less than one percent, except the year 2009-10, when it went past 1 percent (Figure 1). The fiscal surplus arises when the revenue surplus exceeds the capital outlay, leading to higher repayments than borrowing. The fiscal deficit started increasing since 2013-14 and in 2015-16, it crossed 2 percent, although marginally.

The policy decisions over the years do not give a clear perception regarding the necessity to adopt conservative fiscal stance and maintain a strict limit on fiscal deficit or arriving at fiscal surplus. Government of Odisha, however, utilized this unprecedented low deficit period to reduce its debt burden. It needs to be noted here that the 14th Finance Commission extended the facility to the States to incur another 0.5 percent of GSDP of fiscal deficit beyond the FRBM target of 3 percent, based on the record of prudent fiscal management as recommended.

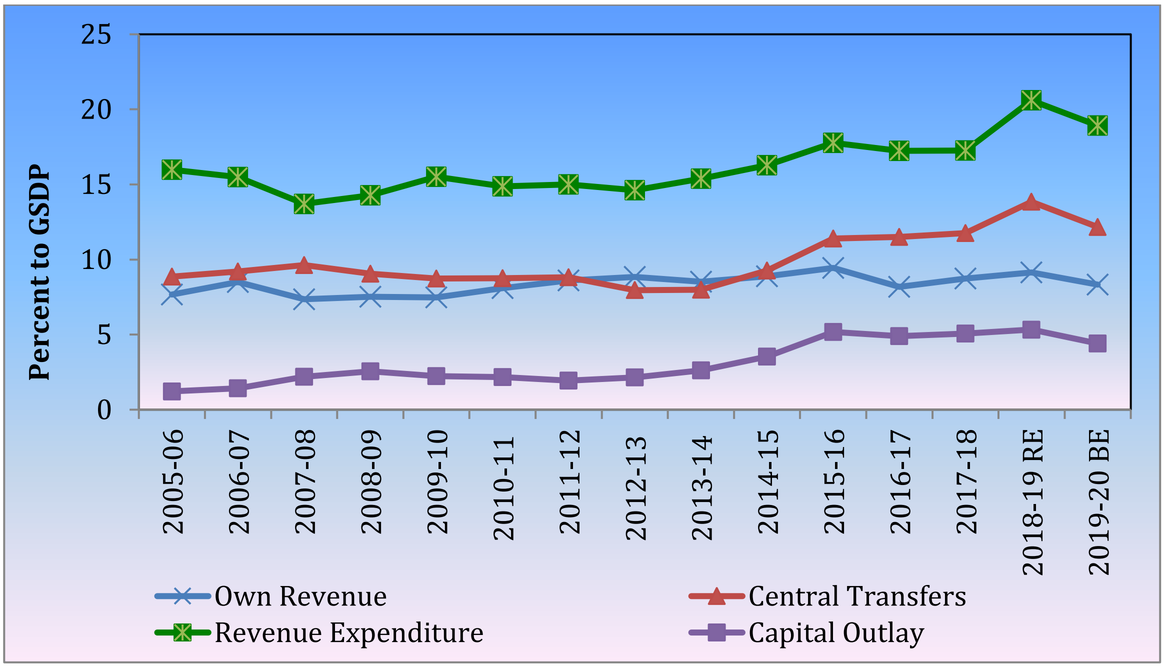
**Figure 1 Fiscal Outcomes**




The surpluses/deficits are not the only indicators of a robust public financial management in the State. The underlying fiscal variables may have different implications for the prospects of the State and its citizens. The unprecedented success with continuing low deficit regime for a long time needs to be explained through rise in revenue receipts or restriction on spending, two ways in which this could happen. The comparison of fiscal outcomes in 2008 over 2001-02, a pre-FRBM Act period, shown in Table 3 demonstrated that, while revenue receipts played an important role, it was the control of public spending that helped the State achieve fiscal consolidation.

The fiscal trends since 2005-06 shown in Figure 3 give broad indicator of fiscal management in the State that involves long period of constriction and recent upward trend in fiscal activities. The State Government managed to keep control over the revenue expenditure, which remained on an average 15 percent of the GSDP during 2005-06 to 2013-14. It was only in 2014-15, the revenue expenditure started rising beyond 16 percent of the GSDP and in 2017-18, it reached at 17.27 percent. Capital outlay by the State Government, which constitutes the major component of total investment in the State, has been around 2 percent of GSDP until 2013-14, about a decade. It increased to 3.52 percent in 2014-15 and since then further to 5.07 percent in 2017-18.

**Figure 2 Broad Fiscal Trends**




The revenue growth exhibited a small increase, which otherwise could have provided flexibility (Figure 2). While the internal revenue effort is directed mostly towards tax mobilization, in Odisha, the royalty from mining has been an important source of non-tax revenue. Own revenue receipts increased from 7.68 percent in 2005-06 to 8.09 percent of GSDP in 2010-11, a marginal change of 0.41 percentage points. Between 2011-12 and 2017-18 the trend of own revenue receipts changed from 8.61 percent to 8.73 percent, a small change of 0.12 percentage points. Central transfers, which included share in Central taxes and grants through finance commission, plan grants, and centrally sponsored schemes (CSS), remained flat as percentage to the GSDP until 2013-14. The routing of all the CSS through State exchequer in 2014-15 increased the Central transfers. It was the decision of the 14th Finance Commission to increase the share of central taxes in the divisible pool that imparted enhancement in the Central transfers starting from 2015-16.

After almost a decade of conservative management, the State Government started opening up starting from 2014-15 (Table 4). There has been enhancement in public spending in both revenue and capital accounts. Rise in Central transfers helped the State Government expanding spending activity. The aggregate revenue receipts, which showed a revival in 2014-15 as against the previous year, improved significantly to 20.48 percent to GSDP in 2017-18. Further improvement has been projected in revised estimates for 2018-19 and budget estimates for 2019-10. While the own revenue declined marginally during 2014-15 and 2017-18, the upturn in Central transfers was as high as 2.5 percentage points relative the GSDP. Improved tax devolution was the driving force for the Central transfers since 2015-16.

## Table 4: Fiscal Profile of Odisha: An Overview

*(Percent to GSDP)*

| | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 RE | 2019-20 BE |
|---|---|---|---|---|---|---|---|---|---|
| **Total Revenue Receipts** | **17.43** | **16.79** | **16.51** | **18.14** | **20.84** | **19.70** | **20.48** | **22.98** | **20.48** |
| **Own Revenue** | **8.61** | **8.83** | **8.52** | **8.88** | **9.44** | **8.19** | **8.73** | **9.13** | **8.33** |
| Own Tax Revenues | 5.82 | 5.74 | 5.70 | 6.31 | 6.81 | 6.06 | 6.71 | 6.60 | 6.11 |
| Own Non-Tax Revenues | 2.79 | 3.09 | 2.83 | 2.57 | 2.63 | 2.13 | 2.02 | 2.54 | 2.22 |
| **Central Transfers** | **8.82** | **7.96** | **7.99** | **9.26** | **11.40** | **11.51** | **11.75** | **13.84** | **12.16** |
| *Tax Devolution* | 5.29 | 5.34 | 5.14 | 5.15 | 7.12 | 7.51 | 7.52 | 7.97 | 7.25 |
| *Grants-in-Aid* | 3.53 | 2.62 | 2.84 | 4.11 | 4.27 | 4.00 | 4.24 | 5.87 | 4.90 |
| **Revenue Expenditure** | **15.01** | **14.61** | **15.39** | **16.27** | **17.77** | **17.24** | **17.27** | **20.60** | **18.92** |
| ***General Services*** | **4.73** | **4.75** | **4.62** | **4.62** | **4.55** | **4.43** | **4.87** | **5.78** | **5.58** |
| Interest Payment | 1.21 | 1.26 | 0.97 | 0.89 | 1.01 | 1.07 | 1.20 | 1.32 | 1.20 |
| Pension | 2.06 | 2.06 | 2.01 | 2.04 | 1.92 | 1.81 | 2.09 | 2.53 | 2.47 |
| ***Social Services*** | **6.21** | **5.72** | **6.31** | **6.67** | **7.45** | **7.32** | **7.11** | **8.92** | **7.83** |
| General Education | 2.88 | 2.69 | 2.79 | 3.13 | 3.34 | 3.13 | 3.31 | 3.86 | 3.47 |
| Medical and Public Health | 0.49 | 0.56 | 0.55 | 0.80 | 0.90 | 0.99 | 0.91 | 1.16 | 0.99 |
| **Economic Services** | **3.78** | **3.90** | **4.15** | **4.72** | **5.50** | **5.23** | **4.99** | **5.59** | **5.24** |
| **Assignment to LBs** | **0.29** | **0.25** | **0.30** | **0.26** | **0.28** | **0.27** | **0.30** | **0.31** | **0.27** |
| **Capital Expenditure** | **1.95** | **2.15** | **2.62** | **3.52** | **5.17** | **4.90** | **5.07** | **5.33** | **4.40** |
| **Revenue Deficit** | **-2.43** | **-2.18** | **-1.12** | **-1.87** | **-3.06** | **-2.45** | **-3.21** | **-2.38** | **-1.56** |
| **Fiscal Deficit** | **-0.27** | **0.00** | **1.56** | **1.74** | **2.13** | **2.49** | **2.25** | **3.14** | **3.00** |
| **Outstanding Debt** | **18.22** | **16.46** | **15.05** | **16.05** | **17.95** | **18.57** | **23.00** | **24.68** | **23.47** |

***Source:*** Finance Accounts of relevant years
**Note 1:** Negative sign in deficit indicates surplus

Rising public spending in recent years may represent a sensible strategy of the State Government to take advantage of the fiscal space created by prudency shown in the previous years. While revenue expenditure showed an improvement of 2.26 percentage points during 2011-12 to 2017-18, the rise in capital outlay was higher at 3.13 percentage points. Instead of treating the capital outlay as residuary in the system, the Government has enhanced it, which increased the fiscal deficit. After remaining at 2 percent of GSDP for a long time, the surge in capital outlay is expected to enable the State to spend on infrastructure.

The fiscal space has been shrinking in the State as the fiscal deficit in last two budgets has already touched the limits prescribed by the Act. If the budget projections relating to revenue receipts, including that of the Central transfers are realized, the spending decisions will come through. For the future years, the State does not have the luxury of the unused fiscal space. The trend of revenue receipts will determine the level of public spending. Given the need for investment in infrastructure, human development, and other poverty alleviation programs, fiscal tightening from here on may not be feasible.

Despite rise in internal revenue in absolute numbers, from Rs.6534 crores in 2005-06 to Rs.36312 crores in 2017-18, its growth remained muted as percentage to the GSDP. Own tax receipt, during 2004-05 to 2017-18, shows a buoyancy coefficient of 1.090 (Table 5). A tax is considered buoyant if the revenue increases more than proportionately in response to a rise in GSDP. The own tax receipts of Odisha, has grown marginally higher than the growth rate of GSDP. The taxes like sales tax, State excise, electricity duty, and stamp duty, during this period, have shown buoyancy higher than one. The non-tax revenue, where the mining royalty is the major component, has not shown any growth as percentage to the GSDP over the years. In fact as percentage to the GSDP, it has gone down from 2.79 percent in 2011-12 to 2.02 percent in 2017-18.

According to the tax-GSDP ratio across the general category States in India during 2011-12 to 2014-15, Odisha was at the lowest four with an average ratio of 5.9 (Figure 3). Average ratio for all the 17 general category States works out to be 6.9 percent. The State, however, showed improvement as it climbed to 9$^{th}$ position with ratio of 6.53 percent as compared to the average of all general category being 6.42 percent during the next three years. The tax effort of the State has shown some improvement as compared to the Indian States in recent years.

**Table 5: Buoyancy of Taxes: 2004-05 to 2017-18**

| | |
|---|---|
| Own Tax Receipts | 1.090 |
| Sales Tax | 1.104 |
| State Excise | 1.395 |
| Motor Vehicle Tax | 0.778 |
| Goods and Passengers | 0.901 |
| Tax on Duties on Electricity | 1.135 |
| Land revenue | 0.977 |
| Stamp Duty | 1.079 |
| Taxes on Profession | 0.669 |
| Other Taxes | 0.977 |

***Source (Basic Data):*** Finance Accounts and State Budget 2019-20

The State needs to improve the tax-GSDP ratio to sustain the spending decisions. The tax buoyancy of little more than one and higher GST received in 2017-18 has helped the rise in own tax revenue. The revised estimates of 2018-19 and budget estimates for 2019-20, show moderation of tax-GSDP ratio as compared to 2017-18. The dependence of the State on Central transfers to sustain its spending plan continues to be high and increased after 2015-16. The relative share of own revenue remained less than that of the Central transfers in most of the years during 2004-05 to 2017-18 (Figure 4).

**Figure 3: Tax GSDP Ratio across States**
**(Two periods: 2011-12 to 2014-15 and 2015-16 to 2017-18)**

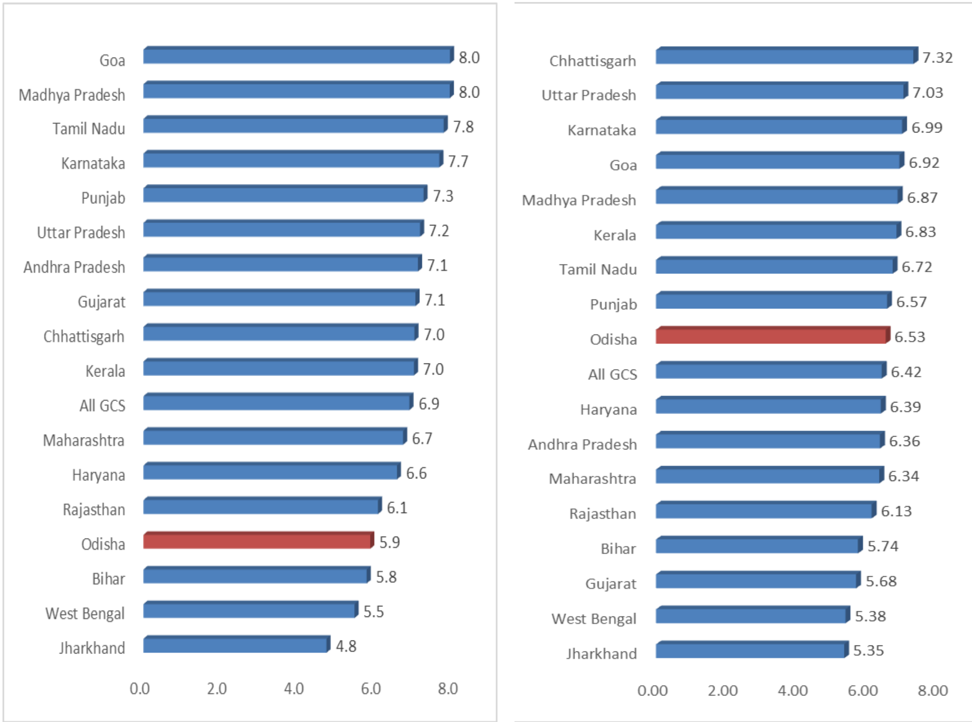
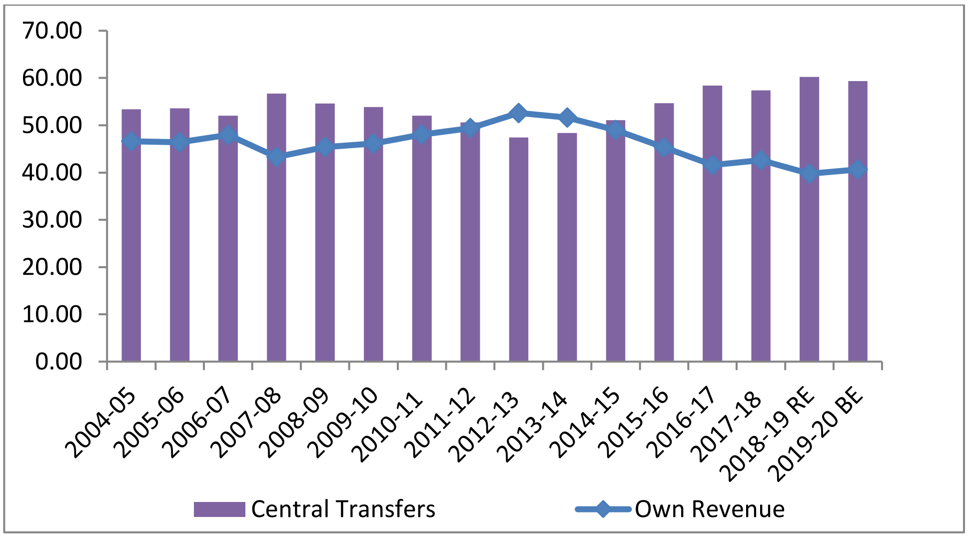



**Figure 4: Relative Share of Own revenue and Central Transfers**




## Public Expenditure Trends and Priorities

The trend of public expenditure over the years indicates changes in Government priorities. First, the rise in public spending in recent years has augmented the relative share of capital outlay as compared to the revenue expenditure, which usually dominates the public spending. The average share of capital outlay was 11 percent for the period 2004-05 to 2010-11. This has increased to 18 percent during 2011-12 to 2017-18, driven by a late surge starting from 2015-16. Second, composition of total expenditure of the State shows that the share of public spending on developmental works has been increasing consistently at the cost of debt repayment (Table 6). This is in agreement with the post FRBM Act fiscal management of the Government, when fiscal deficit and consequent borrowing remained low.

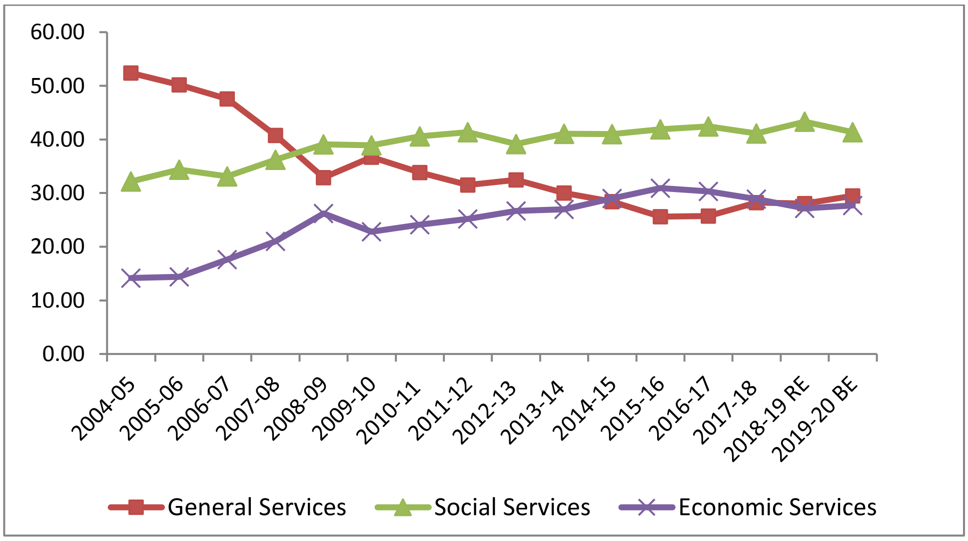
Although, the growth of revenue expenditure remained restricted for a long period, there have been shifts in spending pattern. The quality of revenue expenditures has improved in recent years as the share of less directly productive general services has shrunk and those of social and economic services have increased (Figure 5). This should translate into greater value of public expenditure for the citizens of the state. Education, health, social welfare, and nutrition, agriculture, and rural development have emerged as priority areas. This rise in revenue expenditure did not have any disruptive effect as the fiscal deficit remained below the 3 percent target of the FRBM Act.

**Table 6 Composition of Total Expenditure**

*Percent*

| Heads | 2007-08 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|---|---|
| **Total Expenditure net of debt repayment** | 44 | 61 | 65 | 69 | 70 | 69 | 66 | 68 |
| **Public Debt** | 55 | 38 | 35 | 30 | 30 | 31 | 34 | 31 |
| **Loans and Advances** | 0.93 | 0.97 | 0.32 | 0.60 | 0.40 | 0.31 | 0.00 | 1.37 |

**Figure 5: Composition of Revenue Expenditure**



The level of committed expenditure, which is contractual, committed, and pre-determined in nature, tend to influence the development spending of the Government. Higher share of public money going towards wages and salary, pension payments, and interest payment reduces the discretionary expenditure on providing public services. The dominance of committed spending was evident in Odisha as its share was as high as 61.77 percent in 2007-08, which further increased to 63.72 percent in 2009.10 (Table 7). The rise in committed spending in this period was mainly due to rise in salary payments. The share of committed spending has moderated since 2011-12. The share of interest payment has shown sharp decline due to decline in debt burden, as alluded earlier. While the share of salary and wages seems to have been stabilized, the pension spending continues to grow.

**Table 7: Share of Committed Expenditure in Revenue Expenditure**

*Percent*

| Year | Interest Payments | Pensions | Salaries and Wages | Total Committed Expenditure |
|---|---|---|---|---|
| 2007-08 | 21.83 | 10.16 | 29.77 | 61.77 |
| 2008-09 | 13.64 | 9.79 | 34.81 | 58.24 |
| 2009-10 | 14.01 | 12.98 | 36.73 | 63.72 |
| 2010-11 | 10.42 | 13.66 | 38.20 | 62.29 |
| 2011-12 | 8.04 | 13.72 | 26.20 | 47.97 |
| 2012-13 | 8.65 | 14.07 | 24.89 | 47.60 |
| 2013-14 | 6.33 | 13.07 | 24.12 | 43.53 |
| 2014-15 | 5.50 | 13.18 | 25.17 | 43.84 |
| 2015-16 | 5.69 | 17.77 | 31.65 | 48.12 |
| 2016-17 | 6.20 | 17.24 | 23.84 | 40.56 |

One of the major shifts in the fiscal policy management in the State has been the enhanced focus on the capital outlay. For a long time, particularly after the implementation of the FRBM Act, the capital outlay remained low. This was not only due to the fiscal exigency to keep the deficits low; there were structural problems that hindered the implementation of high value projects. The share of capital expenditure remained relatively low until 2012-13 after which it had started showing improvement. The share of capital expenditure witnessed a sharp rise in 2015-16, as it increased to 22.52 percent. This is almost double of the level spent in the year 2011-12. The State Government continued to give emphasis to capital out in next two years.

While it is acknowledged that public investment contributes to growth process more directly, it is important to finance the identified public investments with high social returns. The Government should carefully undertake the investment management with efficient mechanism for appraisal, selection, costing, and monitoring of public investment projects.

The relative share of spending heads in total expenditure (net of debt repayment, loans, and advances) is given in Table 8 to assess resource allocation priorities of the State. It indicates that that interest payment, pension, education, water supply, sanitation and urban development, welfare activities, agriculture, rural development, irrigation and transport have been big spending items. While interest payment on outstanding debt was a big-ticket item, its share has come down in post-FRBM Act period. The share of pension outgo continues to be large. The spending on education and health continues to be priority areas. The sectors that have emerged as focus areas, as is evident from the rising share in expenditure, are water supply, sanitation housing and urban development, social welfare and nutrition, agriculture, rural development, irrigation, and transport. Broadly, infrastructure development, urban development, and agriculture services have emerged as the priorities for the State Government.

**Table 8: Relative Share of Spending items in Total Expenditure**
***(Net of Debt Repayment)***

| Heads | 2005-06 | 2007-08 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|---|---|---|---|
| Interest Payment | 29.76 | 18.81 | 9.15 | 7.15 | 7.57 | 5.43 | 4.53 | 4.41 | 4.85 | 5.38 |
| Pension | 9.77 | 9.22 | 12.03 | 12.20 | 12.35 | 11.20 | 10.86 | 8.41 | 8.25 | 9.37 |
| Admin. Services | 5.14 | 5.41 | 6.33 | 6.69 | 6.74 | 7.15 | 6.36 | 5.65 | 5.46 | 5.55 |
| Local Bodies | 1.00 | 1.71 | 1.29 | 1.70 | 1.47 | 1.68 | 1.32 | 1.21 | 1.22 | 1.36 |
| Education Sports Art and culture | 15.80 | 15.88 | 19.75 | 17.72 | 16.71 | 15.85 | 16.41 | 15.26 | 14.63 | 15.66 |
| Medical and Public Health | 3.19 | 3.63 | 3.80 | 3.49 | 4.04 | 3.68 | 5.14 | 4.86 | 5.69 | 4.94 |
| Water Supply Sanitation Housing and Urban Dev | 3.68 | 6.06 | 3.32 | 2.83 | 3.42 | 4.43 | 4.40 | 5.40 | 5.92 | 4.06 |
| Welfare of SC/ST/OBC | 2.53 | 2.80 | 3.62 | 3.26 | 3.80 | 3.29 | 3.01 | 3.19 | 2.94 | 2.96 |
| Social Welfare and Nutrition | 2.74 | 3.19 | 3.60 | 4.63 | 5.92 | 6.20 | 5.64 | 4.99 | 4.59 | 5.65 |
| Other Social Services | 4.82 | 2.76 | 3.86 | 6.52 | 3.13 | 4.96 | 2.87 | 2.71 | 3.02 | 3.12 |
| Agriculture | 4.20 | 4.57 | 8.53 | 8.50 | 9.50 | 9.14 | 9.27 | 8.14 | 8.07 | 6.39 |
| Rural Dev. | 3.51 | 4.19 | 4.43 | 4.71 | 4.99 | 5.61 | 7.16 | 9.77 | 9.61 | 9.72 |
| Irrigation | 4.91 | 9.08 | 7.09 | 6.70 | 6.98 | 6.78 | 6.81 | 7.90 | 9.22 | 9.43 |
| Energy | 0.28 | 0.92 | 0.86 | 0.53 | 0.69 | 1.50 | 1.03 | 1.92 | 2.56 | 2.26 |
| Industry | 0.53 | 0.79 | 0.83 | 0.65 | 0.56 | 0.59 | 0.60 | 0.64 | 0.58 | 0.73 |
| Transport | 3.58 | 6.41 | 7.01 | 6.24 | 7.11 | 7.34 | 10.40 | 12.41 | 10.30 | 10.10 |
| General Eco. Services | 2.16 | 2.14 | 1.51 | 3.71 | 2.34 | 2.23 | 1.81 | 1.12 | 1.04 | 1.23 |

The notable achievement of the fiscal management in the State has been the reduction of debt-GSDP ratio. Maintaining the debt burden of the State at sustainable level remains one of the major objectives of the fiscal management of the State as reflected in the FRBM Act. The State Government amended the FRBM Act to include the debt-GSDP ratio targets suggested by the Central Finance Commissions. The decline in the average cost of debt of the state because of the debt restructuring formula of the Twelfth Finance Commission has helped in lowering the debt burden. The debt management process in Odisha also involved keeping the debt stock low by prepaying some of the costly loans to ease up the interest outgo.

The reduced indebtedness will make it easy for the State Government to cope with any new fiscal restructuring path recommended by the 15th Finance Commission. The debt-GSDP ratio of the State, which was about 50 percent in 2001-02, has gone down significantly to 18.57 percent in 2016-17 . The increase after that to about 23 percent remains below the 14th Finance Commission's target of 25 percent, which formed their basis for allowing flexibility in fiscal deficit. The 15th Commission might consider the recommendations of the FRBM Review Committee to reduce the debt-GSDP ratio to 20 percent.

# 4. The Role of Fiscal Management Principles Enunciated in the FRBM Act

The FRBM Act contains mandatory fiscal targets and principles for fiscal management, which are guiding in nature. Establishing fiscal transparency, medium term framework for budget management, improving predictability in tax system, and improving institutional measures have been broad features in this context. These objectives help in developing institutional aspects of a sound public financial management system, and help in maintaining fiscal discipline, effective allocation of resources and Efficient Provision of Public Services (Allen Schick, 2013).

The FRBM Act in India continues to be concerned more about fiscal targets and its success to determine the macroeconomic stability. The reform of public financial management systems in the country, although acknowledged and initiatives were taken based on the recommendation of the expert committees, the process remains as work in progress (Jena, 2016).

In the list of policy interventions, prescribed as fiscal management principles, many are specific and can be assessed from the working of the budgeting system. However, some are generic in nature in the economic policymaking and have overarching governance objectives. The principles enshrined in the FRBM Act state that the State Government should respond appropriately to achieve the stipulated fiscal targets relating to deficits and debt. The principles include series of guidance in the area of debt management, tax policy, expenditure management, and institutional improvements to enhance efficiency. Some of issues in this context have been discussed in the following sections.

## 4.1 Medium Term Perspective

The fiscal management principles make a strong pitch for conducting the budgeting with a medium term perspective, when it calls upon the Government to take policy decisions with due regard to their financial implications on future generations. The Medium Term Fiscal Policy (MTFP), which forms the core of the FRBM related documents, was expected to lead to medium term perspective in budgeting. The MTFP is laid out in the act to provide a fiscal plan of the State Government for the ensuing budget year and two outward years. The features like three-year projection of fiscal outcomes as percentage to the GSDP, inclusion of assumption relating to the projections, requirement of keeping balance between revenue receipts and revenue expenditure and using capital receipts for generating productive assets have been considered to facilitate a medium term perspective. The MTFP is accompanied with another two statements - Macro-economic Statement and fiscal policy strategy statement.

The need for a medium term perspective as compared to a short horizon of an annual budget was the compelling reason behind the rapid expansion of this instrument (Brumby and Hemming, 2013). While the MTFP provides a platform to articulate the fiscal policy objectives and fiscal constraints in quantitative and qualitative terms and forms the basis to assess the fiscal impact of the budget provisions, it did not go further to infuse medium term perspective. The budgeting has remained an annual activity in India. The Central Government has taken lead in incorporating the medium term expenditure framework (MTEF) through the FRBM Act provisions. However, it is a work in progress and continues to provide projection of expenditure variables across the departments (Jena, 2018). In this endeavor, in addition to the Finance Department, spending departments have to take lead as stakeholders in budget preparation process.

### 4.2 Debt Management

The debt management principles of the FRBM Act require the State Government to maintain debt at a prudent level and manage guarantees and other contingent liabilities prudently. A related principle calls upon the Government to use borrowed funds for productive purposes and create capital assets. As the Central Finance Commissions provided a benchmark of debt limit for States as part of their fiscal restructuring plan, the limit became the basis to assess the debt sustainability. As we have discussed earlier, the State Government has reduced its debt stock significantly since the adoption of the FRBM Act. As the State Government has started expanding spending programs and capital outlay, future years will test it capacity to balance prudency and development requirements. The recommendation of the upcoming 15th FC regarding the debt-GSDP ratio will be crucial in this regard.

### 4.3 Principles relating to Tax and Non-taxes

The principles provide comprehensive policy prescriptions relating to **taxes and non-taxes.** Maintaining stability and predictability in the level of tax burden, avoiding incentives, concessions and exemptions, and pursuing the tax policy with due regard to economic efficiency and compliance cost are the core features of any tax policy. Neither the own tax nor the non-tax revenue has shown a sharp rise. As percentage to GSDP, both show slow improvement in recent years. There have not been many changes in tax rate of the individual State taxes. The VAT regime, introduced in 2005, has stabilized in terms of rate and base structure in the State. The starting of GST in 2017-18, further defined the indirect tax reform in the country. While GST forms the major source of tax revenue, a collaborative institutional structure has been placed at the country level to manage and monitor the progress.

### 4.4 Resource Allocation to Priority Areas

The FRBM Act also calls upon the State to pursue expenditure policies that would provide impetus to economic growth and poverty reduction. Indeed, fiscal discipline enables the Government to take prioritized decisions. Institutional improvements relating to expenditure management that includes budgetary environment, allocative efficiency, hard budget constraint, and technical efficiency will facilitate this (Campos, Ed, and Sanjay Pradhan, 1996). The aggregate trend of the public expenditure over the years shows the improvement in quality with rising share of non-debt public spending and in recent years the improvement in capital outlay. The composition of total expenditure (net of debt repayment) shows that the Government has emphasized on education, social welfare and nutrition, irrigation, sanitation and urban development, agriculture and transport sectors. This paper, however, does not attempt to link direct relationship of these priorities with the respective results.

However, the record of the State in terms of growth and development indicators would provide us with some perceptions regarding the policy implications. It also needs to be noted here that the growth of a particular State does not entirely depend upon the fiscal policy decision of the State Government. There are other factors like interventions of the Central Government in infrastructure creation, poverty eradication programs, employment generation and so on and so forth.

**Table 9: Socio Economic Indicators**

| Socio Economic Indicators | Previous status | Latest status | All India Status | Highest in all states |
|---|---|---|---|---|
| Rural-Urban ratio of Population | 85:15 | 83:17 | 69:31 | 89:11 (Bihar) |
| Sex Ratio Females/1000 Males | 972 | 979 | 943 | 1084 (Kerala) |
| Literacy Rate (%) | 63.08 | 73.5 | 74 | 94% (Kerala) |
| Male literacy rate(%) | 75.35 | 82.4 | 82.1 | 96.10 % (Kerala) |
| Female literacy rate (%) | 50.51 | 64.4 | 65.5 | 92.10% (Kerala) |
| Working Population (%) | 38.8 | 41.8 | 39.79 | 47.68 (Chhattisgarh) |
| Infant Mortality Rate (IMR) [SRS] (2016) (per 1000 birth) | 51 (2013) | 44 | 34 | 47 (MP) |
| MMR - [SRS] (2014-16)* | 222 (2011-13) | 180 | 130 | 201 (U.P.) |
| Malnourished Children [NFHS 4]-2015-16 | | 34.4 | 35.7 | 47.8% (Jharkhand) |
| Gross Enrolment Ratio Primary (%) [DISE-2015-16] | 105.53 | 103.73 | 99.21 | |
| Gross Enrolment Ratio Upper Level (%) [DISE-2015-16] | 90.13 | 94.26 | 92.81 | |
| HDI 2018 | 0.58 (2015) | 0.59 | 0.63 | 0.78 (kerala) |
| Household availing banking | | 45 | 58.7 | |
| Safe Drinking Water | | 75.3 | 85.5 | 89.1 (HP) |
| Electrified Villages (%) | | 98.69 | 95.69 | 100% (Kerala) |
| Poverty ratio (2011-12) | 57.2 (2004-05) | 32.59 | 21.92 | 39.9 (Chhattisgarh) |
| Replacement Rate of Population (2016) | 2.4 (2009) | 2.00 | 2.2 | lowest in Sikkim (1.2) & highest Bihar (3.3) |
| Ease of doing Business (2018) | 52.12 (7th rank) | 92.09 (14th rank) | | 98.42 (AP) 1st rank |

| | | | | |
|---|---|---|---|---|
| Credit deposit ratio (2016-17) | 71.95% (2015) | 68.96% | | 119% (Tamil Nadu) |
| Per capita availability of power (KWH)-2016-17 | 634.1 (2015-16) | 637.8 | 938.1 | 2962 (Goa) |
| Length of National Highways (Kms) -2016-17 | 4645 | 4838 | **101011** | 8483 (UP) |
| Length of State Highways (Kms) -2016-17 | 4109 | 4187 | **176166** | 39000 (MP) |

Some of the socio-economic indicators given in Table 9 show that while State had made progress in many areas, there is a need to catch up with others. The educational achievements in terms of overall literacy seem to have been improved, but the State lags behind in female literacy. Despite progress, health indicators like MMR and IMR remains stubbornly high. Similarly, the record of the State in terms urbanization, extent of malnourishment among children, and provision of safe drinking water has not been very encouraging. The State however, stabilized the population growth and improved the availability of infrastructure.

The most notable economic indicators, that shows the relative position of the Odisha among the Indian States is the extent poverty, which stands at 32.59 percent in 2011-12 estimation. The State needs to be lauded for efforts made to reduce chronic poverty in the State, much needs to be done. The performance of Odisha in alleviating poverty has been remarkable during 2005 to 2012 (Odisha Economic Survey, 2015-16). About 82 lakh people shifted out of the poverty trap during this period. The poverty level has gone down from a staggering 57.20 per cent in 2004-05 to 32.59 per cent in 2011-12, a substantial change of 24.61 percentage points.

### 4.5 Institutional Reforms

The principles also include broad spectrum of **public financial management (PFM) objectives** like getting value for money from the use of public resources, maintaining physical assets, increasing transparency, minimizing fiscal risks associated with public sector undertakings (PSUs), realistic budget formulation to minimize the deviations during the course of the year, and an appropriate cash management practice. The FRBM Act is one of the milestones, which became useful as benchmark for fiscal consolidation. This alone will not be sufficient for the ambitious agenda set forth in the principles under the Act. The complex Government systems, PFM processes, and institutions need to be improved upon to inculcate efficiency.

The State Government has taken several initiatives including introducing outcome budget, introducing cash management system, formulating annual maintenance plan and computerization of treasury activities and integrated financial management system (IFMS) to strengthen institutional aspects of public expenditure management.

The State Government adopted **outcome budget** to convert outlays to outcomes. This is based on the template provided in the Central outcome budget (Jena, 2016). The objective of the outcome budget to inculcate performance orientation in the budgeting system and influence the resource allocation based on the utilization of the performance information of the programs has not been served. The outcome budget is still bereft of realistic performance information for the programs. The routine nature of producing the outcome budget by the departments has not helped the process of utilizing the performance information in the programme formation and resource allocation decisions. However, outcome budget provides an opportunity to improve the performance orientation in the budgeting system, which is crucial at the sub-national level.

The introduction of **cash management system** has improved utilization of the budgetary allocation and reduced the tendency of 'March Rush' considerably. While the uncertainties in the timing of flow of Central funds persists, the State Government should monitor the limit set for the last quarter of the financial years is adhered to by the departments.

The Government of Odisha has made significant improvement in the **treasury computerization** process and establishing the **IFMS system**. In this endeavor, the Central Government made important contribution. This is expected to provide a comprehensive electronic system to facilitate capturing of financial transactions of the State Government. This system has been designed to provide services to various users such as the finance department, spending departments, field offices, and AG and treasuries. An operational IFMS will have several other features to integrate the financial transactions relating employees through HRMS, plan finance monitoring system for monitoring of Central schemes, the system for receipt of online accounts, and the RBI for advising electronic payments and receiving scrolls for electronic payments and receipts.

The Fiscal management principles sought to improve the **fiscal transparency** through disclosure of sufficient information to allow the public to scrutinize the conduct of fiscal policy and the state of public finances. It has been acknowledged that the fiscal transparency in India has been high (Jena, PEFA India, 2010). The availability and accessibility to fiscal information relating to Odisha has improved significantly. The Act specifies that the Government should provide information with regard to changes in accounting standards, budgetary documents, and new policies, detailed accounts of fiscal variables, details of employees and salary payments, and revenue, and expenditure details. While availability of data and information removes the opaqueness in the complex Government procedures, it is not sufficient condition to enhance transparency. It is important to provide the measure of the quality of public financial management system that improves the credibility of the Government.

## 5. Budget Credibility: Ability to Transform Plans to Reality

One of the important indicators of the quality of the PFM system is that the budget is realistic, and it is put into effect as intended (PEFA, 2016). Respecting the sanctity of the budgetary provisions increases the credibility of Governments policies. The fiscal management principles to the FRBM Act call upon the Governments to formulate the budget in a realistic and objective manner with due regard to the general economic outlook and realistic revenue prospects and minimize deviations during the course of the year. A realistic budget show the ability of the Government to deliver the public services as enunciated in the Government policies.

Governments do adjust their budget during the course of the year. However, the budget adjustments are many times a response to crises or economic exigencies. When surpluses are expected from some programs, these are also employed during the year prompting some adjustment in the budget. The Government of Odisha makes one adjustment, which is called supplementary in the Indian budgetary parlance, during the course of the year.

Budget credibility does not entirely depend upon the efforts of the State Governments. The pattern and timing of fund flow from the Central Government also influences the spending. Timeliness of reliable information on the allocation from the Central Government for the coming year helps the sub-national Government to take resource allocation decision and the actual flow determines the spending pattern. These issues are relevant in the present context.

The budget reliability is observed by actual revenue generated and expenditure incurred with the original approved budget. Unbiased revenue projections are crucial in the budget preparation process as the spending plan and the ability of the Government to provide services is based on this. Overestimating the revenues leads to unreasonably large resource allocations that would require either an unsettling reduction during the year or an unplanned borrowing to maintain spending plan. Overtly conservatism in revenue forecasts, on the other hand, results in utilization of the surplus revenue in projects and schemes that have not gone through the detailed scrutiny of the budget.

The expenditure variations, while reflect the malaise caused by the biased revenue projections, can also occur due to reasons other than the revenue variations. The macroeconomic shock or exceptional events can derail any carefully planned spending pattern. The capacity of the Government to implement the policies, structural bottlenecks, hurdles posed due to legal and environment factors are issues in this regard.

The deviations of realized revenue and spending figures and budget outcomes from the budget projections have been given in Table 10. The performance of own tax revenue as compared to the budget estimates seems to have been reasonably good. During last three years, the own tax revenue exceeded the budget projections in two years. The deviation, either through falling short or exceeding the target raises questions regarding the quality of projections. The absolute deviation, however, is not large. The annual average growth rate of 13.39 percent over a GSDP growth rate of 11.30 percent at current prices during 2012-13 to 2017- 18, made it a stable source of revenue without much volatility.

The deviation in the own non-tax revenue has been volatile over the period. The large swings, both positive and negative, make the budget projection unreliable. The non-tax revenue constitutes about 15 percent of the total revenue receipts. The performance of various components of non-tax revenue like mining royalties, forestry, irrigation charges, and interest receipts vary across the years. Slowdown in mining activities and changes in prices of iron ore during the year affects the non-tax revenue of the State. The annual average growth rate of 5 percent shows slow growth of actual receipts.

The deviation of Central transfer, which was large until 2014-15, moderated since then due to tax devolution surpassing the budget estimates. The impact of recommendations of

14th Finance Commission was evident during this period. The grants from the Centre, however, showed large variations as compared to the budget projections. A perusal of individual Central schemes revealed that actual receipts under many CSS varied considerably over the years. Budget variation of some of big schemes is given Table 11.

**Table 10: Deviation from Budget Estimates**

*(Percent)*

| | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **Average Growth 12-13 to 17-18** |
|---|---|---|---|---|---|---|---|
| **Revenues** | 0.21 | -4.59 | -15.11 | -2.82 | -4.90 | -4.19 | 13.39 |
| Own Tax Revenues | -3.69 | -4.05 | -0.17 | 5.86 | -1.50 | 4.16 | 13.13 |
| Own Non-Tax Revenues | 55.35 | 22.76 | 0.58 | -3.35 | -18.12 | -11.59 | 5.02 |
| **Central Transfers** | -9.59 | -11.88 | -25.88 | -7.24 | -3.77 | -7.11 | 16.02 |
| Tax Devolution | 3.59 | -4.13 | -11.53 | 20.40 | 6.60 | -0.48 | 17.62 |
| Grants | -28.18 | -23.13 | -38.40 | -32.93 | -18.63 | -16.93 | 15.54 |
| **Revenue Expenditure** | -7.71 | -7.65 | -18.68 | -10.68 | -12.63 | -12.65 | 12.96 |
| General Services | -21.57 | -24.23 | -21.60 | -24.06 | -23.20 | -18.48 | 10.98 |
| Social Services | -3.08 | 3.75 | -18.55 | -5.42 | -10.65 | -14.43 | 13.01 |
| Economic Services | 7.40 | -0.30 | -16.66 | -4.46 | -5.18 | -4.16 | 15.71 |
| **Capital Expenditure** | -20.48 | 1.44 | -18.78 | 12.82 | 10.28 | 1.61 | 26.80 |
| **Revenue Deficit** | 136.41 | 74.79 | 37.43 | 98.68 | 151.37 | 99.68 | |
| **Fiscal Deficit** | 100.08 | -22.06 | -43.50 | -32.09 | -35.47 | -35.16 | |

Budget deviation in revenue expenditure has been persistently negative implying actual spending fell short of the budget projection. This is not planned compression of expenditure. The three major components, general, social, and economic services show this trend, although in varying quantum. The details of budget variation in revenue expenditure for last three years have been given in Annexure 1. In the general services, the decline was largely attributable to lower interest payment and pension outgo as compared to the budget estimates. The difference between budget estimates and actual payments in these items should not be large, as the liabilities are known. From the data, it is clear that excess provision under these heads during budgeting stage was the main reason for savings.

Under social and economic services, there is large number of spending heads and deviation of actual spending from budget projection varies across the years. The annual average growth shown in table 10 indicates that spending under economic services, which are considered as productive in nature, was more than that of the social services. The emerging priorities in terms of their relative shares in total spending have been discussed earlier. From the Annexure 1, it evident that the variation is spread across the departments and they also vary across the fiscal years. While actual spending on education was less by 8 percent in 2015-16, it increased to more than 12 percent in next two years. In the case of urban development, the actual spending was less by 20 and 29 percent in 2015-16 and 2016-17 respectively; actual spending surpassed the budget projection by 15 percent in 2017-18. The Water Resources Department, which improved the budgetary allocation in recent years, was a lagged department in utilizing the budgeted resources in earlier years

**Table 11: Deviation of actual Receipts from budget Estimates in Central Schemes**

| | 2014-15 | 2015-16 | 2016-17 |
|---|---|---|---|
| Accelerated Irrigation Benefit & Flood Management Programme (ACA) | -90.75 | -84.51 | -100.00 |
| Integrated Child Development Scheme (ICDS) | -44.40 | -45.56 | -48.03 |
| Pradhan Mantri Gram Sadak Yojana (PMGSY) | -38.15 | -23.18 | 28.38 |
| Sarva Shiksha Abhiyan (SSA) | -36.48 | -32.12 | -42.52 |
| MGNREGA | -38.75 | -20.69 | -59.10 |
| Rashtriya Krishi Vikash Yojana (RKVY) | -12.35 | -47.28 | 4.39 |
| National Programme to Nutritional Support to Primary Education (MDM) | -20.76 | -36.26 | -11.11 |
| Indira Awas Yojana (IAY) | -22.00 | -19.10 | |
| National Health Mission including NRHM | -21.73 | -22.63 | -5.72 |
| Integrated Watershed Management Programme (IWMP) | 180.45 | -68.98 | 8.38 |
| National Rural Drinking Water Programme | 21.65 | -56.14 | -61.44 |
| Nirmal Bharat Abhiyan | 12.54 | -12.65 | 71.71 |
| National Social Assistance Programme (NSAP) | -37.11 | -6.40 | -27.67 |
| National Horticulture Mission | -24.37 | -45.50 | -34.59 |
| National Food Security Mission | 169.89 | -22.57 | -70.94 |
| Umbrella Scheme for Education of ST students | -54.61 | -17.92 | -29.88 |
| Rashtriya Uchchatar Shiksha Abhiyan (RUSA) | -83.72 | 11.05 | -38.11 |
| National Mission on Sustainable Agriculture | 154.54 | 91.41 | -63.04 |
| National Rural Livelihood Mission (NRLM) | -53.57 | 240.36 | 101.56 |
| Rashtriya Madhyamik Shiksha Abhiyan (RMSA) | -44.89 | 174.88 | -77.14 |
| National Cyclone Risk Mitigation Programme (NCRMP) | -49.77 | 1007.46 | -99.44 |

Utilization of capital outlay, through shows large deviation, has become positive in last three years (Table 10). Annual average growth rate of 26.80 percent reveals the priority of the State Government. Given the need for expanding infrastructural facilities in the State, proper utilization of budgeted provisions for capital expenditure is indeed important. The issues like capacity development in project appraisal and project execution, lack of a medium term sector plan for infrastructure development, and inadequate performance information on programs should be addressed for an effective public spending. Coordination at the policy making level is required to make departments sensitive to sector-wide programs for better outcomes.

### 5.1 Some Crosscutting Issues that affect Budget Credibility

The differences in actual deficit figures and budget projections indicate that State Government achieved higher revenue surplus and lower fiscal deficit during the period for which data is shown in Table 10. This implies shortfalls in utilization of resources allocated in the budget. Given the fiscal space, which was widened further due to recommendations of

14th FC by another 0.5 percent, the year-end savings in spending departments was definitely not to achieve the FRBM limits. There were several issues, which got in the way of the spending departments to utilize the budgeted resources[3].

- Non-receipt of Central grants created uncertainties in program execution. The non-receipt of Central transfers is the difference between actual receipts and the budget projections, which has been shown as unspent amounts.
- The fiscal year 2015-16 being the first year of the FFC award and post-Planning Commission regime, some of the uncertainties went into the budget making process. It was expected that the State Government will internalize that changes in the budgeting process to deliver better public services in future years.
- The closure of several CSS funding and redesigning of some others by the Central Government, made the State Government to rejig its spending pattern to cater to the priority areas. For instance, the State had to redesign programs in the case of school education to safeguard the flow of funds after reduction in grants for RMSA, SSA, and 13th FC funded schemes. The change in sharing pattern for some other schemes, for instance MDM, increased the State's share in funding pattern. The closure of funding through special assistance program of the Planning Commission for disadvantaged areas like KBK and the reduced funding under many CSS created uncertainty.
- Several structural issues hindered many departments in utilizing the available resources. There have been capacity issues in conceptualizing and executing modern infrastructure projects. Legal and environmental issues also affected executing infrastructure projects like irrigations projects.
- The departments need to plan their activities, try to change the entrenched practice to bring innovations in program management, improve accountability structure, make informed choices, give emphasis to maintenance, conduct affairs in a transparent manner, improve technical efficiency, and involve the stakeholders to improve the utilization of budgeted resources.

## 6. Concluding Remarks

The unprecedented success of Odisha in coming out of severe fiscal imbalance had its impact on overall resource allocation to priority areas. The State managed to achieve considerable fiscal correction, more due to expenditure compression. Fiscal management remained conservative for many years after the adoption of fiscal rules. The reduction in fiscal deficit seems large and begs a question regarding the necessity. The fiscal consolidation process during this period put a lid on capital outlay and the available fiscal space was not put to use in the priority sector spending. The achievement that could probably be displayed was the decline in debt burden of the State Government.

[3] The FRBM Review reports of the State starting from 2012-13, carried out by this author, give year-wise analysis of the reasons for deviations in different sectors. The reports are available the website of Government of Odisha.

The fiscal year 2015-16 brought several challenges for the States due to changes in fiscal transfer system following the award of the 14th FC and the removal of plan grants to the States. As the dependence of the State on Central transfers is high, the changes assume significance. The flow of tax devolution following the recommendations of the 14th FC has increased significantly and despite decline in grants components, the share of Central transfers increased. The Central transfer has been crucial factor in growth of revenue receipt in recent years.

The mobilization of internal revenue will be crucial for the State in coming years, which will provide flexibility in fiscal management. Post FRBM Act, while the revenue growth was not spectacular, the control over growth of the spending created a favorable situation for the observance of the fiscal rules. The tax buoyancy being little more than one, the growth of own revenue has been slow, which reduced its relative share in total revenue receipts as compared to the Central transfers. The Government is hopeful that the GST will provide much needed buoyancy to the State tax receipts. To maintain the existing spending plan and improve it further, the State government needs to strengthen its own revenue effort in addition to continued flow of resources from the Central Government.

While winds of changes were witnessed in the year 2013-14, it was in the fiscal year 2014-15 policy decisions were taken to expand the public spending programs. This had not affected the adherence of FRBM Act targets, as the fiscal space available to the Government was large. As the fiscal deficit has grown in recent years and the revised estimates for 2018-19 and budget estimates for 2019-20 indicate that the fiscal space has shrunk, it is time to calibrate future public finance options.

The coming years will test the commitment of the Government to adhere to the fiscal rules and continue with the spending programs. The flexibility offered by the 14th FC in terms 0.5 percent additional fiscal deficit and 25 percent debt-GSDP ratio that would remain valid until 2019-20. The 15th FC is expected to consider the debt-GDP ratio recommended by the FRBM Committee, which suggested reducing it to 20 percent. This will be a constricting factor in fiscal management of the State. There is need to enhance the own resource base and prioritize spending pattern to get value for money from the utilization of public resources.

The FRBM Act also calls upon the State Government to follow appropriate fiscal policy to raise revenue efficiently, improve institutional efficiency, improve transparency, and pursue expenditure policies that would provide impetus for economic growth, poverty reduction, and improvement in human welfare. While fiscal targets became the focus of assessing the fiscal management, imbibing these principles remained peripheral. Although the State made strides over the years, there are areas in which it lags behind as compared to other Indian States. The extent of poverty and the relative position of the State among the Indian States make it imperative of increased State intervention.

The importance of strengthening the institutional framework to improve the decision-making in public finances has been acknowledged by the State Government. Introduction of outcome budget, cash management system, and computerization of treasuries and establishing the IFMS system are part of the initiatives. The State Government needs to take proactive steps to strengthen thee initiatives.

## Annexure 1

**Deviation of Revenue Expenditure from Budget Estimates**

| Heads | Gap b/w Actual and BE-2015-16 | Gap / BE-2015-16 | Gap b/w Actual and BE-2016-17 | Gap / BE-2016-17 | Gap b/w Actual and BE-2017-18 | Gap / BE-2017-18 |
|---|---|---|---|---|---|---|
| **Revenue Expenditure** | **-703328** | **-10.68** | **-940286** | **-12.63** | **-1039993** | **-12.65** |
| ***General Services*** | **-477015** | **-24.06** | **-504933** | **-23.20** | **-459155** | **-18.48** |
| Interest Payment | -100670 | -23.14 | -61457 | -13.22 | -1166 | -0.23 |
| Pension | -224698 | -26.15 | -265242 | -27.93 | -262464 | -23.19 |
| Other General Services | -151647 | -22.02 | -178233 | -23.39 | -195524 | -22.91 |
| ***Social Services*** | **-141117** | **-5.42** | **-328881** | **-10.65** | **-498360** | **-14.43** |
| Education | -97608 | -8.11 | -170419 | -12.61 | -192147 | -12.23 |
| *General Education* | -91279 | -7.78 | -167703 | -12.68 | -199498 | -12.98 |
| Medical and Public Health | -19475 | -6.12 | -2000 | -0.53 | -35494 | -8.53 |
| Water Supply, Sanitation, Housing & Urban | -11932 | -3.72 | -1045 | -0.29 | -234847 | -57.20 |
| *Water Supply and Sanitation* | 8776 | 4.62 | 37259 | 19.06 | -47488 | -21.28 |
| *Housing* | -898 | -2.75 | -1368 | -3.66 | -1248 | -3.80 |
| *Urban Development* | -19811 | -20.27 | -36936 | -29.88 | 23615 | 15.28 |
| Welfare of SC, ST and OBC | 15077 | 8.84 | -23682 | -10.66 | -17759 | -7.41 |
| Social Welfare and Nutrition | -40092 | -7.39 | -132349 | -18.39 | -216871 | -29.50 |
| *Social Security and Welfare* | -22983 | -6.07 | -82955 | -17.87 | -69816 | -14.54 |
| *Nutrition* | -5162 | -41.07 | -2273 | -24.10 | 502328 | 5550.71 |
| *Natural Calamities* | -11948 | -7.88 | -47121 | -19.16 | -143119 | -58.14 |
| Other Social Services | 12913 | 25.86 | 614 | 0.96 | 198760 | 243.36 |
| ***Economic Services*** | **-84930** | **-4.46** | **-107741** | **-5.18** | **-90135** | **-4.16** |
| Agriculture & Allied Activities | -55137 | -8.68 | -45868 | -6.59 | -126317 | -17.88 |
| *Crop Husbandry* | 7437 | 2.70 | -46959 | -11.65 | -71339 | -20.58 |
| *Animal Husbandry* | -2450 | -7.75 | -5544 | -14.71 | -12560 | -24.95 |
| *Forestry and Wild Life* | -11049 | -16.77 | -410 | -0.74 | -12594 | -18.31 |
| *Food Storage and Warehousing* | -29069 | -19.20 | 8746 | 9.75 | -1182 | -1.25 |
| Rural Development | 63987 | 9.47 | -15328 | -1.88 | 491780 | 119.94 |
| *Special Programmes* | -16825 | -32.16 | -5139 | -12.08 | 13765 | 23.14 |
| *Rural Employment* | 76667 | 22.17 | -12530 | -3.09 | 101590 | 24.78 |
| *Other Rural Dev. Programs* | 4693 | 1.71 | 3411 | 0.94 | 31100839 | 8953.05 |
| Irrigation and Flood Control | 551 | 0.30 | -4398 | -2.30 | -17632 | -8.45 |
| *Major Irrigation* | -8120 | -12.86 | -8004 | -12.80 | -9119 | -13.20 |
| *Minor Irrigation* | 11157 | 18.90 | 4640 | 6.18 | -4944 | -6.09 |
| *Flood Control & Drainage* | -385 | -2.14 | -365 | -2.01 | 1768457 | 9078.84 |
| Energy | -175458 | -97.08 | -183052 | -95.63 | -204252 | -97.84 |
| Industry and Minerals | 44600 | 1120.59 | 44240 | 974.02 | 63110 | 1329.82 |
| *Village and Small Industries* | -2527 | -10.54 | -724 | -3.12 | -3124 | -10.31 |
| Transport | -29840 | -13.92 | -38777 | -16.37 | -45787 | -17.07 |
| *Roads and Bridges* | -30243 | -14.19 | -38397 | -16.31 | -45125 | -16.97 |
| General Economic Services | -59746 | -44.59 | -1866 | -2.43 | 25756 | 34.16 |
| *Secretariat Economic Services* | -52491 | -45.18 | 761 | 1.22 | 28148 | 48.37 |
| Other Economic Services | -2737 | -37.25 | -1361 | -20.03 | -411320 | -98.40 |

## References


Campos, Ed, and Sanjay Pradhan.(1996), Budgetary Institutions and Expenditure Outcomes: Binding Governments to Fiscal Performance. Policy Research Working Paper 1646, World Bank,Washington, DC.

Brumby, James and Richard Hemming. 2013. Medium-term Expenditure Frameworks, In (eds.) Richard Allen, Richard Hemming and Barry H. Potter, The International Handbook of Public Financial Management, 219-236. Palgrave Macmillan.

Comptroller and Auditor General of India, 2016. Report No. 27 of 2016, Report of the Comptroller and Auditor General of India on Compliance of Fiscal Responsibility and Budget Management Act, 2003.

Corbacho, Ana and Teresa Ter-Minassian, 2013. Public Financial Management Requirements for Effective Implementation of Fiscal Rules, In (eds.) Richard Allen, Richard Hemming and Barry H. Potter, The International Handbook of Public Financial Management, 219-236. Palgrave Macmillan.

Government of India, Ministry of Finance, 2018 Economic Survey 2017-18

Government of Orissa, (2001), White Paper on Orissa State Finances

Jena, Pratap Ranjan, (2010), India: Public Expenditure and Financial Accountability, Public Financial Management Performance Assessment Report, National Institute of Public Finance and Policy, New Delhi.

_______________, (2016).Reform Initiatives in the Budgeting System in India", Public Budgeting & Finance, Wiley-Blackwell, Spring, Vol.36, Issue 1.

_______________, (2018). Adopting MTEF through Fiscal Rules: Experiences of Multi-year Budget Planning in India, International Journal on Governmental Financial Management - Vol. XVIII, No 2.

PEFA, 2016. Framework for Assessing Public Financial Management, PEFA Secretariat Washington DC 20433, USA

Rao, M. Govinda and Pratap Ranjan Jena. 2009. Recent Trends in State Finances. In (eds.) M. Govinda Rao and Anwar Shah, States Fiscal Management and Regional Equity: An Overview, 19-35, Oxford University Press.

Schick, Allen 2013, Reflections on Two Decades of Public Financial Management Reforms, In (eds.) Marco Cangiano, Teresa Curristine, and Michel Lazzre, Public Financial Management and Its Emerging Architecture, 21-78: International Monetary Fund.

World Bank. 1998. Public Expenditure Management Hand Book, Washington, D.C.

World Bank, 2007. India: Orissa in Transition: From Fiscal Turnaround to Rapid and Inclusive Growth.

## MORE IN THE SERIES

- Gupta, M., and Chakraborty, P. (2019). State Finance Commissions: How successful have they been in Empowering Local Governments?, WP No. 263 (April).

- Patnaik, Ila. and Pandey, R. (2019). How much equity capital should a central bank hold?, WP No. 262 (April).

- Shrestha, R., and Chakraborty, L. (2019). Practising Subnational Public Finance in an Emerging Economy: Fiscal Marksmanship in Kerala, WP No. 261 (April).

Pratap Ranjan Jena, is Associate Professor, NIPFP
Email: pratap.jena@nipfp.org.in

National Institute of Public Finance and Policy,
18/2, Satsang Vihar Marg,
Special Institutional Area (Near JNU),
New Delhi 110067
Tel. No. 26569303, 26569780, 26569784
Fax: 91-11-26852548
www.nipfp.org.in