Fiscal Imbalances and Indebtedness across Indian States: Recent Trends

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Fiscal Imbalances and Indebtedness across Indian States: Recent Trends

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Introduction

By the end of the last century, fiscal balances and indicators thereof in most of the Indian states had reached disturbing levels. With respect to the deficit indicators and the debt level, the fiscal health of central government was not better either. In an effort to restore fiscal discipline, first the central government, and subsequently many states agreed to abide by fiscal rules. As a result, the Fiscal Responsibility and Budget Management Act (henceforth, FRBMA) was passed in the Parliament in 2003. A few States followed suit quickly with their own Acts, while several others also passed their version of the FRBMA after the 12th Finance Commission provided some incentives for the states to do so. The main objectives of the legislations were to eliminate revenue deficits and reduce fiscal deficit to or below 3 percent of GDP.

This paper examines the extent to which the states have been successful in achieving the targets in the last decade, and the route through which the necessary fiscal adjustments were undertaken. Since there are alternative ways of achieving fiscal adjustment and since each of them has a different impact on the economy of the state, this issue has some economic importance. Further, if there is a pattern in the method of fiscal adjustment undertaken by different groups of states, it can provide further insights into sub-national fiscal behaviour. In particular, if the burden of adjustment has been heavier on the low-income states as compared to the other states, and if the adjustment has been more through controlling expenditures, then there are possible serious implications on public supply of services that need to be brought out.

The reference period for this study is 2000-01 through 2010-11 for the 28 States of India, examined in two groups of special category and non-special or general category states. We utilise the method of comparing the simple averages of two 4-year periods at the beginning and at the end of our reference period, namely, 2000-2004 and 2007-11. This implicitly takes the first period to be the pre-reform period and the second as the

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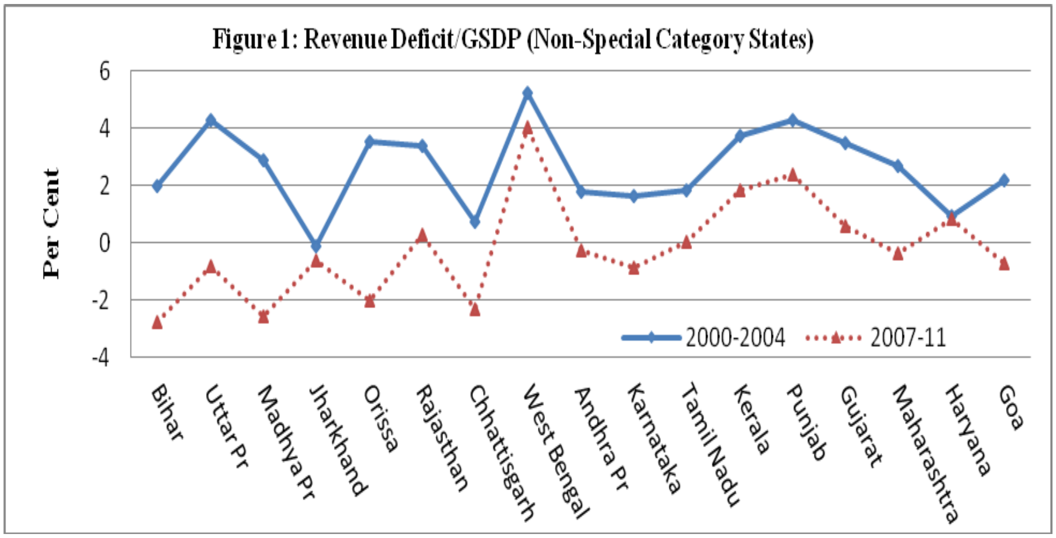
post-reform period, with the intervening years as the core reform years. This is based on the assumption of announcement effects of the 12th Finance Commission recommendations and the fiscal circumstances in most states being most conducive for reforms during these years. The five broad fiscal indicators we consider are revenue deficit, fiscal deficit, primary deficit, interest payments, and fiscal liability. All the indicators are normalized by gross state domestic product (henceforth, GSDP) of respective states at current prices (base: 2004-05). All the data except those on GSDP and population are taken from Finance Accounts of the respective states, while GSDP and population data have been taken form National Accounts Statistics. Fiscal liability of a state is used here in the broad sense including public debt as well as public account liabilities, but not including contingent liabilities.

II. The Pattern of Adjustments

a. Revenue Deficits

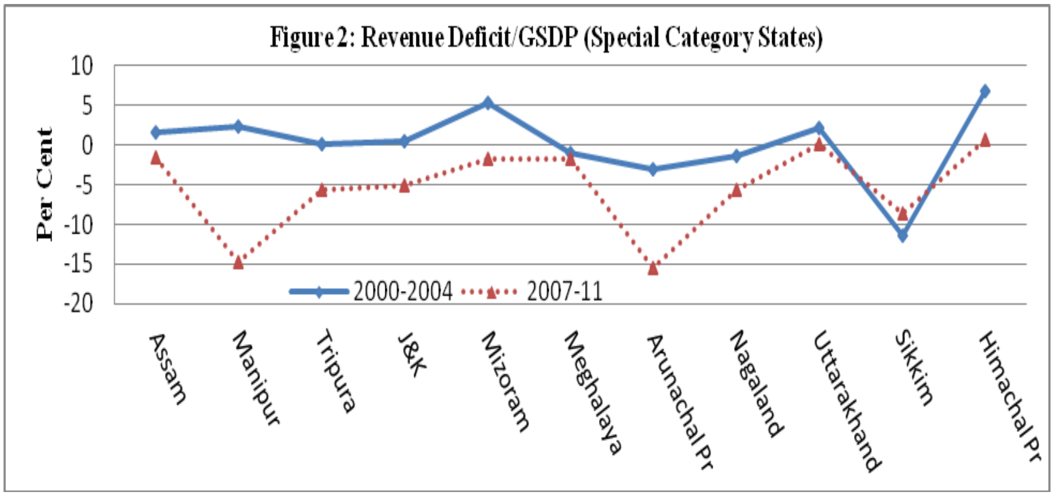
We first focus on the behavior of deficit indicators. The ratio of revenue deficit over GSDP for general category states for two averages has been depicted below in Figure 1. It can be seen that almost all the states have reduced revenue deficit in the second period as a percentage of GSDP except two, Jharkhand and Haryana. However, it can also be seen that the averages of these two states were the lowest in the first period. In contrast, while West Bengal did reduce its revenue deficit, it had the highest average revenue deficit to GSDP ratio among all the general category states in both periods. It appears that Jharkhand and Haryana, with low revenue deficits in the first period itself, were not particularly motivated to undertake revenue account adjustments during the reform period, which resulted in relatively small adjustments seen in the second period as compared to the first. But West Bengal, obviously undergoing serious revenue account imbalance in the first period, did try to achieve some adjustments; but it was not enough to bring down the revenue deficit ratio substantially in the second period. Oddly enough, West Bengal was one of the two states that did not adopt any fiscal reform legislation as suggested and incentivized by the 12th Finance Commission, possibly because it was not likely to meet the targets.



While all the general category states except Jharkhand had some amount of revenue deficit in the first period averages, all but four (West Bengal, Punjab, Kerala and Gujarat, in order of the size of the ratio) of them transited to revenue surpluses in the second period. It is clearly no coincidence that the first three have a history of persistent fiscal imbalances since the 1990s. In terms of the extent of reduction in the ratio, Orissa led the states with a reduction of 5.56 percentage points, with Madhya Pradesh, Uttar Pradesh and Bihar following on its heels at adjustments to the extent of 5.46, 5.10 and 4.76 percentage points. The lowest average revenue deficit to GSDP ratio, actually the highest revenue surplus ratio, for the second period was recorded by Bihar, followed by Madhya Pradesh, Chhattisgarh and Orissa in that order.

The states are deliberately arranged in order of per capita income in the chart, to show any pattern in the adjustments by level of income. As far as the general category states are concerned, there is a pattern immediately noticeable – barring Jharkhand, the extent of reduction in revenue deficits is substantially larger in the low income states as compared to the other states. The reason could possibly lie in the strength of motivation for adjustment; the importance of the incentives mandated by the 12th Finance Commission could have been the highest for the low income states as compared to the others.

Figure 2 presents a similar chart for the special category states, and no clear pattern in their case is immediately discernible. One common feature with general category states is that all the special category states had either revenue surpluses or revenue deficits close to zero (Uttarakhand and Himachal Pradesh) in the second period; but in general, they did not have average revenue deficit to GSDP ratio higher than 3 percent even in the first period, the two exceptions being Mizoram and Himachal Pradesh. A standout feature of Figure 2 as compared to Figure 1 is the large revenue surplus to GSDP ratios that were achieved by some of the states in the second period. Manipur and Arunachal Pradesh had second period averages around a figure as high as 15 percent. In fact, the extent of adjustment carried out in revenue deficit by all the special category states together as per the four year averages at 5.6 percentage points was considerably larger than that by the general category states (2.8 percentage points).



In this category of states, the highest extent of adjustment was recorded by Manipur in terms of the four-year averages, while the lowest was recorded by Meghalaya. Just as Haryana did not carry out much of an adjustment in revenue deficits, Meghalaya, Uttarakhand and Sikkim also did not, perhaps for the same reason, since all three states had either a low fiscal deficit or fiscal surplus in the first period. Of these three, the case of Sikkim is notable because it is the only state that recorded a decrease in the revenue surplus ratio; simultaneously, it must also be noted that it had the highest revenue surplus ratio in the first period itself which remained at a high level even in the second period after the decrease, and it was the only state in the special category that did not adopt a fiscal responsibility legislation as desired by the 12th Finance Commission. However, unlike in the case of West Bengal, there was hardly any need for the same, at least with respect to revenue balance.

Adjustments to reduce deficits in the revenue balance can be achieved through increase in receipts (own tax or non-tax, and transfers from the centre in the form of shared taxes or grants) and/or through expenditure contraction. It is instructive to examine this in some detail to see (a) the role of endogenous and exogenous factors and (b) to understand the impact of the adjustment on the citizens. Table 1 provides the necessary information for both the categories of states.

Table 1: Sources of Revenue Account Adjustment

(Percentage of GSDP Points)

States	Reduction in Revenue Deficit	Increases in				Change in Revenue Expenditure
		Own Taxes	Own Non-Tax	Central Taxes	Grants	
I. Non-Special Category						
Andhra Pradesh	2.05	0.67	0.20	0.05	0.07	-1.06
Bihar	4.76	0.24	1.14	0.04	2.68	-0.65
Chhattisgarh	3.08	1.69	1.28	0.59	1.63	2.11
Goa	2.93	-0.63	0.31	-4.99	0.13	-8.11
Gujarat	2.86	-0.03	0.35	-1.23	-0.40	-4.17
Haryana	0.08	-0.92	0.15	-0.73	0.39	-1.18
Jharkhand	0.52	1.15	2.51	0.38	1.82	5.34
Karnataka	2.49	0.92	0.09	-0.39	0.51	-1.36
Kerala	1.93	0.26	0.10	-0.01	0.10	-1.48
Madhya Pradesh	5.46	1.42	1.56	0.44	1.47	-0.57
Maharashtra	3.05	-0.18	0.17	-0.18	0.67	-2.57
Orissa	5.56	0.53	0.29	0.60	0.66	-3.48
Punjab	1.88	-0.28	0.36	-1.74	0.29	-3.25
Rajasthan	3.10	0.46	0.88	0.18	-0.15	-1.74
Tamil Nadu	1.83	0.15	0.26	-0.01	0.49	-0.94
Uttar Pradesh	5.10	0.97	1.83	0.98	1.42	0.11
West Bengal	1.16	0.00	0.45	0.24	0.07	-0.40
Average	**2.81**	**0.38**	**0.70**	**-0.34**	**0.70**	**-1.38**
II. Special Category						
Arunachal Pradesh	12.49	1.11	3.32	6.31	7.00	5.25
Assam	3.05	1.15	2.34	1.13	1.73	3.30
Himachal Pradesh	6.18	1.07	0.62	2.87	-0.17	-1.79
Jammu & Kashmir	5.59	2.07	1.60	-1.03	2.13	-0.82
Manipur	17.12	0.92	3.96	1.77	14.33	3.86
Meghalaya	0.76	0.66	1.88	0.09	-0.22	1.64
Mizoram	7.05	1.01	4.09	0.66	1.74	0.44
Nagaland	4.38	0.56	2.72	0.58	1.77	1.26
Sikkim	-2.81	0.28	1.89	-30.34	-15.02	-40.39
Tripura	5.66	1.45	2.59	-0.67	4.14	1.86
Uttarakhand	2.03	0.79	1.36	-0.24	-0.77	-0.90
Average	**5.59**	**1.01**	**2.40**	**-1.72**	**1.51**	**-2.39**
All States	**3.90**	**0.62**	**1.37**	**-0.88**	**1.02**	**-1.77**

In the majority of general category states, the single largest source of adjustment in the revenue account was expenditure contraction, with Chhattisgarh, Jharkhand, Madhya Pradesh, Uttar Pradesh and West Bengal being the exceptions. Jharkhand is a totally different case with a large increase in revenue expenditures; increases in revenue expenditure can be observed in Chhattisgarh and Uttar Pradesh too, but of a smaller magnitude. Goa had the largest cut in revenue expenditures among these states (more than 8 percentage points), followed by Orissa and Punjab (3.48 and 3.25 percentage points respectively). For all states in this category together, the reduction was 1.38 percentage points out of the total adjustment (decrease) of 2.81 percentage points in revenue deficit. Total non-tax revenues contributed a little more than equal adjustment (increase) of 1.40 percentage points, states' own and grants contributing equally, for all these states together. The largest increases in both own non-tax revenues and central grants can be seen in Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh and Uttar Pradesh. There were two states (Gujarat and Rajasthan), however, where the central grants actually decreased.

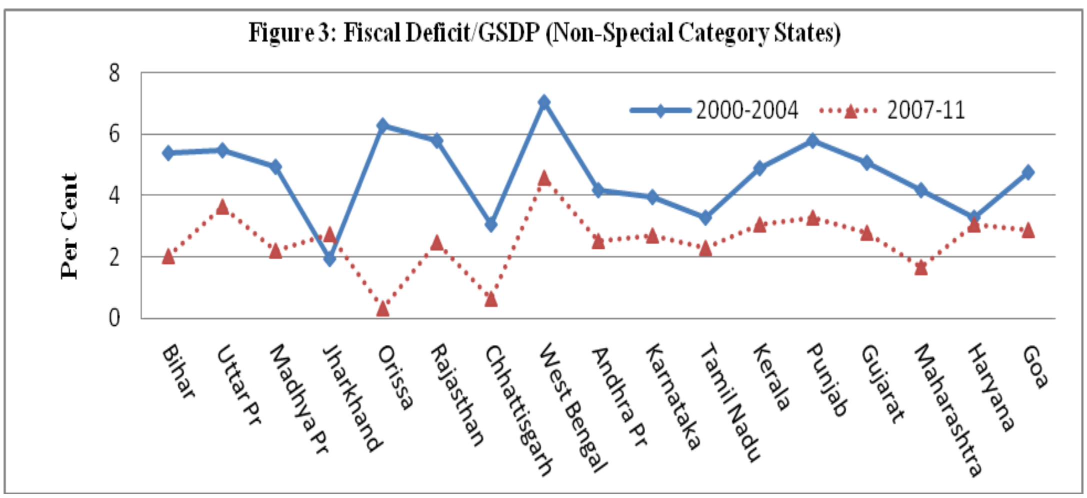
States' own tax revenues contributed a smaller increase of 0.38 percentage points, almost fully offset by a fall in shared taxes. While the largest increases in own tax revenues were seen in Chhattisgarh, Madhya Pradesh and Jharkhand (in order of the extent of increase), there were some states where there was no increase but a decrease (Goa, Gujarat, Haryana, and Punjab). It is of interest to note that all these states are among the high income states of India. Shared taxes also decreased for all these states, plus some of the middle income states (Karnataka, Kerala and Tamil Nadu).

The pattern that emerges is that of the low income states carrying out a steeper reduction in revenue deficit in general, with an all-round adjustment effort (increase in both types of own revenues and reduction in revenue expenditure), supported by both types of central transfers. While Jharkhand and Chhattisgarh could not reduce their revenue expenditure despite significant adjustment on the receipts side, the massive adjustment of revenue deficit in Orissa was primarily achieved through expenditure contraction; in Madhya Pradesh, the large adjustment was mainly through own revenues – both tax and non-tax, with only a small degree of expenditure contraction. In Uttar Pradesh too the expenditure contraction was relatively small, but all sources of revenue receipts contributed to the revenue account adjustment. Bihar managed a significant adjustment primarily through increased central grants. Of the states with higher per capita incomes, Goa, Gujarat, and Maharashtra exhibit relatively large reductions in revenue deficits, and in all three cases this was achieved primarily by slashing expenditures.

In the case of special category states, their adjustment efforts were by and large heavily dependent on central transfers, which is not surprising given their dependence on the same. Two large adjustments in Arunachal Pradesh and Manipur are obvious examples of this. However, all of them barring Sikkim made significant efforts to raise their own revenues too. Uttarakhand's adjustment could actually be ascribed primarily to own revenues, as also of Jammu and Kashmir. The case of Sikkim is a peculiar one, with huge reductions in central transfers, and almost matching reduction in expenditures (probably a case of transfer-financed expenditures), with a net result of increase in revenue deficit. Barring Sikkim, and to a much smaller extent Himachal Pradesh, special category states by and large did not carry out adjustments through expenditure contraction to any significant extent, and in several cases actually increased expenditures.

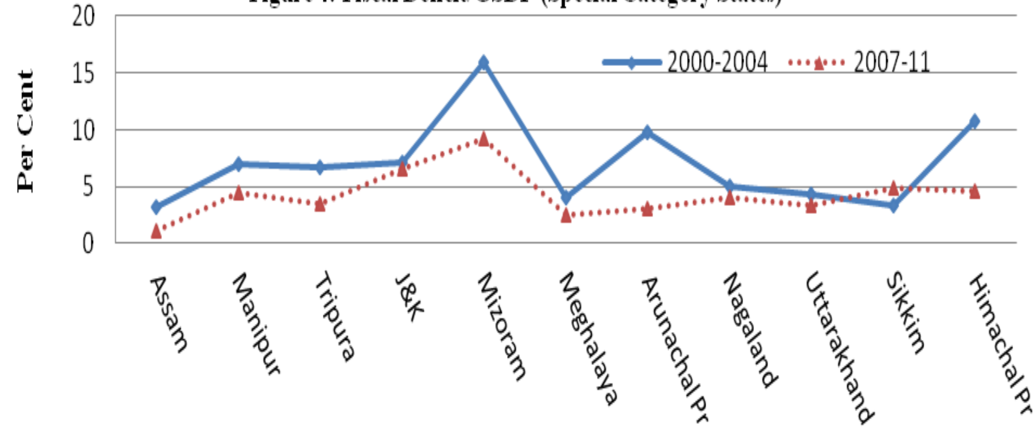
b. Fiscal and Primary Deficit

The scenario with respect to fiscal deficits is very similar to that regarding revenue deficits in general category states (Figure 3); so much so that the Figure 3 looks almost the same as Figure 1 but for the scale. This is not particularly surprising since revenue deficits were the overwhelming components of fiscal deficits of states, with capital outlays and net lending relatively small and in some cases insignificant. Turing to adjustment pattern of fiscal deficit, we find that all the states except Jharkhand and Haryana have substantially reduced fiscal deficit in the second period. Not so surprisingly, Jharkhand registered an increase in the fiscal deficit by 0.79 percentage points; having the lowest fiscal deficit ratio in the first period itself (below 2 percent), it could afford a slight increase since the target ratio was 3 percent or less for all states. The largest extent of adjustment was again in Orissa (about 6 percentage points) followed by Bihar (3.37) and Rajasthan (3.32). Notice that the four-year average fiscal deficit ratios of two states – Orissa and Chhattisgarh – were reduced to a level of almost zero, considerably below the target level. Most other states stayed close to or inside a band of 2-3 percent in the second period. Only West Bengal had a relatively high fiscal deficit ratio of above 4 percent even in the second period, despite undertaking visible fiscal adjustment. Taken together, the general category states reduced fiscal deficit ratio by 2.28 percentage points.



With respect to special category states, the picture relating to fiscal deficits is qualitatively different from that relating to revenue deficits. While Arunachal Pradesh and Himachal Pradesh undertook large reductions in fiscal deficit (6.8 and 6.1 percentage points respectively) to get close to the target level of 3 percent, Mizoram had a very high level of fiscal deficit ratio of around 9 percent in the second period despite undertaking a sharp reduction in the same by 6.7 percentage points, because its fiscal deficit ratio was extremely high at above 15 percent in the first period.

Figure 4: Fiscal Deficit/GSDP (Special Category States)



Sikkim was the only state in this category which had a higher ratio in the second period as compared to the first, though by a relatively small 1.5 percentage points, possibly because it did not subject itself to the discipline of a fiscal responsibility legislation. However, it is clear that despite adopting the same, several states in this category missed out on the incentives in at least one year each due to non-fulfilment of the conditions. Taken together, states in this group reduced fiscal deficit by 2.7 percentage points in the second period.

In the case of primary deficit, among the general category states, a large reduction between the two averages is observed in states like Orissa, Madhya Pradesh, Maharashtra, and Rajasthan (2.9, 2.08, 1.94, and 1.93 percentage points respectively). Since Jharkhand showed an increased fiscal deficit in the second period, it is no surprise that the same is seen in primary deficits too; the same is seen in the case of Haryana too where the smaller interest payments in the second period converts the marginal reduction in fiscal deficits to an increase in primary deficits. While none of these states had a primary surplus (only Jharkhand had a primary deficit close to zero) in the first period, four of them (all of them being low income states – Bihar, Orissa, Rajasthan and Chhattisgarh) had primary surpluses in the second period, with Madhya Pradesh and Maharashtra having average primary surpluses close to zero.

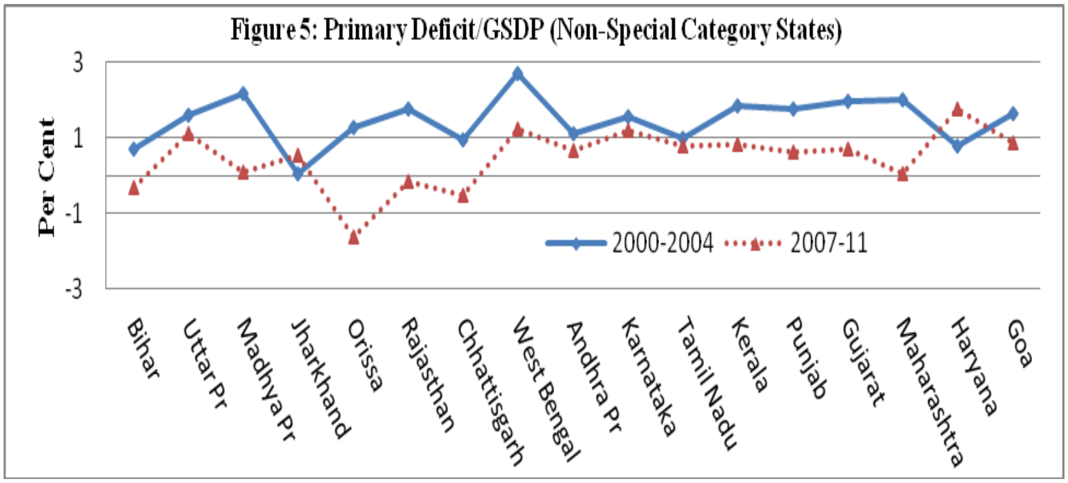


Figure 5: Primary Deficit/GSDP (Non-Special Category States)

In the case of special category states, all of them except Sikkim (which converted its substantial surplus into deficit) recorded a fall in the average primary deficits. There was a rise of 4.3 percentage points between these two averages in Sikkim, while large reductions came from Arunachal Pradesh, Mizoram, and Himachal Pradesh (5.77, 4.57, and 4.39 percentage points respectively). None of these states except Sikkim had a primary surplus in the first period, and only Assam and Arunachal Pradesh had noticeable surpluses in the second. Mizoram had a relatively large primary deficit even after a large reduction, while all other states had primary deficits close to zero, or at least not too large, in the second period.

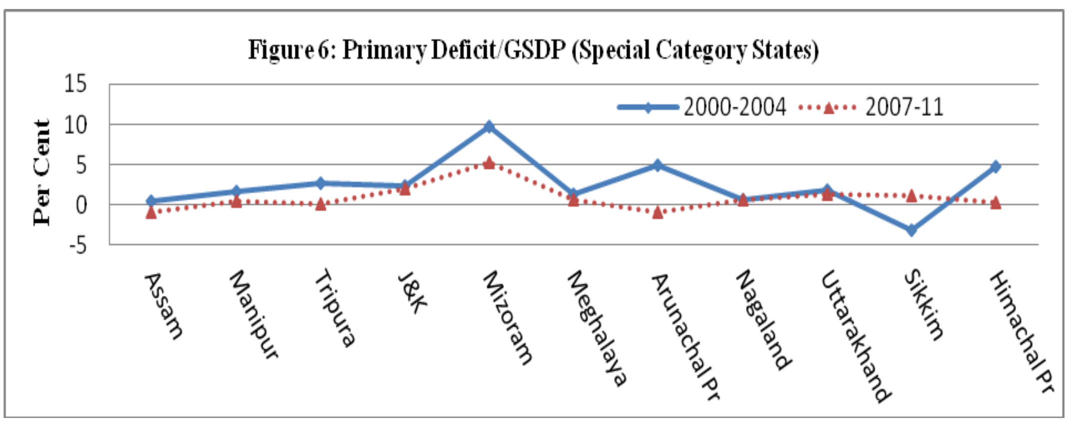


Figure 6: Primary Deficit/GSDP (Special Category States)

Given the revenue account adjustments, those in fiscal deficits are additionally determined by mainly two components, capital outlay and net lending. The remaining (small) extent of adjustment is traceable to miscellaneous receipts, mostly receipts from disinvestments in state public enterprises (Table 2). In general, states did not cut down on capital outlay in the process of adjustment, the only exception being Sikkim, allowing it to post a smaller increase in fiscal deficit as compared to the increase in revenue deficit. Because of the increase in capital outlay, in most states the reduction in fiscal deficit was smaller than that in the revenue deficit, but there were notable exceptions when the cut in net lending exceeded the increase in capital outlay – Haryana, Orissa, Punjab, Rajasthan, and West Bengal were in this group.

In the special category states, the most outstanding case was that of Manipur, with a huge reduction in revenue deficit (more than 17 percentage points) neutralised to a large extent by only slightly less huge increase in capital outlay (14.57 percentage points). A similar, but less extreme case was that of Arunachal Pradesh. Jammu and Kashmir, and Nagaland also exhibit similar outcomes of revenue account adjustments being neutralised significantly by relatively large increase in capital outlay, thereby limiting their adjustment of fiscal deficit to a small one.

It is a matter of some comfort that Indian states understand the importance of capital outlays (possibly on social and economic services) *qua* public investment for development, even at a time of strong pressures to cut their fiscal deficits. This behaviour in fact negates some views that capital outlays are the first casualty during times of belt-tightening, as they constitute expenditures that are most discretionary in nature. Many of the states (but not all) have preferred to cut down on net lending instead, which may not necessarily be a bad development; in many cases such lendings were only to perpetuate dysfunctional public enterprises that also had become financial liabilities. The fiscal adjustments could have proved to be the necessary catalyst for public enterprise reforms.

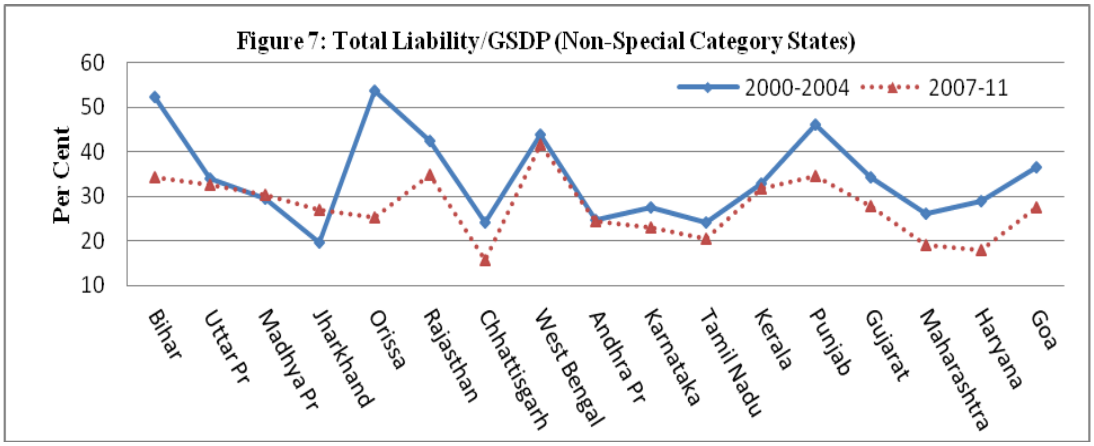
Table 2: Sources of Adjustment in Fiscal Deficits

(Percentage of GSDP oints)

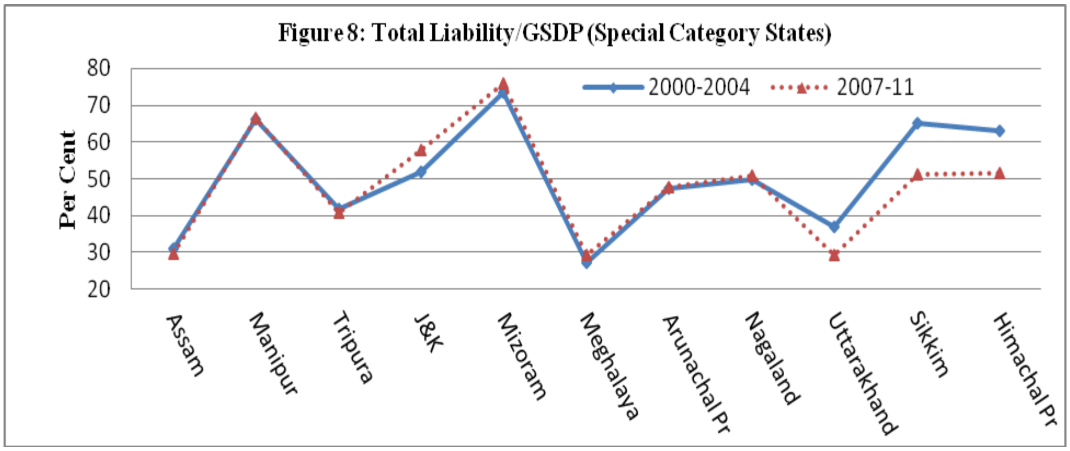
States	Decrease in Fiscal Deficit	Decrease in Revenue Deficit	Increase in Capital Outlay	Decrease in Net Lending	Increase in Misc. Receipts
I. Non-Special Category					
Andhra Pradesh	1.65	2.05	0.58	-0.16	0.35
Bihar	3.37	4.76	2.70	1.31	0.00
Chhattisgarh	2.40	3.08	1.17	0.47	0.01
Goa	1.91	2.93	0.99	-0.02	0.00
Gujarat	2.29	2.86	0.36	-0.21	0.00
Haryana	0.22	0.08	0.79	0.93	0.00
Jharkhand	-0.79	0.52	1.34	0.03	0.04
Karnataka	1.26	2.49	1.32	0.05	0.01
Kerala	1.82	1.93	0.28	0.17	0.05
Madhya Pradesh	2.72	5.46	1.53	-1.25	0.00
Maharashtra	2.50	3.05	0.41	-0.14	0.00
Orissa	5.98	5.56	0.61	1.03	0.00
Punjab	2.54	1.88	0.17	0.83	0.00
Rajasthan	3.32	3.10	0.20	0.42	0.00
Tamil Nadu	0.96	1.83	0.86	-0.01	0.00
Uttar Pradesh	1.86	5.10	1.99	-1.25	0.00
West Bengal	2.47	1.16	0.13	1.45	0.00
Average	**2.28**	**2.99**	**0.89**	**0.15**	**0.03**
II. Special Category					
Arunachal Pradesh	6.79	12.49	5.63	-0.06	0.00
Assam	2.05	3.05	1.18	0.19	0.00
Himachal Pradesh	6.09	6.18	0.32	-0.13	0.36
Jammu and Kashmir	0.52	5.59	5.30	0.22	0.02
Manipur	2.55	17.12	14.57	0.00	0.00
Meghalaya	1.54	0.76	0.12	0.89	0.00
Mizoram	6.68	7.05	1.36	0.99	0.00
Nagaland	0.96	4.38	3.42	0.00	0.00
Sikkim	-1.49	-2.81	-1.65	-0.34	0.00
Tripura	3.20	5.66	2.47	0.01	0.00
Uttarakhand	0.88	2.03	1.48	0.34	0.00
Average	**2.71**	**5.59**	**3.11**	**0.19**	**0.03**
All States	**2.37**	**3.90**	**1.77**	**0.21**	**0.03**

c. Liabilities

Fiscal sustainability of a state government is judged by the fiscal liabilities position also, besides the deficits. This is obviously because liabilities provide the stock figure, which annual deficits add to. A small amount of liabilities can allow high levels of deficit for some time without affecting sustainability too much, while a high level of liabilities reduces the tolerance for deficits drastically. It is for this reason that the 12th Finance Commission had recommended a prudent maximum level of state indebtedness at 25 percent of GSDP. Since the reference period for the analysis here is a decade, it provides ample scope for substantial changes in fiscal liabilities flowing from fiscal reforms.



The changes in the fiscal liabilities position is shown in Figures 7 and 8 for the general and special category states respectively. In the general category states, the pattern of fiscal adjustment with respect to fiscal liabilities by and large replicates the adjustment in fiscal deficits with some notable exceptions. Despite significant reductions in fiscal deficit, Andhra Pradesh, Kerala, Madhya Pradesh, Uttar Pradesh and West Bengal managed only a small reduction in the accumulated liabilities. In contrast, Haryana managed a larger reduction in the liabilities in spite of a small adjustment in fiscal deficit. The largest reduction in liabilities occurred again in Orissa (more than 28 percentage points); other states with large reductions were Bihar and Punjab (about 18 and 12 percentage points respectively). The average reduction of all general category states was a substantial 6.6 percentage points. After the reduction, the four-year average for the second period was the lowest in Chhattisgarh (16 percent of GSDP); other states below the 25 percent prudent limit were Andhra Pradesh, Karnataka, Tamil Nadu, Maharashtra and Haryana. The figure for Orissa was marginally above 25 percent; but with progressively declining liabilities, its latest figure was below the prudent limit and likely to decline further. The highest post-adjustment average was in West Bengal (42 percent).

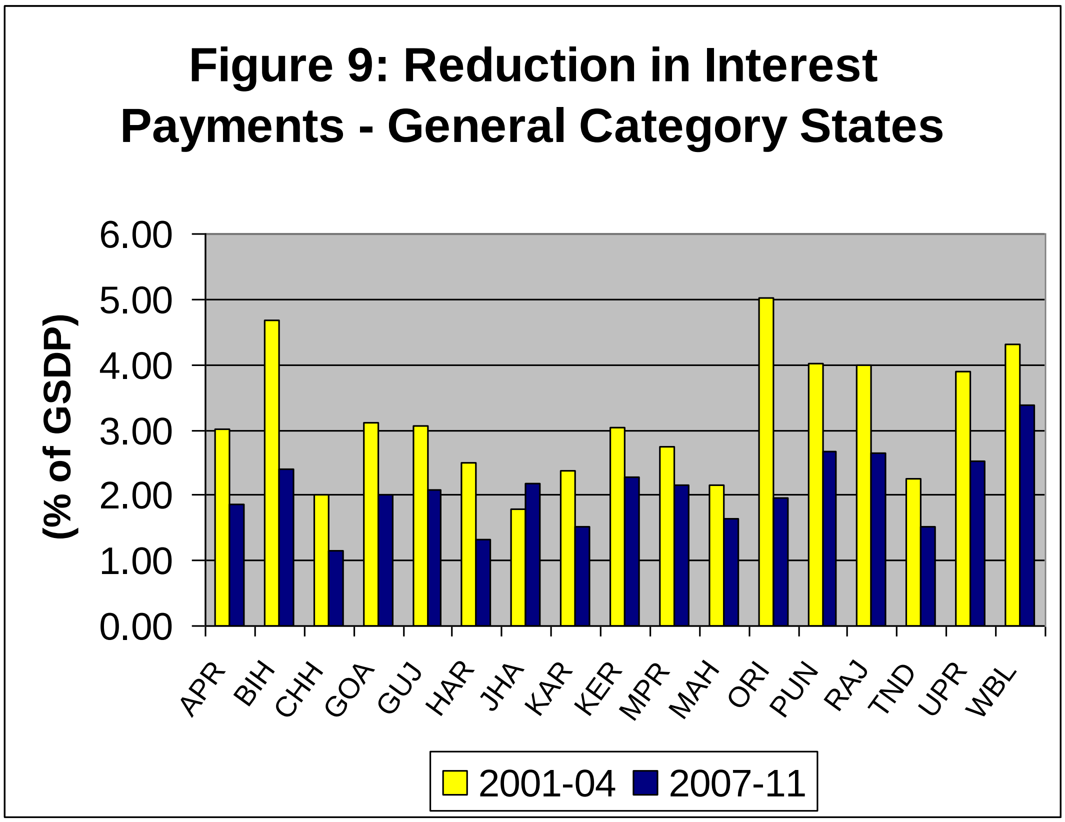


Special category states reduced their collective fiscal liability by 2.03 percentage point between the first and the second period, a smaller reduction compared to the general category states. Though large reductions occurred in Sikkim, Himachal Pradesh, and Uttarakhand (13.85, 11.46 and 7.71 percentage points respectively), states like Jammu and Kashmir, Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland recorded an increase in outstanding liability. The increase in Jammu and Kashmir was the largest, by 6.19 percentage points, but the states that had fairly high levels of liabilities even in the second period averages were Mizoram and Manipur, at 76 and 66 percent of GSDP respectively. None of these states could pull down their liabilities below the prudent limit of 25 percent of GSDP, the lowest being in Meghalaya at a little higher than 29 percent; Uttarakhand and Assam also had similar levels of fiscal liability.

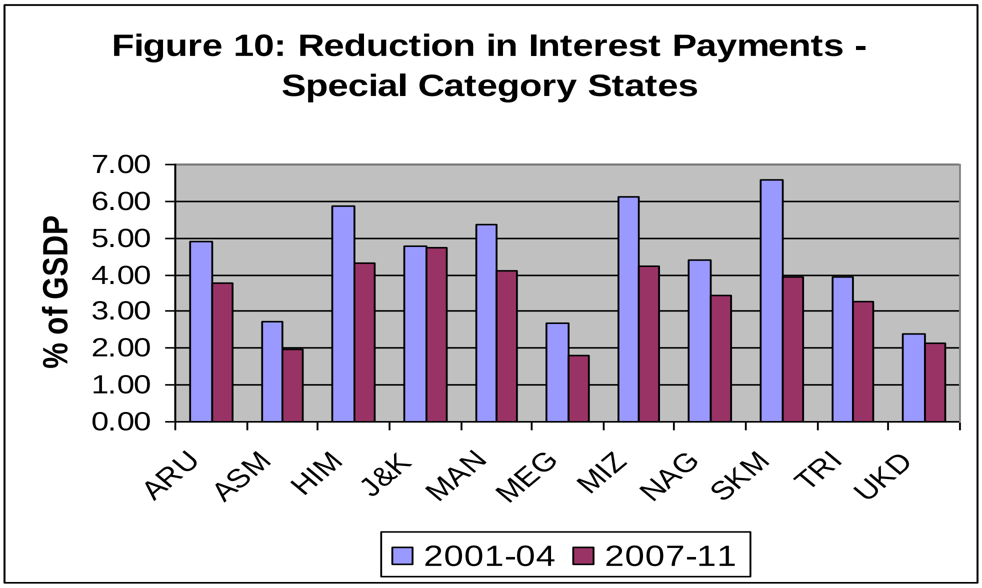
d. Reduction in Interest Payments

In recent years, interest payments have been one of the major components of revenue expenditure of states, so much so that the 12th Finance Commission felt obliged to indicate a prudent limit for it. The reasons for rising interest payments have been discussed at length in the relevant literature; instead of going into that discussion, we examine here the extent of reduction in interest payments for individual states in the background of the prominent role played by expenditure contraction in the adjustment efforts of states.

Figures 9 and 10 depict the reduction from the first to second period average of interest payments (as percentages of GSDP) for the general and special category states respectively. Among the general category states, the largest reductions in interest payments are seen in Orissa and Bihar. It may be recalled that the huge deficit reduction in Orissa was largely ascribable to a large reduction in revenue expenditures; it turns out that it was primarily caused by a large reduction in interest payments, thus removing the possibility of a significant contraction of developmental expenditures. In Bihar, it makes the quality of the adjustment even better – the large reduction in interest payment means that the perceived expenditure contraction was actually increase in expenditures in terms of non-interest revenue expenditures! The only state showing increase in interest payment is Jharkhand, and it probably contributed to the lack of fiscal adjustment there. Among other states with relatively high interest outgo were Punjab, Rajasthan, Uttar Pradesh, and West Bengal. Of these, the reduction was the least in West Bengal, coinciding with its inability to cut down its revenue deficit by the large margin that was required to bring its fiscal balance to a comfortable level. Clearly, the importance of being able to reduce interest payments in undertaking fiscal adjustment cannot be minimized.



In the special category states, all of them succeeded in reducing their interest payments. Sikkim, Mizoram, Himachal Pradesh and Manipur had the highest levels of interest-GSDP ratios; despite significant reductions in the ratios, all four continued to have relatively high interest outgo in the second period too. But the highest level of post-adjustment interest payments is seen in Jammu and Kashmir, which could reduce the same from the first to the second period only marginally. The link between reduction in interest payments and the extent of fiscal correction achieved is not seen to be so clear-cut in the case of special category states, because not many of them relied on expenditure contraction to achieve fiscal adjustment.



e. Fiscal Adjustment by Income Groups of States

We now try to ascertain whether the fiscal adjustment process was more strenuous for the poorer states or not. This presumption has some logical basis: in a normative sense, the revenue base in the poorer states is smaller but the expenditure responsibilities are larger because of lower private capacity to pay for various services and the need for larger investments for development, leading to higher deficits. That this is not seen in the actual numbers for deficits of income categories of states is mainly because per capita expenditures in Indian states are positively correlated with per capita incomes – the affordability factor is much more important than need. In any case, given the relative compulsion of their fiscal stance, imposition of a uniform level of deficits across the states would be expected to strain the poorer states to a greater extent. But they also would be expected to undertake the strain more enthusiastically because the payoff in terms of the incentives would be more attractive to them because of paucity of resources. Table 3 summarizes the actual adjustments by income categories of states.

Table 3: Trends in Fiscal Adjustment by Per Capita Income Groups

(percentage of GSDP)

	REVENUE DEFICIT			FISCAL DEFICIT			PRIMARY DEFICIT			TOTAL LIABILITY		
States (General Category only)	**2000-04**	**2007-11**	**Reduc-tion**	**2000-04**	**2007-11**	**Reduc-tion**	**2000-04**	**2007-11**	**Reduc-tion**	**2000-04**	**2007-11**	**Reduc-tion**
High income	2.71	0.56	2.16	4.62	2.72	1.89	1.63	0.81	0.82	34.42	25.40	9.01
Medium income	2.85	0.96	1.89	4.66	3.02	1.63	1.63	0.94	0.69	30.59	28.29	2.29
Low income	2.40	-1.54	3.94	4.69	1.99	2.70	1.22	-0.12	1.34	36.50	28.55	7.95

It can be seen from the table that it is indeed the low-income states that have undertaken a greater extent of fiscal adjustment than both high- and middle-income states in terms of all deficit indicators. To the extent that this was achieved through methods other than contraction of developmental expenditure and capital outlay, it would not be so much a matter of concern. Our discussion regarding the decomposition of revenue account adjustments coupled with the discussion of interest payments shows that there was no serious contraction of developmental expenditure in low income states except in Orissa to a small extent. This leads to the conclusion that the negative fallout of the fiscal adjustment process should have been minimal. In the cases where own revenues contributed a large part of fiscal adjustment also, there could possibly be a negative impact in that states' own revenue receipts are mostly indirect taxes and user charges that may not be progressive in nature, and a higher resource mobilization by the government could mean a significant reduction in already limited private disposable income (and therefore consumption) in low-income states. Reverting again to the decomposition of revenue account adjustments, four low-income states are seen to have relied to a significant extent on own revenues – Chhattisgarh, Jharkhand, Madhya Pradesh and Uttar Pradesh. The possibility of increased hardships for the citizens of these states as a result of the fiscal correction undertaken cannot be dismissed, although a firmer assessment can be made only after a detailed examination of the sources of increased revenues in each of them.