| Chapter VIII | PROJECTION OF STATE FINANCES |
|---|---|

- For Chhattisgarh to achieve the desired level of infrastructure development discussed in the position papers, the State must regularly review its financial position to ensure that lack of finance does not become a constraint to the overall development process.
- Presently Chhattisgarh has a better fiscal position than most other Indian States. It is one of the few States, which has a primary surplus and relatively low revenue and fiscal deficit -1.43% and 3.27% of the NSDP respectively. However, Chhattisgarh also has one of lowest capital expenditure to NSDP ratios at 2.38%, which must be increased for the overall development of the state.
- State finances have been projected over the next 10 years under two scenarios. Scenario 1 assumes that the current trends would continue in the future. Scenario 2 has been constructed assuming the State is likely to undertake wide ranging fiscal improvement measures in line with recommendations of the Eleventh Finance Commission. The forecasted capital expenditure under both the scenarios has been obtained from the position papers.
- Under Scenario 1, on the assumption that past trends continue, Chhattisgarh would face serious fiscal problems with revenue deficit reaching 17.6% of NSDP and fiscal deficit reaching a very unmanageable level of 33.6% of NSDP by the year 2009-10. Under Scenario 2, with Chhattisgarh undertaking fiscal reforms - restructuring its revenue expenditures, tax reforms for greater revenue mobilisation, etc. - the fiscal and revenue deficits are expected to be 12.79% and 1.72% of NSDP by 2009-10. Hence, even after undertaking fiscal reforms, the situation is likely to be difficult.
- Taking appropriate steps to facilitate the involvement of the private sector in infrastructure development can reduce the burden on the State's finances. In this scenario the State can achieve its desired level of development without facing serious financial constraints. In order to attract private participants the State has to ensure a favourable investment climate, prioritise its projects to efficiently utilise its resources, frame growth enabling policies and ensure that state owned utility companies (CSEB, State Transport Corporation of undivided MP etc.) are self sustaining entities

## Section 1: Introduction

### Introduction

The analysis of various infrastructure sectors in Chhattisgarh clearly establishes the need for massive investments to create and upgrade infrastructure stock over the next 10 years. More recently, the private sector, besides the government, has also started playing an important role in providing funds for infrastructure development. However, these investments, as with the other states, have been restricted to a few projects in the transportation and energy sectors. This implies that the government would continue to be the prime source of funds for infrastructure development.

The State government allocates funds for infrastructure development from its state finances. State finances refer to public revenue and expenditure accounts for activities, which are aimed at improving the social and economic situation of the people in the State. The role of State finances has assumed critical importance of late because of the steady deterioration in the fiscal deficit of States over the past few years and the resultant pressure on State governments to sustain investments for infrastructure development.

With this background an attempt has been made to project Chhattisgarh's State finances[1] over the next 10 years. The purpose of the study is to

- Evaluate the extent to which the State can meet the investment requirements of infrastructure sectors
- Get a perspective on the options available to Chhattisgarh for improving the fiscal position and hence ease the constraints imposed by the lack of funds on capital investments
- Understand the importance of private sector participation in infrastructure development projects in order to further ease these financial constraints

The likely trends in State finances have been projected under two different scenarios. While Scenario 1 assumes that the past trends would continue in the future, Scenario 2 has been constructed assuming that the State is likely to undertake wide ranging fiscal improvement measures in line with the recommendations of the Eleventh Finance Commission[2] (EFC).

### Methodology, Data Sources and Assumptions

***Methodology:***

At the outset, the State finances of Chhattisgarh have been compared to the State finance of 'all states' of India (including Chhattisgarh) put together. This comparison has been done to understand the relative position of Chhattisgarh's State finances in the Indian context. A comparison of the State finances of Chhattisgarh has also been made with some of the progressive States such as Karnataka, Tamil Nadu, Andhra Pradesh and

[1] The State government budget is primarily divided into revenue and capital accounts. While the capital account deals with cash and financial assets and liabilities like loans, investments, properties, etc., the revenue account covers current receipts and expenditures that are in the nature of recurring items.

[2] EFC: The EFC was constituted by an order of the President in 1999 to review the finances of the Union and the States and suggest ways and means by which the governments may bring about a restructuring of public finances so as to restore budgetary balance. It is in this context that the EFC had undertaken an exercise of projecting the state finances for all the states till 2004-05 by assuming several fiscal improvement measures.

Punjab to understand the impact of sustainable development initiatives (of these States) on their public finances.

Thereafter, the State finances of Chhattisgarh have been projected over the next ten years under two different scenarios. Both the scenarios have been developed under a different set of assumptions. A further analysis has been done in both the scenarios to understand the impact of private sector participation in infrastructure development (under alternate scenarios of contribution i.e. 25%, 50% and 75%).

***Data Sources:***

The data for State finances of all the States individually and at an aggregated level has been sourced from the Reserve Bank of India (RBI) studies on State finances, which the RBI compiles and issues annually.

Data regarding the State finances of Chhattisgarh have been obtained primarily from the budget estimates for the year 2001-02.

Data on NSDP has been obtained from the Department of Economics and Statistics, Chhattisgarh.

The data for arriving at assumptions for projections under Scenario 2 has been arrived at from the EFC report.

## Section 2: Fiscal Position of Chhattisgarh

### Chhattisgarh vis-à-vis All-India

The purpose of this section is to compare the fiscal position of Chhattisgarh to the consolidated fiscal position of 'All States' in order to map the fiscal performance of Chhattisgarh at a national level.

Table VIII.1 compares the fiscal performance/ position of Chhattisgarh against the finances of all the States put together.

**Fiscal position of Chhattisgarh vis-à-vis All States** **Table VIII.1**

| | All States 2000-01 BE | Chhattisgarh 2001-02 BE |
|---|---|---|
| Gross Fiscal Deficit/ NSDP | 4.10% | 3.27% |
| Revenue Deficit/NSDP | 2.10% | 1.43% |
| Primary Deficit/NSDP | 1.60% | -0.07% |
| **Revenue Account** | | |
| *Revenue Income* | | |
| Total Revenue Income/ NSDP | 10.94% | 17.62% |
| States own revenue/ NSDP | 7.02% | 9.99% |
| States own revenue/ Total Revenue | 64.20% | 56.71% |
| States own tax revenue/ NSDP | 5.61% | 7.19% |
| States own non-tax revenues/ NSDP | 1.41% | 2.81% |
| *Revenue Expenditure* | | |
| Revenue Expenditure/ NSDP | 12.98% | 19.05% |
| Development Expenditure/ NSDP | 10.06% | 13.51% |
| Development Expenditure/ Aggregate Expenditure | 64.21% | 63.06% |
| Revenue Expenditure/ Aggregate Disbursement | 82.85% | 88.89% |
| States own revenue/ Revenue Expenditure | 54.10% | 52.45% |
| States own revenue/ Aggregate Expenditure | 44.82% | 46.62% |
| **Capital Account** | | |
| Capital Expenditure/ GDP (NSDP) | 2.69% | 2.38% |
| Capital Expenditure/ Aggregate Expenditure | 17.15% | 11.11% |

Based on the comparison, a few inferences can be drawn about the relative strength of the State finances of Chhattisgarh, which are:

- The key indicators reflecting the fiscal position of State finances are deficits[3]- fiscal, revenue and primary deficits. The lower fiscal/revenue and primary deficits of Chhattisgarh vis-à-vis 'All States' as a percentage of NSDP is an indication of the fact that Chhattisgarh's fiscal situation is better than the national average. The deficits are compared as a % of NSDP to arrive at a common base for comparison, as absolute values of these figures could be of little meaning given the vastly different base figures
- A surplus in the revenue account means that the State generates more revenues than its expends in this account. The income in the revenue account would constitute tax and non-tax revenues while the expenditures would constitute regular operations and maintenance expenditures, salaries, pension, etc., for developmental and non-developmental activities undertaken by the State. The implication of a surplus in the revenue account is reduction in the debt for financing capital investments approximately equal to the surplus generated in the revenue account. Hence, a surplus in the revenue account is what governments ideally target. A deficit in the revenue account on the other hand would not only mean that debt would need to be taken to balance revenue expenditures but also the fact that the level of capital expenditure would reduce on account funds being diverted towards interest payments.
  Most States (including Chhattisgarh) have a deficit on the revenue account. The revenue deficit of

[3] Revenue Deficit: The excess of expenditure on revenue account over receipts on revenue account measures Revenue Deficit
Gross Fiscal Deficit: The Gross Fiscal Deficit measures that portion of state government expenditure that is financed by borrowing and drawing down of cash balances.
Primary Deficit: Primary Deficit is calculated as Fiscal Deficit less interest payments.

Chhattisgarh is around 1.43% of NSDP, which is lower than the national average of around 2.1% of NSDP (aggregated). There has been a revenue deficit in all States including Chhattisgarh due to higher expenses towards salaries and wages (which increased steeply after the pay commission recommendations), and a high interest burden faced by the States due to past debts

- Even though Chhattisgarh has a revenue deficit it is one of the few States, which has a primary surplus (of about Rs18.54 crores). This means that Chhattisgarh actually generates a surplus in the revenue account (if interest payments are not considered). The surplus could in turn be used to repay the debt and reduce its interest obligations over and above its other expenditure commitments. Most of the other Indian States, however, also face a primary deficit
- The income in the revenue account for Chhattisgarh (21.32% of NSDP) is better than the national average (10.94% of NSDP). This has been partly because of the higher 'states own tax' and 'states own non-tax' revenue mobilisation, which is considerably higher as a percentage of NSDP as compared to the figure for 'All States' put together
- The budgeted revenue expenditure as a percentage of NSDP for Chhattisgarh is higher than the national average. While the revenue expenditure as a % of NSDP for 'All States' is 10.94%, it is 21.34% for Chhattisgarh. The higher percentage of revenue expenditure is on account of proportionately higher expenditures for developmental purposes and interest payments
- About 64% of the revenue expenditure is being spent for development purposes in Chhattisgarh (more or less equal to the national average). However, given the smaller base or absolute value of the amount (Rs.3583 crores for compared to Rs.225230 crores for 'All States') and greater developmental needs of Chhattisgarh compared to several of the other States even this may not be adequate.
  The capital expenditure to aggregate expenditure ratio for Chhattisgarh (11.11%) is lower than the national average (17.15%). For a newly formed state like Chhattisgarh where significant investments have to be made to increase and improve infrastructure stock, this ratio will have to be significantly higher
- The relatively better position of the State's finances (on account of lower fiscal deficit) is because Chhattisgarh is a newly formed State with little or no legacies. Chhattisgarh received only 22% of the State Government employees from the erstwhile Madhya Pradesh instead of the stipulated 26%, thereby reducing the burden on expenditure in the form of salaries and wages. Also, Chhattisgarh has not been apportioned its share of liabilities on account of the bifurcation of utility companies of erstwhile Madhya Pradesh, like MPSEB

**Chhattisgarh vis-à-vis Progressive States**

Apart from a comparison with the national average, the State's finances have been also been compared with other States such as Karnataka, Andhra, Punjab and Tamil Nadu[4] (Table VIII.2).

Tamil Nadu. The revenue and fiscal deficits of Chhattisgarh are much lower or at least comparable to those of the above mentioned States. Among the four states compared, Punjab has the highest fiscal deficit, which is about 6.8% of NSDP. Even with such a high fiscal deficit, Punjab has been able to sustain social and economic growth.

**Comparison of Chhattisgarh with other states** Table VIII.2

| | Karnataka | Andhra Pradesh | Punjab | TamilNadu | Chhattisgarh |
|---|---|---|---|---|---|
| **(in Rs. Crores)** | 2000-01 | 1999-00 | 2000-01 | 2000-01 | 2001-02 |
| **Revenue Income** | **15779.83** | **18593.28** | **12290.24** | **18923.54** | **4671.3** |
| Tax Revenues (State's own) | 9159.14 | 9529.54 | 5350.45 | 12504.43 | 1904.92 |
| Share in Central Taxes | 2568.28 | 3849.51 | 1964.28 | 3228.78 | 1246.33 |
| Non Tax Revenues(State's own) | 2168.93 | 2472.36 | 4067.88 | 1968.68 | 744.2 |
| GRANTS | 1883.48 | 2741.87 | 907.63 | 1221.65 | 775.85 |
| **Revenue Expenditure** | **17159.44** | **20173.31** | **14707.57** | **21564.87** | **5050.67** |
| Developmental Expenditure | 10836.17 | 12782.6 | 5980.18 | 12466.5 | 3025.56 |
| Non-Dev. Exp.(Except interest) | 3393.52 | 3954.31 | 4159.77 | 5189.66 | 1032.82 |
| Interest payments | 2392.59 | 3249.67 | 2931.21 | 2749.03 | 886.28 |
| Assignment to local bodies | 537.16 | 186.73 | 1636.41 | 1159.68 | 106.01 |
| **Capital Income** | **164.47** | **160.82** | **199.87** | **451.67** | **144.68** |
| Recovery of loans and advances | 164.47 | 160.82 | 158.64 | 275.38 | 22.54 |
| Others | | | 41.23 | 176.29 | 122.14 |
| **Capital Expenditure** | **2906.49** | **4169.97** | **2900.95** | **3048.74** | **630.46** |
| Developmental | 1919.4 | 2384.89 | 1150.49 | 1865.97 | 557.42 |
| Non Developmental | 567.56 | 835.1 | 1522.13 | 789.46 | 18.52 |
| Loans and Adv. of State Govt. | 419.53 | 949.98 | 228.33 | 393.31 | 54.52 |
| NSDP | 63025 | 108019.8 | 39589 | 77685 | 26512 |
| **Capex/NSDP(%)** | **4.61%** | **3.86%** | **7.33%** | **3.92%** | **2.38%** |
| **RD / NSDP(%)** | 2.19% | 1.46% | 6.11% | 3.40% | 1.43% |
| **FD/ NSDP(%)** | 4.35% | 3.71% | 6.82% | 3.34% | 3.26% |

The States mentioned above are widely believed to have made / are making significant investments in developing infrastructure. The purpose of comparing Chhattisgarh's State finances with these states is to get a perspective on the level of fiscal deficit a State can manage while ensuring sustainable development and also to get an understanding of the maximum debt appetite of frontrunner States.

From Table VIII.2 it can be seen that the fiscal position of Chhattisgarh is stronger than that of states like Karnataka, Andhra Pradesh, Punjab and (Punjab has one of the highest per capita incomes in the country). Punjab's commitment to development can be seen by comparing the ratio of capital expenditure to NSDP (7.33% - the highest amongst the states compared). A higher capital investment is one of the major reasons for Punjab's higher fiscal deficit. Compared to the other States, Chhattisgarh has the least capital expenditure to NSDP ratio at 2.38%. This indicates the possibility for the State to substantially increase capital investments in infrastructure development and resorting to financing its capital expenditures though debt.

[4] While the budgeted estimates of State finances for the year 2000-01 have been used for Karnataka, Punjab and T.N, the actual values for the year 1999-2000 has been used for A.P.

## Section 3: Fiscal Projection

### Introduction

The State finances of Chhattisgarh have been projected for a period until 2009-10 under two alternative scenarios.

***Scenario 1:*** The projections are based on historical growth rates of various revenue and capital inflow and outflow streams of undivided MP, after incorporating for the base correction[5] in the quantum of figures reflected in the budgeted estimates for the year 2001-02.

***Scenario 2:*** This scenario has been developed on the assumption that the State would undertake fiscal disciplining and reform in line with the recommendations of the EFC. This would in turn improve the fiscal position of the State.
Under each of the above scenarios, apart from the projection of the State's finances, the NSDP for Chhattisgarh has been projected for the next ten years. Whereas, NSDP is not a constituent of State finances, it has been projected to arrive at a common base to compare the magnitude of fiscal and revenue deficits relative to the overall economic development in the forecast period.

### Assumptions

Several assumptions have been made while projecting the State's finances under both scenarios. While some of the assumptions are common, several of them are specific to each of the scenarios developed.

[5] The base correction represents the major break in the trend followed by the State finances of M.P., during the time of division of M.P., mainly because of the on-going discussion on apportionment of expenses and revenues between the two States.

The **common assumptions** applicable to both scenarios are:

- Capital expenditure for developmental purposes (mainly for physical infrastructure creation) are based on the detailed investment requirements estimated and presented in the position papers.
- In making the projections under both scenarios it has been assumed that capital expenditure projected over the next ten years is entirely funded by the State (from the State's finances with almost no private sector participation).
- Under both the scenarios the rate of interest on any fresh debt, which is taken each year to fund the fiscal deficit, is assumed to be 10%.

### Scenario 1

Scenario 1 is simply a projection based on the past trends of the State finances of undivided MP for all the income and expenditure heads except for capital expenditure for developmental activities or infrastructure.

Table VIII.3 presents the State finances of Chhattisgarh over the next 10 years under this scenario.

#### *Assumptions under Scenario 1*

Apart from the common assumptions made for both the scenarios there are a few specific assumptions applicable only under Scenario 1 while projecting the State's finances. These include:

- Since no past trend regarding the State finances of Chhattisgarh is available, the trend of the State finances of undivided MP is assumed to be followed in the future.
- *Revenue Receipts:* Assuming that the trends in the revenue

**Scenario 1- Projection of state finances** **Table VIII.3**

| (All figures in Rs. Crore) | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-2010 | CAGR |
|---|---|---|---|---|---|---|---|---|---|---|
| **REVENUE INCOME** | **4671.30** | **5239.98** | **5882.60** | **6609.33** | **7431.87** | **8363.64** | **9420.11** | **10619.11** | **11981.21** | **12.49%** |
| Tax Revenues | 3151.25 | 3560.56 | 4024.33 | 4549.98 | 5145.93 | 5821.78 | 6588.49 | 7458.53 | 8446.13 | 13.12% |
| Total states own tax revenues | 1904.92 | 2158.44 | 2446.95 | 2775.42 | 3149.55 | 3575.86 | 4061.82 | 4616.03 | 5248.32 | 13.51% |
| Share in Central Taxes | 1246.33 | 1402.12 | 1577.39 | 1774.56 | 1996.38 | 2245.93 | 2526.67 | 2842.50 | 3197.81 | 12.50% |
| Non Tax Revenues(State's own | 744.20 | 825.99 | 919.49 | 1026.69 | 1150.02 | 1292.34 | 1457.16 | 1648.67 | 1871.97 | 12.22% |
| GRANTS | 775.85 | 853.44 | 938.78 | 1032.66 | 1135.92 | 1249.51 | 1374.47 | 1511.91 | 1663.10 | 10.00% |
| **REVENUE EXPENDITURE** | **5050.67** | **5833.89** | **6804.00** | **8020.50** | **9564.50** | **11547.27** | **14122.21** | **17501.89** | **21982.44** | **20.18%** |
| Developmental Expenditure | 3025.56 | 3377.60 | 3775.78 | 4226.46 | 4736.89 | 5315.41 | 5971.54 | 6716.24 | 7562.04 | 12.13% |
| Non-Dev. Exp(except interest) | 1032.82 | 1289.10 | 1618.33 | 2043.37 | 2594.76 | 3313.32 | 4253.86 | 5490.08 | 7121.37 | 23.93% |
| Interest payments | 886.28 | 1037.85 | 1252.10 | 1558.17 | 1998.01 | 2632.04 | 3547.26 | 4869.12 | 6778.76 | 25.36% |
| Compensation & assignment to local bodies | 106.01 | 129.33 | 157.79 | 192.50 | 234.85 | 286.51 | 349.55 | 426.45 | 520.27 | 19.33% |
| **CAPITALEXPENDITURE** | **631.36** | **1107.18** | **1459.41** | **1956.06** | **2660.51** | **3665.25** | **5105.81** | **7181.53** | **10186.72** | **36.21%** |
| Developmental Expenditure | 557.42 | 1028.24 | 1375.14 | 1866.07 | 2564.40 | 3562.59 | 4996.14 | 7064.35 | 10061.49 | 37.91% |
| Non Developmental | 18.52 | 20.19 | 22.00 | 23.98 | 26.14 | 28.50 | 31.06 | 33.86 | 36.90 | 7.96% |
| Loans & Advances of state gov | 55.42 | 58.75 | 62.27 | 66.01 | 69.97 | 74.16 | 78.61 | 83.33 | 88.33 | 5.32% |
| **CAPITAL INCOME** | **144.68** | **185.35** | **238.30** | **306.60** | **394.75** | **508.59** | **655.66** | **845.74** | **1091.53** | **25.17%** |
| Recoveries of loans | 22.54 | 26.57 | 31.88 | 38.26 | 45.91 | 55.09 | 66.11 | 79.33 | 95.20 | 17.36% |
| Others(Disinvestment) | 122.14 | 158.78 | 206.42 | 268.34 | 348.84 | 453.50 | 589.55 | 766.41 | 996.33 | 26.26% |
| REVENUE DEFICIT | 379.37 | 593.90 | 921.40 | 1411.16 | 2132.63 | 3183.63 | 4702.10 | 6882.78 | 10001.23 | 43.84% |
| GROSS FISCAL DEFICIT | 866.05 | 1515.73 | 2142.52 | 3060.63 | 4398.39 | 6340.29 | 9152.25 | 13218.57 | 19096.42 | 41.02% |
| **NSDP** | **26512.00** | **29163.19** | **32079.51** | **35287.47** | **38816.21** | **42697.83** | **46967.62** | **51664.38** | **56830.82** | **10.00%** |
| **RD (% OF NSDP)** | **1.43%** | **2.04%** | **2.87%** | **4.00%** | **5.49%** | **7.46%** | **10.01%** | **13.32%** | **17.60%** | |
| **GFD (% OF NSDP)** | **3.27%** | **5.20%** | **6.68%** | **8.67%** | **11.33%** | **14.85%** | **19.49%** | **25.59%** | **33.60%** | |

receipts of undivided M.P over the past 8-10 years were to continue into the future, the revenue receipts are expected to grow at about 12.5% (CAGR) till 2010. The growth rate of revenue receipts have in the past been fuelled by the growth rate of tax revenues, chief among which were stamp & registration duties (which grew @14.9%), state excise (which grew @ 14%) and sales tax (which grew @ 13.6%)

- *Revenue Expenditure:* Assuming that trends in the revenue expenditure of undivided M.P over the past 8-10 years were to continue into the future, the growth rate in the revenue expenditure is expected to grow at about 21% (CAGR) till 2010. The chief contributors to the growth of the revenue expenditure would be the interest payment (which is determined by the amount of fiscal deficit) and is expected to grow @ 26.6% (CAGR) and developmental expenditure (which in the past grew @ 12.13% CAGR)
- *Capital Expenditure:* The growth rates in the non-developmental expenditures and 'loans and advances by State governments' is assumed to follow the past trends of the same heads in undivided MP and are assumed to grow @ 9% and 6% per annum respectively. The growth rate of capital expenditures for development purposes is assumed (based on the investment requirements from the position papers) to be about 37.91% CAGR till 2010
- *Capital Income:* The focus here is on the non-debt component of the State. The past trends in 'recoveries of loans and advances' and 'other Income' is assumed to continue into the future and would grow at about 20% and 30% per annum respectively
- *NSDP:* The NSDP has been assumed to follow the past trends of the NSDP of undivided MP from 1993-94 till 2000-01. The CAGR of NSDP (at current

prices) in the past has been about 10.1% and the CAGR of NSDP (at constant prices) has been about 3.1% implying an annual inflation of about 7%. A similar growth rate of NSDP (10%) is assumed to continue till 2010

***Inferences***

From Table VIII.3, the following inferences can be made if the trends in the fiscal position of erstwhile M.P were to continue till 2010 as in the past:

- *Revenue Receipts & Expenditures:* The revenue receipts, under the above assumptions, would more than double from the current level of Rs. 4671 crore to Rs. 11981 crores by 2010. Tax revenues would account for about 70% of the revenue receipts.
  Revenue expenditure on the other hand, would more than quadruple from Rs.5050 crores to about Rs.21982 crores by 2010
- *Revenue Deficit:* The implication of such a trend in the receipts and expenditures of the revenue account is that revenue deficit would worsen from the current levels of Rs 379 crore or 1.43% of NSDP to about Rs 10,000 crores or about 17.6% of NSDP. The high revenue deficit would imply that a large amount of debt would be used to finance the day to day functions of government and this in turn would worsen the deficit further on account of higher interest payments.
  The trends in the revenue account for Chhattisgarh, hence, call for radical fiscal reforms and fiscal disciplining measures by the State government
- *Capital Expenditure:* The Capital expenditure of the State is expected to grow from the current level of Rs 631 crores to about Rs 10,000 crores. This is more than a fifteen-fold increase and this growth is considered necessary to improve the physical and social infrastructure of the State. As can be seen from Table VIII.3, about 99% of the total capital expenditure is spent on developmental activities
- *Fiscal Deficit:* The implication of such a rapid increase in the capital expenditure is a worsening fiscal deficit which is expected to deteriorate from the current levels of Rs. 866 crores or 3.27% of the NSDP to about Rs. 19096 crores or about 33.6% of the NSDP by 2010

Scenario 1 clearly shows that the fiscal position of the State is likely to worsen significantly assuming that the past trends (of undivided Madhya Pradesh) continue into the future while assuming a significant increase in the outlay of capital expenditure for developing physical and social infrastructure.

### Scenario 2

In order to improve its fiscal position the State would need to undertake a number of measures to improve its fiscal health. Scenario 2 is based on the assumption that the State will implement a comprehensive fiscal reform program and will undertake fiscal disciplining exercises with the aim of maximising its revenues and minimising costs. This could be termed as an optimistic scenario.

**Scenario 2 - Proiection of state finances** **Table VIII.4**

| (All figures in Rs. Crore) | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-2010 | CAGR |
|---|---|---|---|---|---|---|---|---|---|---|
| **REV. INCOME** | **4671.30** | **5308.12** | **6040.18** | **6882.75** | **7853.67** | **8973.90** | **10267.97** | **11764.71** | **13498.03** | **14.18%** |
| Tax Revenues | 3151.25 | 3628.70 | 4181.92 | 4823.40 | 5567.73 | 6432.04 | 7436.34 | 8604.13 | 9962.96 | 15.48% |
| Total states own tax revenues | 1904.92 | 2204.97 | 2555.45 | 2965.24 | 3444.78 | 4006.44 | 4664.83 | 5437.22 | 6344.07 | 16.23% |
| Share in Central Taxes | 1246.33 | 1423.73 | 1626.47 | 1858.16 | 2122.95 | 2425.59 | 2771.51 | 3166.91 | 3618.89 | 14.25% |
| Non Tax Rev.(State's own) | 744.20 | 825.99 | 919.49 | 1026.69 | 1150.02 | 1292.34 | 1457.16 | 1648.67 | 1871.97 | 12.22% |
| GRANTS | 775.85 | 853.44 | 938.78 | 1032.66 | 1135.92 | 1249.51 | 1374.47 | 1511.91 | 1663.10 | 10.00% |
| **REVENUE EXP.** | **5050.67** | **5679.98** | **6404.60** | **7247.40** | **8239.77** | **9425.59** | **10866.99** | **12653.08** | **14912.87** | **14.49%** |
| Dev. Expenditure | 3025.56 | 3438.15 | 3909.74 | 4448.90 | 5065.45 | 5770.63 | 6577.36 | 7500.43 | 8556.83 | 13.88% |
| Non-Dev. Exp (except interest) | 1032.82 | 1108.51 | 1190.05 | 1277.90 | 1372.60 | 1474.69 | 1584.80 | 1703.59 | 1831.77 | 7.43% |
| Interest payments | 886.28 | 1015.65 | 1174.20 | 1375.61 | 1640.80 | 2001.63 | 2506.55 | 3228.97 | 4279.97 | 21.75% |
| Assignment to local bodies | 106.01 | 117.67 | 130.61 | 144.98 | 160.93 | 178.63 | 198.28 | 220.09 | 244.30 | 11.00% |
| **CAPITAL EXP.** | **630.46** | **1107.18** | **1459.41** | **1956.06** | **2660.51** | **3665.25** | **5105.81** | **7181.53** | **10186.72** | **41.59%** |
| Dev. Expenditure | 557.42 | 1028.24 | 1375.14 | 1866.07 | 2564.40 | 3562.59 | 4996.14 | 7064.35 | 10061.49 | 43.57% |
| Non-Dev. Exp | 18.52 | 20.19 | 22.00 | 23.98 | 26.14 | 28.50 | 31.06 | 33.86 | 36.90 | 9.00% |
| Loans & Advances of state . | 54.52 | 58.75 | 62.27 | 66.01 | 69.97 | 74.16 | 78.61 | 83.33 | 88.33 | 6.22% |
| **CAPI. INCOME** | **144.68** | **185.35** | **238.30** | **306.60** | **394.75** | **508.59** | **655.66** | **845.74** | **1091.53** | **28.74%** |
| Recoveries of loans | 22.54 | 26.57 | 31.88 | 38.26 | 45.91 | 55.09 | 66.11 | 79.33 | 95.20 | 19.73% |
| Others | 122.14 | 158.78 | 206.42 | 268.34 | 348.84 | 453.50 | 589.55 | 766.41 | 996.33 | 30.00% |
| REVENUE DEFICIT | 379.37 | 371.85 | 364.42 | 364.65 | 386.10 | 451.69 | 599.03 | 888.37 | 1414.84 | 17.88% |
| FISCAL DEFICIT | 865.15 | 1293.68 | 1585.53 | 2014.12 | 2651.86 | 3608.36 | 5049.19 | 7224.16 | 10510.03 | 36.64% |
| NSDP | 26512.00 | 29761.33 | 33541.67 | 38191.52 | 43872.51 | 50634.11 | 58907.61 | 69357.33 | 82203.75 | 15.19% |
| **RD / NSDP(%)** | **1.43%** | **1.25%** | **1.09%** | **0.95%** | **0.88%** | **0.89%** | **1.02%** | **1.28%** | **1.72%** | |
| **FD/ NSDP(%)** | **3.26%** | **4.35%** | **4.73%** | **5.27%** | **6.04%** | **7.13%** | **8.57%** | **10.42%** | **12.79%** | |

Under this scenario the status of the Chhattisgarh's State finances till 2010 is summarised in Table VIII.4

***Assumptions under Scenario 2***

Apart from the common assumptions made for both the scenarios there are a few specific assumptions applicable only under scenario 2 while projecting the State's finances. The basis for these assumptions have been arrived at from the fiscal reform methods suggested by the EFC to restructure public finances. These assumptions include:

***Revenue Receipts:***

*Tax revenues-*

As seen earlier, revenue income as a percentage NSDP for Chhattisgarh is better than the national average. The growth rate of tax revenues in undivided MP under most of the heads (i.e. land revenues, stamp and registration fees, and taxes on vehicles, goods and passengers) has also been better than the EFC norms in the past. Hence, the growth rates of revenues under these heads are assumed to continue at the same rate as in the past. However, there is scope for improvement in tax revenue sources on several counts:

- The growth rate in the duties on electricity have been assumed to increase to 10% per annum from the current rate of 8.5% by assuming reductions in T&D losses and power subsidy to the agricultural sector
- Sales tax is assumed to grow at 19.6% p.a. from the present growth rate of 13.6% p.a. as per RBI recommendations. The rationale behind the assumption is the decision of State governments to implement a harmonised floor rate of sales tax, as a prelude to the introduction of a uniform value added tax (VAT). Such a harmonised floor rate is expected to fuel a rise in the growth rate of sales tax due to the increase in the tax base
- The States' share of Income tax is assumed to grow at about 13.3% p.a. in the future while its share in central excise duties is assumed to grow at 14.9% p.a., both of which are higher than the present growth rates of about 12.5% p.a. The rationale for the increase in growth rate is the fiscal strengthening exercise, which is expected to be initiated by the Centre

*Non-Tax Revenues-*

As the growth rate in the non-tax revenues of undivided MP in the past has been better than the growth rates recommended by EFC, it has been assumed that the past growth rates would continue in the future except in the cases of 'royalties from minerals' and 'grants from centre'

- Royalties on minerals and revenues from forests are the two major sources of non-tax revenues for Chhattisgarh. The revenues on account of royalties from mining are assumed to grow at 15% p.a. from the present rate of 11%. The rationale behind the assumption is that the Central government would revise the royalty rates on minerals regularly and that the State would take adequate steps to prevent leakage of these revenues
- The growth rate in the grants to the States from the Centre is assumed to reduce to 5% in the future as per the EFC recommendations

***Revenue Expenditure:***

Under Scenario 1 it was clear that if the past trends in revenue expenditure were to continue in the future, expenditure would more than quadruple and the revenue deficit would shoot up to 18.7% of NSDP by 2010. Hence, if the State has to improve its fiscal performance a major effort has to be made to curtail expenditure in the revenue account. The areas identified to curtail revenue expenditure for economic, social and general services (or non-developmental expenditure) are on account of both the salary and non-salary components.

- The expense on account of salaries has been assumed to grow at 6%[6] based on the recommendations of the EFC. The EFC also assumes the growth in the non-salary bill to be 13% p.a. (same as NSDP) for economic services. However, with the increased emphasis on improvement in quality of lives, the non-salary expenditure - on account of social services - is assumed to increase at 25% p.a. Growth of the non-salary component of general services is assumed to be 7% as per the EFC recommendation
- The percentage of salary to non-salary expenses in the case of general services is higher than that of economic and social services. Expense on account of salaries is assumed to be about 75% of the total general services expenditure with the rest constituting the non-salary component. For social services the expense on account of salaries is assumed to be about 50% of the total expenditure with the non-salary component constituting the rest. In the case of economic services the salaries are expected to constitute about 25% of the total expenses with the non-salary component constituting the remaining 75%
- It has been assumed that the revenue expenditure would also be curtailed by putting a freeze on budgetary support to those public sector undertakings (PSUs) which are not capable of breaking even
- As regards pensions and other post retirement benefits a growth rate of 10% has been assumed along the lines of EFC recommendation. The rationale is that 1999-00 has largely absorbed the impact of pension revision and the future requirements of expenditure would depend upon the net increase in the number of retired persons and the need to provide inflation protection in their basic pension. While the rate of

[6] The assumed growth rate has been arrived at by considering the net impact of fresh recruitment (1%), retirements (4%), increments (3%) and inflation protection (6%).

retirement has been assumed to be 4% per annum, the inflation rate is assumed to be 6%

- The compensation to local bodies is guided by the growth rate of revenue receipts, as compensation to the urban and rural local bodies is a fixed percentage of the State's revenue receipts. Hence, the growth rate of expenses on account of compensation and assignments to local bodies is assumed to be the same as the growth rate of revenue receipts

*Capital Expenditure and Income:* As the development of physical and social infrastructure is of the highest priority, it has been assumed that the State would not compromise on the level of capital investment required. Hence, the projection of investment/ expenditure in the capital account under Scenario 2 is assumed to be the same as in Scenario 1.

Similarly, the projected capital income under Scenario 2 is assumed to be the same as in Scenario 1.

*NSDP:* NSDP is projected into the future by assuming that the economy would be fuelled in the initial years by the primary and secondary sectors and would lay the foundations for the tertiary sector, which in turn would grow at a much higher rate. The estimated CAGR of NSDP from 2001-02 to 2009-10 is about 15.2% with the NSDP (at current prices) more than tripling from the current value of Rs. 26512 crore to Rs. 82203 crore by the year 2009-10.

***Inferences***

From Table VIII.4 the following inferences can be made:

- The result of the above reform measures in revenue mobilisation is an increase in both the tax and non-tax revenues which in turn leads to an increase in the revenue income from about Rs. 4670 crores to about Rs. 13,500 crores by the year 2009-10. While the tax revenues grow at a CAGR of about 15%, the non-tax revenues grow @ of about 12%. The net result of these reform measures under Scenario 2 would be an additional mobilisation of tax revenues of Rs. 1500 crores compared to Scenario 1 by the year 2009-10
- On the assumption that the salary and non-salary component will grow at 6% and 7% respectively, the growth rate in the non-developmental expenditure (except interest payments and Pensions) is expected to grow @ 6.25% p.a. The implication of such a disciplining effort is a reduction in the expenditure on account of non-developmental expenditure by about Rs. 5000 crores against the expenses projected under Scenario 1 in the year 2009-10. The implication of the fiscal disciplining measures on the expenditure on economic and social services leads to an increase in the revenue expenditure by about Rs. 990 crores in Scenario 2 over Scenario 1
- The result of these disciplining measures in reducing the various components of revenue expenditure would lead to a reduction in expenditure from about Rs. 21,980 crores in Scenario 1 to about Rs. 14,900 crores (a reduction of Rs 7000 crores) in Scenario 2 by the year 2009-10. This is reflected in the fiscal deficit, which reduces to about 12.8% by 2009-10 in Scenario 2 from about 33.6% in Scenario 1. *While the reduction in the fiscal deficit has been significant under Scenario 2, the level of deficit still seems unsustainable if the State has to fund its infrastructure requirements completely*.

**Section 3: The Way Forward**

## Impact of Private Sector Participation on the State's Finances

From the two scenarios discussed earlier we see that even if the State undertakes significant fiscal reform and disciplining exercise, it would find it very difficult to finance all the investments required in the infrastructure sector - as reflected by the fiscal deficit figures.
It is therefore imperative for the State to encourage PSP in the infrastructure sector. Strategies for encouraging private sector participation in each sector have been discussed extensively in the position papers. This section primarily looks at the impact of increased private sector participation on the State's finances (in terms of the likely fiscal deficit).

In both Scenario 1 and Scenario 2 the fiscal deficit of the state has been projected till 2009-10 under four alternate cases (Table VIII.5):

- ***Base Case:*** The government invests 100% of the capital investments in infrastructure development with no private sector participation. This case has been assumed while forecasting the State's finances under both Scenarios 1 and 2
- ***Case 1:*** The government invests 75% of the capital investments with 25% of the investments being made by the private sector
- ***Case 2:*** The government invests 50% of the capital investments with 50% of the investments being made by the private sector
- ***Case 3:*** The government invests 25% of the capital investments with 75% of the investments being made by the private sector

From Table VIII.5 we can see that as the level of private sector participation keeps increasing the fiscal deficit reduces.

Under Scenario 1 we see that the fiscal deficit reduces from about Rs. 19,096 crores when the State invests completely to about Rs. 8152 crores when the State invests only about 25% of the required investments (the remaining investment gap being filled by the private sector) by the year 2009-10.

Under Scenario 2 we see that the State's fiscal deficit reduces from 12.8% of the NSDP when the State does all the investment to a fiscal surplus of 0.5% by the year 2009-10 when about 75% of the investment is made by the private sector. From Table VIII.5 it can also be inferred that for every 1% increase in private sector participation the fiscal deficit reduces by about Rs. 145 crores. The fiscal deficit can potentially, be substantially reduced without

**Scenario Analysis - Fiscal Deficit at different levels of Private sector participation under scenario 1 and 2** **Table VIII.5**

| | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-2010 |
|---|---|---|---|---|---|---|---|---|---|
| **Scenario 1 : Trend Analysis** | | | | | | | | | |
| FISCAL DEFICIT (Base Case ) in Rs. crore | 866.0 | 1515.7 | 2142.5 | 3060.6 | 4398.4 | 6340.3 | 9152.3 | 13218.6 | 19096.4 |
| FISCAL DEFICIT (Case 1) in Rs. Crore | 866.0 | 1230.1 | 1728.8 | 2464.6 | 3542.1 | 5111.6 | 7388.8 | 10684.7 | 15448.5 |
| FISCAL DEFICIT (Case 2) in Rs. Crore | 866.0 | 944.5 | 1315.1 | 1868.5 | 2685.9 | 3882.9 | 5625.4 | 8150.9 | 11800.6 |
| FISCAL DEFICIT (Case 3) in Rs. Crore | 866.0 | 658.9 | 901.4 | 1272.5 | 1829.6 | 2654.2 | 3862.0 | 5617.0 | 8152.6 |
| **FD/ NSDP(%) ( Base Case )** | **3.3%** | **5.2%** | **6.7%** | **8.7%** | **11.3%** | **14.8%** | **19.5%** | **25.6%** | **33.6%** |
| **FD/ NSDP(%) (Case 1)** | **3.3%** | **4.2%** | **5.4%** | **7.0%** | **9.1%** | **12.0%** | **15.7%** | **20.7%** | **27.2%** |
| **FD/ NSDP(%) (Case 2)** | **3.3%** | **3.2%** | **4.1%** | **5.3%** | **6.9%** | **9.1%** | **12.0%** | **15.8%** | **20.8%** |
| **FD/ NSDP(%) (Case 3)** | **3.3%** | **2.3%** | **2.8%** | **3.6%** | **4.7%** | **6.2%** | **8.2%** | **10.9%** | **14.3%** |
| **Scenario 2: Fiscal reform/ disciplining** | | | | | | | | | |
| FISCAL DEFICIT (Base Case ) in Rs. crore | 865.2 | 1293.7 | 1585.5 | 2014.1 | 2651.9 | 3608.4 | 5049.2 | 7224.2 | 10510.0 |
| FISCAL DEFICIT (Case 1) in Rs. Crore | 866.0 | 1008.1 | 1171.8 | 1418.1 | 1795.6 | 2379.7 | 3285.8 | 4690.3 | 6862.1 |
| FISCAL DEFICIT (Case 2) in Rs. Crore | 866.0 | 722.4 | 758.1 | 822.0 | 939.3 | 1151.0 | 1522.4 | 2156.5 | 3214.2 |
| FISCAL DEFICIT (Case 3) in Rs. Crore | 866.0 | 436.8 | 344.4 | 225.9 | 83.1 | -77.7 | -241.0 | -377.4 | -433.7 |
| **FD/ NSDP(%) ( Base Case )** | **3.3%** | **4.3%** | **4.7%** | **5.3%** | **6.0%** | **7.1%** | **8.6%** | **10.4%** | **12.8%** |
| **FD/ NSDP(%) (Case 1)** | **3.3%** | **3.4%** | **3.5%** | **3.7%** | **4.1%** | **4.7%** | **5.6%** | **6.8%** | **8.3%** |
| **FD/ NSDP(%) (Case 2)** | **3.3%** | **2.4%** | **2.3%** | **2.2%** | **2.1%** | **2.3%** | **2.6%** | **3.1%** | **3.9%** |
| **FD/ NSDP(%) (Case 3)** | **3.3%** | **1.5%** | **1.0%** | **0.6%** | **0.2%** | **-0.2%** | **-0.4%** | **-0.5%** | **-0.5%** |

compromising on the investments required by encouraging private sector participation.

## Conclusion

The analysis in the previous sections clearly bring out the following:

- The State would need to pursue a fiscal adjustment programme that is aimed at restructuring expenditure, improving expenditure management and looking at ways of alternative sources of augmenting revenues.
  - The various measures that can be undertaken by the State to restructure its expenditure include higher allocation to O&M for better utilisation of existing assets, higher allocation to health and education as private sector participation in this sector would be at best limited, and increase in the component of capital expenditure
  - In order to improve the management of its expenditure, the State needs to select projects based on cost benefit analyses with an emphasis on completion of ongoing projects. It should also consider undertaking zero-based evaluation of every scheme to phase out ineffective and infructuous ones
  - Although, Chhattisgarh fares well with all India figures on revenue collections to NSDP ratio, this ratio would need to improve further to match the massive developmental needs of the State. In this context, the State should undertake a tax reform strategy aimed at rationalising its tax structures and using information technology for effective tax administration
- The State would need to ensure that the State Electricity Board and State Transport Corporation are self-sustaining entities. These two entities have in general been responsible for the poor fiscal health of many States in the country. In this connection, the State would need to put in place a system that ensures full cost recovery of public utility services. These include power, transport, irrigation, urban water supply, etc.
- Frame growth enabling policies with the objective of ensuring higher private sector participation, especially in sectors such as power, transportation, urban development, industrial estates and IT. The ability of the State to fund the massive infrastructure requirement over the next 10 years would to a very large extent depend upon the ability of the State to channelise large private sector investment in these sectors.

The State would need to prioritise projects, based purely on their developmental impact to ensure that limited resources are spent in the most optimum way. The State would also need to improve the efficiency and effectiveness of the State's existing assets. For example, low expenditure on the operation and maintenance of the existing irrigation network has meant reduced efficiency of the State's irrigation network.