Gujarat Finances

Reform of Budgetary Management

This paper examines the performance of Gujarat's revenue and expenditure systems. It attempts to identify the basic weaknesses of the existing revenue sources and indicates a broad direction of future reforms. Its major thrust, however, is on identifying the sources of inefficiencies of budgetary and expenditure policy and management, and preparing reform proposals for enhancing expenditure effectiveness.

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The budgetary policy of Gujarat as of any other state, evolved in the planning process in the mixed economy framework. Being a part of the federal system, central government policies particularly in regard to fiscal transfers, pricing of goods produced by its enterprises and interest rates have also influenced, to an extent, Gujarat's revenue and expenditure systems. In the reform period, beginning from mid-1991, central government's several reforms measures have adversely impacted state's budgets. For example, in its efforts to curb fiscal deficits, the central government reduced fiscal transfers to states in some years. Its tax reforms, liberalisation of interest rates and prices of goods such as coal and petroleum products produced by its public sector undertakings also induced direct or indirect impact on Gujarat's budgets. Recent pay revision of the state government employees along with the central pay revision of its employees is another example of how some of the central government policy decisions impact the state's budgetary transactions. The actual impact of some such policy decisions on Gujarat's budget will find a mention in appropriate places. The short point is that some of the sources of strain on Gujarat's finances fall outside its realm of decision-making.

Almost all states in India have witnessed a secular deterioration in their fiscal balances. As the Tenth Finance Commission has noted, states have passed through three phases of deterioration in the revenue account balance. In the first phase up until 1986-87, the non-plan account surplus was larger than the plan deficit, and to that extent, contributed to an overall revenue surplus. Between 1986-87 and 1991-92, the plan deficit rose sharply and far exceeded the shrinking non-plan surplus. The third phase from 1991-92 marked the beginning of growing deficit on non-plan revenue account.[1]

Gujarat does not exactly follow this pattern. The plan revenue account yielded deficit beginning from 1985-86. There existed, however, surplus on non-plan account except for 1990-91. Yet revenue expenditure outstripped revenue receipts almost continuously from 1985-86 barring three years (1996-97) in the reform period (Table 1 and Table 1A).

The gap between revenue receipts and current expenditure came to account for 2.90 per cent of NSDP in 1990-91. Though it declined in subsequent years, it still stood at 1.01 per cent of NSDP in 1997-98. But it is the growing interest liability which has essentially driven the wedge between revenue receipts and current expenditure. This means that the state's revenue was adequate to meet its non-interest current expenditure. But interest liability alone cannot explain the growing fiscal deficit of Gujarat, as the trend of primary deficits particularly since 1993-94 suggests.

With growing revenue deficit, the fiscal deficit widened. The fiscal deficit which stood at 7.37 per cent of NSDP in 1990-91 came down to 1.34 per cent NSDP in 1993-94 but started claiming once again to reach the level of 4.15 per cent in 1996-97 and further to 4.44 per cent in 1997-98 (RE) (Table 2A). This means that the state government has trailed far behind the target of 3.5 per cent of NSDP set for 1997-98. The fiscal deficit came down during 1993-94 and the following year essentially as a result of capital expenditure continued while the fiscal deficit kept moving up. In fact, the revenue deficit on the average contributed 11.3 per cent of gross fiscal deficit during 1990-95 (Table 3A).

This suggests that revenue expenditure continued to grow far in excess of revenue receipts. Gujarat's aggregate revenue receipts, as per cent of NSDP was higher than aggregate revenue expenditure as per cent of state income till 1984-85. This trend has reversed since then except for 1993-94 and 1994-95. During these two years, revenue-income ratio was a little higher than the expenditure-income ratio (Table 4A).

The important implication of growing revenue deficit is that the unit cost of public services rises to the extent the interest liability increases due to financing revenue expenditure with borrowed funds. This method of financing revenue expenditure further fuels the growth of the already bulging public debt which, in turn,

Table 1: Major Deficit Indicators

(As per cent of NSDP)

Itmes	Year				
	1980-81	1985-86	1990-91	1996-97	1997-98
Balance on revenue account	0.06	0.02	(–)Neg	(+)Neg	NA
Beget deficit	–0.62	0.16	0.56	–0.01	0.32
Fiscal deficit	3.77	4.23	7.37	4.15	4.44
Fiscal deficit	4.34	4.61	7.91	2.41	4.61
Primary deficit	2.72	2.68	5.19	1.32	1.45
Revenue deficit	–1.86	0.58	2.90	–1.04	1.01
Interest adjusted revenue	0.81	–2.13	–5.07	–1.79	–4.00
NSDP estimates	65.47	121.47	242.69	568.64	632.90

Note: (–) sign Indicated Surplus. NSDP for 1997-98 assumed GDP growth rare in that year.
Sources: (1) Gog, DOES, *Budget in Brief*, various issues ; (2) *RBI Bulletin*, various issues.

adds to the fast growing interest and thus to revenue expenditure growth.

In the Indian federal system, a state functions under a hard budget constraint. A state cannot borrow on its own as long as it is indebted to the central government. Nor can it resort to deficit financing. Even so, all states in India have rising fiscal deficit. This is financed by central loans, market loans, and other loans and using the surplus on public accounts. It is the latter source, which has given the states some leeway in their fiscal adjustment because other sources are determined exogeneously. Frequent use of surplus on public account, though it has relaxed the budget constraint to an extent, has important consequences on state's allocative efficiency.

Revenue

Gujarat's aggregate revenue receipts rose to 17.26 per cent of its NSDP in 1997-98 from 15.66 per cent in 1980-81 – just one and a half percentage points over more than one and a half decades. The state's own tax revenue increase alone has contributed this growth. The other two broad components, viz, non-tax revenue and central transfers in terms of tax shares and grants, as percentage of NSDP declined during the same period. The former dippled from 2.83 per cent in 1980-81 to 2.66 per cent in 1997-98 and the latter from 4.71 per cent to 3.85 per cent over the same period. Their contributions to aggregate revenue also fell over time Table 2.[2]

Gujarat's tax performance as measured by tax-income ratio is higher than three states (Haryana, Punjab and Maharashtra) which are above it in income scale. Some other studies have also made similar observations on Gujarat's relative tax performance in earlier years.[3] But relatively less developed states like Kerala, Karnataka and Tamil Nadu have realised much higher tax-income ratios. Gujarat, however, lags far behind Haryana and Punjab but not Maharashtra in tapping non-tax sources (Table 3).

Aggregate revenue of the state grew almost at the same rate (14.47 per cent per annum) both in pre-reform period of about 20 years (1978-91) and the past seven years of the reforms. However, the state's own tax revenue growth slumped from 15.66 per cent per annum in the preceding period to 13.44 per cent per annum in the latter period. Non-tax revenue growth declined to a much lower rate of 8.55 in the reform period as compared to its growth of 15.69 per cent per annum in the pre-reform period (Table 4).

Buoyancy coefficients clearly suggest that the growth of different revenue components has not kept pace with the state income growth in the reform period. For example, the aggregate revenue of the state rose only by 0.98 per cent in response a 1 per cent increase in state income in the 1991-98 period as compared to 1.09 per cent in the preceding period. More important, the state's own tax revenue response is still weaker at 0.95 per cent in the reform period in comparison with 1.19 per cent in the 1978-91 period. It implies that the design of the state's tax system is not wide enough to mop up a part of the incremental income. This is the most serious weakness of the state's tax system.

Gujarat has levied nine major taxes: three direct taxes – profession tax, land revenue and stamp duty and registration – and six indirect taxes – sales tax, state excise, motor vehicles tax, goods and passenger tax, electricity duty and entertainment tax. There are still a few minor taxes such as a luxury tax and mineral rights tax. Among these, sales tax alone contributes around two-thirds of the state's own tax revenue (Table 5A). The only other tax, which contributes one-tenth or more of the state's own tax revenue is electricity duty. Stamp duty had registration and motor vehicles add more than 5 per cent each to Gujarat's own tax revenue. The other taxes provide no more than 2 per cent of state's own revenue receipts.

The most dominant tax, which is the sales tax, has become sluggish in the reform period. The revenue growth dipped from 16 per cent in 1978-91 to 13 per cent per annum during 1991-98. Its response to state income also declined in the latter period. The electricity duty, the tax next in importance, however, improved its growth performance from 18 per cent per annum during 1978-91 to 21 per cent in the reform period. So did its buoyancy from 1.37 per cent to 1.52 per cent in the corresponding periods. Among the remaining taxes, motor vehicles tax, and stamp duty and registration improved both growth and buoyancy while the rest slumped or remained stagnant (Table 5)

State excise deserves a special mention in the context of Gujarat. Gujarat has never considered state excise as a source of

Table 2: Composition of Gujarat's Aggregate Revenue
(Per cent)

Components	1980-81		1990-91		1997-98 (RE)	
	Share of Aggregate Revenue	Share of NSDP	Share of Aggregate Revenue	Share of NSDP	Share of Aggregate Revenue	Share of NSDP
Revenue transfer from the centre	30.09	4.71	17.05	2.37	22.30	3.85
State's own tax revenue	51.81	8.11	71.02	9.89	62.31	10.75
State's non-tax revenue	18.10	2.83	11.94	1.66	15.40	2.66
Aggregate revenue receipt	100.00	15.66	100.00	13.92	100.00	17.26

Source: GoG, DOES, *Budget in Brief.*

Table 3: Comparison of State's Own Tax and Non-Tax Revenue
(Per cent)

States	1984-85		1995-96		1995-96	
	Own Tax Revenue to Total Own Revenue	Non-Tax Revenue to Total Own Revenue	Own Tax Revenue to Total Own Revenue	Non-Tax Revenue to Total Own Revenue	Own Tax Revenue to NSDP	Non-Tax Revenue to NSDP
Andhra Pradesh	51.16	48.84	72.00	28.00	6.64	2.59
Assam	27.08	72.92	67.70	32.30	4.59	2.19
Bihar	25.87	74.13	67.70	32.30	5.05	2.41
Gujarat	55.39	44.61	76.90	23.10	10.76	3.24
Haryana	51.29	48.71	49.80	50.20	8.67	8.74
Karnataka	52.27	47.73	81.00	19.00	12.24	2.87
Kerala	55.26	44.74	86.30	13.70	13.63	2.16
Madhya Pradesh	39.34	60.66	66.40	33.60	7.36	3.72
Maharashtra	53.61	46.39	79.80	20.20	8.31	2.11
Orissa	27.64	72.36	64.20	35.80	5.39	3.00
Punjab	60.79	39.21	59.90	40.10	7.73	5.18
Rajasthan	39.71	60.29	54.80	45.20	6.92	5.72
Tamil Nadu	58.25	41.75	89.30	10.70	10.81	1.30
Uttar Pradesh	36.25	63.75	69.50	30.50	6.06	2.66
West Bengal	52.68	47.32	92.70	7.30	7.16	0.57

Note: Non-tax revenue here includes central transfers and is thus not comparable with that in Table 2.
Source: *RBI Bulletin*, various issues.

revenue and remains the lone state in the country to continue to enforce prohibition ever since 1931.

The Gujarat government has initiated certain tax reform measures. These are in the right direction but are yet to go to the root of poor tax elasticity. As a result, they have not contributed much to improving tax buoyancy. Major tax reforms since 1992-93 are as follows.

(i) Sales tax: The process of the reforms was initiated in 1992. Additional tax was abolished from April 1, 1992. New schedules in the act were prepared. Barring a few commodities, the levy of tax was brought to the first state and single point. From April 1, 1996, the number of tax rate was reduced from 23 to 17. From April 1, 1997; turnover tax was abolished; number of rates of tax was consolidated to six; the number of items in the list of prohibited goods was reduced to 33 from 63; and rate of input tax was brought down from 2.4 per cent to 2 per cent.

(ii) Profession tax: The rate structure was made progressive from April 1, 1997.

(iii) Stamp duty: From April 1, 1997 rates of stamp duty on certain commercial transactions was reduced. Updated ready reckoners implemented from August 1998.

Budget 1998-99 proposed immediate implementation of updated ready reckoners for valuation of immovable properties.

(iv) Transport taxes and goods taxes: From April 1, 1993, composite tax based on number of seats in private buses was introduced in place of additional tax, which was leviable on the basis permits and numbers of passengers. The elements of motor vehicles and additional tax were merged. This has resulted in the eliminated of corruption and permits system, less administrative work, transparent tax system and more revenue. From April 1, 1997, goods tax and motor vehicle tax were merged in respect of goods vehicles. Budget 1998-99 has replaced weight based rate structure by ad valorem rate: 4 per cent on the ex-factory price of motor cars and jeeps though no change is proposed in tax structure for two wheelers.

(v) Luxury tax: Budget 1998-99 has raised the exemption limit and introduced some minor adjustment in tax rates to encourage tourism.

(vi) Creation of directorate of taxation: GoG has created a nodal organisation called directorate of taxation to accelerate the process of tax reforms.

The tax analysis clearly drives him four important points. (i) The state operates a multiple tax regime. (ii) The state overwhelmingly depends on one single tax, viz, sales tax, for resource mobilisation. (iii) Gujarat's tax performance is essentially based on tax deepening rather than on base widening. Gujarat State Finance Commission (GFC) has also made a similar observation. (iv) The existing tax design does not provide an adequate tax base that yields revenue in response to income growth.

To sum up, it is not that Gujarat has not used the tax instruments to mobilise resources. It has done, and done even better in comparison with some of the more advanced states. But the tax designs as they exist at present are seriously faulty. These have led to the overdependence on one single source, viz, sales tax. Even this is not buoyant. An in-depth study of the working of the present sales tax system has identified the major reasons for its being so.[4] These are: narrow tax-base, excessive dependence on input taxation, cumbersome administrative procedures and outlandish administration, provision of a long list of tax-free goods and numerous industrial incentives and exemptions. The examination of the other state taxes has also highlighted similar drawbacks. As a consequence, tax revenue has failed to grow with the state's income growth. This clearly suggests the direction of future tax reforms: simply and rationalise the tax system and widen the tax base. Modernise tax administration and facilitate compliance. The thrust of tax reforms in the state has to be on widening the tax base while keeping the tax design simple and transparent that facilitates better tax administration and compliance.

Receipts from state-owned enterprises (SOEs) and departmentally run schemes, user charges inclusive of receipts from irrigation, royalty on mines and minerals, revenues from forest and interest recovery are the broad sources of non-tax revenue. With considerably low forest coverage, there is hardly any scope for enlarging receipt from forests in Gujarat. The state is endowed with mines and minerals, but the union government determines the royalty on major minerals. The royalty on minor minerals, which are fixed by the state government, is passed on to the panchayats. Receipts from the other non-tax sources fall within the realm of state decision-making.

Non-tax revenue contributes in normal years less than one-fifth of Gujarat's total revenue. Royalty on crude oil alone accounted for more than one-fifth of the

Table 4: Growth and Buoyancy of Broad Revenue Sources

Itmes	Growth Rates		Buoyancy	
	1978-91	1991-98	1978-91	1991-98
Aggregate revenue receipts	14.47	14.47	1.09	0.98
State's own tax revenue	15.66	13.44	1.19	0.95
State's own non-tax revenue	15.69	8.55	1.19	0.63
Receipts from shared taxes	8.58	18.99	0.63	1.38
Grants from the centre	13.07	13.07	0.96	0.86

Source: Estimated.

Table 5: Growth and Buoyancy of State Taxes

Items	Growth Rates		Buoyancy	
	1978-91	1991-98	1978-91	1991-98
Sales tax	16.00	13.00	1.24	0.96
Electricity duty	18.00	21.00	1.37	1.52
Motor vehicle tax	15.00	20.00	1.10	1.38
Stamp and registration duties	15.00	19.00	1.10	1.32
Goods and passenger	11.00	-3.00	0.87	-0.17
Land revenue	12.00	12.00	0.91	0.91
Tax on entertainment	7.00	10.00	0.52	0.67
State excise	13.00	12.00	0.97	0.84

Table 6: Budgetary Outgo for SOEs
(Rs million)

Type of Outgo	1993-94		1995-96	
	Government Cos	Statutory Corpn	Government Cos	Statutory Corp
Equity/capital contributions	2436.2	111.0	767.2	–
Loans from budget	296.0	2572.1	4310.1	1884.8
Subsidy	716.6	8781.2	813.4	7350.0
Total	3448.8	11464.3	12740.7	9234.8

Source: Report of the Comptroller and Auditor General of India for the year ended March 31, 1996, No 2 (commercial).

state's non-tax revenues in 1996-97. This indicated still less state efforts to mobilise funds from its other sources. Non-tax share even inclusive of oil royalty from the centre has slumped gradually to only 15.40 per cent in 1997-98 (RE.) As noted earlier, its growth dropped to 8.55 per cent per annum in the 1991-98 period. Neglect of these sources for resource mobilisation is common to almost all states in the country (Table 3).[5] The basic reason lies states' reluctance to take hard decisions that affect some deeply entrenched interest groups. Low water charges and power tariff, low cost recovery of non-merit public services and poor interest are largely due to this constraint.

The Vaidyanathan Committee made several realistic recommendations for water rate fixation. The GFC has considered and endorsed these recommendations for implementation. The Gujarat government is, however, yet to implement them.

Gujarat has 40 government companies inclusive of seven subsidiaries, six deemed companies and five statutory corporations. Five statutory corporations, which employed capital of Rs 66.16 billion as on March 31, 1995, earned a total return of Rs 5.43 billion or 8.19 per cent rate of return during 1994-95. This rate of return includes the subsidy of Rs 6.562 billion provided to Gujarat Electricity Board (GEB). Without this subsidy, GEB's return on capital employed worked out at Rs (–)1,929.2 million. In any case, two of the five corporations, viz, Gujarat Road Transport Corporation and Gujarat state Warehousing Corporation earned negative return of Rs 431.6 million and Rs 3 million respectively in 1994-95. Again, 40 government companies earned Rs 392.4 million or 2.4 per cent rate of return during 1994-95 on the capital of Rs 16.39 billion employed on these companies.[6] All the SOEs (54) reported losses of about Rs.1.33 billion in 1994-95. The poor performance of SOEs has caused heavy drain in the form of capital contributions, loans and subsidy on the state's exchequer year after year (Table 6).

The GFC examined closely the working of SOEs ad made important specific recommendations for restructuring/privatisation/merger/divestment. The government of Gujarat (GoG) is seized of the problem of restructuring and privatisation of SOEs and has taken several initiatives under the Public Sector Restructuring Programme (PSRP). It constituted a standing committee under the chairmanship of chief secretary to operationalise the recommendations of GFC on SOEs. Subsequently, it set up an independent technical secretariat to advise the finance department and other ministries and SOEs in developing restructuring/divestment proposals for the SOEs selected under PSRP.

The GoG has constituted a high powered cabinet sub-committee with chief minister as chairman for the purpose of smooth, transparent and timely implementation of SOE reforms. This committee is vested with decision-making powers for restructuring SOEs. The technical secretariat mentioned above provides support to the committee.

The state government has identified under the PSRP 28 SOEs for the purpose of their restructuring, closure, merger, privatisation and divestment (Table 6A). Subsequently, as part of Asian Development Bank (ADB) technical assistance, the Price Waterhouse studied 10 SOEs and submitted restructuring programmes for them.

The GoG has also created a state renewal fund to provide a social safety net mechanism for restructuring of SOEs. These initiatives are in the right direction, and their successful completion would have favourable impacts on Gujarat's finances.

In the current regime, the government has to borrow at the market determined interest rate. As a result, the cost of borrowing has gone up. Even so, government lending is at a highly subsidised rate. For example, the loan and advances given by the Gujarat government stood at Rs 42.65 billion as on March 31, 1995. The total interest realised on this huge sum during 1995-96 was only Rs 71.3 million and the average interest worked out was only 0.17 per cent. This realised interest rate is abysmally lower than even the modest rate of 4 per cent recommended by the Tenth Finance Commission on the loans outstanding to third-parties as on March 31, 1995.[7] The implementation of various types of restructuring SOEs, which are consideration of the Gujarat government, is likely to have a favourable impact on further accretion of loans and advances at subsidised interest rate for certain purposes such as vehicle purchase or house building advance to government employees in the new economic environment.

The GFC has made a very detailed examination of the issue of subsidies. It has estimated the recovery rate of different types of public services and shown that the average cost recovery rate of total social

Table 7: Growth of Different Fiscal Aggregates

Item	Growth Rates	
	1978-91	1991-98
(1) Total revenue expenditure	16.41(15.01)	13.31(12.72)
(i) Development expenditure	17.85(14.83)	12.36(11.24)
(a) Social services	15.21(14.84)	11.66(11.43)
(b) Economic services	16.42(14.83)	12.00(11.13)
(ii) Non-developmental expenditure	15.54(15.77)	16.67(15.77)
(a) Interest	22.15	16.85
(b) Establishment	13.32	15.43
(2) Total capital outlay	10.70	9.66
(i) Developmental expenditure	10.91	7.72
(a) Social services	10.32	7.87
(b) Economic services	10.79	8.03
(ii) Non-developmental expenditure	10.09	19.37

Note: Figures in brackets indicate the growth rate of revenue and capital expenditure combined.
Source: Computed.

Table 8: Broad Expenditure Categories as Per Cent of NSDP and Total Expenditure
(Per cent)

Categories	1980-81		1990-91		1997-98 (RE)	
	Share of NSDP	Share of Total Exp	Share of NSDP	Share of Total Exp	Share of NSDP	Share of Total Exp
(A) Total expenditure	20.00	–	21.83	–	21.82	–
(a) Revenue expenditure	13.80	68.99	16.82	77.04	18.26	83.72
(1) Development	15.35	76.76	16.25	74.45	15.38	70.48
(i) Eco services	9.27	46.34	9.31	42.64	8.39	38.46
(ii) Social services	6.08	30.42	6.95	31.82	6.99	32.02
(2) Non-development	4.56	22.80	5.50	25.19	6.35	29.13
(i) Interest	1.05	5.24	2.18	9.98	2.99	13.70
(ii) Establishment	2.59	12.95	2.70	12.35	2.67	12.23
(b) Capital expenditure	6.20	31.01	5.01	22.96	3.55	16.28

Note: Total expenditure comprises revenue expenditure, capital outlay and government lending.
Source: Computed.

services was no more than 5.08 per cent in 1980-81. What is worse, it further declined to 2.23 per cent a decade later (1990-91).[8] The report of the National Development Council on Austerity put the ratio of cost recovery to the cost of public services for Gujarat at 14.26 per cent as against 26.35 per cent for Maharashtra in 1987-88.[9] All this clearly calls for a strategy to improve cost recovery of public services.

This brief discussion brings out the following important points. First, the non-tax sources have not received the attention of GoG as a source of revenue. Second, there is considerable scope for resource mobilisation from some of these sources and expenditure reduction in respect of some others. For example, successful implementation of restructuring and privatisation of SOEs as is being attempted by GoG will reduce subsidies and budgetary support. Third, there exists the long prevailing practice of providing public services at a low or no price. This leads to a resistance to any price hike. Therefore, the success of resource mobilisation from some of these sources will call for imaginative schemes combining proper pricing and improved delivery system as well as effective public information programmes. Fourth, some of the existing schemes, loans and advances for certain purposes as indicated earlier, have lost their relevance in the new economic context.

Expenditure Effectiveness

Growing at the rate of 16.53 per cent per annum for more than a decade (1978-91), the revenue expenditure growth slowed down to 13.31 per cent per annum in the reform period (1991-98). Even so, the level of revenue expenditure continued to surpass revenue receipts in the reform period. Capital expenditure which expanded at a much lower rate of 10.70 per cent per annum further slowed down (9.66 per cent per annum) in the reform period (Table 7). As a result, capital expenditure as percentage of NSDP dripped to 3.55 in 1997-98 from 5.01 in 1990-91 while the corresponding ratio for revenue expenditure shot up to 18.26 from 16.82 with some year-to-year fluctuations in between. This indicates that the reduction in fiscal deficit was achieved largely by compressing capital expenditure.

When total (revenue and capital outlay and lending) expenditure is decomposed into development and non-development, similar disturbing behaviour is observable. Development expenditure as percentage of state's NSDP tended to decline while the ratio relating to non-development expenditure rose (Table 8).[10] More importantly, non-development expenditure has recorded a rapid growth of 15.77 per cent per annum during 1991-98 as compared to 11.24 per cent annum during the same period (Table 7). However, unlike most states, Gujarat allocated larger proportion – more than two-thirds of its revenue expenditure – for development activities although non-development activities claimed increasingly rising share overtime (Table 9). In fact, Gujarat along with Maharashtra apportioned highest proportion of their respective revenue expenditure for development activities during 1990-98 in comparison with the other major states. This holds even when the relative share is examined combining both revenue and capital expenditure.

Within development expenditure, economic services have an edge over social services in revenue expenditure allocation. As for capital expenditure, social services received not only lesser share it that was also shrinking over time. Even economic services' share in capital expenditure was almost continually falling with the share shrinking in Gujarat's aggregate public expenditure. This should be a matter of great concern for the state. For, as a leading industrialised state in the country, Gujarat has to improve not only provision but also the quality of the goods and services as well as skills that allow the markets to flourish. But the weighted index of 'relative development of infrastructure'[11] of Gujarat plunged to 124 in 1990-95 from 132 in 1966-68 and Gujarat's relative position among the states is fifth which is lower than its fourth position in per capital income scale. It is conceivable that physical and social infrastructure constraints would hinder sustaining Gujarat's growth at a higher trajectory.

Table 9: Broad Composition of State Expenditure, 1990-98

States	As Per Cent of Total Revenue Expenditure					Developmental Capital Outlay as Per Cent of Total Capital Outlay	Developmental Expenditure as Per Cent of Total Expenditure
	Developmental Expenditure	Social Services	Economic Services	Non-Developmental Expenditure	Interest Payment		
Andhra Pradesh	67	39	28	32	14	99	70
Assam	66	41	24	34	14	97	68
Bihar	61	37	24	39	19	99	63
Gujarat	69	35	34	31	15	98	72
Haryana	48	23	25	50	11	97	51
Karnataka	67	38	29	31	13	90	70
Kerlala	61	41	20	38	15	96	64
Madhya Pradesh	67	37	30	30	12	99	70
Maharashtra	69	35	28	34	15	98	72
Orissa	64	39	25	36	20	98	69
Punjab	53	27	26	46	21	95	57
Rajasthan	64	39	24	36	16	98	69
Tamil Nadu	68	39	29	29	11	95	70
Uttar Pradesh	41	32	23	43	20	93	44
West Bengal	62	41	21	36	18	96	64

Source: 'Finances of State Governments', *RBI Bulletin*, various issues.

Table 10: Composition on Non-Interest Expenditure (Total)

Categories	1990-91	1996-97	1997-98 (RE)
(1) Developmental expenditure	82.70	79.00	81.66
(2) Economic services	47.36	45.27	44.56
(i) Agriculture	6.56	5.15	5.37
(ii) Irrigation and flood control	11.82	18.60	15.80
(iii) Rural development	5.95	3.72	4.47
(iv) Energy	11.20	9.38	11.68
(v) Industries	4.07	3.31	2.89
(vi) Transport and communication	7.76	5.11	4.35
(3) Social Services	35.35	33.73	37.11
(i) Education	19.44	19.62	19.15
(ii) Health	9.37	8.64	10.51
(iii) Welfare	6.53	5.47	7.45
(4) Non-developmental expenditure	16.89	20.55	17.88

Note: Development expenditure and non-development expenditure will not add to the total revenue expenditure. Because some items under non-development categories.

Source: Computed.

Among economic services, irrigation together with flood control and energy have received higher priority in non-interest expenditure allocation. Transport and communication has been losing its share over time (Table 10), so has the allocation for industries. This should not be a source of worry if the government has performed its role as a facilitator of private sector investment.

Of social services, education has claimed the highest share in non-interest expenditure but its share has tended to decline over time. On the other hand, a wide variety of welfare programmes have received an increasingly larger share in the 1990s (Table 10). In fact, the expenditure under various welfare programmes is far more than that for agriculture, rural development, transport and communication and industry. In an unequal society like Gujarat's as much as India's welfare schemes do receive policy-makers' attention. But the fact is that these are loosely targeted and implemented. Consequently, they fail to achieve the desired objectives. A smaller number of well targeted and easy to administer programmes will be cost-effective as well as more beneficial.

Gujarat has trailed behind other comparable states in regard to the performance of health and education indicators. Their improvement will support of rapid industrial growth.

Of non-development expenditure comprising more than one-quarter of Gujarat's revenue expenditure, interest liability and establishment are the two major components. Interest as percentage of NSDP moved up to 2.99 in 1997-98 (RE) from only 1.05 in 1980-81. The corresponding proportion for establishment remained more or less steady below 3 in the entire period (Table 8).

Interest liability recorded a high growth of 22.15 per cent per annum during 1978-91. After almost doubling its claim on Gujarat's total expenditures, interest liability continued to grow at 16.85 per cent per annum during 1991-98 (Table 9). It came to claim 13.70 per cent of the state's total expenditure and 2.99 per cent of NSDP in 1997-98 (RE) as against 9.98 per cent and 2.18 per cent respectively in 1990-91. This share, though rising, is not high by itself. But a part of this burden has arisen for financing revenue deficit. To that extent, it is the reflection of poor management of the state finances.

Establishment, which essentially comprises wages and salaries, is the other major item of expenditure claiming more than one-tenth of the state's total expenditure all through. It has further increased subsequent to the recent pay revision in the wake of the Fifth Pay Commission Report implemented by the central government. The charge on revenue in terms of wages and salaries shot up by Rs 15 billion as arrears of pay between January 1, 1996 and March 31, 1998 and annually by another Rs 11 billion. To that extent, there will be a jump in establishment charges. The rise in establishment expenditure, which has increased at the rate of 15.43 per cent per annum, is largely due to rising emolument per employee rather than employment growth (Table 11). The state government is faced with the problem of overstaffing. A GoG resolution enforced from 1990-91 required prior permission before filling any vacancy, new recruitment, and promotion. Similarly, prior permission was required for travels abroad and in India by government employees for certain specified purposes, for purchase of new vehicles or disposing of the old ones. Such measures while positive make only a marginal difference.

The GFC has examined this issue very closely and recommended a two-pronged strategy to reduce the number of employees and improve productivity: "On the one hand, a time-bound comprehensive programme of administrative reforms should be undertaken at all levels of government in order to streamline procedures and improve productivity...The other part of the strategy should be aimed at reducing the number of government employees by hiving off organisations and activities which are not longer relevant to the basic objectives of the government or have become totally redundant in the present environment" (p 6).

A high powered expenditure priorities committee (EPC) should operationalise this strategy in an integrated manner while defining the role of the government in the new context. At the same time the GoG should consider introducing an attractive VRS. The state government should strictly adhere to the policy of non-recruitment against natural attrition and filling posts through deputation rather than creation of new posts. The GoG has indeed taken an important step by creating a surplus staff cell out of the surplus employees of SOEs under the PSRP.[12]

Explicit budgetary subsidies' share in total expenditure shot up to almost one-tenth of Gujarat's revenue expenditure in 1997-98 from 6.40 per cent in 1990-91. Total subsidies inclusive of the implicit component will obviously be much higher. No estimate of this is available for any recent year. The volume on non-tax revenue has estimated the total implicit subsidy for Gujarat at Rs 80.2 billion of Rs 1,790 per capita in 1995-96 and the per capita implicit subsidies for economic and social services at Rs 402 and Rs 934 respectively. The corresponding per capita implicit subsidies were worked out at Rs 261.27 and Rs 266.22 for 1987-88.[13] These budgetary subsidies have essentially arisen because of non-recovery of cost of public services. The state government has not

Table 11: Growth of Public Sector Employment and Salary Bill

Employment (000)	1980	1985	1990	1993	1994	1995
State government	187	204	217	215	217	215
Local bodies	234	266	290	300	311	309
Public enterprises	189	244	293	302	306	302
Total	610	714	800	817	834	826
State salary bill	1,661.40	3,227.20	6114.90	8702.20	9788.60	11617.90
Per employee (Rs)	8,884.49	15819.61	28179.26	40475.35	45108.76	54036.74

Source: GoG, DOES, Socio-Economic Review, Economic and Functional Classification.

Table 12: Claim of Downward Rigid Items on Revenue Receipts and Expenditure of Gujarat Government

Per Cent of Revenue Expenditure	1980-81	1990-91	1996-97 RE	1997-98 BE
Wages, salaries and pensions	13.49	15.23	14.00	18.02
Interest	4.70	9.74	12.31	12.65
Transfers	25.20	29.11	24.46	24.47
Subsidies	4.20	6.40	14.30	9.68
Total	47.59	60.48	65.07	64.82
Per cent of aggregate revenue receipt	63.33	95.85	85.09	84.43
Per cent of aggregate revenue available for other purposes	36.67	4.15	14.91	15.57

Source: GoG, DOES, An Economic and Purpose Classification of the Budget, Gujarat State, relevant issues.

yet recognised the unrecovered cost of non-merit public services as subsidies. To begin with, the state government should bring out an official estimate of the subsidies implicit in providing these services and present annually to the legislature for public debate as to the desirability of such large untargeted and indiscriminate subsidies. As for explicit subsidies, a small number of objective criteria-based targeted schemes will be more beneficial and cost-effective.

Interest, wages and salaries, subsidies and transfers are four downward rigid items of expenditure. These items together accounted for 47.59 per cent of Gujarat's revenue expenditure in 1980-81. About a decade and a half-later (1997-98), they required as much as 64.82 per cent of its revenue expenditures. As a result, these four items alone demanded 84.3 per cent of the state's revenue receipt in 1997-98 as against 63.33 per cent in 1980-81 (Table 12). Its implication is that only 36.67 per cent of state's revenue receipts remained for other expenditures in 1980-81 and just about 15 per cent in 1997-98 (BE). This has set a limit to the allocative powers of the state government to allocate its non-debt receipts for any effective intervention elsewhere.

In a state of affairs such as this, maintenance of expenditure is treated as residual. This explains the reason for poor maintenance of roads, hospitals, administrative building, irrigation systems, and other assets created. Poor maintenance of irrigation systems, power stations, and other productive assets created has resulted in their gross underutilisation.

With current expenditure crowding out capital expenditure, gross capital formation in the state government sector as per cent of NSDP which was no more than 5 per cent in 1980-81 dropped gradually to less than 2 per cent in 1996-97. This is disproportionately low as compared to Gujarat's total expenditure income ratio of more than 20 per cent in the 1990s.

The outstanding debt as on March 31, 1986 as percentage of NSDP was 20.19, which rose to 22.50 by March 31, 1998. The reasons for growing debt are obvious. The state had to borrow to meet the deficit arising from the current expenditure outpacing the state revenue while at the same time to finance an increasingly large plan. On the other hand, the net availability of loans (after taking care of interest and repayment) sharply declined to 37.70 per cent in 1997-98 (RE) from 51.19 per cent just two years earlier.

The growing debt of the state viewed in the context of falling capital formation suggests poor management of borrowed funds. Revamping investment policy, which explicitly considers rate of return together with terms of loan, has become unavoidable. More so, when the Gujarat government has to borrow at an increasingly higher interest rate following interest rate liberalisation. The interest rate at which Gujarat borrowed from the centre moved up to 12.55 per cent in 1997-98 from only 6.85 per cent in 1986-87. It is even higher for internal debt inclusive of market loans and those from public account (Table 13).

Gujarat like other states regularly used surplus on public accounts to finance a part of its fiscal deficit (Table 8A). An easy access to this source has not helped the state in prioritisation of its expenditure programmes. On the other hand, the state government, which essentially functions as a banker in respect of this account, has failed to maximise the return on the surplus on public account. It is, therefore, appropriate to establish a separate pension and gratuity fund for Gujarat government employees out of annual contributions of the government. The state government should entrust public sector financial institutions and mutual funds with impeccable track record to manage it professionally. This institutional mechanism will serve the interest of the state better particularly after if comes out of the current imbalance on the revenue account.

Policy Weaknesses and Reform Strategy

Budgetary policy of the state has led to certain features of Gujarat finances that are not in conformity with sound principles of public finance. Current expenditures are outpacing revenue growth. Non-development expenditures are growing faster than development expenditures. Current expenditure is crowding out capital expenditure. The fast growing downward sticky items – some of them are uncontrollable – have drastically curbed the state's allocative flexibility and thus the state government has lost its control over expenditure priorities and its effectiveness. The method of loan financing even a part of revenue expenditure has imparted a feedback process in: (a) revenue expenditure growth via rising interest liability; and (b) debt build-up via shrinking net availability of fresh loan. All these explain why the state has failed to realise the modest target of containing its fiscal deficit at 3.5 per cent of NSDP for 1997-98.

The state should adopt a threefold strategy for restructuring its expenditure. One, restrict the role of the government to the areas of market failures inclusive of the provision of merit goods and the activities and institutions that flourish private initiatives and investments. Two,

Table 13: Gujarat's Debt-NSDP Ratio and Average Interest Rate

(Per cent)

Year (As on March 31)	Outstanding Debt-NSDP Ratio			Average Interest Rate		
	Aggregate Debt	Central Loans	Internal Debt	Aggregate Debt	Central Loans	Internal Debt
1985-86	20.19	16.92	3.27	6.81	6.55	7.87
1990-91	24.31	21.23	3.09	8.43	8.39	8.67
1996-97	21.06	17.51	3.55	12.20	11.93	13.68
1997-98(RE)	22.50	18.65	3.85	12.78	12.43	14.51

Source: Compound on the basis of data supplied by Finance Department, GoG.

Table 14: Illustrative List of Overlapping Activities/Schemes in Some Departments

Department	Overlapping Activities Being Prepared by Agencies/Offices
Tribal department	Tribal development corporation, tribal development commissioner, project administrator, director of tribal department, tribal areas sub-plan (TSAP), tribal advisory board
Welfare of scheduled castes	SC economic development corporation, scheduled castes welfare plan as a part of the budget
Rural development	District rural development authority (DRDA), district panchayat officers, state government's rural development department.
Land development	Some agricultural development corporation, Gujarat land development corporation, Wasteland development board, khar land development board, DRDA also allocates for some of the activities looked after by the above agencies.
Agriculture	District agricultural officer under district panchayat, agro industries corporations, seed development corporation, seed farms under various district panchayats, Gujarat agriculture university schemes.

offload the activities outside the above domain. Three, modernise the state machinery by (a) updating the existing rules, procedures and norms; (b) restructuring organisational structure eliminating multi-layer decision-making process and updating the skill of staff; (c) introducing computerisation and building MIS; and (d) removing staff redundancy.

Expenditure inefficiencies of GoG have arisen from four major sources: (a) continuing interface with the institutions, conventions and practices evolved in another regime; (b) divergence between of policy goals/expenditure targeting and affordability; (c) antiquated budgetary planning, monitoring and control; and (d) procedure-driven but not delivery-driven functioning of implementing agencies.

Some of the weaknesses in budgetary and expenditure management have arisen from the existing system of inter-governmental transfers, practices and conventions evolved in the earlier regime that placed the public sector at the commanding height.

States' dependence on fiscal transfers is generally high. Though much lower than many states, Gujarat receives more than one-fifth of its total revenue receipts from the centre in the form of tax share and grants in addition to almost similar amount as loans. As is widely recognised, the method of determining inter-governmental transfers has not promoted efficiency in expenditure management by states. On the contrary, Finance Commission transfers based on gap filling approach together with its loan forgiveness had given wrong messages to states. This could also be one of the reasons for imprudence in the management of state finances.

Similarly, Planning Commission assistance in the ratio of 30:70 between grants and loans for the major states which is invariant between types of activities has not encouraged states to base their investment decisions on the basis of rate of returns and terms of finance.

Following the acceptance of planning for economic development, both the central and state governments have developed a compulsion to continually enlarge the size of their respective five-year plans without any reference to resource availability. This hsa eventually led to a number of adverse consequences on budgetary and expenditure policies at both the centre and states.

The dichotomy that has arisen between plan and non-plan has resulted in compression of non-plan expenditure even if it

Appendix Table 1A: Balances from Current Revenues (BCR) and Revenue Balance

(Rs in billion)

Year	Revenue Receipt	Revenue Expenditure			BCR	Revenue Surplus Deficit
		Total	Non-Plan	Plan		
1980-81	10.25	9.03	7.15	1.88	3.10	1.22
1981-82	11.59	10.39	8.38	2.01	3.21	1.20
1982-83	13.49	12.83	10.55	2.28	2.94	0.66
1983-84	15.65	14.26	11.65	2.62	4.01	1.39
1984-85	17.69	17.01	14.24	2.77	3.46	0.68
1985-86	19.02	19.72	16.77	2.95	2.25	-0.70
1986-87	21.60	24.69	19.48	5.22	2.12	-3.10
1987-88	28.06	30.93	22.43	8.50	5.64	-2.87
1988-89	32.36	33.62	27.40	6.22	4.95	-1.27
1989-90	36.01	37.27	31.11	6.17	4.91	-1.26
1990-91	33.79	40.82	34.00	6.81	-0.21	-7.03
1991-92	46.63	52.38	42.42	9.96	4.20	-5.76
1992-93	59.11	62.11	47.28	14.82	11.83	-3.00
1993-94	70.30	69.34	62.71	6.62	7.59	0.96
1994-95	78.06	75.44	67.19	8.25	10.88	2.62
1995-96	85.44	87.66	76.32	11.34	9.12	-2.22
1996-97	96.68	102.59	91.14	11.46	5.54	-5.91

Sources: *Budget in Brief*, Government of Gujarat Directorate of Economics and Statistics; NPRE figures have been supplied by Finance Department, Government of Gujarat.

Appendix Table 2A: Major Deficit Indicators as Per Cent of NSDP

Year	Budget	Revenue	Fiscal	Fiscal	Primary	Interest
1980-81	-0.62	-1.86	3.77	4.34	2.72	-0.81
1981-82	0.48	-1.47	3.07	3.76	2.07	-0.47
1982-83	-0.39	-0.76	4.33	5.12	3.18	-0.39
1983-84	-0.10	-1.23	3.61	4.00	2.57	-0.19
1984-85	-0.29	-0.58	4.43	4.61	2.68	-2.13
1985-86	0.16	0.58	4.23	4.87	3.18	-0.60
1986-87	-0.08	2.21	6.42	6.97	4.68	-3.95
1987-88	-0.12	2.06	7.02	7.74	4.81	-4.28
1988-89	0.23	0.65	3.76	4.66	1.77	-2.65
1989-90	-0.93	0.59	4.53	4.81	2.36	-2.76
1990-91	0.56	2.90	7.37	7.91	5.19	-5.07
1991-92	0.06	2.20	6.86	7.55	4.13	-4.93
1992-93	0.12	0.86	3.31	4.65	0.64	-3.54
1993-94	-0.02	0.25	1.34	2.50	-1.32	-2.41
1994-95	-0.02	-0.55	2.70	2.95	0.22	-1.93
1995-96	-0.13	0.45	3.53	3.94	0.22	-1.93
1996-97	-0.01	-1.04.	4.15	2.41	1.32	-1.79
1997-98 (RE)	0.32	1.01	4.44	4.61	1.45	-4.00

Note: (-) sign indicate surplus.

Source: *Budget in Brief*, Directorate of Economics and Statistics, Gujarat, various issues.

Appendix Table 3A: Revenue Deficit as Percentage of Gross Fiscal Deficit (Major States)

(Per cent)

States	Revenue Deficit/GFD			
	1985-90 Average	1990-95 Average	1996-97 (RE)	1997-98 (BE)
Andhra Pradesh	7.7	11.5	25.0	37.2
Bihar	-47.6	51.3	67.4	27.8
Goa	0.6	-38.3	-4.7	14.1
Gujarat	21.5	11.3	13.4	1.9
Haryana	-25.0	14.1	64.3	42.2
Karnataka	10.5	11.2	34.8	25.5
Kerala	36.4	44.0	49.7	51.9
Madhyapredesh	-1.7	10.1	69.1	33.1
Maharashtra	11.5	8.8	28.6	11.0
Orissa	15.3	22.4	46.4	40.0
Punjab	9.9	45.9	51.3	45.1
Rajasthan	17.6	3.4	22.5	1.8
Tamilnadu	12.5	72.3	52.7	49.8
Utter Pradesh	9.3	34.2	56.8	69.8
West Bengal	18.0	52.0	52.9	42.3

Source: *RBI Bulletin*, February 1998, supplement: Finance of State Government 1997-98.

relates to highly desirable public services, and neglect of maintenance of assets. The separation has also discouraged proper attention to the affordability of the overall budget as well as the total delivery of public services. This has eventually led to widening gap between resource availability and expenditure level planned.

Balance from current revenue (BCR), additional resource mobilisation (ARM), contributions of SOEs, market borrowing, share in small savings, loans from financial institutions and loans from public accounts are the main sources in addition to plan assistance for financing a state plan. With the BCR turning negative since 1985 and the shrinking scope for raising non-debt resources, loans emerged as the major source of financing Gujarat's plan expenditure. This, in turn, has contributed to debt build-up, on the one hand and growing interest liability under revenue account, on the other.

Mobilising additional resources year after year to support increasingly larger plans resulted in ad hoc measures that contributed to complexity in the tax system, thus making it less amenable to efficient tax administration and compliance and hence to improving tax buoyancy. Budgetary policy has paid little attention to tap the potential on non-tax sources such as water rates, power tariff and cost recovery of public provided services for enlarging plan investment.

To convention of adding committed and maintenance expenditure of plan scheme to non-plan expenditure at the end of every plan has the effect of expanding non-plan expenditure in bulk every five years. This practice together with rising interest liability from debt build-up for plan financing has contributed in no small measure to worsening revenue balance.

With increasingly larger plan size but sluggish revenue growth and laxity in expenditure management, states have experienced a secular deterioration in their fiscal balances. There has been a drastic shift to a regime relying more on market forces. But the approach to planning or the role of a state in the new regime has not been appropriately altered even almost a decade after reforms began. There is, however, a growing awareness among policy-makers of the crippling effects on budget and expenditure management of these past development paradigm, and practices and conventions.

In the new regime the state has to be a facilitator rather than a direct provider of growth. Planning should essentially focus on the areas of market failures and identifying the constraints of dynamic growth and instruments of strategic intervention for removing them.

Future reforms will involve:

(i) Doing away with plan and non-plan dichotomy in revenue expenditure and maintaining the distinction between revenue/current and capital expenditure.

(ii) Redefining the role of planning with focus on the areas of market failures and strategic interventions.

(iii) Abolishing the fixed loan component of central assistance to state plans and replacing this with specific purpose loans on the basis of bank-ability of investment programme.

(iv) Substituting the current system of providing resources for numerous central schemes by a package of well-targeted schemes.

(v) Re-distributive transfers with particular reference to poorer states.

These measures will inevitably entail extensive discussions and agreement among states and the centre in for a like the national development council and inter-state council prior to their implementation.

Appendix Table 4A: Gujarat Revenue and Expenditure Total and Broad Components as Per Cent of NSDP

Year	Revenue Receipts	Total Tax Trans from Centre	State's Own Tax Revenue	State's Own Non-Tax Revenue	Revenue Expenditure	Total Expenditure Inclusive Repayment	Total Expenditure Excluding Repayment
1980-81	15.66	2.90	8.11	2.83	13.80	22.90	20.00
1981-82	14.13	2.54	8.05	2.30	12.66	20.57	17.89
1982-83	15.55	2.43	8.80	2.83	14 79	23.49	20.68
1983-84	13.87	2.01	7.79	2.59	12.64	21.59	17.88
1984-85	15.07	2.61	8.35	2.83	14.49	21.41	19.94
1985-86	15.72	2.31	8.88	2.70	16.30	23.25	20.32
1986-87	15.40	0.88	9.02	3.97	17.61	27.11	22.38
1987-88	20.18	2.59	10.97	3.27	22.24	32.25	27.92
1988-89	16.60	2.04	9.60	2.94	17.25	26.18	21.25
1989-90	16.81	2.00	10.08	3.79	17.40	23.24	21.63
1990-91	13.92	1.15	9.89	1.66	16.82	23.54	21.83
1991-92	17.85	1.18	11.08	4.35	20.05	29.80	25.40
1992-93	17.03	2.34	9.96	3.34	17.89	25.03	21.68
1993-94	17.92	2.51	10.05	3.57	17.68	23.70	20.43
1994-95	16.31	2.04	9.91	3.11	15.76	20.08	19.26
1995-96	17.28	2.30	11.18	3.24	17.73	21.86	21.21
1996-97	17.00	2.07	10.67	2.77	18.04	22.89	21.46
1997-98	17.26	2.46	10.75	2.66	18.26	22.09	21.82

Note: Estimates for 1996-97, 1997-98,1998-99 is by us.

Appendix Table 5A: Composition of State Taxes

(Per cent)

Year	Sales Tax	Profession Tax	Land Revenue Tax	Stamp and Registration Duty	State Excise Duty	Motor Vehicle Tax	Goods Passenger Tax	Electricity Duty	Entertainment Tax	Miscellaneous Tax/ Duty	State's Own Tax
1980-81	66.64	1.49	2.43	5.55	0.65	4.19	6.40	6.82	3.96	1.86	100.00
1981-82	69.99	1.38	2.20	5.70	0.60	4.01	2.44	7.76	4.24	1.67	100.00
1982-83	66.05	1.43	1.78	5.-03	0.64	4.08	7.06	8.18	4.18	1.55	100.00
1983-84	63.12	1.49	1.85	4.54	0.60	4.03	9.61	9.15	4.34	1.27	100.00
1984-85	62.18	1.63	1.74	4.48	0.46	3.99	6.86	11.04	4.15	3.47	100.00
1985-86	64.25	1.73	1.60	4.41	0.53	3.85	5.47	11.01	3.73	3.42	100.00
1986-87	68.38	1.70	1.67	4.18	0.51	4.22	4.27	9.01	2.99	3.06	100.00
1987-88	66.88	1.75	1.23	4.44	0.55	6.68	5.79	8.78	2.48	1.42	100.00
1988-89	69.19	1.63	1.37	4.62	0.56	3.75	5.39	10.13	1.86	1.49	100.00
1989-90	71.05	2.07	1.42	5.10	0.62	4.03	4.32	8.38	1.64	1.37	100.00
1990-91	72.50	1.59	1.42	5.22	0.50	3.99	4.40	7.81	1.30	1.27	100.00
1991-92	69.49	1.35	1.27	5.77	0.45	3.91	2.61	13.01	1.11	1.04	100.00
1992-93	66.56	1.18	1.33	5.34	0.43	4.20	3.52	15.74	0.85	0.86	100.00
1993-94	70.30	1.13	1.50	5.35	0.47	4.43	2.98	11.81	0.87	1.16	100.00
1994-95	67.17	0.93	1.28	5.71	0.44	4.39	1.38	16.68	0.86	1.15	100.00
1995-96	67.51	0.86	1.46	6.68	0.40	5.74	2.02	13.07	1.07	1.20	100.00
1996-97	66.37	0.80	1.44	6.58	0.40	5.51	1.59	14.85	0.97	1.50	100.00
1997-98	67.90	0.82	1.07	5.96	0.42	5.78	0.91	14.89	0.89	1.37	100.00

Gujarat, like any other state, attempted to set an increasingly higher expenditure target from one plan to another but not within its affordability to achieve multiple objectives. In pursuit of too many objectives with limited resource availability, the state has ended up spreading resources too thinly across a wide variety of expenditure programme. In the process expenditure programmes have not gotten appropriately prioritised. The high powered committee, EPC as recommended earlier, should fix priorities in alignment with macro objectives and resources affordability.

Adding plan schemes regardless of their affordability has contributed to the accumulation of ongoing projects that are rolled over from plan to plan without resulting in any assets or income. Implementing departments' preference for adding new programmes over completing the existing ones has also contributed to the proliferation of incomplete projects. This has resulted in cost and time overrun. Again, different departments formulated expenditure programmes independent of one another to achieve almost identical objectives (Table 14). Such fragmented decision- making yielded less than optimal results.

A high level committee of secretaries should: (i) identify the programmes which require fast-tracking and those which deserve closing down, and (ii) redesign overlapping schemes within and between departments for cost effectiveness and enhancing impact. The committee should function in close collaboration with the state public finance reforms committee (SPFRC).

For easy access to central government fund, the state undertook a large number of centrally sponsored schemes committing some of its own resources. Many a time this has distorted priorities. Worse still, the state has continued the schemes without proper evaluation deploying its own resources even after the withdrawal of central funding.

Similarly, the state government has implemented a large number of externally aided projects. But the state had to absorb the project staff even after the completion of the projects for legal obligation or other extraneous considerations.

In situations such as these, apart from unintended resource commitment, government decisions work at cross purposes. For example, Gujarat government took a policy decision not to recruit automatically against vacancies arising from natural attrition. But the absorption of staff employed on the centrally sponsored schemes/externally aided projects as above has acted counter to the objective of staff reduction.

The government should constitute a sub-committee with chief secretary as chairman and finance secretary and secretary of the concerned departments as members to decide as to the desirability of continuation of such schemes.

Gujarat's budget based on 'procedural rationality' is essentially incremental with a near-term focus. This traditional budgeting accepts last year's expenditure as the base. Added to it are the provisions for inflation, increase in salary, etc. The new

Appendix Table 6A: Progress of Restructuring and Privatisation of Gujarat's SOEs

Name of SOE	ADB Condition	Present Status
GSTC	Closure	Done
GFDC	Closure	Under implementation
GSRDC	Closure	Under consideration
GWRDC	Closure	
GCCL	Closure	To be decided
GDDC	Closure	To be decided
GTCL	Transfer more than 51 per cent control	Under Implementation
GCEL	Transfer more than 51 per cent control	Under Implementation
GSEC	Transfer more than 51 per cent control	Under Implementation
APL (agrocel)	Transfer more than 51 per cent control	Done
GIL (insecticides)	Transfer more than 51 per cent control	Done
TCGL	Transfer more than 51 per cent control	
GSFC*	Dis investment 26 per cent to 51 per cent	26 per cent done
GMDC*	Dis investment 26 per cent to 51 per cent	26 per cent done
GIIC*	Dis investment 26 per cent to 51 per cent	Under Implementation
GIDC*	Dis investment 26 per cent to 51 per cent	
GAIC*	Dis investment 26 per cent to 51 per cent	
GHB*	Merger	
GSCB	Merger	
GSLIDC	Merger	
GRIMCO	Merger	
GSHC (handloom)	Merger	
GSHC (handicraft)	Merger	
GMB*	Restructuring	
GSIC*	Restructuring	
GSRTC*	Restructuring	
GWSSB*	Restructuring	
FDCG	Closure	

Notes: Last four SOEs are indirectly part of ADB conditions. * PW reports are available.
Source: Technical Secretariat to advise on restructuring of the SOEs under PSRP.

Appendix Table 7A: Composition of Expenditure
(Per cent)

Year	Total Revenue and Capital Expenditure						Revenue Expenditure					
	Development Expenditure to		Social Service to		Economic Service to		Non-Development Rev Exp to		Interest to		Establishment to	
	NSDP	Total	NSDP	Total	NSDP	Total	NSDP	Total	NSDP	Total	NSDP	Total
1980-81	15.35	76.76	6.08	30.42	9.27	46.34	3.64	18.19	1.05	5.24	2.59	12.95
1981-82	14.08	78.73	5.55	31.04	8.53	47.69	3.06	17.11	1.00	5.57	2.06	11.54
1982-83	16.72	80.88	7.25	35.06	9.47	45.82	3.31	16.03	1.15	5.56	2.17	10.47
1983-84	14.57	81.52	5.85	32.75	8.72	48.77	2.82	15.75	1.04	5.81	1.78	9.94
1984-85	16.09	80.65	7.08	35.52	9.00	45.14	3.35	16.79	1.24	6.24	2.10	10.55
1985-86	15.77	77.59	7.81	38.42	7.96	39.17	3.99	19.63	1.55	7.63	2.44	12.00
1986-87	17.68	79.01	7.77	34.73	9.91	44.29	4.08	18.23	1.74	7.78	2.34	10.46
1987-88	22.11	79.19	9.67	34.64	12.44	44.55	4.99	17.86	2.22	7.94	2.77	9.92
1988-89	16.21	76.24	7.09	33.37	9.11	42.87	4.54	21.35	2.00	9.40	2.54	11.95
1989-90	16.30	75.37	7.10	32.83	9.20	42.53	4.86	22.45	2.17	10.04	2.68	12.41
1990-91	16.25	74.45	6.95	31.82	9.31	42.64	4.87	22.33	2.18	9.98	2.70	12.35
1991-92	19.17	75.49	7.70	30.32	11.47	45.17	5.49	21.61	2.73	10.74	2.76	10.87
1992-93	16.23	74.88	6.16	28.41	10.07	46.47	5.08	23.43	2.67	12.33	2.41	11.10
1993-94	15.09	73.86	6.39	31.27	8.70	42.59	4.93	24.13	2.66	13.01	2.27	11.11
1994-95	13.80	71.65	6.06	31.46	7.74	40.20	4.76	24.71	2.48	12.88	2.28	11.83
1995-96	15.50	73.07	6.61	31.15	8.89	41.92	5.23	24.67	2.69	12.66	2.55	12.01
1996-97	14.72	68.58	6.28	29.28	8.43	39.30	5.80	27.03	2.83	13.19	2.97	13.84

Source: GoG, *Budget in Brief.*

Appendix Table 8A: Debt Burden of Gujarat Government

(Rs in million)

Year	Opening	Receipts	Discharge	Closing Balance	Interest Payment	NSDP	Outstanding (Per Cent)
1985-86	20516.20	7019.70	3096.60	24439.30	1396.90	121030.00	20
1986-87	24439.30	6863.20	2285.80	29016.70	1794.20	140220.00	21
1987-88	29016.70	11790.20	5020.90	35786.00	2338.30	139080.00	26
1988-89	35786.00	15423.00	9602.90	41606.10	3008.70	194960.00	21
1989-90	41606.10	10645.90	3313.10	48938.90	3546.90	214230.00	23
1990-91	48938.90	15863.00	5800.10	59001.80	4124.30	242690.00	24
1991-92	59001.80	21708.20	11511.90	69198.10	5765.60	261240.00	26
1992-93	69198.10	18337.90	11384.70	76151.30	7556.90	347140.00	22
1993-94	77537.80	17722.30	12857.20	82402.90	8341.10	392260.00	21
1994-95	82402.90	13370.10	3941.50	91831.50	9375.80	478690.00	19
1995-96	91831.50	16199.60	3181.10	104850.00	10435.60	494470.00	21
1996-97	104850.00	18441.90	3531.80	119760.10	12791.20	568640.00	21
1997-98	119760.10	30124.40	7513.00	142371.50	15305.40	632900.00	22

Source: Finance Accounts 1985-86 to 1995-96.

schemes while being admitted allow for some reasonable increase. Thus this budgeting assumes: (i) schemes sanctioned in the past need to be continued, and (ii) the methods adopted for achieving a task are the best, and there is no superior cost-effective method. Such budgeting does not permit weeding out the schemes and programmes that have outlived their relevance. It is in this process that the government expenditure system has lost much of its effectiveness.

Zero-base budgeting, if used as a management tool, will improve expenditure effectiveness. This method entails defining objectives, mission and key result areas under a decision unit. The process involves: (i) identification and sharpening of objectives; (ii) examination of different alternatives to achieve them; (iii) selecting the most cost effective method among the available alternatives; (iv) prioritisation and ranking of objectives and programmes; and (v) switching of resources from low to high priority programmes.

It is clear that zero-base budgeting will weed out the activities that have outlived their utility and merge those which are overlapping. It will also establish a closer alignment between objectives and expenditure programmes. All this will eventually lead to ensuring expenditure effectiveness: getting more out of every rupee government spends.

Gujarat introduced zero-base budgeting in 1987-88 for agriculture and rural development and health and family planning following the recommendations of the Baveja committee. The government made preparations to cover all departments but abandoned the method in 1988-89. GoG is once again considering adopting this method of budgeting. Maharashtra introduced zero-base budgeting from 1987-88. Gujarat should not postphone this important budgetary reform any longer.

The budget formulation passes through multi-level bureaucratic scrutiny. This process does build into programmes some rationality based on elaborate procedures/forms but suffers from one serious weakness. The expenditure programmes thus incorporated in the budget have only vaguely defined links with macro goals or even micro objectives at the department level. This leads to poor prioritisation as well as weak budget monitoring and controls and thus to expenditure inefficiency. Priority-based ceiling for each department in alignment with set goals prior to budget preparation as recommended earlier, will encourage prioritisation of expenditure programmes in departmental budgets.

Implementing agencies, in their monitoring and controls are more oriented to meeting accounting requirements and seeking larger funds than improving the efficiency and quality of expenditures. The government should consider giving more autonomy and accountability to the line agencies, and fixing performance norms to encourage better service delivery.

Gujarat government introduced the practice of preparing annually a 'performance budget' for strengthening the monitoring of physical performance of expenditure programmes. But this document relating to most departments does not provide even basic parameters like unit cost and physical target. As a result, the whole exercise has become perfunctory and degenerated into an annual ritual. The government should consider integrating the basic parameters of performance budget into zero-base budgeting and in respective expenditure programmes while computerising its budget operations.

To conclude, the analysis of Gujarat finances has clearly shown both the sources of inefficiencies as well as the areas for policy reforms. The paper has also suggested both the directions and strategy for fiscal reforms that would enhance effectiveness of budgetary policy. It is only with such fiscal reforms that the state will be better positioned to sustain higher industrial growth and meet the challenges of faster urbanisation. EPW

Notes

[This paper is based on the ADB project on Gujarat's Reform of Public Finances. Presented at the Seminar 'Dynamics in Gujarat' held at the Centre for Development Alternatives, Ahmedabad during April 23 and 24, 1999.]

1 See Report of the Tenth Finance Commission, December 1994.

2 State's own tax revenue-income ratio was exceptionally high in 1990-91. A closer examination of these ratios before and after this year as shown in Appendix Tables bears this out.

3 K M Parekh, 'Resource Mobilisation by Indian States: A Structural Analysis with Special Reference to Gujarat' in Yoginder K Alagh et al (ed), *Stability and Development*, Haranand Publications, 1993.

4 The volumes 'Directions of Sales Tax Reform' and 'Proposal of Value Added Tax Introduction' of the ADB project on 'Gujarat's Reform of Public Finances'.

5 See Report of the Tenth Finance Commission, December, 1994.

6 Report of the comptroller and auditor general of India for the year ended March 31, 1996, No 2 (Commercial) GoG, pp 121-24 and 132-33.

7 See, Report of the Tenth Finance Commission, op cit, p 10.

8 Report of the Gujarat State Finance Commission, April-1994, p 45.

9 For further details, see, Report of the GFC, p 42.

10 For detailed discussion on growth performance, see, Archana R Dholakia, 'Changes in the Trend and Structure of Fiscal Expenditure in Gujarat', *Anvesak*, 1998.

11 CMIE, Economic Intelligence Service, *Profiles of States, March 1997.*

12 The surplus staff has been given three alternatives: (I) continue under a new management; (ii) accept voluntary retirement; and (iii) get registered with the surplus staff cell.

13 M G Rao and S Mundle, 'An Analysis of Changes in Government at State level: 1977-78 to 1987-88' as reproduced in GFC, op cit, pp 43 and 44.