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Government of India
Ministry of Finance
Department of Expenditure**

North Block,
New Delhi 110 001
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Sub: States' Fiscal Consolidation (2010-2015)

States' fiscal consolidation has been a major objective of successive Finance Commissions. The Eleventh Finance Commission (EFC) recommended a Fiscal Reform Facility (FRF) for the period 2000-05, to support States to reduce their revenue deficits. This was backed by the Fiscal Reform Facility Incentive Fund of Rs.10, 607.72 crore. The Twelfth Finance Commission (TFC) reviewed the FRF and recommended a Debt Consolidation and Relief Facility (DCRF) for its award period 2005-10, linked to adoption of a statutory route by States to eliminate revenue deficit and reduce fiscal deficit.

2. The Thirteenth Finance Commission (FC-XIII) was required to review the operation of the States' DCRF, and suggest measures to maintain a stable and sustainable fiscal environment consistent with equitable growth. FC-XIII has noted that most States that have enacted their fiscal responsibility legislation have reached their expenditure and debt targets ahead of schedule. Fiscal correction has been achieved mainly through higher revenue buoyancy, both in the States and the Centre. The States have also been able to reduce their debt to GSDP ratios. However, there are variations among the States' performance. To support States towards urgent fiscal correction FC-XIII has worked out a fiscal consolidation roadmap for each state, requiring States to eliminate revenue deficit (RD) and achieve fiscal deficit (FD) of 3% of their respective Gross State Domestic Product (GSDP) by 2014-15. FC-XIII has also recommended a combined debt target of 24.3% of GDP to be reached by States by 2014-15 from a level of 27% in 2008-09. This combined debt reduction target is also expressed in terms of outstanding debt to GSDP ratios for each State for each year. Government of India has accepted these recommendations.

3. The RD, FD and outstanding debt to GSDP targets for States for the award period of FC-XIII are tabulated in **Annexes I, II and III** of this communication. Specific attention is invited to paragraphs 9.67 to 9.90 of FC-XIII's report in this regard. States are required to enact/amend their Fiscal Responsibility and Budget Management (FRBM) Acts to conform to the aforementioned fiscal reform path. States are also required to set up independent review/monitoring mechanism under their FRBM Acts.

4. The debt relief measures flowing from the recommendations of FC-XIII, and the actions required to implement these, are:

i) Interest on loans to States from National Small Savings Fund contracted till 2006-07 and outstanding at the end of 2009-10 is to be reset at 9% p.a. Structural reforms are to be brought in to make the NSSF scheme more market linked. A committee has been set up to work out detailed modalities in this regard, and States are being consulted on these.

ii) Loans from Gol to States and administered by ministries/departments other than MoF, outstanding as at the end of 2009-10, are to be written off. Such writing off will be subject to the prescribed enactment/amendment of FRBMAs by States, and the communication of these actions to this Department. State wise outstandings have been compiled in this regard.

iii) The DCRF scheme came to an end on 31 March 2010. However, the exercise to assess States' eligibility for debt waiver for the years 2008-09 and 2009-10, based on fiscal performance, would continue up to the end of 2011-12. Therefore, the States' finance accounts may be made available at an early date to facilitate assessment. It is reiterated that any debt write-off must be accounted such that it does not artificially affect the revenue or fiscal deficit of the States.

iv) For States that had not availed the benefit of debt consolidation under DCRF, the facility, limited to consolidation and interest rate reduction, will be extended subject to enactment of an FRBM Act containing prescribed commitments regarding reduction of fiscal deficit and outstanding debt and elimination of revenue deficit, referred to in paragraph 3 above.

5. The States' enactment/amendment of their FRBMAs, incorporating the above targets will be a pre-condition for release of all state-specific grants and debt relief measures. States may therefore expedite action to enact/amend their FRBMAs and inform this Department of the same and send their claims for the reliefs contained in para 4 above.

6. The methodology for determining annual borrowing ceilings of States during 2010-15, is laid down in paragraphs 9.85 to 9.87 of FC XIII's report, read with the targets referred to in paragraph 3 of this communication. The borrowing limits of States are being worked out and enforced by Ministry of Finance (MoF) following the prescribed fiscal reform path for each State. From the year 2011-12 onwards, since the final estimates of GSDP numbers are available with a time lag, the borrowing ceilings for any year will be determined taking into consideration the GSDP estimates of the year preceding the previous year (t-2) and the growth rates and FD/GSDP targets indicated by FC XIII in Annex 7.2 and 9.2 of its report respectively. In case the Final Estimates (FE) of GSDP are over 3% less than the estimates relied upon for determining borrowing ceiling, the concerned State's borrowing limits will be adjusted in the year in which the FE become available. The GSDP estimates relied upon for the purpose of determining each year's borrowing ceilings are being communicated to the States, and these estimates will be used by the States for the purpose of maintaining the prescribed outstanding debt to GSDP ratios. It shall be for the States to ensure adherence to the targeted debt to GSDP ratio (tabulated in **Annex III** of this communication). It will also be for each State to ensure that its fiscal deficit is not over-financed on account of larger than anticipated NSSF flows: in case NSSF flows are higher than expected, the State will reduce its open market borrowings appropriately, even though it may have received consent of Government of India for higher market borrowings. The net borrowing ceilings determined annually for a State and the borrowings which the State can raise against maturities are to be circumscribed by the debt-GSDP targets. In other words, the gross borrowing limits in any year will be determined by the maturities or the debt to GSDP ratio, whichever is the lower number.

7. The Medium Term Fiscal Plan (MTFP) of each State should contain three-year-forward estimates of revenues and expenditure, with detailed breakup of major items, and a narrative explanation of how these

estimates have been generated. These estimates should be in broad conformity with the fiscal parameters recommended by FC-XIII. The intent should be to ensure a tighter integration of the MTFP into the State's budget, and the MTFP more a statement of commitment rather than a statement of intent [para 9.38 read with para 9.83]. It is recommended that FC – XIII's recommendations for the Centre, in paragraphs 9.34 to 9.54 of its report, may be perused as these are to be replicated at the State level. The main recommendations applicable to States have been indicatively listed in Annex- IV.

8. Its terms of reference required FC–XIII to consider the objective of not only balancing the revenue account but also generating surplus for capital investment. This underlines the need for ensuring commercial viability of certain critical sectors such as irrigation, power, and departmental undertakings. Structural reforms in these areas are essential for the States' fiscal reform programmes to succeed. While a perusal of paragraphs 7.92 to 7.138 FC-XIII's report is recommended, the main recommendations are listed in Annex-V.

9. Based on the recommendation of TFC, States constituted Monitoring Committees to review the State's progress on its fiscal correction path and advise corrective action, if required. These committees, headed by Chief Secretary of the State concerned, with the Finance Secretary and other Secretaries concerned as members, may be continued (and replicated by any State which does not have such a system in place). Each State's committee may meet at least twice a year to review the fiscal and debt position of the State. A copy of the minutes of the meeting may be forwarded to MoF.

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To
The Chief Secretaries of all State Governments
Copy to Finance Secretary of all State Governments

Annex I

(Annex 9.3 of FC-XIII's Report)

Revenue Deficit Targets

(as per cent of GSDP)

Sl. No	States	2011-12	2012-13	2013-14	2014-15
1	Andhra Pradesh	0.0	0.0	0.0	0.0
2	Arunachal Pradesh	0.0	0.0	0.0	0.0
3	Assam	0.0	0.0	0.0	0.0
4	Bihar	0.0	0.0	0.0	0.0
5	Chhattisgarh	0.0	0.0	0.0	0.0
6	Goa	0.0	0.0	0.0	0.0
7	Gujarat	0.0	0.0	0.0	0.0
8	Haryana	0.0	0.0	0.0	0.0
9	Himachal Pradesh	0.0	0.0	0.0	0.0
10	Jammu & Kashmir	0.0	0.0	0.0	0.0
11	Jharkhand	0.0	0.0	0.0	0.0
12	Karnataka	0.0	0.0	0.0	0.0
13	Kerala	1.4	0.9	0.5	0.0
14	Madhya Pradesh	0.0	0.0	0.0	0.0
15	Maharashtra	0.0	0.0	0.0	0.0
16	Manipur	0.0	0.0	0.0	0.0
17	Meghalaya	0.0	0.0	0.0	0.0
18	Mizoram	0.0	0.0	0.0	0.0
19	Nagaland	0.0	0.0	0.0	0.0
20	Orissa	0.0	0.0	0.0	0.0
21	Punjab	1.8	1.2	0.6	0.0
22	Rajasthan	0.0	0.0	0.0	0.0
23	Sikkim	0.0	0.0	0.0	0.0
24	Tamil Nadu	0.0	0.0	0.0	0.0
25	Tripura	0.0	0.0	0.0	0.0
26	Uttar Pradesh	0.0	0.0	0.0	0.0
27	Uttarakhand	0.0	0.0	0.0	0.0
28	West Bengal	1.6	1.1	0.5	0.0

Annex II

(Annex 9.2 of FC-XIII's Report read with para 9.87)

Fiscal Deficit Targets

(as per cent of GSDP)

Sl. No.	States	2010-11	2011-12	2012-13	2013-14	2014-15
1	Andhra Pradesh	3.0	3.0	3.0	3.0	3.0
2	Arunachal Pradesh	3.0	3.0	3.0	3.0	3.0
3	Assam	3.0	3.0	3.0	3.0	3.0
4	Bihar	3.5	3.0	3.0	3.0	3.0
5	Chhattisgarh	3.0	3.0	3.0	3.0	3.0
6	Goa	3.5	3.0	3.0	3.0	3.0
7	Gujarat	3.0	3.0	3.0	3.0	3.0
8	Haryana	3.0	3.0	3.0	3.0	3.0
9	Himachal Pradesh	3.5	3.0	3.0	3.0	3.0
10	Jammu & Kashmir	5.3	4.7	4.2	3.6	3.0
11	Jharkhand	3.5	3.0	3.0	3.0	3.0
12	Karnataka	3.44	3.0	3.0	3.0	3.0
13	Kerala	3.33	3.5	3.5	3.0	3.0
14	Madhya Pradesh	3.43	3.0	3.0	3.0	3.0
15	Maharashtra	3.0	3.0	3.0	3.0	3.0
16	Manipur	3.5	3.5	3.5	3.0	3.0
17	Meghalaya	3.0	3.0	3.0	3.0	3.0
18	Mizoram	7.5	6.4	5.2	4.1	3.0
19	Nagaland	3.5	3.5	3.5	3.0	3.0
20	Orissa	3.0	3.0	3.0	3.0	3.0
21	Punjab	3.5	3.5	3.5	3.0	3.0
22	Rajasthan	3.22	3.0	3.0	3.0	3.0
23	Sikkim	3.5	3.5	3.5	3.0	3.0
24	Tamil Nadu	3.0	3.0	3.0	3.0	3.0
25	Tripura	3.5	3.0	3.0	3.0	3.0
26	Uttar Pradesh	3.5	3.0	3.0	3.0	3.0
27	Uttarakhand	3.5	3.5	3.5	3.0	3.0
28	West Bengal	3.5	3.5	3.5	3.0	3.0

Annex III

(Annex 9.1 of FC-XIII's Report)

Outstanding Debt Targets

(as per cent of GSDP)

Sl. No.	States	2010-11	2011-12	2012-13	2013-14	2014-15
1	Andhra Pradesh	30.3	29.6	28.9	28.2	27.6
2	Arunachal Pradesh	61.3	58.2	55.2	52.5	50.1
3	Assam	28.2	28.3	28.4	28.4	28.5
4	Bihar	48.2	46.4	44.6	43.0	41.6
5	Chhattisgarh	22.0	22.5	23.0	23.5	23.9
6	Goa	33.0	31.9	30.8	29.9	29.1
7	Gujarat	29.4	28.8	28.1	27.6	27.1
8	Haryana	22.4	22.6	22.7	22.8	22.9
9	Himachal Pradesh	49.7	47.0	44.4	42.1	40.1
10	Jammu & Kashmir	56.1	55.1	53.6	51.6	49.3
11	Jharkhand	29.0	28.5	27.8	27.3	26.9
12	Karnataka	26.2	26.0	25.7	25.4	25.2
13	Kerala	32.8	32.3	31.7	30.7	29.8
14	Madhya Pradesh	38.4	37.6	36.8	36.0	35.3
15	Maharashtra	26.3	26.1	25.8	25.5	25.3
16	Manipur	65.8	62.9	60.1	57	54.3
17	Meghalaya	33.1	32.7	32.3	32	31.7
18	Mizoram	87.3	85.7	82.9	79.2	74.8
19	Nagaland	56.8	55.8	54.9	53.5	52.3
20	Orissa	31.0	30.6	30.2	29.8	29.5
21	Punjab	42.5	41.8	41.0	39.8	38.7
22	Rajasthan	40.4	39.3	38.3	37.3	36.5
23	Sikkim	68.4	65.2	62.1	58.8	55.9
24	Tamil Nadu	24.1	24.5	24.8	25.0	25.2
25	Tripura	45.2	44.9	44.6	44.2	43.8
26	Uttar Pradesh	48.7	46.9	45.1	43.4	41.9
27	Uttarakhand	42.2	41.1	40.0	38.5	37.2
28	West Bengal	40.6	39.1	37.7	35.9	34.3
	Grand total	33.2	32.5	31.7	31.0	30.3
	As per cent of GDP	26.7	26.1	25.5	24.9	24.3

Improvements in States' Medium Term Fiscal Plans (MTFPs)

The main reforms recommended by FC XIII in MTFPs are:

- i) Medium Term Fiscal Plan (MTFP) to contain three-year-forward estimates of revenues and expenditure, with detailed breakup of major items, and a narrative explanation of how these estimates have been generated. These estimates should be in broad conformity with the fiscal parameters recommended by FC-XIII. The intent should be to ensure a tighter integration of the MTFP into the State's budget, and the MTFP more a statement of commitment rather than a statement of intent. Tighter integration between the multi-year framework provided by MTFP and annual budget exercise. [para 9.38 read with para 9.83]
- ii) The following disclosures to be made along with the annual budget/MTFP:
 - a) Detailed breakup of central grants to States, into constituent flows. [para 9.41 read with para 9.84]
 - b) Statement on tax expenditure to be systematised and the methodology to be made explicit. [para 9.42 read with para 9.84]
 - c) Compliance costs of major tax proposal to be reported. [para 9.43]
 - d) Revenue Consequences of Capital Expenditure (RCCE) to be projected in MTFP, along with related liabilities, physical and financial assets and vacant public land and buildings. [para 9.45 read with para 9.84]
 - e) Future expenditure commitments of major policy changes to be incorporated in MTFP [para 9.46 read with para 9.84]
 - f) Liabilities explicit and implicit in Public Private Partnerships to be reported in the MTFP. [para 9.48 & 9.49 read with para 9.84]
 - g) MTFP to make explicit the values of parameters underlying projections for receipts and expenditure and the band within which they can vary while remaining consistent with targets. [para 9.61 read with para 9.83]

Reforms for areas that critically impact States' finances

With the objective of not only balancing the revenue account but also generating surplus for capital investment and the need for ensuring commercial viability of certain critical sectors such as irrigation, power, and departmental undertakings, certain structural reforms have been recommended in paragraphs 7.92 to 7.138 of FC-XIII's report are indicated below:

i) The practice of diversion of plan assistance to meet non-plan not to be continued in the case of Special Category States. [para 7.79]

ii) With reference to public sector undertakings [PSUs]:

a) All states should endeavour to ensure clearance of the accounts of all PSUs. b) States should use the flexibility provided by C & AG to clear the back log of PSU accounts.

c) All States need to draw up a roadmap by March 2011 for closure of non-working companies. Divestment and privatisation of PSUs should be considered and actively pursued.

d) A task force may be constituted to design a suitable strategy for disinvestment/ privatisation and oversee the process. A Standing Committee on restructuring may be constituted under the chairmanship of Chief Secretary to operationalise recommendations of the task force. An independent technical secretariat may be set up to advise the Finance Departments in states on restructuring/disinvestment proposals. [paras 7.94 to 7.98]

iii) With reference to power sector:

a) Reduction of Transmission & Distribution losses to be attempted through metering, feeder separation, introduction of High Voltage Distribution Systems, metering of distribution transformers and strict anti-theft measures. Distribution franchising and Electricity Services Company based structures for efficiency improvement to be considered.

b) Unbundling to be done on priority and open access to transmission should be strengthened. Governance to be improved through state load

dispatch centres and this function should eventually be made autonomous.

c) Systems to be put into place to avoid delays in completion of hydro projects.

d) Instead of putting up thermal power plants far away from coal sources, States to consider JVs in or near the coal rich states.

e) Case 1 bid process should be extensively used to avoid vulnerability to high cost purchases during peak demand periods.

f) Regulatory institutions should be strengthened through capacity building, consumer education and tariff reforms like multi - year tariff. Best practices of corporate governance should be introduced in power utilities.

[paras 7.120 and 7.121 read with paras 7.108 to 7.113]

iv) Migration to the New Pension Scheme to be completed at the earliest. [para 7.122 read with para 12.108]

v) States with large cash balances to make efforts towards utilising their cash balances before resorting to fresh borrowings.

[para 7.127 read with paras 7.123 to 7.126]

vi) Accounting reforms:

a) Details of contra-entries as well as summary of transactions between public account and Consolidated Fund to be provided as a separate annex to finance accounts of the states. [para 7.131 read with para 7.53]

b) Public expenditure through creation of funds outside consolidated fund of the states to be avoided. [para 7.132&133]

c) The following statements to be provided with finance accounts of the States:

i) Comprehensive data on all subsidies. [para 7.135 read with para 7.134]

ii) Consolidated information on number of employees at each level along with the commitment on salary. This statement to also include information of employees and their salary where such expenditure is shown as grants booked under other expenditure head. [para 7.136 &7.137 read with para 7.134]

iii) Details of maintenance expenditure. [para 7.138 read with para 9.44]