Emerging Fiscal Priorities and Resource Concerns: A Perspective on Fiscal Management from Madhya Pradesh

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Abstract

State finances of Madhya Pradesh mirrors the fiscal situation of states in India and emerging challenges that include lack of buoyancy of internal revenue, prolonged slow economic growth and uncertainties regarding central transfers, and impact of recommendations of the 15th Finance Commission. While the State adhered to fiscal rules, the fiscal space available has been shrinking and coming years will test the ability of the Government to adhere to numerical fiscal targets and to avoid fiscal stress. The State's achievement with regard to human development, particularly education and health indicators have not been impressive. The fiscal policy of the State Government in the future needs to be calibrated keeping these areas in consideration. The ability to generate resources and develop and implement clear fiscal strategy will lead to achieving stated goals. Building up of fiscal pressure at state level in recent years makes it imperative to improve efficiency of public spending to get best value from utilization of public resources. Government of Madhya Pradesh should utilize the opportunities available from the budgeting innovations initiated in earlier years for institutional development.

JEL Classification Codes: E62, H50, H61, H70, H71, H72, H76

Keywords: Fiscal policy, Budgeting system, tax effort, public expenditure management, fiscal rules, MTEF

1. Introduction

Fiscal management at sub-national level in India has positively contributed to fiscal discipline and thereby to macroeconomic stabilization process. This has come through the compliance with broad targets set under fiscal rules in the form of fiscal responsibility and budget management act (FRBM Act) (Rao and Jena 2009, RBI, 2019). The incentives provided by the central government through the recommendations of the central finance commissions helped in establishing the fiscal rules firmly across states. While fiscal discipline is considered to be a crucial factor in enabling the governments to take appropriate decisions relating to resource allocation and achieving operational efficiency, responding to emerging socio-economic issues and development aspirations assumes significance (World Bank, 1998). The states being closer to their people in a federal set up have to be responsive to preferences of their constituencies (Oats, 1972). The ability to generate resources and develop and implement clear fiscal strategy leads to achieving fiscal goals. Building up of fiscal pressure at state level in recent years makes it imperative to improve efficiency of public spending to get best value from the utilization of public resources.

Sound bottom lines displayed by the state finances in terms of remaining within the fiscal targets specified in FRBM Act are not the only indicators of a sound public financial management. The overarching fiscal policy and the underlying fiscal variables may have different implications for the prospects of the state and its people. This paper reviews the achieved fiscal trends in Madhya Pradesh to get a reasonable idea of the implications of the observed fiscal stance of the State Government, The paper also assesses public financial management issues and the ability of the Government in implementing the budget to achieve the stated policy goals.

The record of economic growth and poverty reduction in Madhya Pradesh has been mixed and the state continues to be economically weak[1]. The State, however, is richly

[1] World Bank (2018) India State briefs: Madhya Pradesh

endowed with natural resources with potential for industrial investments. Like many of India's states, economy of Madhya Pradesh depends significantly on agriculture, which employs large number of workforce. The State has large potential for diversification of agricultural and horticultural crops, and strategic promotion of agro-based industries. The State Government has been giving priority to infrastructure building, power sector development, and investments in agricultural improvements and irrigation. The state lags behind in many of the human development indicators, particularly education and health, among the Indian states. There is a huge need for resource augmentation, and effective and efficient utilization of public resources.

2. Macroeconomic Outlook

The macroeconomic outlook is a crucial factor in fiscal policy and budget making process as it provides the idea on possible revenue implication from contribution of various sectors to state economy. A stable growth process ensures improvement in revenue forecasting and thereby predictability of flow of funds in the budget implementation. Getting an unbiased picture of resource envelope is useful for resource allocation decisions in the budget management process. The ratio of tax to gross state domestic product (GSDP) is considered as an indicator of resource generation effort of the government. Assessing macroeconomic outlook at sub-national level assumes significance as the inter-state disparities in India influences the spending pattern. The ability of low income states to spend on infrastructure and human development continues to be less than that of the affluent states (Rao M. Govinda, 2017).

The growth of the economy is an enabling factor for better opportunities for people and improvement in standard of living (Bhagwati and Pangariya 2013)[2]. However, in a federal set up, it is the growth of the national economy and performance of various economic activities like industrial production, agricultural production, and growth in the external sector that become more relevant for development process. According to

[2] The authors in their book "Why Growth Matters", argue forcefully that economic growth, led by markets overseen and encouraged by liberal state policies would help the poor.

Musgrave, subnational governments tend to ensure the efficiency of public goods provision within their jurisdictions, while the federal government should be responsible for macroeconomic stabilization and income redistribution (Musgrave, 1959).

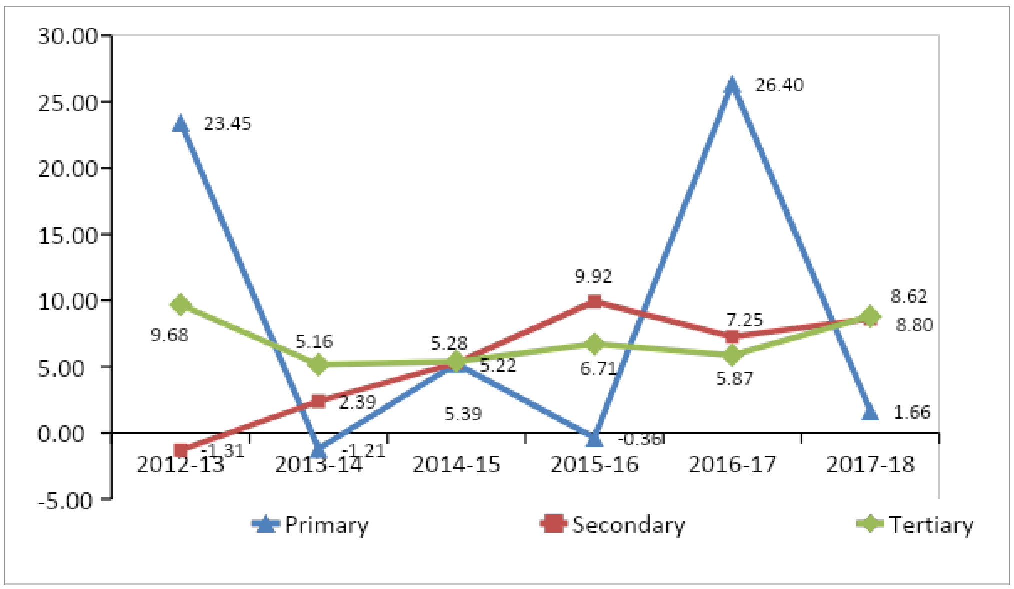
The trend of state income assumes significance for some real-world reasons in the context of fiscal management. The fiscal targets of the FRBM act and their achievements over the years are expressed as ratio to the state GSDP. Further, the outlook regarding the state GSDP is used by the central government to fix the borrowing limit of state governments. The borrowing limit in recent years is linked with the fiscal deficit limit stipulated in the FRBM Act. The tax buoyancy, which is utilized to examine the internal revenue effort of the State Government, is derived by assuming the GSDP as proxy for tax base. Keeping all these factors in consideration, the medium term fiscal plan (MTFP) statement, which is part of the FRBM Act related statements, outlines the growth perspectives.

The GSDP growth in Madhya Pradesh, at constant prices, during 2011-12 to 2017-18 shows considerable volatility[3]. The growth rate slumped from 11.45 percent in 2012-13 to a low of 3.82 percent next year. After two years, the GSDP growth jumped to high of 14.01 percent in 2016-17 and once gain came down sharply to 7.30 percent in 2017-18. The volatility in the growth of GSDP is also reflected in the growth of contributing sectors, particularly in agriculture (Figure 1). The industry sector, which showed improvement from low growth in 2012-13 to reach a peak of 9.92 percent in 2015-16, has declined since then. The growth of services sector has gone down over the years. The agriculture sector has been showing large variations in growth trend. For instance its growth rate declined from 23.45 percent in 2012-13 to a negative growth rate the next year. Further between 2016-17 and 2017-18, its growth rate gone down from 26.40 percent to 1.66 percent.

[3] After change in methodology and base of GDP series to 2011-12, the new GSDP series is available since 2011-12.

The gross state value added (GSVA) shows that in recent years agriculture sector has emerged as the major driving force of the economy, relative share of manufacturing sector has declined, and relative share of services sector has remained stagnant (Table 1). The composition of GSDP indicates that the industry sector is yet to find a strong footing in the State. This kind of growth process, however, may not augur well for improving the tax effort in the GST regime. The relative share of agriculture and associated activities has increased from 28.86 per cent in 2011-12 to 31.09 per cent in 2017-18. The secondary sector, mainly the manufacturing and construction, witnessed a decline from 26.07 per cent to 22.46 per cent during this period.

Figure 1: Growth rate of economic activities



The services sector, which consists of financial service, hotel industry, transport services, services relating to real estate, and public administration, has been a growing sector in the national economy. This trend has positively affected the service tax collection, which now is part of the nation-wide Goods and Services Tax (GST). The expanding services sector also helps the states in increasing the GST collection. The composition of the services sector in Madhya Pradesh indicates that it is the largest component of the GSDP. However, the relative share of the sector indicates that it has remained more or less stagnant within 37 to 38 percent until 2015-16, after which it declined 35.51 percent in 2017-18. This slide is large.

Table 1: Composition of GSDP (Constant Prices)

Economic Activity	Percentage Share						
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Agriculture, Forestry and Fishing	28.86	32.24	31.00	31.32	29.24	32.91	31.09
Mining and Quarrying	3.71	3.84	3.33	3.03	2.97	2.81	2.75
Primary	**32.57**	**36.08**	**34.33**	**34.36**	**32.22**	**35.72**	**33.84**
Manufacturing	12.13	11.23	10.04	9.79	10.31	9.71	10.01
Electricity, Gas, Water Supply & Others	2.86	2.62	3.09	3.70	4.44	4.38	4.47
Construction	11.08	9.24	9.64	9.31	8.83	8.09	7.98
Secondary	**26.07**	**23.09**	**22.77**	**22.80**	**23.58**	**22.18**	**22.46**
Trade, Repair, Hotels and Restaurants	10.71	10.66	10.65	10.58	10.13	9.54	9.46
Transport, Storage, Communication	5.80	5.92	6.10	6.38	6.72	6.53	6.84
Financial Services	5.05	4.86	5.07	4.93	5.33	4.23	4.26
Real estate	5.19	5.02	5.24	5.35	5.40	5.20	5.28
Public Administration	5.16	5.00	5.05	4.88	4.83	4.52	4.55
Other Services	5.68	5.54	5.35	5.43	5.31	5.01	5.12
Tertiary	**37.59**	**37.00**	**37.47**	**37.56**	**37.72**	**35.02**	**35.51**
TOTAL GSVA at Basic Prices	**96.24**	**96.17**	**94.58**	**94.71**	**93.52**	**92.92**	**91.81**

Source: Central Statistical Office, GoI

3. Fiscal Profile of Madhya Pradesh

The fiscal rules (FRBM Act) has become a major factor to qualify the fiscal management in India, more so for states, given their record of adherence to fiscal targets over the years. The transfer of resources from central government played a crucial role in the process of fiscal consolidation of states. A perceptible change has been witnessed in fiscal management at sub-national level due to changes in central transfer system after the recommendations of 14th Finance Commission. While states received higher tax devolution, the loss of plan grants necessitated reorganization of spending pattern. The policy choices to fund existing plan schemes from untied tax devolution or redesigning the spending priorities created interruptions and some uncertainties in fund flows to various programs and projects. Although routing of CSS funds through state budgets started in 2014-15, uncertainties and unpredictability regarding the flow of funds from CSS persisted.

3.1 Fiscal Profile of Madhya Pradesh: Complying to Fiscal Rules

Madhya Pradesh holds an impressive record of adherence to the fiscal rules since adoption of FRBM Act, 2005. The State managed to come out of fiscal imbalance witnessed during late nineties and early 2000s, and reduced the fiscal deficit and stabilized debt burden. The fiscal deficit has remained less than targeted 3 percent of the GSDP since 2006-07 (Figure 2). The State managed to generate surplus in revenue account after adopting FRBM Act. The 14th Finance Commission provided flexibility of raising the fiscal deficit by 0.5 percent with conditions relating to limiting interest payment and fiscal prudence in previous years. The fiscal deficit of the state was well within this limit in 2017-18, and the revised estimates for the year 2018-19 and budget estimates for the year 2019-20s also show fiscal deficit below amended target of 3.5 percent of GSDP[4].

Fiscal trends since 2004-05 shown in Figure 3 give broad indicators of fiscal management in the state, which shows a guarded movement with periodic variations. The State Government managed to keep control over growth of revenue expenditure, which remained on an average 17 percent of the GSDP during 2005-06 to 2017-18. However, since 2015-16 there has been some upswing due to revival of revenue receipts buoyed up by tax devolution. The revenue expenditure as percentage GSDP has increased to 18.42 percent in 2017-18. The revised estimates for 2018-19 and budget estimates for 2019-20, seems to have continued with this trend. The revenue account remained in surplus while higher revenue flows helped the State Government to expand the resource allocation in social and economic sectors.

[4] The borrowing in lieu of UDAY scheme, however, was excluded while assessing the compliance to the FRBM Act, as it was did not impact the estimation of deficit.

Figure 2: Key Fiscal Outcomes

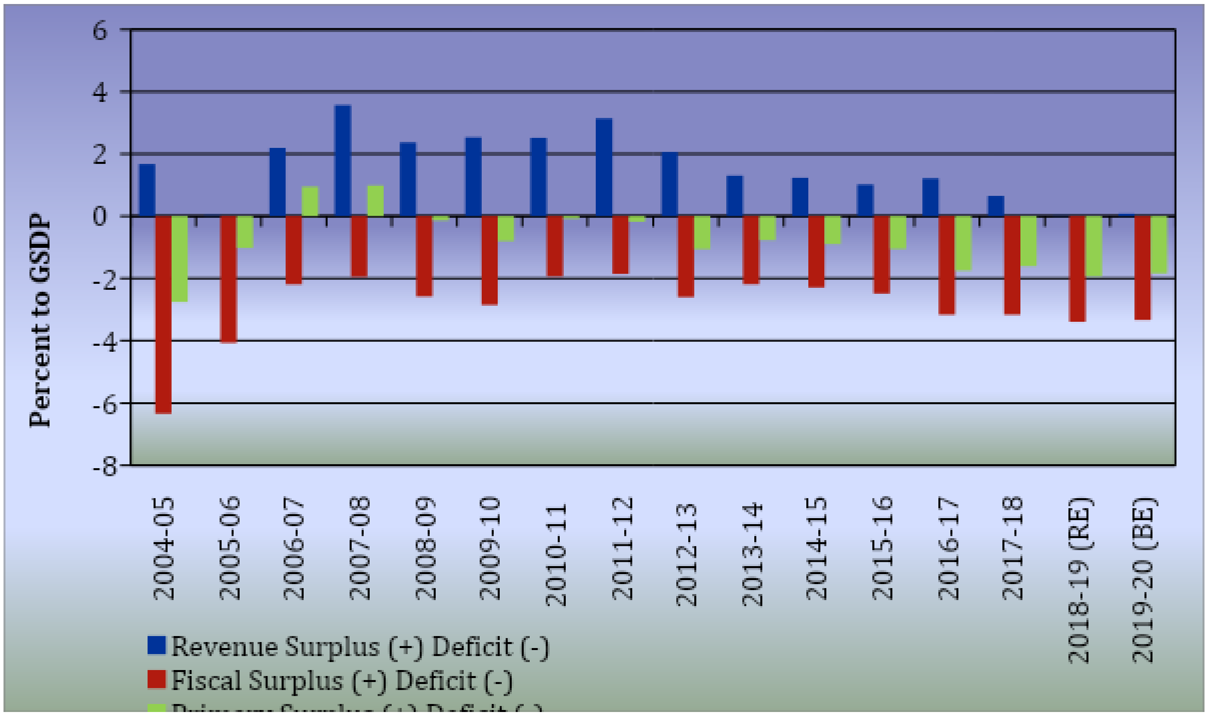
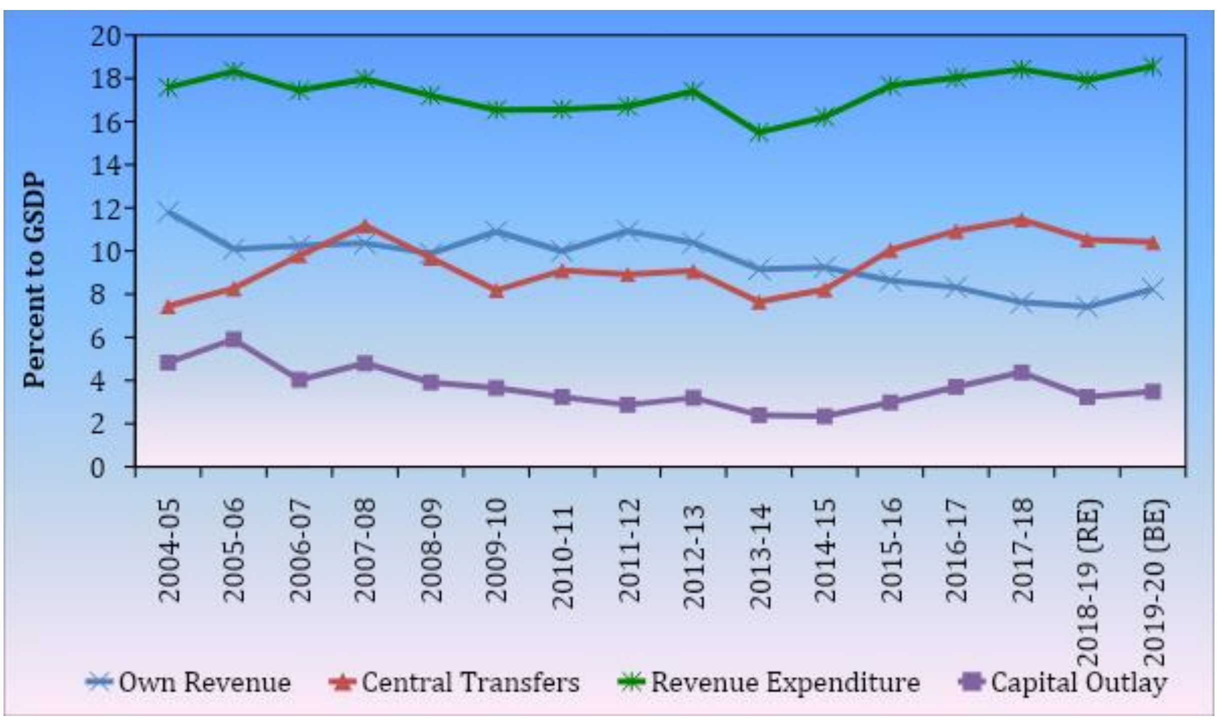


Figure 3: Broad Fiscal Trends



Capital outlay by the State Government constitutes the major component of total investment in the State. However, given the downward rigidity of the committed spending, capital outlay net of debt repayment is generally perceived as residuary in the system, unless large number of infrastructure schemes is tied up through specific funding arrangements. In Madhya Pradesh, the capital outlay as percentage to the GSDP shows a late revival after a declining trend. It remained reasonably high during 2004-05 to 2010-11 and declined after that. On an average the capital outlay was 4.34 percent of GSDP during 2004-05 to 2010-11 and declined to 2.70 percent during 2011-12 to 2014-15. Improvement has been witnessed in recent years as capital outlay as percentage to GSDP has increased to an average of 3.70 percent during 2015-16 to 2017-18. The surplus in the revenue account in 2016-17 and incurring higher fiscal deficit beyond 3 percent of GSDP by availing the flexibility provided by the 14th FC facilitated higher capital spending. Some flexibility in the fiscal rules, as provided by the 14th FC, helps in widening the fiscal space to improve the capital investment.

The revenue receipts of the State Government, over the years, has not shown much buoyancy. Looking at more recent years, while the aggregate revenue receipts of the State has increased in nominal terms from Rs.62,604 crores in 2011-12 to Rs.1, 34, 875.39 crores in 2016-17, as percentage to GSDP, it has remained stagnant. While the aggregate revenue receipts remained on an average 19.58 percent to the GSDP during 2004-05 to 2012-13, it has not shown much improvement after that (Table 2). It was at 19.08 percent in 2017-18. The own revenue of the State, which comprises of own tax and non-tax revenue, which remained in range of 7 to 8 percent of GSDP until 2015-16, seems to have declined in recent years. The revival of revenue receipt in last two years, for which audited data is available, was mostly due to rise in central transfers. The higher inflow of tax devolution, 2.45 percentage points higher in 2017-18 as compared to 2014-15, has improved the total revenue receipts.

The fiscal outcomes over the years show that fiscal space available to the Government in terms of revenue surplus or level of fiscal deficit below the permitted level has been shrinking. Steady decline in revenue surplus as percentage to the GSDP after 2011-12, has had its impact on growth of the capital outlay. The revenue surplus has come down from 3.14 percent of GSDP in 2011-12 to 0.65 percent in 2017-18. The projections for 2018-19 and 2019-20 shows further dip in the revenue surplus. The downward rigidity, usually seen in the current expenditure due to the expansion of committed spending makes it difficult to maintain a large surplus in the revenue account. The Government spending, particularly revenue expenditure started showing increments after 2015-16 due to increase in central transfers. The capital expenditure, which includes direct capital outlay and loans to various government entities, as percentage to GSDP also showed some improvements particularly in 2016-17 and 2017-18. The fiscal deficit, at the same time, increased although remaining within the FRBM Act limit of 3 percent and the amended limit of 3.5 percent after availing the flexibility permitted by the 14th FC. The outstanding debt as percentage to GSDP, which was showing a declining trend, has once again picked up and crossed 24 percent in recent years.

Table 2: Fiscal Profile of Madhya Pradesh: An Overview

(Percent to GSDP)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19 (RE)	2019-20 (BE)
Total Revenue Receipts	**19.85**	**19.46**	**16.80**	**17.45**	**18.67**	**19.25**	**19.08**	**17.94**	**18.64**
Own Tax Revenues	**8.55**	**8.45**	**7.44**	**7.20**	**7.12**	**6.90**	**6.34**	**6.26**	**6.78**
Own Non-Tax Revenues	**2.37**	**1.93**	**1.71**	**2.04**	**1.52**	**1.42**	**1.28**	**1.15**	**1.45**
Central Transfers	**8.92**	**9.08**	**7.65**	**8.21**	**10.03**	**10.93**	**11.46**	**10.53**	**10.40**
Tax Devolution	5.78	5.75	5.04	4.75	6.79	7.19	7.19	6.82	6.62
Grants-in-Aid	3.15	3.33	2.61	3.46	3.24	3.74	4.26	3.71	3.78
Revenue Expenditure	**16.71**	**17.40**	**15.50**	**16.21**	**17.66**	**18.04**	**18.42**	**17.93**	**18.56**
General Services	**4.15**	**4.89**	**4.57**	**4.40**	**4.55**	**4.36**	**4.54**	**4.62**	**4.70**
Interest Payment	1.68	1.54	1.42	1.39	1.43	1.42	1.56	1.45	1.50
Pension	1.40	1.37	1.32	1.35	1.39	1.37	1.31	1.50	1.46
Social Services	**6.44**	**6.74**	**6.16**	**6.31**	**7.55**	**7.49**	**8.25**	**7.30**	**7.55**
General Education	3.04	2.96	2.98	3.14	2.97	3.25	3.28	3.23	3.11
Medical and Public Health	0.77	0.86	0.73	0.89	0.93	0.84	0.91	0.80	0.97
Economic Services	**4.11**	**4.65**	**3.76**	**4.67**	**4.52**	**5.13**	4.63	5.13	5.54
Assignment to LBs	**1.02**	**1.12**	**1.01**	**0.83**	**1.04**	**1.06**	1.00	0.88	0.78
Capital Expenditure	**5.00**	**4.66**	**3.50**	**3.53**	**3.50**	**4.38**	**3.83**	**3.41**	**3.41**

Capital Outlay	2.87	3.20	2.40	2.34	2.98	3.71	4.37	3.23	3.48
Net Lending	2.13	1.47	1.10	1.19	0.53	0.68	-0.55	0.18	-0.07
Revenue Deficit	**-3.14**	**-2.06**	**-1.30**	**-1.23**	**-1.02**	**-1.21**	**-0.65**	**-0.02**	**-0.08**
Fiscal Deficit	**1.86**	**2.60**	**2.19**	**2.29**	**2.49**	**3.17**	**3.17**	**3.40**	**3.34**
Outstanding Debt	**25.71**	**24.73**	**21.33**	**21.26**	**22.50**	**23.18**	**24.36**	**24.33**	**25.24**

Source: Finance Accounts of relevant years
Note 1: Negative sign in deficit indicates surplus
Note 2: Capital Outlay includes capital spending and loans.
Note 3: The capital expenditure excludes spending related to UDAY loans. This is according to the amendments carried out in FRBM Act in 2017.

3.2 Own Revenues at Disaggregated level

Own revenue receipts that include both tax and non-tax receipts provide flexibility to the state governments to pursue their own development agenda. The changes in central transfers in recent years and the trend of own revenue receipt has resulted in rise in the relative share of central transfers in total revenue receipts (Figure 4). The own revenue receipts, which was 55 percent of total revenue receipts in 2011-12, has declined since then to 40 percent in 2017-18. The relative share of central transfers has increased from 45 percent to 60 percent during this period. This could be termed as dependency of the State on central transfers. Own tax revenue and non-tax revenue constituted on an average about 41 and 10 percent of total revenue of the State respectively, during the period 2011-12 to 2016-17. Sales tax/VAT constituted about half of the own tax revenue. This relative share has not changed much after the GST revenue is accounted for in 2017-18. The next important tax for the State has been the excise duty, which constituted about 18 percent of the own tax revenue.

The annual average growth of own tax revenue from 2012-13 to 2016-17 is about 10 percent, and growth rate in last two to three years has been below 10 percent. The growth rate in 2017-18 was abysmally low at 1.74 percent. With this subdued growth rate experienced since 2012-13, the own tax revenue as percentage to the GSDP has actually declined (Table 3). The sales tax/VAT as percentage to the GSDP has remained more or less stagnant. The growth rate of sales tax, which was high at about 22 percent in 2011-12, suffered a steady decline until 2015-16, when it grew at 9.21 percent. Its growth rate had improved to 13.91 percent in 2016-17. The fiscal year 2017-18 being the first year of the GST, the growth rate of sales tax and GST taken together remained low at about 5 percent. Other state taxes have not shown buoyancy in recent years.

Figure 4: Composition of Total Revenue Receipts

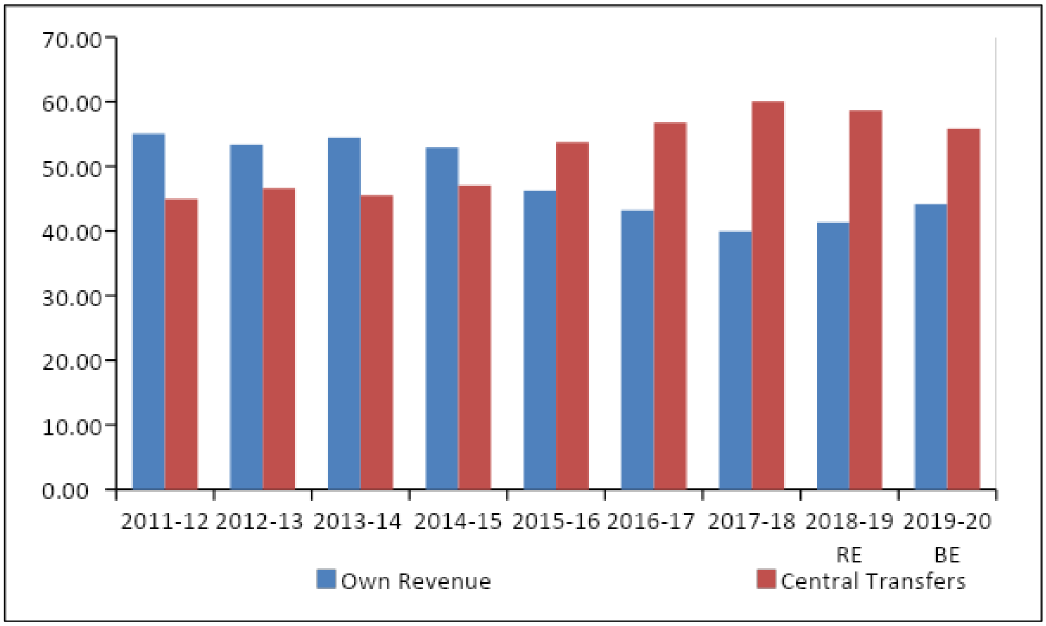


Table 3: Own Tax Revenues in Madhya Pradesh

(% of GSDP)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19 RE	2019-20 (BE)
Own Tax Receipts	**8.55**	**8.45**	**7.44**	**7.20**	**7.12**	**6.90**	**6.34**	**6.26**	**6.78**
State GST							1.23	2.39	2.50
Sales Tax	3.97	4.11	3.69	3.57	3.51	3.52	2.12	1.21	1.25
State Excise	1.37	1.40	1.31	1.32	1.40	1.18	1.17	1.13	1.35
Motor Vehicle Tax	0.43	0.42	0.35	0.36	0.34	0.35	0.38	0.36	0.42
Goods and Passengers	0.65	0.66	0.57	0.53	0.55	0.59	0.16	0.00	0.00
Tax on Duties on Electricity	0.56	0.41	0.44	0.40	0.40	0.41	0.37	0.34	0.33
Land revenue	0.09	0.12	0.08	0.05	0.05	0.06	0.07	0.06	0.10
Stamp Duty	1.04	1.09	0.75	0.77	0.68	0.61	0.68	0.63	0.68
Taxes on Profession	0.08	0.07	0.06	0.06	0.06	0.05	0.05	0.03	0.04
Other Taxes	0.36	0.17	0.18	0.16	0.14	0.12	0.12	0.12	0.12
Growth of Own Tax	**25.93**	**13.38**	**9.71**	**8.99**	**10.04**	**9.82**	**1.40**	**17.76**	**23.69**

Source: Finance Accounts of relevant years

Another way to assess the performance of the State taxes is to examine the buoyancy coefficients. Tax buoyancy measures efficiency and responsiveness of revenue mobilization in response to growth in the GDP (Mansfield, 1972). The State taxes of Madhya Pradesh have not shown a buoyant growth rate. The buoyancy coefficients for the State taxes during the period 2004-05 to 2017-18, given in Table 4, reveal that the growth of taxes has fallen behind the growth of the GSDP. The buoyancy coefficient for total own-tax receipts was at 0.940. The state excise, and goods and passenger tax have shown buoyancy more than one.

Table 4: Buoyancy of Taxes: 2004-05 to 2017-18

Own Tax Receipts	0.940
Sales Tax	0.933
State Excise	1.041
Motor Vehicle Tax	0.797
Goods and Passengers	1.021
Tax on Duties on Electricity	0.795
Land revenue	0.854
Stamp Duty	0.866
Taxes on Profession	0.422
Other Taxes	2.615

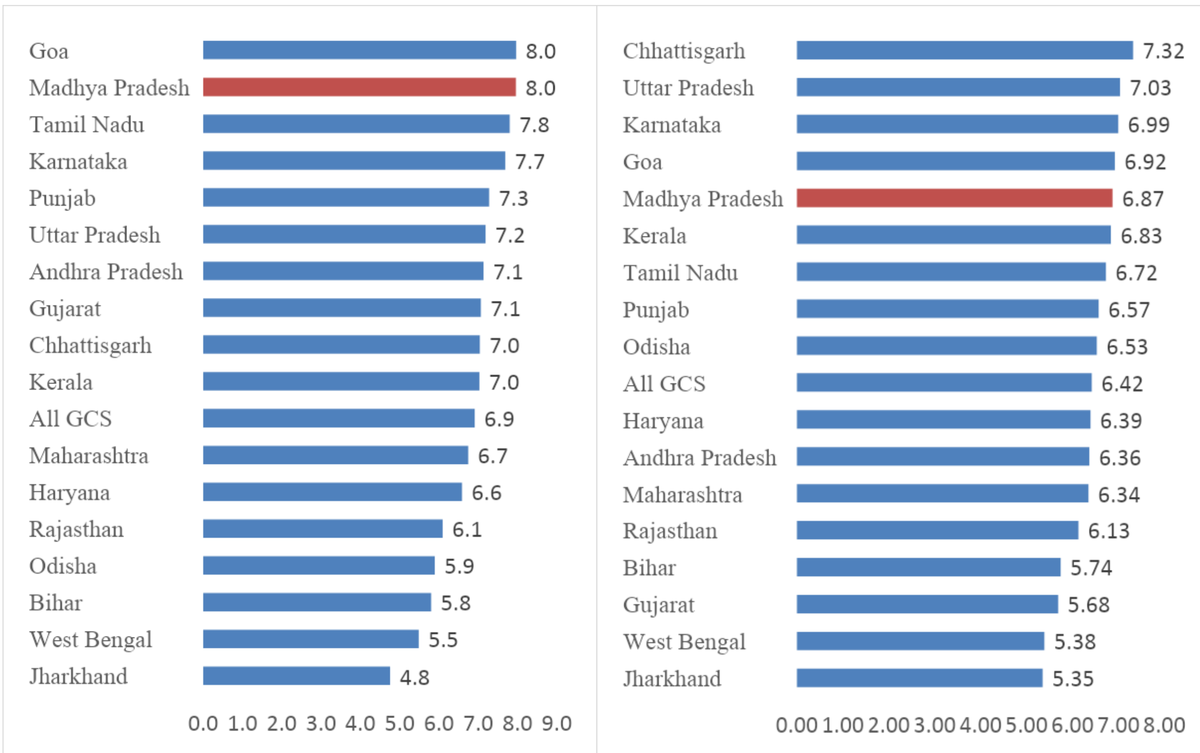
Source (Basic Data): Finance Accounts and State Budget 2018-19

Tax buoyancy has been a crucial parameter in the assessment of State finances carried out by the Central Finance Commission. The 14th FC used a normative principle to improve the tax effort of the states by using a higher tax buoyancy of 1.5 for the State, whose tax-GSDP ratio was below the all-states average ratio of 8.26[5]. While the Commission projected the tax revenue of Madhya Pradesh to rise to Rs. 85, 867 crore in 2019-20, the budget projection was Rs. 65, 274 crore. This level of tax projection remains much higher than that of the projection of the State Government.

[5] The Finance Commission assesses the state finances over the award period of five years to determine post-tax devolution surplus of deficit to recommend revenue deficit grant. The Commission assumes a normative growth rate based on buoyancy coefficients. The normative growth rate becomes a yardstick, which often remains beyond the ability of the states to achieve.

Comparing average tax-GSDP ratio across States indicates that, the ratio, which was high for Madhya Pradesh at 8 percent for the period 2011-12 to 2014-15, has come down to 6.87 percent for the period 2015-16 to 2017-18. While the tax-GSDP ratio of the State still remains higher than a lot of States, the climb down is unmistakable.

Figure 5: Tax GSDP ratio Across States
(Panel A: Average of 2011-12 to 2014-15; Panel B: Average of 2015-16 to 2017-18)



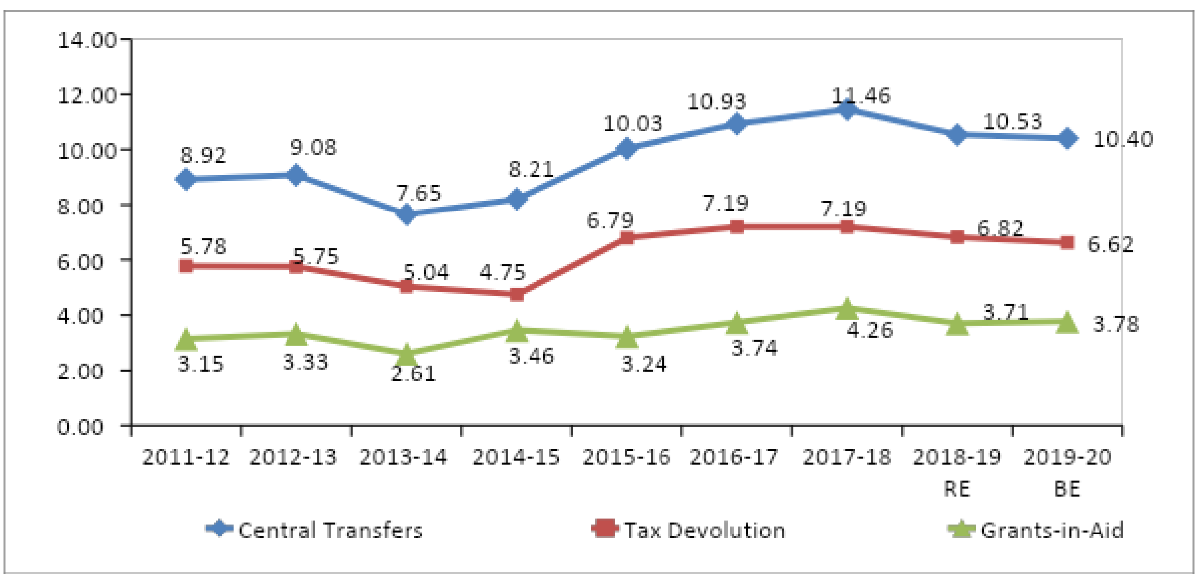
receipts, dividends and user fees from services provided by the State Government. The non-tax revenue constituted about 10 percent of total revenue receipts and about 20 percent of own revenue during 2011-12 to 2017-18. The annual average growth rate of non-tax revenue has remained low during this period at 5.38 percent.

The GST regime, ushered in the fiscal year 2017-18, is expected to improve the State tax revenue. While the SGST and the part of IGST due to the State are included in the own tax revenue, the CGST becomes part of the divisible pool based on the recommendations of the Central Finance Commission. The State Government continues to collect VAT on petroleum products and alcohol products separately outside the GST. The provision of compensation in the case of a State incurring loss due to joining GST system made the system more acceptable. The adoption of GST, however, has not improved the growth of revenue for the state.

3.3. Central Transfers

The impact of recommendations of the 14th FC relating to raising the tax devolution to 42 percent of the divisible pool and its impact on Central transfers has been discussed in an earlier section. Starting from the fiscal year 2015-16, the higher tax devolution improved the aggregate transfers to the State (Figure 5). Higher growth of central transfers with an annual average growth of 20 per cent, helped the aggregate revenue to grow at a rate of 15 percent. The grants component in the transfers has not changed much as percentage to the GSDP. While block grants to the State plan were stopped, the major grants that continued to flow are the Centrally Sponsored Schemes (CSS).

Figure 5: Central transfers as percentage to GSDP



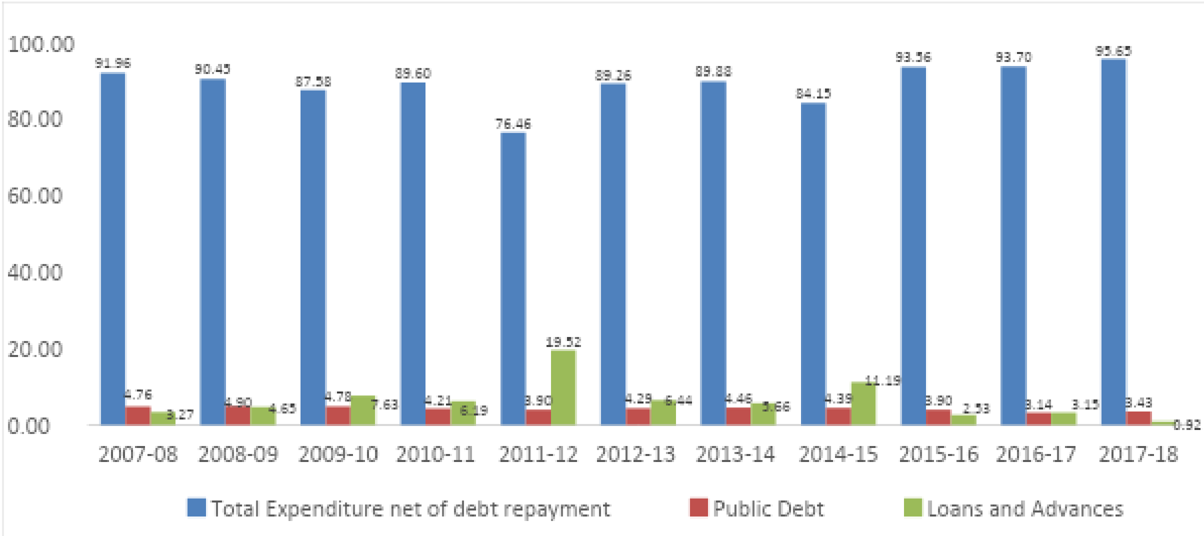
3.4 The Expenditure Trends: Emerging Priorities

The spending pattern in Madhya Pradesh indicates two positive trends in terms of quality. The composition of aggregate expenditure shows that State has been increasingly spending on development activities. On an average, the State had spent about 90 percent of total expenditure on various sectors and administrative services, 4 percent on debt repayment and about 6 percent on loans and advances to various public sector undertakings over last decade. There has been a steady increase in relative share of expenditure net of debt repayment and loans over the years, from 91.96 percent in 2007-08 to 95.65 percent in 2017-18 with few exceptions (Figure 6). While the share of debt repayment remained more or less constant during this period, the share of loans and advances has declined. While the annual debt repayment depends upon the repayment schedule of the loan instruments undertaken by the Government, the easing of debt stock over the years in recent years had its impact on the debt repayment.

Second, the capital outlay, which was lying low for many years has started showing increasing trend in recent years. The relative share of revenue expenditure remained high as during 2011-12 to 2015-16, the average share of revenue expenditure was 85.88 percent. The Government of Madhya Pradesh availed the flexibility recommended by the 14th FC and raised fiscal deficit beyond 3 percent of GSDP, which augmented the capital outlay. The relative share of capital outlay, which was about 14 percent on an average during 2011-12 to 2015-16, increased to 19.8 percent in 2017-18.

While it is acknowledged that public investment contributes to growth process more directly, it is important to finance the identified public investments with high social returns. The investment projects need to meet financial feasibility constraints with adequate rates of return to service the additional debt. As the increase in capital expenditure as percentage to the GSDP, in recent years involve additional borrowing, the Government should carefully undertake the investment management with efficient mechanism for appraisal, selection, costing, and monitoring of public investment projects.

Figure 6: The Composition of Total Expenditure



The spending priorities of the Government and the emerging focus areas ascertained from aggregate sector expenditure (net of debt repayment, loans, and advances) indicate that interest payment, pension, education, water supply, sanitation and urban development, electricity, agriculture and transport have been big spending items. The composition of total expenditure has been given in Table 5. Some of the sectors in recent years have emerged as priorities for the Government. While interest payment on outstanding debt was a big-ticket item in pre-FRBM Act period, its share has come down in post-FRBM Act period. The share of pension outgo did not witness much change since 2005-06. The spending on education, art and culture, which evinced a steady growth from 2004-05 to 2014-15, started showing quite a bit of volatility after that. However, it remains the most important spending item for the Government.

The sectors that have emerged as focus areas, as is evident from the rising share in expenditure, are water supply, sanitation housing and urban development, social welfare and nutrition, agriculture, rural development, irrigation, and electricity. Broadly, infrastructure development, urban development, and agriculture services have emerged as priorities for the State Government. The share of health and medical services, which has increased from 3.19 percent in 2011-12 to 4.42 percent in 2017-18. The transport sector, although an important sector for infrastructure building has suffered in recent years.

Table 5: Composition of Total Expenditure (net of debt repayment and loans)

(Percent)

Heads	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Interest Payment	6.56	6.67	7.12	6.31	6.49	5.79	6.56
Pension	5.47	5.94	6.62	6.12	6.29	5.63	5.51
Admin. Services	4.38	4.94	5.38	4.68	4.80	4.09	4.36
Other Gen. Serv. (Rev. Exp.)	3.69	3.65	3.81	2.85	3.05	2.28	2.62
Local Bodies	3.97	4.87	5.06	3.77	4.73	4.34	4.19
Capital Outlay on Police	0.05	0.09	0.06	0.09	0.15	0.23	0.24
Capital Outlay on Public works	0.15	0.15	0.13	0.12	0.27	0.21	0.20
Other Gen. Serv. (Capital Exp.)	0.00	0.01	0.03	0.02	0.02	0.00	0.01
Education	12.36	13.22	15.41	14.77	14.29	13.96	14.19
Public Health	3.19	3.96	3.84	4.25	4.38	3.79	4.42
Water Supply Sanitation Housing & Urban Dev.	3.15	4.27	4.20	3.90	6.26	7.85	11.68
Welfare of SC/ST/OBC	2.76	3.26	3.07	2.24	2.71	2.33	2.62
Welfare and Nutrition	5.27	5.88	5.96	4.76	8.49	4.17	4.02
Other Social Services	0.38	0.54	0.58	0.56	0.52	0.59	0.88
Agriculture	6.39	7.62	7.13	7.55	6.09	7.02	7.31
Rural Development	4.82	6.22	4.58	7.02	6.84	7.65	5.35
Irrigation	4.92	5.97	5.93	4.44	5.62	5.84	5.12
Energy	3.83	4.82	4.42	5.37	6.23	10.94	10.23
Industry and Minerals	1.54	2.72	1.85	1.27	2.19	2.78	1.32
Transport	3.24	4.06	4.23	3.72	3.68	3.78	4.45
Science Tech.	0.06	0.11	0.16	0.11	0.17	0.15	0.19
General Eco. Services	0.26	0.28	0.32	0.21	0.30	0.25	0.19

The revenue expenditure being the larger component of Government spending, its composition could be an important indicator of the spending priorities. The State spends about 72 percent on social and economic services and about 28 percent on general services. About 60 percent of general services is spent on interest payment and pension. The relative share of social services is the largest at 45 percent including grants to local bodies and the share of economic services is about 26 percent. The spending on social services shows a steady rise from 6.44 percent in 2011-12 to 7.55 percent in 2017-18 relative to GSDP (Table 6). The composition of the social services indicates that spending on education, health, water supply and sanitation, welfare, and nutrition have been the focus areas. The share of general services has shrunk due to decline in interest payment and to some extent the pensions. The economic services registered a rise from 4.11 percent of GSDP in 2011-12 to 5.54 percent in 2017-18. While central funding through CSS helped the State Government[6], the trend has been unambiguous in recent years.

The level of committed expenditure, which is contractual, committed, and pre-determined in nature, is crucial for the trend of revenue expenditure and availability of funds for development activities and maintenance of assets. The expenditures on wages and salary, pension payments, and interest payment are considered as committed expenditure. While the rising share of committed expenditure will show an elevated level of spending in various sectors, in reality it reduces the flexibility available to the Government in taking spending decisions in a prioritized manner. The share of committed expenditure in revenue expenditure in Madhya Pradesh has been shrinking (Figure 7). It has come down from 51.70 percent in 2007-08 to 35.32 percent in 2017-18. While spending on pension remained more stable, both interest payment and salary and wages showed declining trend in the State.

In the fiscal management of states in India, the capital expenditure has become a residual due to fiscal rule stipulations and to accommodate spending demands arising out of political interests. During the period 2011-12 to 2015-16, the relative share of capital outlay had not changed in Madhya Pradesh. The share of capital expenditure witnessed considerable rise to 17.04 percent in 2016-17 as again to 19.18 percent in 2017-18. It was the flexibility availed by the State to increase the fiscal deficit that helped augmenting the capital expenditure. It is not only the fiscal exigency that made capital expenditure residually determined. There are structural problems that hinder the implementation of high value projects. To improve capital expenditure, the State

[6] The central government changed the earlier practice of routing the funding of CSS directly through the implementing agencies and resorted to direct routing through state budget.

government needs to strengthen its own revenue effort in addition to continued flow of resources from the Central Government.

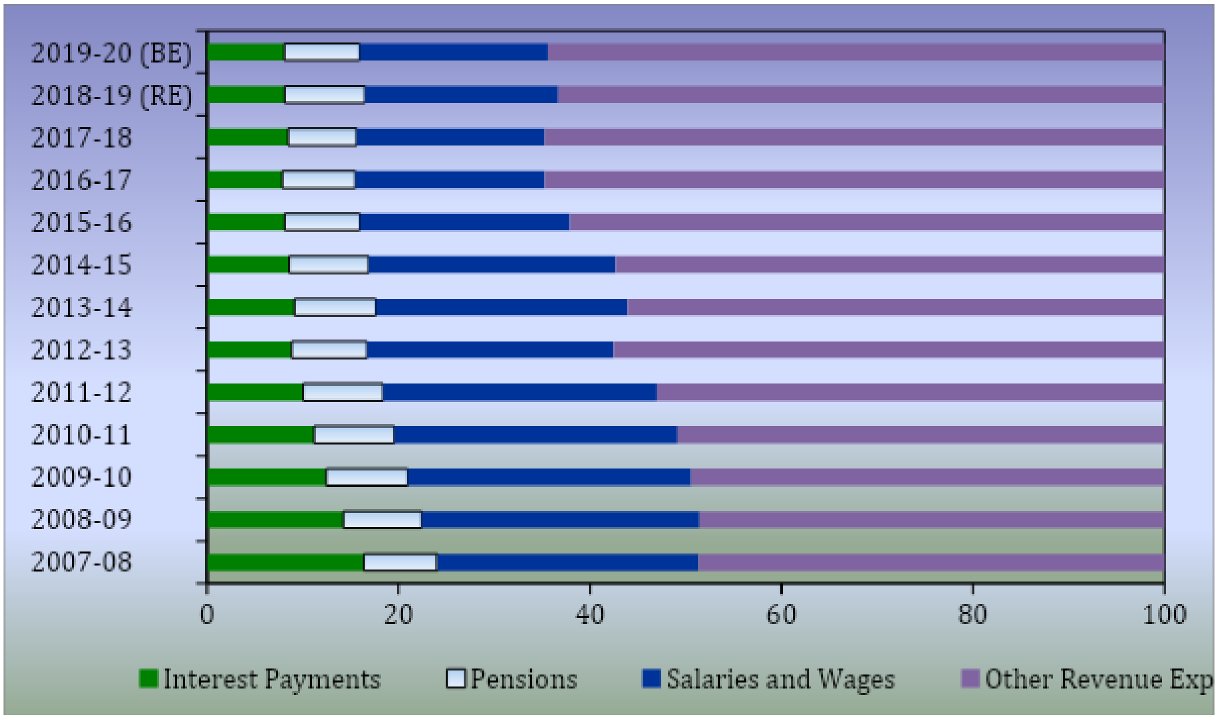
Table 6: Revenue Expenditure Trend

Percent to GSDP

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19 (RE)	2019-20 (BE)
Revenue Expenditure	**16.71**	**17.40**	**15.50**	**16.21**	**17.66**	**18.04**	**18.42**	**17.93**	**18.56**
General Services	**5.15**	**4.89**	**4.57**	**4.40**	**4.55**	**4.36**	**4.54**	**4.62**	**4.70**
Interest Payment	1.68	1.54	1.42	1.39	1.43	1.42	1.56	1.45	1.50
Pension	1.40	1.37	1.32	1.35	1.39	1.38	1.31	1.50	1.46
Others	2.06	1.98	1.83	1.66	1.73	1.56	1.66	1.66	1.74
Social Services	**6.44**	**6.74**	**6.16**	**6.31**	**7.55**	**7.49**	**8.25**	**7.30**	**7.55**
Education	3.04	2.96	2.98	3.14	2.97	3.25	3.28	3.23	3.11
Health	0.77	0.86	0.73	0.89	0.93	0.84	0.91	0.80	0.97
Water Supply, Sanitation, Housing & Urban	0.57	0.76	0.63	0.65	1.11	1.75	2.45	1.65	1.79
Welfare of SC, ST and OBC	0.57	0.63	0.54	0.44	0.53	0.48	0.47	0.47	0.46
Social Welfare	1.32	1.35	1.11	1.03	1.86	0.99	0.94	0.91	0.99
Other Social Services	0.16	0.17	0.17	0.17	0.16	0.18	0.20	0.23	0.24
Economic Services	**4.11**	**4.65**	**3.76**	**4.67**	**4.52**	**5.13**	**4.63**	**5.13**	**5.54**
Agriculture & Allied Activities	1.59	1.66	1.38	1.63	1.32	1.61	1.69	2.46	2.35
Rural Development	0.93	1.03	0.76	1.30	1.08	1.38	0.96	0.95	1.05
Irrigation and Flood Control	0.21	0.20	0.17	0.17	0.11	0.11	0.09	0.10	0.11
Energy	0.66	0.77	0.74	1.01	1.28	1.32	1.38	1.24	1.55
Other Economic Services	0.73	0.98	0.72	0.56	0.72	0.72	0.51	0.39	0.47
Compensation to LBs	**1.02**	**1.12**	**1.01**	**0.83**	**1.04**	**1.06**	**1.00**	**0.88**	**0.78**

Source (Basic Data): Finance Accounts and State Budget 2018-19

Figure 7: The share of Committed Spending in Revenue Expenditure



3.5 Debt Burden of the State

While the State Government maintained the debt burden within the limit stipulated by the FRBM Act, it has been rising steadily and may pose a problem if 15th Finance Commission recommends a lower debt burden in its fiscal consolidation roadmap. The state governments were guided by the fiscal roadmap worked out by the 12th and 13th Finance Commissions to determine outstanding debt burden. The debt-GSDP ratio of Madhya Pradesh in fiscal year 2014-15 was at 21.26 percent, which was much below the target of 35.5 percent stipulated by 13th FC (Table 7). The 14th FC, while anchoring the fiscal deficit at 3 percent of GSDP, stipulated a benchmark of 25 percent for debt-GSDP ratio to be counted as prudent fiscal management. The debt-GSDP ratio of Madhya Pradesh has remained within this limit. The decline in the average cost of debt of the state because of the debt restructuring formula of the Twelfth Finance Commission has helped in lowering the debt burden. Decline in the average cost of debt resulted in reduction in interest payment as percentage to GSDP, which helped generating surplus in revenue account. The interest payment had declined from 1.68 percent of the GSDP in

2011-12 to 1.56 percent in 2017-18. However, as the debt-GSDP ratio surpasses 24 percent of GSDP, it may be a matter of concern in the future years.

The composition of public debt reveals that the share of Central Government loans to the State has been reduced considerably and dependence on the market borrowing has increased. Central loans declined from 14.01 per cent in 2011-12 to 8.56 percent in 2017-18. Following the recommendations of the 12th Finance Commission the Central Government loans to the States has been reduced significantly. The relative share of other liabilities from the public accounts like small savings and provident fund, reserve fund and deposits has declined from 24.32 percent in 2011-12 to 19.64 percent in 2017-18. The debt-GSDP ratio has stabilized in the state during the post FRBM Act period and there has been compositional shift to market borrowing.

Table 7: Outstanding Liabilities

(Rs. Crore)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Public Debt	**61370**	**66577**	**72113**	**82262**	**97386**	**122308**	**138424**
Internal Debt	**50011**	**54309**	**59395**	**69008**	**83718**	**108391**	**123683**
Loans from Central Government	**11359**	**12268**	**12718**	**13254**	**13668**	**13917**	**14741**
Other Liabilities	**19725**	**22930**	**24051**	**25765**	**29096**	**32830**	**33829**
Small savings & PF	9355	10191	11137	12098	13121	13932	14322
Reserve Fund	3068	5087	5751	5893	7627	7115	0
Deposits	7303	7652	7163	7774	8348	11784	**19508**
Total Liabilities	**81095**	**89507**	**96164**	**108026**	**127144**	**148440**	**172254**
Debt-GSDP Ratio (%)	**25.71**	**24.73**	**21.33**	**21.26**	**22.50**	**23.18**	**24.36**
Composition							
Public Debt	**75.68**	**74.38**	**74.99**	**76.15**	**76.60**	**82.40**	**80.36**
Internal Debt	**61.67**	**60.68**	**61.76**	**63.88**	**65.85**	**73.02**	**71.80**
Loans from Central Government	**14.01**	**13.71**	**13.23**	**12.27**	**10.75**	**9.38**	**8.56**
Other Liabilities	**24.32**	**25.62**	**25.01**	**23.85**	**22.88**	**22.12**	**19.64**
Small savings & PF	11.54	11.39	11.58	11.20	10.32	9.39	8.31
Reserve Fund	3.78	5.68	5.98	5.46	6.00	4.79	0.00
Deposits	9.01	8.55	7.45	7.20	6.57	7.94	11.32

Source: Finance Accounts, various issues

Guarantees given by the State Government

The State Government gives guarantees for the discharge of certain liabilities like loans raised by statutory corporations, government companies, joint stock companies, co-operative institutions, local bodies, firms, and individuals, etc. These guarantees constitute contingent liabilities on the state revenue. "Guarantees" are contingent liabilities that may have to be invoked if an event covered by the guarantee occurs. Since guarantees result in increase in contingent liability, care should be taken while incurring such liabilities. Justification of public purpose to be served should be main criterion behind the sovereign commitments. The Government usually puts limit on guarantees to be given by it as permitted under the Constitution. The State Government limits the annual incremental guarantees to ensure that the total guarantees do not exceed 80 per cent of the total revenue receipts in the year preceding the current year. Following the recommendations of Central Finance Commissions, the State Government has constituted a Guarantee Redemption Fund to provide for amortization[7] of debt. This fund is maintained outside the consolidated fund of the States in the public account and is not to be used for any other purpose, except for redemption of loans.

4. The Issues Relating to the Fifteenth Finance Commission

The transfer of resources through the recommendations of the Finance Commission constitutes an important source of revenue for the State. It has played a crucial role in rule-based management of government finances. The fiscal consolidation process at the states' level continues to be revenue driven (Rao and Jena, 2009). Acceleration of economic growth in the country, which enlarged the tax base of both the Union and the states, had significantly contributed to this consolidation. The incentive structure in the form of debt and interest relief recommended by the 12th Finance

[7] Ninth, Tenth and Eleventh Finance Commissions suggested establishing sinking funds to provide for the amortization of debt. The Twelfth Finance Commission also recommended in similar line to set up sinking funds / guaranteed redemption fund for amortization of all loan including loans from banks, liabilities on account of NSSF, through earmarked guarantee fees.

Commission facilitated the consolidation process[8]. The role of 15th FC assumes significance in a period where uncertainty regarding economic growth seems to be getting prolonged reducing the resource available to government. The 15th FC needs to reduce vulnerability of the states to revenue shocks to maintain the course of fiscal consolidation[9].

The recommendations of the Commission on fiscal consolidation roadmap will be crucial. While deliberating fiscal consolidation path. The Commission will consider the recommendations of the FRBM Review Committee (Chairperson: Mr. N.K. Singh, who also heads the 15th FC). The Review Committee had recommended that debt to GDP ratio of 60 percent should be targeted by 2023 for the general government with a 40 percent limit for the Centre and 20 percent limit for the states. While recommending fixed deficit targets, the committee suggested counter-cyclical covers by setting 0.5 per cent as escape clause for fiscal deficit target with a clear commitment to return to the original fiscal consolidation path. State governments, which have to bring down the existing debt-GSDP ratio (almost as high as 25 percent of GSDP) to 20 percent, have to incur lower deficit as compared to meeting the fiscal deficit target of 3 percent (Roy and Kotia, 2017; RBI, 2019). It will be constricting for the states to comply with 20 percent target.

The Fourteenth Finance Commission refrained from providing any assistance for specific needs of the states. The increase in tax devolution was considered as the source for states to augment expenditure in specific sectors with high degree of externalities. The only grants awarded by the Commission were disaster relief grants and grants for local bodies, a statutory requirement. The 15th FC, in its first report, has given broad contours of important areas for sectoral grants and performance-based incentives

[8] The 12th Finance Commission incentivized the states to introduce FRBM Act through restructuring the debt burden and provided repayment waiver facility on adherence to the fiscal targets.

[9] The 15th Finance Commission was expected to make its recommendation by 30 November 2019 for an award period commencing 1 April 2020. However, the Commission has been given new mandate to submit two reports i.e. a first report for financial year 2020-21 and a final report for the period 2021-22 to 2025-26. The Commission is asked to submit the report by 30 October 2020.The reorganization of the State of Jammu and Kashmir and continuing slow down required more time to come out with credible projections to avoid the risk of being excessively aspirational and inaccurate.

during the award period. The state-specific grants, while providing additional resources for certain schemes, acts as incentives to implement programs of national interest.

5. Fiscal Management Principles and Issues of Public Financial Management Systems

The FRBM Act of the state governments, including that of Madhya Pradesh, contain overarching fiscal management principles, to respond appropriately to achieve the stipulated fiscal targets. These principles include series of guidance in expenditure management and institutional improvements to enhance efficiency. It may not be possible to assess these objectives and principles in the context of annual budgetary developments, as they evolve over a period to establish a robust public financial management system. Some of the crucial principles are analyzed here.

- Responding appropriately to generate revenue surplus to be used for creating capital assets and contain the fiscal deficit at a sustainable level. While the State Government has succeeded in generating surplus in the revenue account, there has been a deceleration in the revenue account due to spending pressure and lack of buoyancy in the revenue generation. This will continue to haunt the Government, as economic situation in the country continues to be grim.
- Raising non-tax revenue with due regard to cost recovery and equity. The State finances across the Indian States shows that, while the governments have been expanding provision of public services in different areas, non-tax sources of revenue have been shrinking. The sources like royalties from minerals and income from tariffs from provision of electricity and transport, where these are wholly managed by State departments continue to be important source of revenue. Subsidies on various service provisions like electricity, transport, irrigation and so on has affected the non-tax revenue. The revenue receipt from other services has always remained small. The own non-tax revenue as percentage to the GSDP has declined from 2.11 percent in 2011-12 to 1.28 percent in 2017-18.

- Laying down norms for prioritization of capital expenditure. While budget documents do not give norms of prioritizing capital spending, the trend over the years reflects the composition of capital expenditure and shifting priorities. From Table 8, it is evident that the composition of capital expenditure reflects the usual trend, where the relative share of economic services has been the highest followed by social services and the general services. While aggregate share of capital spending on social sector has not changed much, there has been some decline in the economic services. There has been a rise in relative share of general services, mainly due to higher spending on public works. In the social service, the share of capital spending on education and health has increased. In the economic service, there has been improvement in capital spending in agriculture and irrigation sectors.

Table 8: Composition of Capital Expenditure

(Percent)

Heads	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19 RE	2019-20 BE
General Services	**1.85**	**1.77**	**1.82**	**2.17**	**3.26**	**2.94**	**2.40**	**3.71**	**4.03**
Police	0.45	0.62	0.54	0.81	1.13	1.53	1.31	1.35	2.11
Public works	1.35	1.09	1.06	1.15	1.98	1.39	1.06	2.16	1.66
Other Services	0.04	0.07	0.22	0.20	0.15	0.02	0.03	0.19	0.24
Social Services	**17.66**	**14.01**	**17.57**	**17.43**	**17.96**	**13.84**	**17.33**	**20.32**	**24.89**
Education	1.90	1.27	1.22	2.71	4.50	3.11	2.23	3.69	5.23
Public Health	1.56	1.53	1.54	2.02	1.34	2.38	3.36	3.81	3.43
Water Supply Sanitation Housing and Urban Dev	8.21	7.15	8.56	9.18	9.07	4.68	7.65	8.84	10.82
Welfare of SC/ST.OBC	4.65	3.81	3.18	2.49	2.43	2.32	3.43	3.53	4.76
Welfare and Nutrition	1.18	0.07	3.03	0.85	0.34	0.86	0.38	0.17	0.41
Other Social Services	0.16	0.18	0.05	0.18	0.27	0.50	0.28	0.28	0.25
Economic Services	**80.49**	**84.21**	**80.62**	**80.40**	**78.77**	**98.20**	**80.26**	**75.97**	**71.07**
Agriculture	1.41	2.99	1.73	1.44	0.70	2.92	1.28	5.60	4.72
Rural Development	10.76	12.55	6.50	10.51	14.37	13.36	7.07	11.22	14.40
Irrigation	36.64	36.91	41.96	34.75	37.85	35.69	25.79	32.16	25.78
Energy	11.33	10.60	5.84	7.66	3.27	19.66	24.20	3.70	1.04
Industry and Minerals	0.43	1.85	1.80	1.15	1.47	6.39	0.84	1.89	3.11
Transport	19.09	18.29	22.04	24.20	20.06	19.69	20.70	21.08	21.53
Science Technology	0.04	0.25	0.21	0.18	0.01	0.02	0.01	0.03	0.18
General Eco Services	0.80	0.78	0.54	0.51	1.05	0.48	0.37	0.30	0.32

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

- Pursuing expenditure policies that would provide impetus for economic growth, poverty reduction, and improvement in human welfare. This, in fact relates to the whole gamut of expenditure management with a result oriented budgeting system. It is not clear as to how fiscal rules with defined objective of pursuing fiscal discipline can be used to achieve expenditure prioritization. We had earlier analyzed the composition of total expenditure (net of debt repayment, loans, and advances), in which the interest payment, pension, education, water supply, sanitation and urban development, electricity, agriculture and transport are shown to be big spending items. There are some sectors like water supply, sanitation housing, and urban development, social welfare and nutrition, agriculture, rural development, irrigation, and electricity have emerged as priorities for the State.
- The performance of some sectors has been linked with the spending priorities shown by the State Government over the years. The prime example is increasing share of agriculture in State GSDP. The aggregate government spending on agriculture and irrigation has increased over the years. Similarly, high government spending on infrastructure like electricity, urban infrastructure, and transport has been supported with better outcomes in these sectors.

Table 9: Socio Economic Indicators and Ranking of Madhya Pradesh

Socio Economic Indicators		All India Status	Highest in all states
Decadal Growth Rate (%, 2011)	20.35	17.7	25.42 (Bihar)
Rural-Urban ratio of Population	72:28	69:31	89:11 (Bihar)
Sex Ratio Females/1000 Males	931	943	1084 (Kerala)
Literacy Rate (%)	69.3	73	94% (Kerala)
Male literacy rate (%)	78.7	80.9	96.10 % (Kerala)
Female literacy rate (%)	59.2	64.6	92.10% (Kerala)
SC share in Total Population (2011)	15.6	16.63	31.90 (Punjab)
ST share in Total Population (2011)	21.1	8.61	30.62 (Chhattisgarh)
Total working Population to total Population (%)	43.47	39.79	47.68 (Chhattisgarh)
IMR [SRS] (2013) (per 1000 birth)	54	40	51 (2nd highest Odisha)
Maternal Mortality Ratio (MMR) [SRS] (2014-16)*	173	130	201 (U.P.)
Malnourished Children (% of underweight children under < 5 years [NFHS 4]-2015-16	42.8	35.7	47.8% (Jharkhand)

Human Development Index (HDI 2018)	0.59	0.63	0.78 (kerala)
Percentage of Forest Area to Geographical Area	30.72	23.41	44.21 (Chhattishgarh)
Number of workers per lakh of population (ASI)	319	864	2350 (Tamil Nadu)
Percentage of Electrified Villages	97.13	95.69	100% (Kerala)
Percentage of Total Population Below Poverty Line	31.6	21.9	39.9 (Chhattisgarh)
No. of Telephone Connections Per Lakh of Population	7153		16748 (U.P.)
Replacement Rate of Population	2.7	2.2	lowest in Sikkim (1.2)

- Madhya Pradesh, however, has lagged behind all India average and many other states in the human development indicators, particularly in education and health. From Table 9, it is evident that the achievements in the case of literacy, IMR, and MMR have remained below all India average. The population below poverty line in Madhya Pradesh also has been large. Percentage of underweight children shown as malnourished is distressing. The population growth has been high in the State for which it remains far away from the required replacement rate. While objectives of the FRBM Act are logical and based on sound economic principles, finding the link between policy and achievements is challenging.
- The Act calls upon the State Government to improve efficiency in public financial management system by improving transparency in policy making, establishing stability and predictability in fiscal policy, improving accountability and responsibility in the management of public finances, and enhancing integrity in budget formulation.

While the FRBM Act has proven to be a milestone to benchmark the achievement of fiscal consolidation, the agenda set forth in the principles under the Act has been broader. Describing various aspects of the PFM system to claim having transparency, stability and predictability, integrity in budgeting, and efficiency will not suffice. It may need observable indicators, which are evidence based, to prove the claims. The outturns of complex Government systems, PFM processes, and institutions need to be qualified against appropriate standards to assess the quality of PFM system (PEFA 2016).

Some of the measures taken by the Government to improve PFM system include introducing outcome budget, introducing cash management system, and computerization of treasury activities and integrated financial management system (IFMS) to strengthen institutional aspects of public expenditure management.

One of the important budgetary innovations started by the Government of Madhya Pradesh was taking initiatives to introduce medium term expenditure framework (MTEF). Linking Policy, Planning, and Budgeting under MTEF is conceptualized by determining the available resource envelope to the government and allocating these resources in line with government priorities in a multi-year budgeting framework (Brumby and Hemming, 2013). The MTEF initiatives at the Central Government level continues to be a work on progress and has not evolved into a useful budgeting instrument to influence program formulation and resource allocation (Jena 2018). While the State Government started these initiatives few years back, it has not succeeded in utilizing it in budgeting process. The State Government, instead of building a structured MTEF process, has now embarked upon projecting the expenditure impact of all the Government programs, starting from 2017-18. These projections will provide a medium-term perspective to the budget making.

The State Government adopted outcome budget to convert outlays to outcomes. This is based on the template provided in the central outcome budget (Jena, 2016). The objective of the outcome budget to inculcate performance orientation in the budgeting system and influence the resource allocation based on the utilization of the performance information of the programs (Shah and Shen, 2007). The outcome budget is still bereft of realistic performance information for the programs. The routine nature of producing the outcome budget by the departments has not helped the process of utilizing the performance information in the program formulation and resource allocation decisions. However, outcome budget provides an opportunity to improve the performance orientation in the budgeting system, which is crucial at the sub-national level.

The introduction of cash management system has improved utilization of the budgetary allocation and reduced the tendency of 'March Rush' considerably. While the uncertainties in the timing of flow of Central funds persists, the State Government should monitor the limit set for the last quarter of the financial years is adhered to by the departments (Ghosh and Jena, 2008).

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

6. Budget Credibility: Sanctity of the Budget needs to be Respected

The fiscal management principles of the Act call on the Government to improve predictability in fiscal policy and improve integrity in budget making process. These principles strongly suggest that the budget should be realistic. The budget should be formulated in an objective manner, with due regard to the general economic outlook and realistic revenue prospects, and to minimize deviations during the course of the year. A realistic budget shows the ability of the Government to deliver the public services as enunciated in the Government policies (PEFA, 2016). A realistic budget facilitates implementation of fiscal rules. There are several factors that affect budget credibility. Weakness in forecasting revenue receipts is one of the major factors that affect the budget credibility (Simson and Welham, 2014).

Governments do adjust their budget during the course of the year. The expenditure data shows that there have been instances of large variation in the revised estimates as compared to the budget estimates. Budget adjustments, or in Indian parlance, moving the supplementary demands during the year are many times a response to crises or economic exigencies[10]. When surpluses are expected from some programs, these are to be employed during the year prompting some adjustment in the budget. However, if it becomes a practice then, the sanctity of the budget will be lost.

The state governments, despite their best efforts, may still end up with variations in their actual spending as compared to what they had budgeted. The pattern and timing of fund flow from the Central Government also influences the spending. Timeliness of reliable information on the allocation from the Central Government for the coming year helps the sub-national governments to take resource allocation decision and the actual flow determines the spending pattern. The capacity of the Government to implement the policies, structural bottlenecks, and hurdles posed due to legal and environment factors are other reasons for derailment of spending plans. At the Central Government level, the deviation at the aggregate expenditure level is more realistic than that of the decomposed spending items (Jena and Sikdar, 2019).

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

In the Table 10 the deviations of revenue and expenditure variables from the budget estimates has been shown since 2012-13. The revenue outturn is derived here by taking the change in revenue the original approved budget and end of the year outturn. The revenue outturn is usually assessed to give an ordinal scoring on a scale of A to D

[10] Article 115 of the Constitution allows the Government to move supplementary demands during the year to respond to emerging budgetary situations.

taking into account at least two of the last three years. Instead of looking at annual outcomes, a contiguous blocks of three years are considered and score is given taking into account the performance for best two years to avoid any one outlier year. As per this methodology, a good performance with score of ‘A’ is given if the actual revenue remains within 97% to 106% of budgeted revenue. Score ‘B’ is given if it remains between 94% to 112% and ’C’ is given if it is within 92% and 116% and a performance less than this gets a score of ‘D’ (PEFA, 2016). In the case of aggregate expenditure a variance of 5 percent from the budget estimates gives score of A and a 10 percent variance gives a score of B. A 15 percent variance from budget gives a lower score of C and below that the spending pattern gets a score of D.

The own tax revenue during the first block, 2012-13 to 2014-15, exceeded the budget estimates in two years and fell short of the budget estimates once. In the year 2013-14, the actual collection was marginally higher that BE. Although receiving higher revenue is comforting for the Government, the performance gets a score of C for this block as the deviation was more than 6 percent in two years. In next three years, the actual collection fell short of the budget estimates in all three years and the extent of deviation was more than 6 percent in at least two years for which the score becomes C. The non-tax revenue in this block performed badly by deviating considerably, which attracts a score of D. Thus own revenue performance, in terms remaining close to the budget estimates needs improvement. The Central transfers remained less than budget estimates from 2012-13 to 2015-16 and exceeded the budget estimates during 2016-17 and 2017-18, which worked in favor of the Government.

The performance of aggregate revenue expenditure as compared to the budget projections is relatively better with a score of B in both the three-year blocks as the deviation remained below 10 percent. The revenue expenditure, however, was less than the budget estimates with high deviations in years like 2014-15 and 2015-16. Two major components of revenue expenditure, interest payment and pension remained volatile. The capital outlay shows considerable volatility as compared to the budget projections. While, in 2017-18, the deviation was very small at 1.59 percent, the preceding year shows a huge deviation of 22.82 percent. It only confirms the residual nature of the capital outlay. While the capital outlay grew at faster rate in recent years due to revenue augmentation by central transfers, budget projection was higher than what is realistic.

Table 10: Deviations from budget Estimates

Heads	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Own Tax Revenues	8.02	0.51	-6.21	-7.38	-4.96	-10.90
Own Non-Tax Revenues	-4.46	1.60	53.51	-15.36	-20.86	-22.42
Central Transfers	-4.17	-10.73	-27.79	-6.82	2.81	5.01
Tax Devolution	-3.70	-4.13	-12.91	26.01	5.47	-0.50
Grants	-4.97	-21.20	-41.49	-39.71	-1.94	15.81
Revenue Expenditure	-0.90	-6.07	-16.81	-8.33	-5.76	-3.18
Interest Payment	-11.18	-1.95	2.05	0.41	-11.28	-4.29
Pension	-15.09	-9.17	7.93	-5.36	-15.73	-24.89
Capital Expenditure	3.00	-9.59	0.08	-11.32	-1.19	-10.65
Capital Outlay	6.90	-2.71	-16.02	-7.19	-22.82	-1.59

Note: The difference between actual revenue and budget estimates as percentage to budget estimates

Capital expenditure includes capital outlay and net loans and advances

The comparison of budget projections with actual outcomes indicate that, while expenditure was affected by deviations of the revenue receipts, there were several other factors at the program management level and budget execution level that affected the spending pattern. Some of the factors are discussed here.

Power Sector

The Government gives large amount of subsidy on power tariff to various sections of the society and when power tariff is revised during the year, it automatically raises the subsidy amount. It increases the spending, which is not foreseen in the budget estimates. This rise in subsidy also pushes capital expenditure downward and actual expenditure falls short of the budget quite considerably. The delay in fund flows under externally aided projects due to delay in completion of works is another reason for anomaly in spending of budgeted amount. .

Agriculture

The revision of crop insurance during the year creates unplanned spending as it was the case in 2016-17. When a planned revision is not actually spent, then actual spending falls short of budget as was the case in 2015-16. The uncertainty in CSS continues to create hindrance in spending.

Irrigation

The deviations of the actual expenditure from the budget in the irrigation sector happen for various reasons.

- Capital expenditure exceeds the budget in the major irrigation due to the decisions to expand the irrigation facility during the fiscal year.
- The revenue expenditure falling short of the budget estimates was mostly due to the usual problems faced by irrigation departments, which include land acquisition problem, environmental issues relating to forest clearance, and resettlement and rehabilitation problems.
- There has been mismatch between the eligibility of the State and actual flow of funds in CSS that affected the revenue spending.

Rural development

The important schemes like MGNREGA, Swachh Bharat, Pradhan Mantri Awas Yojana and so on are covered under this broad head. While the State Government has been making innovations, improving the control, and monitoring system for all these CSS, the uncertainty in fund flows has affected the resource allocation in this sector.

Water Supply and Sanitation – PHED

According to the department, the large deviation from the budget estimates in recent years happened due to the uncertainties in transfer funds under the CSS and NABARD schemes. The NABARD scheme was stuck in the procedural matters like preparing DPR, survey and so on. However, putting together user groups, tendering, labour problem, and submission of UCs, took time for which spending could not be aligned with the budget estimates. The teething problems faced during initial years of treasury computerization also hindered the utilization of budgeted funds.

Higher Education

A large part of budget deviation was due to running with 40 to 50 percent vacancy in institutions of higher education as budget provision is made for all the sanctioned posts. The Central grants for the CSS such as Rashtriya Uchchatar Shiksha Abhiyan (RUSA) was less than what was budgeted for during these two years. The World Bank funded scheme through the EAP route for quality improvement was delayed, which resulted in non-utilization of budgeted provisions. In many other Central Government schemes there has been mismatch between budget estimates and actual flow of grants that affected the spending pattern

Primary Education

Discussion with the primary education department revealed that the uncertainties in fund flows and reduction of allocation under the CSS by the Central Government have been affecting the spending pattern. While the budget for these CSS is drawn on the basis of detailed district wise plans submitted to the Central Government well in time, arbitrary reduction in CSS fund affects the spending plan. The State Government contribution also declines due to reduction in central share.

7. Concluding Remarks

Successes and failures with regard to the objectives related to resource generation, prioritizing spending pattern, establishing stability and predictability in fiscal policy, optimizing fiscal policy for development should not delinked with State's effort to comply with FRBM Act. What is important in this context is imbibing these principles in the fiscal policy strategy. While the State made strides over the years, there are areas in which it lags behind as compared to other Indian States. The State's achievement with regard to human development, particularly education and health indicators have not been impressive. The fiscal policy of the State Government in the future needs to be calibrated keeping these areas in consideration.

The fiscal trends in the State shows that the growth of own revenue receipt has remained subdued in recent years, which had its impact on the spending pattern. The tax buoyancy has remained low resulting in decline in tax-GSDP ratio. The growth of the tax receipts during the post-VAT period seems to have been dissipated. The mobilization of internal revenue will be crucial for the State in coming years due to qualms about national growth and flow of resources from the Centre. While the rise in tax devolution since 2015-16, has provided some flexibility to the Government to expand the revenue and capital expenditure, the decisions of the 15th FC and prospects of economic growth will be crucial in future years.

Although, the State managed to comply with the FRBM fiscal targets, the coming years will test the ability of the Government to adhere to numerical fiscal targets and avoid fiscal stress. Fiscal space for the State has been shrinking for which it will be difficult to expand the public spending. The State has been availing the flexibility provided by the 14th FC and increased the fiscal deficit beyond 3 percent. Consequently, the debt-GSDP ratio has almost touched the 25 percent benchmark stipulated by the 14th FC. The 15th FC is expected to consider the debt-GDP ratio suggested by the FRBM Committee, which suggested reducing it to 20 percent. This will be a constricting factor in fiscal management of the State. There is need to enhance the own resource base and prioritize spending pattern to get value for money from the utilization of public resources.

Government of Madhya Pradesh over the years has undertaken several initiatives to improve institutional aspects of public financial management and utilization of public resources. These include introduction of outcome budget, cash management system, and computerization of treasuries and establishing the IFMS system. The State Government also made efforts to introduce medium term expenditure framework (MTEF). While performance budget was not earnestly pursued in India, the outcome budget provides opportunity to improve the performance orientation in the budgeting system. Significant improvement in the treasury computerization process and establishment of IFMS system is expected to improve the information system, which will help policy makers to take informed decision.

Madhya Pradesh has attempted to introduce MTEF. This is not common at sub-national level in India. MTEF is expected to improve budgeting system, provide a medium term perspective of spending requirements, and help achieving results. The initial experience in the State was not favorable due to the problems associated with forecasting future revenue stream. Building a structured MTEF has always remained a difficult task in addition to being costly. The State Government, without pursuing the objective of building a structured MTEF process, has now decided to project the expenditure impact of all the Government programs, starting from 2017-18. These projections will provide a medium term perspective to the budget making.

Observed fiscal prudency in recent years and political willingness to function under fiscal rules should be construed as opportunities to strengthen institutional framework to improve efficiency and effectiveness of public spending. Given the insecurities regarding resources, getting value for money from the utilization of public resources and enhancing operational efficiency in public service delivery should be key features in this regard. The budgeting reforms like outcome budgets and medium term expenditure framework should be pursued more vigorously. Periodic evaluation to assess the quality of public financial system would help the Government to undertake further reforms. Updating technical infrastructure, information system, and management tools of the PFM system should be continuously undertaken to improve the capacity of the organizations to achieve Government policy objectives and improve service delivery system. The State needs to remove the structural bottlenecks in program management for better utilization of budgeted allocation in different programs.

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