EVALUATION REPORT OF COMPLIANCE TO PROVISIONS OF THE MADHYA PRADESH FRBM ACT FISCAL YEARS 2017-18 AND 2018-19

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1. Objectives and Approach

This evaluation report is prepared and submitted by National Institute of Public Finance and Policy (NIPFP), New Delhi, to the Government of Madhya Pradesh as part of an independent review process of state finances and compliance to the state Fiscal Responsibility and Budget Management Act (FRBM Act). The State Government entrusted the responsibility of reviewing the compliance of the Act for the fiscal years 2017-18 and 2018-19 to NIPFP. The evaluation report summarizes the key conclusions and lessons of fiscal management for these two years. In addition to highlighting state's compliance to fiscal responsibility act targets, the report contains broad trend of fiscal management. Budgetary projections relating to revenue and expenditure were analyzed keeping the outturns in consideration to assess the ability of the government to implement the budgetary plans. The report incorporates the revenue augmentation efforts of the state government and resource transfers from union government to assess the revenue plan and outturns and assess the spending plans of the departments under social, economic and general services. It draws upon earlier review reports and available literature on state finances of Madhya Pradesh.

The report is based on literature review, background analytical work to define an approach to the evaluation, and a quantitative analysis of fiscal data. This is a draft report, and its results will be presented to the Finance Department of Government of Madhya Pradesh for their internal discussion and comments. The final report will incorporate the comments received from the Department. The report will be placed in the state legislature as per the requirements of the FRBM Act for the legislative approval. The independent review report of state finances in the context of compliance with fiscal responsibility legislation, thus, will be part of established accountability structure of the state government and is expected to improve transparency in the fiscal management. The placement of the report on state's website, will help in the process of wider dissemination of information and consultation process.

1.1 Objectives of the Evaluation

The evaluation aims to address following issues pertaining to state finances in general and fiscal responsibility legislation in particular:

a) Compliance of the State Government to the provisions of FRBM Act in the fiscal years of 2017-18 and 2018-19. These include fiscal targets relating to deficit, debt, and other fiscal variables as specified in the Act.
b) Assessment of macroeconomic outlook that includes broad composition of gross state domestic product, contribution of various sectors to the state income, and growth perspective. The FRBM Act calls upon the state to prepare a macroeconomic outlook along with its medium - term fiscal plan (MTFP).
c) Assessment of state finances in terms of revenue effort, central transfers, spending pattern, and debt management. Assessment of fiscal management in these years provides a context and background to comprehend the response of the state government to the requirements of fiscal responsibility act given the availability of resources and commitments.
d) Evaluation of credibility of state budget in terms of its budget projections and outturns, both on revenue and spending side. An examination of state will MTFP also be carried out to find to what extent the state was able to adhere to past projections.
e) While assessing the compliance of the state to the provision of the FRBM Act, the report reviews the state's adherence to fiscal management principles and transparency requirements enunciated in the Act.

1.2 The Context of Independent Evaluation

Independent evaluation forms an essential part of state accountability and transparency framework, which helps in research activities and policy making. The provision for an independent review provides an institutional process to assess the fiscal management process of the state government keeping the statutory fiscal targets and fiscal management principles enshrined in the FRBM Act in consideration. While Covid-19 pandemic affected revenue generation, increased expenditure and changed the spending pattern, particularly in 2020-21, fiscal management in 2017-18 and 2018-19 will reflect the capacity of the Government to come back to the consolidation process.

Presenting fiscal policy to independent scrutiny is a means of practicing transparency in governance, which enhances trust on government policies[1]. Fiscal transparency requires that governments declare their fiscal policy objectives, programs to implement the policies, announce outcomes and explain the deviations from plans so that they can take corrective measures. The entire process, from policy formulation to achievement of results, need to come under established legislative control, and the information need to become available to the public. Independent scrutiny becomes instrumental in this process, by helping legislatures and the public in assessing the quality of fiscal policies, plans and performance.

The requirement of transparency goes beyond disclosing information on policies and results as it also helps policy makers to take informed decisions. For that, states need to produce fiscal information in a timely manner[2]. Fiscal transparency is not only a discernible perspective, its spread and level can be ascertained using several indicators. These include comprehensiveness of the state budget, accessibility of budget documents comprising all the key fiscal information, level of coordination with central government as reflected in flow of funds in central schemes[3]. While accounting and reporting the fiscal information is crucial, the state governments should also prepare performance indicators, and output expectations from the programs which should be included in the budget documents along with information relating to policy objectives and goals.

Independent evaluation of fiscal policy and fiscal rules in practice has taken the shape of creating independent fiscal agencies called fiscal councils. The mandate of this institutional structure varies from country to country[4]. Fiscal councils have been established in the form of permanent executive or legislative agencies. They have been entrusted with the responsibilities

[1] IMF Code of Good Practices on Fiscal Transparency.
[2] Kopits, G., and Craig, J. (1998). Transparency in government operations. IMF Occasional Papers No. 158, Washington DC: International Monetary Fund.
[3] PEFA: Framework for Assessing Public Financial Management, (2016), PEFA secretariat, Washington DC
[4] Hemming Richard (2013). The Role of Independent Fiscal Agencies, in Allen, R., Hemming R. and Potter B. H. (eds.). The International Handbook of Public Financial Management (pp. 219-236). Palgrave Macmillan, London

that include unbiased scrutiny of fiscal policies, plans and performance. The objective of setting fiscal councils, however, is not to give them statutory status or audit responsibilities. Fiscal councils also do not impinge on the working of parliamentary committees. Establishing fiscal council is advocated with key functions like advising on fiscal policies and plans and auditing fiscal plans and performance[5]. The research shows that independent fiscal council tends to boost accuracy of fiscal projections even as it helps countries stick to fiscal rules better[6].

The FC-XIII recognized that an independent review mechanism could be a potential instrument to bring in efficiency to public spending and improve credibility. While some of the state governments including Madhya Pradesh, had already included the provision of independent review of their fiscal management in their fiscal responsibility legislations, the FC-XIII recommended to institutionalize this both at the level of the Union and State. According to the Commission the independent review mechanism should evolve into a fiscal council with legislative backing over time[7]. FC-XIV and other expert bodies also favored creating fiscal council at the Union level[8]. The Union Government, however, has entrusted the responsibility of independent evaluation of FRBM Act to the Comptroller and Auditor General of India (CAG). Establishing fiscal council for all the states could be a complex effort, for which periodical independent review looks more feasible to enhance accountability and transparency.

The Fiscal Responsibility and Budget Management Act (FRBM), 2005 of Madhya Pradesh provides for an independent review/monitoring of compliance of the implementation of the FRBM Act.[9] While most of the state governments acquired this feature in their fiscal rules

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[5] Hemming, R., & Joyce, P. (2013). The role of fiscal councils in promoting fiscal responsibility. in Cangiano, M., Curristine, T. and Lazare M. (eds.), Public financial management and its emerging architecture, 205-24, Washington, DC: International Monetary Fund.

[6] Roel M. W. J. Beetsma ; Xavier Debrun ; Xiangming Fang ; Young Kim ; Victor Duarte Lledo ; Samba Mbaye ; Xiaoxiao Zhang (2018), Independent Fiscal Councils: Recent Trends and Performance, Working Paper No. 18/68, International Monetary Fund

[7] Report of the Thirteenth Finance commission, paras 9.65 and 9.66, pp.137

[8] The 13th and 14th Finance Commissions advocated for establishing independent fiscal agencies to review the government’s adherence to fiscal rules, and to provide independent assessments of budget proposals. The N.K. Singh committee, (2017) on the review of fiscal rules suggested the creation of an independent fiscal council that would provide forecasts and advise the government on whether conditions exist for deviation from the mandated fiscal rules. In 2018, the D.K. Srivastava committee on Fiscal Statistics suggested the establishment of a fiscal council that could co-ordinate with all levels of government to provide harmonized fiscal statistics and provide an annual assessment of overall public sector borrowing requirements.

[9] Clause 11(4) of the “Madhya Pradesh Rajkoshiya Uttardayitva Avam Budget Prabandhan Adhiniyam, 2005”

following the recommendations of the Thirteenth Finance Commission (TFC) in this regard, FRBM Act of Madhya Pradesh contained this feature since its adoption in 2006. The first review report was placed in the legislature in 2013, which reviewed the compliance of the State Government in achieving the provisions of the FRBM Act for the period 2009-10 to 2012-13. The second report reviewed the performance of the State Government for the years 2013-14 and 2014-15 and the third report for the years 2015-16 and 2016-17. This report contains the review of the fiscal management of the State Government and progress in achieving the targets and objectives of the FRBM Act for the years 2017-18 and 2018-19.

The FRBM Act of states emphasizes on formulating budget in a realistic manner through fiscal management principles enshrined in the Act. According to these accepted principles, minimizing deviations from projected revenues and spending plans leads to enhanced credibility of budget. The budget when implemented as planned shows the ability of the government to deliver public services as enunciated in government policies[10]. Given the disruption in revenues receipts, rising expenditure burdens and changes in priorities due to Covid-19 pandemic the states need to be more realistic in their budget planning and implementation. The budget credibility at sub-national level in India faces challenges like generating less than budgeted revenue due to deviations in own revenue and central transfers and consequent adjustments in spending plan[11]. This has also affected forward projections of fiscal variables in MTFPs of the states[12].

Fiscal rules have been adopted by the countries across the world to reduce the fiscal deficit within a range to stabilize the debt ratio at a prudent level and containing the debt ratio over the medium to long term[13]. The fiscal rules were adopted in India to address the deterioration of public finance both at Central and state levels in late nineties and the initial success was mostly

[10] PEFA: Framework for Assessing Public Financial Management, (2016), PEFA secretariat, Washington DC
[11] Jena Pratap Ranjan and Abhishek Singh," Sub-national Budget Credibility: Institutional Perspective and Reform Agenda in India", Working Paper No. 338, July-2021, National Institute of Public Finance and Policy.
[12] Chakraborty, P., Chakraborty, L., & Shreshtha, R. (2019). Budget Credibility of Subnational Governments: Analyzing the Fiscal Forecasting Errors of 28 States in India. NIPFP Working Paper Series, (280)
[13] Kopits, George, and Steven Symansky. 1998."Fiscal Policy Rules."Occasional Paper No.162, International Monetary Fund.

revenue driven[14]. The incentives provided by the Union Government, higher central transfers and acceleration of GDP growth contributed to fiscal consolidation process at the state level[15]. Although states managed to navigate through the financial crisis of 2008-09 and consequent decline in national growth rate and reduced central transfers, the Covid-19 pandemic induced fiscal stress has brought about large disruptions. Indeed, maintaining fiscal discipline is reasonably easy when the economy is strong, and it becomes challenging under adverse conditions[16]. While revival of growth process will be instrumental in coming back to fiscal consolidating path, the political commitment shown by the states in adhering to the fiscal rules will be crucial factor in this process. Political willingness to accept the constraints play significant role in maintaining the fiscal rules[17].

Fiscal management principles given in the state FRBM Act, while guiding the policy formulation, act as a catalyst for institutional change for better public financial management process. One of the important institutional developments that the states in India adopted was the preparation of MTFP along with the budget, which gives fiscal targets in a medium term. This was expected to evolve into a medium-term budgeting framework (MTBF) or more structured medium term expenditure framework (MTEF). MTEF has been considered as one of the most popular budget innovations both in developed and developing world as they help in establishing fiscal discipline and providing scope for better prioritization in resource allocation[18]. Madhya Pradesh is one of the few states in India, which made efforts to adopt a structured medium term expenditure framework (MTEF) to provide a medium-term perspective to the spending plan.

Fiscal discipline is crucial in the public financial management to take sound decisions on resource allocation and achieve operational efficiency. At the same time fiscal policy needs to

[14] Rao, M. Govinda, and Pratap Ranjan Jena. 2009. "Recent Trends in State Finances. "In States' Fiscal Management and Regional Equity: An Overview, edited by M. Govinda Rao and Anwar Shah, 19–35. Oxford University Press.
[15] Government of India (2016). Economic Survey 2013-14, Government of India, Ministry of Finance
[16] Schick, Allen 2003. "The Role of Fiscal Rules in Budgeting." OECD Journal on Budgeting. 3(3): 7–34.
[17] Hagen, J€urgen von (2007). "Budgeting Institutions for Better Fiscal Performance. "In Budgeting and Budgetary Institutions, edited by Anwar Shah, 27–51, The World Bank.
[18] Brumby, J., & Hemming, R. (2013). Medium-Term Expenditure Frameworks, in Allen, R., Hemming R. and Potter B. H. (eds.) The International Handbook of Public Financial Management (pp. 219-236). Palgrave Macmillan, London

respond to emerging socio-economic issues and development requirement. The ability to develop and implement clear fiscal strategy leads to achieving fiscal goals. The economy of Madhya Pradesh depends significantly on agriculture, which employs a large workforce. The State has large potential for diversification of agricultural and horticultural crops, and strategic promotion of agro-based industries. The State Government continues to give priority to infrastructure building, power sector development, investments in irrigation and agricultural improvements. The State, however, needs to improve upon its human development performances, particularly in areas of education and health sectors. Fiscal policy needs to respond to emerging socio-economic issues and development requirements.

1.3 Data and Information for the Evaluation Report

The budgetary data published by the state government, CAG reports, and other socio-economic data formed the basis of this evaluation report. The fiscal data culled out from state budgets of the relevant years and data from finance account and appropriation account are major sources of information for this study. The department of finance provided data and information on state finances for this study and gave an overall perspective on the state fiscal management including revenue receipts trends, debt management, resource allocations to different sectors, and achievement of FRBM fiscal targets. The study also benefited from the inputs provided by the spending departments. The issues related to sector priorities and expenditure pattern and utilization of budgeted amount under revenue and capital heads for the years 2017-18 and 2018-19 were discussed with them.

1.4 Organization of the Report

The report is organized as follows. Chapter 2 of this chapter provides an overall assessment of macroeconomic outlook and sector composition of GSDP. Chapter 3 contains analysis on state finances in recent years. Compliance of the State Government to the fiscal targets and fiscal management principles under the Madhya Pradesh FRBM Act are covered in Chapter 4. Issues relating to revenue mobilization and expenditure pattern for the years 2017-18 and 2018-19 as compared to the budget provisions are analyzed in this chapter. Concluding observations are contained in Chapter 5.

2. Macroeconomic Outlook

Economic growth slowed down considerably due to Covid-19 pandemic in India. While GDP growth has already slowed down since 2016-17, the pandemic hit the country hard. The GDP growth in 2019-20 declined to 3.9 percent, mainly due to contraction in secondary sectors like manufacturing and construction. The impact of lockdown towards end of March also had its impact on this trend. The impact of Covid-19 induced lockdown and loss of business activities exacerbated the slowing down of national economy as it contracted by 5.8 percent in 2020-21. With the opening up of the economy and restoration of business activities, the recovery process has already started and the results of the first quarter of 2021-22 look promising. The growth process in the country will help the states to improve their GSDP growth and revenue generation.

In this context, assessing macroeconomic outlook of Madhya Pradesh during 2017-18 and 2018-19 assumes significance to show the strength of the state economy to augment the fiscal management process. With the growth of GDP picking up, the state economy will be stabilized and help in developing sound fiscal strategy and ensure predictability of flow of funds. A stable economic situation in the long run helps the state government building sound fiscal forecasting to support development oriented fiscal policy. Growth of the economy serves as an accepted base for revenue generation effort of the State Government. Getting an unbiased picture of resource envelope is a crucial factor in the budget management process while taking allocation decisions.

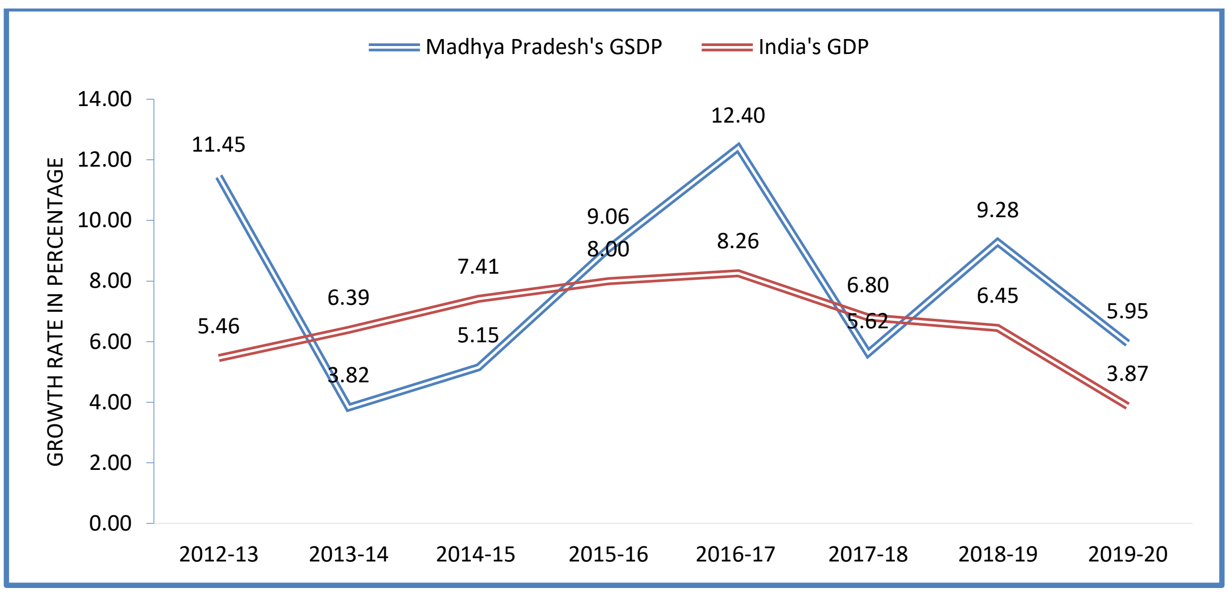
The FRBM Act stipulates that the state government should provide a macro-economic framework statement along with the FRBM related documents, which should contain analysis of growth and sectoral composition of GSDP. Contribution of various sectors to the State economy assumes significance in the context of budget management to ascertain possible revenue implications. While macroeconomic outlook at national level is an important factor for fiscal policy both at Union and state level, the GSDP reflects revenue base of the state. 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. The Union Government determines the borrowing limit of the state as proportion to the GSDP. The borrowing limit in recent years is linked with the fiscal deficit limit stipulated in the FRBM Act.

2.1 Gross State Domestic Product of Madhya Pradesh

The GSDP growth in Madhya Pradesh at constant prices, after a sharp decline from 11.45 per cent in 2012-13 to a low of 3.82 percent in 2013-14, continued to grow steadily until 2016-17, when it reached a peak of 12.40 percent (Figure 2.1). Once again, the GSDP suffered a setback in 2017-18, as it declined to 6.80 percent. The growth of GSDP again increased in 2018-19 to 9.28 percent, but due to slowdown in the economy, it decreased to 5.95 percent in 2019-20. A comparison of GSDP growth at constant prices with India's GDP growth during 2012-13 to 2019-20 shows that GSDP growth exceeded the GDP growth in several years.

Fig 2.1

Madhya Pradesh's Economic Growth: GDP-GSDP Growth rates (at constant prices)



Per capita income of the state is a compelling indicator of economic progress. Per capita income of Madhya Pradesh has improved from Rs. 69,110 in 2015-17 to Rs. 1,01,647 in 2018-19 and further to Rs. 1,13,224 in 2019-20 at current prices. At constant prices it stands at Rs. 69,429 in 2019-20. The per capita income of the State shows an annual average growth rate of 12.73 percent during 2015-16 to 2019-20. Based on average per capita income during the period from 2015-16 to 2019-20, Madhya Pradesh occupies 15th position among 18 states. It remains ahead of only three states, Jharkhand, Uttar Pradesh and Bihar. Despite the problems of outliers influencing per capita income, it remains as an important measurement of the stability and wealth within an economy.

Table 2.1

Per Capita Income (in Rs.) of all General States (at current prices)

States	2015-16	2016-17	2017-18	2018-19	2019-20	Average
Goa	365806	415411	454172	467795	484326	437502
Haryana	183249	204727	231909	249932	272884	228540
Gujarat	162796	186072	205499	227299	246419	205617
Maharashtra	164554	184979	203399	227979	245323	205247
Karnataka	160284	179427	199492	225039	243761	201601
Tamil Nadu	155626	175530	198002	222320	249820	200260
Kerala	166351	184113	195195	212006	229488	197431
Telangana	158072	174054	194834	215784	243189	197187
Punjab	132467	143124	155781	171556	179163	156418
Andhra Pradesh	119777	134879	154020	169621	188069	153273
Rajasthan	93094	102422	109270	119956	128319	110612
Odisha	83456	90426	100014	110728	126121	102149
Chhattisgarh	81907	94083	99452	110291	117700	100687
West Bengal	76350	90855	101550	111892	119075	99945
Madhya Pradesh	**69110**	**81768**	**90094**	**101647**	**113224**	**91169**
Jharkhand	58139	65405	73628	79936	87127	72847
Uttar Pradesh	53113	59249	64120	70680	74141	64261
Bihar	33218	37052	40065	44451	49272	40812

Source: Central Statistical Office, GoI

The GSDP growth at constant prices shows the fluctuating trend over the years. During 2012-13 to 2019-20, it varied in the range 3.82 to 12.40 (Table 2.2). The average annual growth rate during this period works out to be 7.33 percent. The growth rate of GSDP becomes a crucial factor in the context of budget making as it is the denominator in all targets fiscal ratios, and it is also the determining factor for borrowing limit of the State. The growth rates assumed by Central Finance Commissions become reference points while making budget estimates. FC-XIV projected the GSDP growth at current prices for Madhya Pradesh for the award period

2015-16 to 2019-20 at 13.91 percent. However, the average annual growth rate of GSDP during this period was better at 14.66 percent.

Table 2.2

Key Aggregates of State Domestic Product (Constant Prices)

Item	Growth over previous year (in %)							
	2012-13	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
Gross State Value Added	11.36	2.11	5.30	7.22	12.20	5.27	9.63	4.35
Taxes on Products	15.83	6.30	9.39	25.20	7.14	9.01	6.72	12.76
Less Subsidies on Products	17.33	19.67	17.43	8.02	-3.55	7.08	9.74	-9.63
Gross State Domestic Product	**11.45**	**3.82**	**5.15**	**9.06**	**12.40**	**5.62**	**9.28**	**5.95**
Consumption of Fixed Capital	35.07	-5.11	5.08	7.43	6.63	7.70	10.39	10.73
Net State Value Added	8.45	3.21	5.33	7.19	12.99	4.94	9.53	3.48
Net State Domestic Product	8.67	5.13	5.16	9.28	13.15	5.36	9.14	5.35
GSDP at Current Prices	*20.71*	*15.37*	*9.21*	*12.74*	*20.10*	*11.77*	*14.42*	*12.95*

Source: Central Statistical Office, GoI

2.2 Sector-wise Composition of GSDP

In Madhya Pradesh agriculture traditionally remained as an important activity and as driving force of the economy. While service sector including trade, hotel, transport, real estate, and financial services is the largest contributor to the economy, its share after remaining stagnate for many years, shows declining trend in recent years. Industry sector including manufacturing, construction, and electricity, has not fared well in the State as its relative share has declined over the years. The GSVA by economic activities since 2011-12 shows that relative share of agriculture increased from 28.86 percent in 2011-12 to 32.10 percent in 2016-17 and declined after that to 28.08 percent in 2018-19. In 2019-20, its share has marginally improved to 29.73 percent (Table 2.3). Primary sector containing value added from agriculture, mining and quarrying constitutes on an average 35.59 percent of the GSVA during 2011-12 to 2019-20.

The service 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. Improving the service sector augurs well for revenue generation and particularly for states in increasing the GST collection. The contribution of service sector in Madhya Pradesh indicates that it is the largest component of the GSDP. On an average during 2011-12 to 2019-20, service sector constituted about 36.65 percent of GSDP at constant prices. Relative share of service sector in the GSVA over the years has declined in the state from 37.59 percent in 2011-12 to 35.95 percent in 2018-19 and further to 35.69 percent in 2019-20.

What is noticeable in composition of GSDP at constant prices is the declining share of industry sector, which constitutes of manufacturing, electricity, and construction activities. It has declined from 26.07 percent in 2011-12 to 23.66 percent in 2019-20. The components of services sector either show some decline in their relative shares or have remained stagnant over the years.

Table 2.3
Composition of GSDP (Constant Prices)

Economic Activity	Percentage Share								
	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
Agriculture, Forestry and Fishing	28.86	32.24	31.00	31.32	28.60	32.10	30.46	28.08	29.73
Mining and Quarrying	3.71	3.84	3.33	3.03	2.95	2.85	3.15	3.00	2.45
Primary	**32.57**	**36.08**	**34.33**	**34.36**	**31.55**	**34.95**	**33.61**	**31.08**	**32.18**
Manufacturing	12.13	11.23	10.04	9.79	11.52	11.30	11.53	13.51	12.25
Electricity, Gas, Water Supply & Others	2.86	2.62	3.09	3.70	4.25	3.21	3.52	3.86	3.75
Construction	11.08	9.24	9.64	9.31	8.61	7.95	8.11	8.54	7.66
Secondary	**26.07**	**23.09**	**22.77**	**22.80**	**24.38**	**22.47**	**23.15**	**25.91**	**23.66**
Trade, Repair, Hotels and Restaurants	10.71	10.66	10.65	10.58	10.24	10.26	10.63	11.18	10.91
Transport, Storage, Communication	5.80	5.92	6.10	6.38	6.58	5.90	5.89	5.91	5.94
Financial Services	5.05	4.86	5.07	4.93	5.16	4.40	4.21	3.91	3.73
Real estate	5.19	5.02	5.24	5.35	5.19	4.98	5.07	4.89	4.84
Public Administration	5.16	5.00	5.05	4.88	4.70	4.76	4.88	5.08	5.23
Other Services	5.68	5.54	5.35	5.43	5.31	5.22	5.20	4.99	5.04
Tertiary	**37.59**	**37.00**	**37.47**	**37.56**	**37.19**	**35.53**	**35.88**	**35.95**	**35.69**
TOTAL GSVA at Basic Prices	**96.24**	**96.17**	**94.58**	**94.71**	**93.11**	**92.95**	**92.64**	**92.94**	**91.53**

Source: Central Statistical Office, GoI

3. Fiscal Overview of Madhya Pradesh

State finances in India depend considerably on transfers from Union Government and features like institutional framework relating to division of financial sources and functions, own revenue effort of states, and changing dynamics of transfer system influence the fund flows. For Madhya Pradesh central transfers assume significance as more than half of the revenue receipts come from these sources. As the distortions were created by Covid-19 pandemic in both flow of central transfers and own revenues, it becomes imperative to look at the pre-Covid period to assess the strengths and weaknesses public financial management in the State. The evaluation report assesses the experience of the State in responding to changes in resource transfer system under the award of FC-XIV to remain on the fiscal consolidation path as fiscal stress was looming on the horizon[19].

The FC-XIV made a compositional shift in its recommendations relating to tax devolution and grants to states for the period 2015-16 to 2019-20. The Commission recommended a large increase in tax devolution to 42 percent, continued with statutory grants for local bodies and disaster response, revenue deficit grants for a very few states, and mostly refrained from recommending any state specific or sector specific grants. According to the Commission the compositional shift aimed at giving more untied funds to the states, which would give flexibility to the states to take policy decisions based on their spending priorities. The State Government initially had to make several adjustments in the fund-flow mechanism to adapt to the new transfer mechanism, which included a rise in tax devolution and a drastic fall in plan transfers. By the fiscal year 2017-18 and 2018-19, our evaluation period, the states firmed up their policy responses to these changes.

The shift in composition of central transfers not only included the changes in tax devolution and grants recommended by the Finance Commission, but also plan grants to state budgets. Following the rise in tax devolution, the Union Government restructured the assistance to state

[19] RBI 2019, State Finances: A study of Budgets

plans by removing plan grants to state budgets leaving mostly the CSS funds[20]. A perceptible change was witnessed in the fiscal management at the sub-national level as the states received higher tax devolution, the loss of plan grants required reorganization of the spending pattern. The policy choices to fund the existing plan schemes from the untied tax devolution or redesigning the spending priorities created interruptions and some uncertainties in fund flows to various programs and projects.

The FRBM Acts of the states in India were amended to reflect the fiscal consolidation path recommended by FC-XIV, which includes deficit and debt targets and flexibility for higher borrowing for prudent fiscal management. While states continued to adhere to FRBM Act targets, the state finances were affected by moderation in national growth and its adverse impact on flow of central funds. Debt burden has increased continually since 2015-16, led by restructuring of power sector through schemes like UDAY. The RBI Study on State Finances (RBI 2019, State Finances: A study of budgets) has indicated that there has been a continual decline in state expenditure, mainly capital, which has wider repercussion on development process. The study of state finances of Madhya Pradesh shows the underlying factors that shaped the fiscal management process.

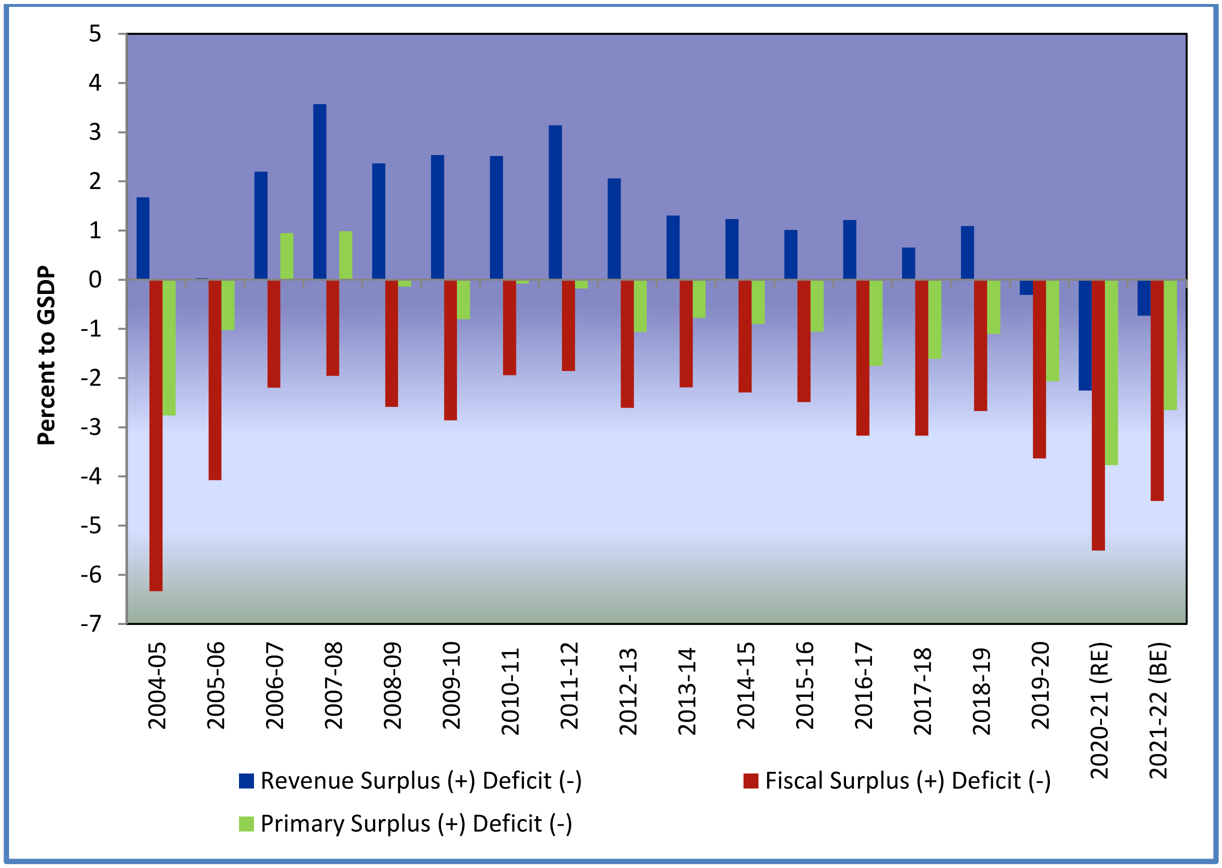
3.1 Overview of State Finances: Sustaining Consolidation Process

After adopting FRBM Act in 2005, Madhya Pradesh consistently adhered to the fiscal targets stipulated in the Act. The fiscal deficit remained within the prescribed limit of 3 percent of GSDP since 2006-07 and the state managed to generate surplus in the revenue account (Figure 3.1). The debt GSDP ratio, which was touching almost 40 percent of GSDP in pre-FRBM Act period, gradually came down and since 2012-13, it remained within 25 percent. Growth of primary deficit of the state remained limited in the post-FRBM Act period. Madhya Pradesh availed the flexibility provided by FC-XIV to raise the fiscal deficit by 0.5 percent in 2016-17 by satisfying conditions related to the interest payment and fiscal prudence in previous years.

[20] The Central Government subsumed Normal Central Assistance (NCA), Special Plan Assistance, Special Central Assistance in the FFC award and delinked eight schemes like National e-Governance Plan, the Backward Regions Grant Fund (BRGF), the Rashtriya Krishi Vikas Yojana (RKVY) etc. from Central funding. The Central Government also restructured the CSS based on the recommendations of the subgroup of chief ministers in 2016-17.

The fiscal deficit exceeded 3 percent of GSDP in 2016-17 and remained at same level in 2017-18. It came down in 2018-19 below the 3 percent mark once again. The borrowing in lieu of UDAY scheme in 2016-17 and 2017-18, however, was excluded while assessing the compliance to the FRBM Act[21].

Figure 3.1
Key Fiscal Variables



The trends of fiscal variables are further analyzed in this section to assess the fiscal performance of the state and observe the implications of the observed fiscal stance. The fiscal outturns are the results of several factors that include the ability of the state to prepare and implement the budget keeping the strategic fiscal policy under consideration, generate the projected revenue

[21] The rise in fiscal deficit and debt burden since 2019-20 shows the Covid-19 pandemic induced fiscal stress and the efforts of the state to come back to the fiscal consolidation path following the recommendations of FC-XV. The fiscal disruption holds true for all the states in India.

that includes managing the uncertainties and risks, and implement the programs to achieve agreed upon results.

The trend of aggregate revenue in the state shows that, while its growth remained subdued as percentage of GSDP since 2011-12, an upward trend has been witnessed since 2015-16 due to higher flow of central transfers (Table 3.1). The revenue receipts as percentage to GSDP was 19.8 percent in 2011-12, which reduced to 17.4 percent in 2014-15 and increased again in 2015-16. The aggregate revenue improved to 19.1 percent in 2017-18 as compared to 18.7 percent of GSDP in 2015-16. In the fiscal year 2018-19, there has been a marginal decline in aggregate revenue as percentage of GSDP. The overall growth scenario in the country was not conducive to both the union and state governments to raise higher revenue.

The quantum of resource envelope available to the government in nominal terms shows that the total revenue receipt has grown from Rs. 62,604 crores in 2011-12 to Rs. 1,50,391.77 crores in 2018-19. The average annual growth rate was about 14 percent during 2011-12 to 2018-19 and the average growth rate was 10 percent[22] for the two years 2017-18 and 2018-19 of study. Own revenue of the state comprising of own tax revenue and non-tax revenue as percentage to GSDP, has remained more or less stagnant since 2015-16. Higher inflow of tax devolution in 2015-16 by about 2.73 percentage points relative to GSDP helped in improving total revenue receipts. The central transfers continued as driving force for state revenue during 2017-18 and 2018-19.

Spending pattern suggests that both revenue and capital expenditure followed the revenue trend. In the case of revenue expenditure, the restraint seen since 2011-12 has given to way some increase in spending as percentage to GSDP after 2015-16 due to higher infusion of central transfers. As percentage to GSDP it remained on an average at 16.5 percent during 2011-12 to 2014-15 and increased to 17.9 percent during 2015-16 to 2018-19. In nominal terms, the revenue expenditure increased from Rs. 99, 770 crores in 2015-16 to Rs. 141, 577 crores in 2018-19. The average annual growth rate of revenue expenditure during 2017-18 to 2018-19 was 10.72 percent, marginally higher than the growth of aggregate revenue at 10.44 percent. Despite the upward movement in revenue expenditure, the overall trend over the years shows

[22] Due to impact of Covid-19 pandemic the growth of revenue receipts in 2019-20 and 2020-21 turned negative.

that the state adopted a policy of control over the growth of revenue expenditure, which helped to generate surplus in revenue account.

Table 3.1
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	2019-20	2020-21 (RE)	2021-22 (BE)
Total Revenue Receipts	**19.8**	**19.5**	**16.8**	**17.4**	**18.7**	**19.3**	**19.1**	**18.6**	**16.3**	**14.5**	**14.5**
Own Tax Revenues	**8.6**	**8.5**	**7.4**	**7.2**	**7.1**	**6.9**	**6.3**	**6.3**	**6.2**	**5.6**	**5.7**
Own Non-Tax Revenues	**2.4**	**1.9**	**1.7**	**2.0**	**1.5**	**1.4**	**1.3**	**1.6**	**1.1**	**1.0**	**1.0**
Central Transfers	**8.9**	**9.1**	**7.6**	**8.2**	**10.0**	**10.9**	**11.5**	**10.6**	**9.0**	**7.8**	**7.8**
Tax Devolution	5.8	5.7	5.0	4.7	6.8	7.2	7.2	7.1	5.5	4.6	4.6
Grants-in-Aid	3.1	3.3	2.6	3.5	3.2	3.7	4.3	3.5	3.5	3.3	3.2
Revenue Expenditure	**16.7**	**17.4**	**15.5**	**16.2**	**17.7**	**18.0**	**18.4**	**17.5**	**16.6**	**16.7**	**15.3**
General Services	**5.1**	**4.9**	**4.6**	**4.4**	**4.5**	**4.4**	**4.5**	**4.6**	**4.4**	**5.2**	**4.9**
Interest Payment	1.7	1.5	1.4	1.4	1.4	1.4	1.6	1.6	1.6	1.7	1.8
Pension	1.4	1.4	1.3	1.3	1.4	1.4	1.3	1.5	1.3	1.6	1.5
Social Services	**6.4**	**6.7**	**6.2**	**6.3**	**7.5**	**7.5**	**8.3**	**7.3**	**7.1**	**7.0**	**6.0**
General Education	3.0	3.0	3.0	3.1	3.0	3.2	3.3	3.2	3.1	3.2	2.9
Medical and Public Health	0.8	0.9	0.7	0.9	0.9	0.8	0.9	0.7	0.9	0.9	0.9
Economic Services	**4.1**	**4.6**	**3.8**	**4.7**	**4.5**	**5.1**	**4.6**	**4.7**	**4.5**	**3.9**	**3.9**
Assignment to LBs	**1.0**	**1.1**	**1.0**	**0.8**	**1.0**	**1.1**	**1.0**	**0.9**	**0.7**	**0.6**	**0.5**
Capital Outlay	**5.0**	**4.7**	**3.5**	**3.5**	**3.5**	**4.4**	**3.8**	**3.8**	**3.3**	**3.3**	**3.8**
Revenue Deficit	**-3.1**	**-2.1**	**-1.3**	**-1.2**	**-1.0**	**-1.2**	**-0.7**	**-1.1**	**0.3**	**2.3**	**0.7**
Fiscal Deficit	**1.9**	**2.6**	**2.2**	**2.3**	**2.5**	**3.2**	**3.2**	**2.7**	**3.6**	**5.5**	**4.5**
Outstanding Debt	**25.7**	**24.7**	**21.3**	**21.3**	**22.5**	**23.2**	**24.4**	**24.0**	**25.4**	**30.1**	**29.7**

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

Capital outlay, which showed a decline from 5 percent of GSDP in 2011-12 to 3.50 percent in 2014-15, has gained momentum in recent years. It increased to 4.4 percent of GSDP in 2016-17 and remained at 3.8 percent in both the fiscal years of 2017-18 and 2018-19. This imparted a positive quality to the spending pattern of the state. The improvement in capital outlay was influenced by the state availing the flexibility provided by the FC-XIV to increase the fiscal deficit by 0.5 percent.

The trend of major fiscal targets are as follows:

Revenue Surplus/Deficit: The extent of surplus in revenue account provides an idea about the flexibility of the state to incur capital outlay and borrow within the constraint of FRBM Act targets. While revenue surplus has been generated consistently, it has fallen as percentage of GSDP over the years. Revenue surplus has declined from 3.1 percent in 2011-12 to 0.7 percent in 2017-18. It has improved to 1.1 percent of GSDP in 2018-19.

Fiscal Deficit: The fiscal deficit, which remained less than the stipulated 3 percent of GSDP in post-FRBM Act period, increased to 3.2 percent in 2016-17 and 2018-19, before coming down to 2.7 percent in 2018-19. The amendment in FRBM Act to avail the flexibility provided by FC-XIV facilitated a higher than 3 percent fiscal deficit. Fiscal deficit remaining within the targets provided by the FRBM Act and maintenance of surplus in revenue account shows the commitment of the state government to remain in fiscal consolidation path despite resource problems.

Debt Stock: The outstanding debt as percentage to the GSDP, which was declining until 2015-16, increased by about 1 percentage point and in 2018-19, it was 24 percent of the GSDP. It remains below the FC-XIV prescribed debt-GSDP ratio of 25 percent that is considered as a benchmark to avail the flexibility in incurring fiscal deficit.

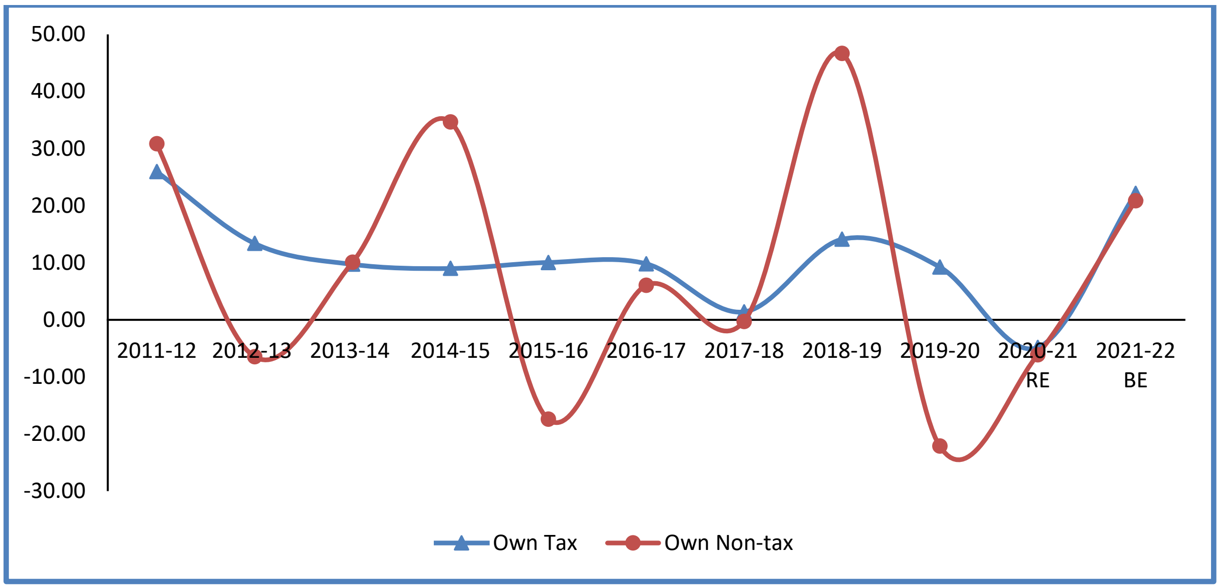
3.2 Own Revenue Receipts

As shown in table 3.1, own revenue receipt of the state has suffered a decline relative to GSDP. It has declined from 10.9 percent in 2011-12 to 7.4 percent in 2017-18 and marginally increased to 8 percent in 2018-19. Own tax revenue and non-tax revenue constituted about 39 and 9 percent of total revenue of the state respectively during the period 2011-12 to 2018-19. Own tax revenue constitutes about 80 percent of own revenue. Annual growth rates of own tax and non-tax revenue over the years are shown in Figure 3.1. The growth rate of own tax receipts has been declining continuously over the years. In the fiscal year 2018-19 the growth rate picked up to 14.09 percent over a very low growth of 1.4 percent seen in 2017-18[23]. Relatively

[23] The growth in own tax revenue was only 1.40 per cent during 2017-18 over the previous year. This was primarily due to the teething problems encountered in implementation of GST in 2017-18 and consequent low growth. The GoI has provided compensation on account of rolling out of GST amounting to Rs.2,511 crore, which was accounted for under grants-in-aid. If the compensation received from GoI is included in own tax, the growth would

higher growth seen in 2018-19 was due to a low base in the previous year and higher receipt of SGST and state excise duty. While the average annual growth of own tax revenue was 11.67 percent from 2011-12 to 2018-19, for the years 2017-18 and 2018-19, it was only 7.75 percent. The own tax revenue of the State has increased from Rs. 26,973 crores in 2011-12 to Rs. 44,810 crores in 2017-18 and further to Rs.51,126 crores in 2018-19. The non-tax revenue shows a fluctuating growth pattern with large negative growth rates in several years.

Figure 3.2
Growth of Own Revenue



Relative share of own revenue receipts as compared to central transfers has declined in recent years (Figure 3.3). The share of own revenue receipts, which was 55 per cent of total revenue receipts in 2011-12, has declined since then to 43 percent in 2018-19. Slow growth of own revenue and rise in central transfers in 2015-16 due to the recommendations of FC-XIV increased the relative share of central transfers in aggregate revenue receipts. Relative share of central transfers has increased from 45 percent in 2011-12 to 57 percent in 2018-19. Own revenue receipt provides flexibility to take decisions in resource allocations and priorities. The rise in central transfers based on recommendations of FC-XIV was more due to a rise in tax

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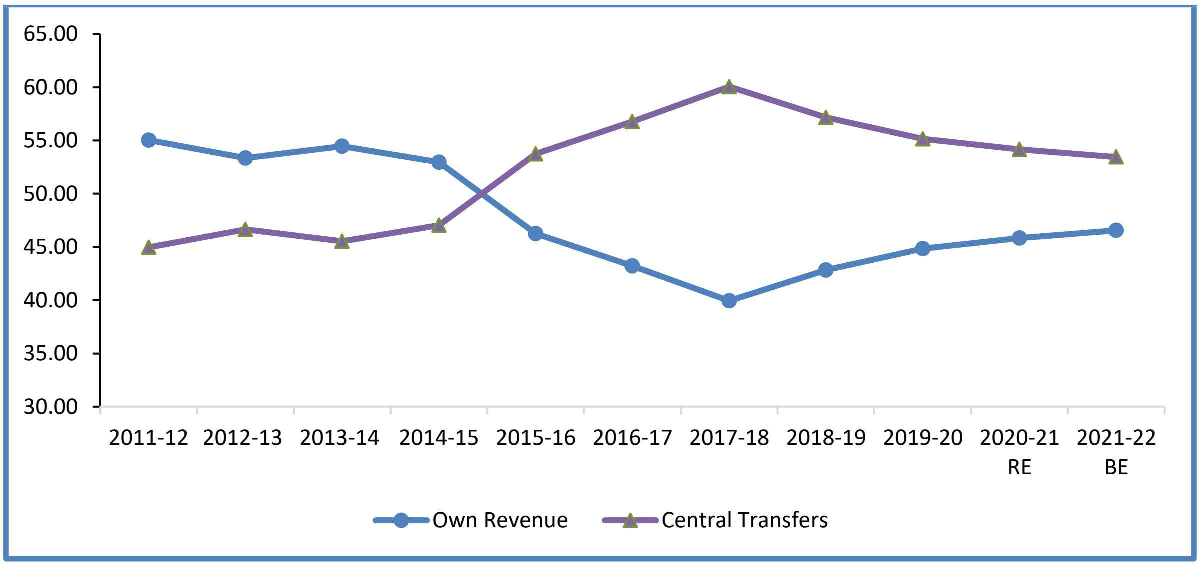
be 7.08 per cent. GoI had also provided compensation for loss on account of rolling out GST amounting to Rs.2,866 crore as grants-in-aid in 2018-19.

devolution. The tax devolution is formulaic and untied in nature, which does not reduce the flexibility of the state. The uncertainties in flow of funds under tax devolution due to slow growth of national economy is unavoidable.

Figure 3.3
Relative Share of Own Revenue and Central Transfers



Composition of own tax receipts show that sales tax/VAT constituted about half of the own tax revenue (Table 3.2). It was expected that implementation of GST in 2017-18 would improve the tax base of the state government and relative share of this commodity tax would further increase. The average relative share of sales tax/VAT over the years 2011-12 to 2016-17 was 49.08 percent. For the two years 2017-18 and 2018-19, the average share of sales tax including state GST works out to be 49.98 percent, a marginal rise. However, for 2019-20, this share was set to increase. The sales tax and SGST taken together grew at the rate of 4.96 and 1.78 percent 2017-18 and 2018-19 respectively as compared to the growth rate 13.91 percent seen in fiscal year 2016-17. The compensation provided by GoI amounting to Rs. 2, 511 crore and Rs. 2, 866 crores in 2017-18 and 2018-19 was accounted for under grants-in-aid.

The other important state taxes are excise duty and stamps duty and registration fees, which constituted about 18 percent and 11 percent of own tax revenue respectively. The share of other taxes varies within 5 to 6 percent with land revenue accounting for less than one percent. While government generated revenue amounting to Rs. 24090.82 crores from sales tax and GST in 2018-19, the receipts from excise and stamp duty were Rs. 9542.15 crores and Rs. 5277.99 crores respectively.

Table 3.2
Composition of Own Tax Revenue

(Percent)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 (RE)	2021-22 (BE)
State GST							19.4	27.8	36.6	33.0	35.4
Sales Tax	46.4	48.6	49.6	49.6	49.2	51.1	33.4	19.4	20.2	24.0	21.9
State Excise	16.0	16.6	17.6	18.3	19.7	17.0	18.4	18.7	19.4	17.5	18.7
Motor Vehicle Tax	5.0	5.0	4.8	5.0	4.8	5.1	6.0	5.9	5.8	5.0	5.5
Goods and Passengers	7.6	7.8	7.7	7.3	7.7	8.6	2.6	0.2	0.3	0.2	0.1
Electricity Duties	6.6	4.8	5.9	5.5	5.6	5.9	5.8	5.1	4.1	5.9	4.8
Land revenue	1.0	1.5	1.1	0.7	0.7	0.9	1.1	0.8	1.0	0.8	1.3
Stamp Duty	12.2	12.9	10.1	10.6	9.6	8.9	10.7	10.3	10.0	10.9	10.0
Profession Tax	0.9	0.8	0.8	0.8	0.8	0.7	0.8	0.8	0.9	1.0	0.7
Other Taxes	4.3	2.0	2.4	2.2	1.9	1.7	1.8	11.1	1.8	1.8	1.6

Buoyancy coefficients of state taxes provide indicators to assess the performance of taxes as compared to growth of state income. Tax buoyancy measures responsiveness of revenue mobilization efforts in response to growth of the GSDP. A tax is said to be buoyant if the tax revenue increases more than proportionately in response to a rise in GSDP. The buoyancy coefficients estimated taking changes in tax and GSDP have been given in Table 3.3. A longer-term tax buoyancy for the period 2011-12 to 2018-19 estimated through regression analysis reveals that the growth of taxes has fallen behind the growth of the GSDP. The buoyancy coefficient for total own-tax receipts for the period 2011-12 to 2018-19 was very low at 0.656. All the individual taxes show similar low buoyancy figures. While annual buoyancy figure varies, the buoyancy coefficient for the year 2017-18 is very low at 0.12 percent. There has been improvement in annual buoyancy coefficient for the year 2018-19, as it exceeded one. Taxes like sales tax including SGST, state excise, motor vehicle tax and taxes on profession show buoyancy figures more than one in 2018-19. As referred to earlier, the growth rate for own tax in the year 2018-19 was better than the previous year mostly driven by better performance of SGST and excise duty, which is reflected in buoyancy coefficient more than one.

Table 3.3
Buoyancy Coefficient of State Taxes

Percent

	2015-16	2016-17	2017-18	2018-19	2011 to 2018-19
Own Tax Receipts	0.79	0.49	0.12	1.20	0.656
SGST				5.39	
Sales Tax & SGST	0.72	0.69	0.43	0.15	0.714
State Excise	1.44	-0.25	0.82	1.34	0.804
Motor Vehicle Tax	0.47	0.82	1.70	1.00	0.833
Goods and Passengers	1.16	1.16	-6.03	-7.67	-1.842
Tax on Duties on Electricity	0.97	0.80	-0.10	0.09	0.587
Land revenue	1.09	2.33	1.80	-1.86	0.251
Stamp Duty	-0.05	0.07	1.91	0.87	0.402
Taxes on Profession	0.90	0.18	0.39	2.07	0.517
Other Taxes	-0.21	-0.07	0.67	50.25	1.050

Source (Basic Data): Finance Accounts and relevant State Budgets

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 states by using a higher tax buoyancy of 1.5 for the state, whose tax-GSDP ratio was below the average ratio of 8.26. Thus, for instance, as the tax-GSDP ratio for Madhya Pradesh remained below the 8.26 mark, the Commission used a normative buoyancy of 1.5 to derive a growth rate to project the tax revenue during the period 2015-16 to 2019-20. The tax buoyancy for the State as given in Table 3.3 was below one. The Commission projected the tax revenue of the State to rise to Rs.74, 926 crore in 2018-19 and Rs.85, 867 crore in 2019-20. This level of tax projection remains much higher than what has actually been realized for these two years.

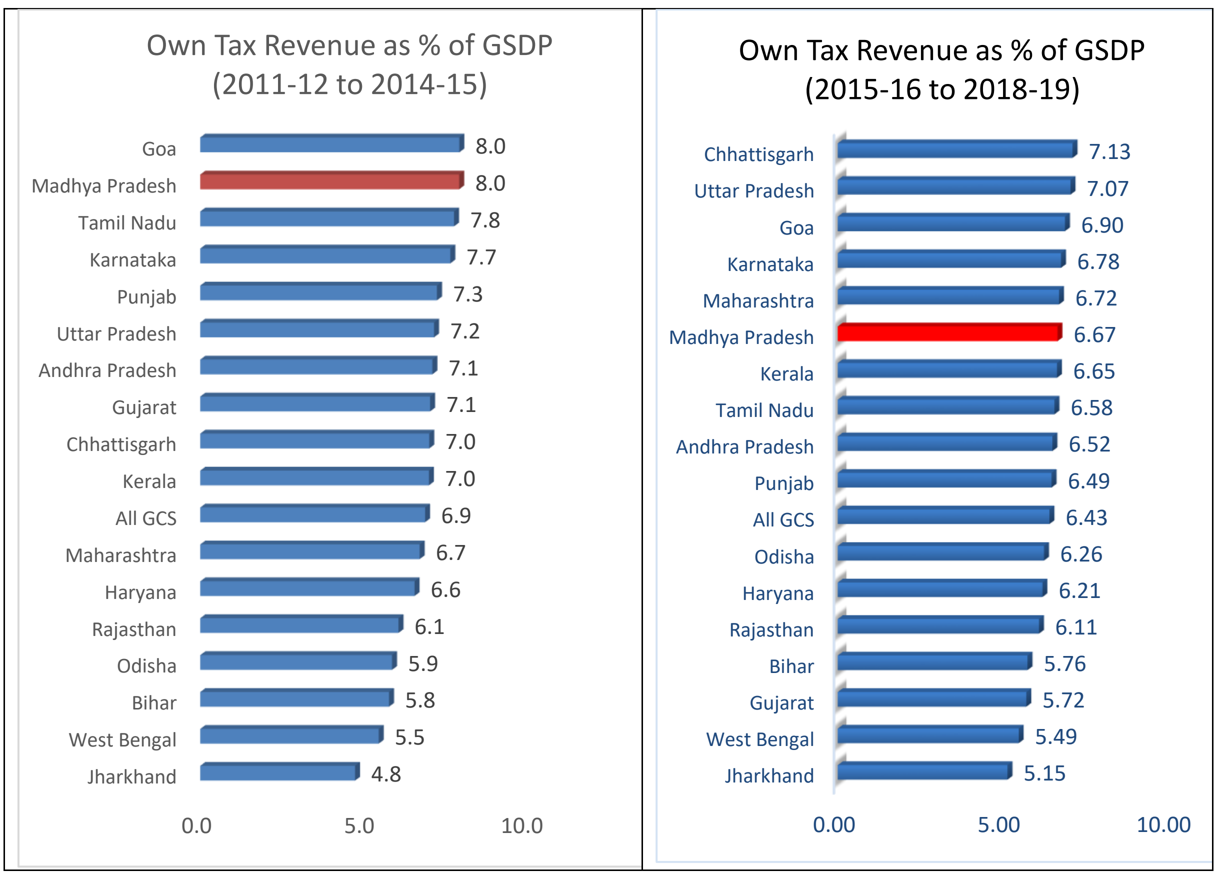
The growth of own non-tax revenue of the State has remained considerably volatile over the years with large negative growth in several years. While it shows a negative growth of 0.28 in 2017-18, the growth rate increased to 46.64 percent in 2018-19. In 2019-20 growth of state non-tax revenue declined by 22 percent. Despite this volatility the average annual growth on non-tax revenue from 2011-12 to 2018-19 was 13 percent. The non-tax revenue constituted about 9 percent of total revenue receipts and about 19 percent of own revenue during 2011-12 to 2018-

19. State non-tax revenue contains income from mining, forestry, interest receipts, dividends and user fees from services provided by the State Government. The state received Rs.9061 crores in 2017-18, which increased to Rs.13288 crores in 2018-19.

Own tax Revenue across the States in India

Average Own-tax GSDP ratio across the states in India as given in figure 3.4 for two periods - 2011-12 to 2014-15 and 2015-16 to 2018-19 shows that the performance of Madhya Pradesh is better than many of the states. While in first period – 2011-12 to 2014-15, the State occupies second position with an average tax-GSDP ratio of 8 percent, in the second period, 2015-16 to 2018-19, it occupies 6th position with 6.67 percent among 18 states. Given the low per capita income and a tax buoyancy coefficient less than one, tax effort of Madhya Pradesh among the states in India looks favorable. It is important to notice in these two periods that the tax-GSDP ratio of the State has come down significantly.

Figure 3.4
Tax GSDP ratio of States



3.3 Central Transfers

States in India benefited from the recommendations of FC-XIV with rise in tax devolution to 42 percent of the divisible pool despite the fact that Union government reduced plan grants and the CSS funding pattern was restructured. Starting from the fiscal year 2015-16, the higher tax devolution improved the aggregate transfers to Madhya Pradesh (Table 3.1). While own revenue growth remained restrained in recent years, the higher growth of central transfers with an annual average growth of 20 per cent during 2015-16 to 2018-19 helped the aggregate revenue to grow at a rate of 14 percent during the same period. The central transfers improved from 8.2 percent of GSDP in 2014-15 to 10.6 percent in 2018-19. The improvement came due to the rise in tax devolution as grants component in the transfers has not changed much as percentage to the GSDP.

Tax devolution being untied in nature provides flexibility to the state government in resource allocation. It is also formulaic for which discretions do not influence the follow of funds. Despite these factors, there is always an uncertainty in flow of tax devolution depending on amount of collection of central taxes. Growth of national economy determines the tax collection. Table 3.4 shows that as against the recommended tax devolution by FC-XIV, Madhya Pradesh has received less, and the deviation has increased over the years.

Table 3.4
Recommended and Actual tax Devolution

Rs. Crore

	2015-16	2016-17	2017-18	2018-19	2019-20
Recommended Tax Devolution	43914	50679	58562	67754	78480
Actual Tax Devolution	38371	46064	50853	57353	49486
Difference	-5543	-4615	-7709	-10401	-28994

3.4 The Expenditure Trends

Revenue Expenditure

The broad composition of government expenditure in terms of revenue and capital expenditure classification reflects distribution of expenditure across sectors and to a certain extent shows the priorities depending on availability of aggregate revenue. Revenue expenditure, taking average of relative share during 2011-12 to 2018-19, constitutes about 84 percent of total expenditure (Table 3.5). As revenue expenditure contains a large portion of committed spending, this is most likely to be met from the consolidated fund. Despite the pressure and demand for increasing this type of spending, the Government of Madhya Pradesh, have contained the growth of revenue expenditure over the years. While the relative share of revenue expenditure was rising since 2011-12, since 2015-16, a declining trend has been witnessed. This implies a rise in relative share of capital outlay in recent years, which reflects favorably on quality of expenditure.

Table 3.5
Relative Share of Revenue and Capital Expenditure

(Percent)

Heads	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21 (RE)**	**2021-22 (BE)**
Revenue Expenditure	85.3	84.5	86.6	87.4	85.6	83.0	80.8	82.8	83.7	84.2	81.0
Capital Expenditure	14.7	15.5	13.4	12.6	14.4	17.0	19.2	17.2	16.3	15.8	19.0

Source (Basic Data): Finance Accounts and State Budgets

In revenue expenditure, the state government spends about 67 percent (average during 2011-12 to 2018-19) on social and economic services, out of which 41 percent was spent on social services. The relative share of general services during the same period was 26 percent and grants to local bodies was 6 percent. The composition of revenue expenditure shows that the share of social and economic services has increased over the years.

The spending on social services shows a steady rise from 6.4 percent in 2011-12 to 7.3 percent in 2018-19 relative to the GSDP (Table 3.6). The increased expenditure due to COVID 19 pandemic and constraints on the existing resources has led to a change in government priorities. 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, which did not change as percentage to GSDP, shows marginal uptick in 2017-18 and 2018-19 as compared to 2016-17. The economic services registered a growth from 4.1 percent of GSDP in 2011-12 to 4.7 percent in 2018-19. While changes in central transfers and in CSS structure has brought in changes fiscal management practices, the priorities have been unambiguous in recent years.

Table 3.6
Revenue Expenditure Trend

Percent to GSDP

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 (RE)	2021-22 (BE)
Revenue Expenditure	**16.7**	**17.4**	**15.5**	**16.2**	**17.7**	**18.0**	**18.4**	**17.5**	**16.6**	**16.7**	**15.3**
General Services	**5.1**	**4.9**	**4.6**	**4.4**	**4.5**	**4.4**	**4.5**	**4.6**	**4.4**	**5.2**	**4.9**
Interest Payment	1.7	1.5	1.4	1.4	1.4	1.4	1.6	1.6	1.6	1.7	1.8
Pension	1.4	1.4	1.3	1.3	1.4	1.4	1.3	1.5	1.3	1.6	1.5
Others	2.1	2.0	1.8	1.7	1.7	1.6	1.7	1.6	1.5	1.9	1.5
Social Services	**6.4**	**6.7**	**6.2**	**6.3**	**7.5**	**7.5**	**8.3**	**7.3**	**7.1**	**7.0**	**6.0**
Education	3.0	3.0	3.0	3.1	3.0	3.2	3.3	3.2	3.1	3.2	2.9
Health	0.8	0.9	0.7	0.9	0.9	0.8	0.9	0.7	0.9	0.9	0.9
Water Supply, Sanitation, Housing & Urban	0.6	0.8	0.6	0.6	1.1	1.7	2.4	1.7	1.3	1.0	0.7
Welfare of SC, ST and OBC	0.6	0.6	0.5	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Social Welfare	1.3	1.4	1.1	1.0	1.9	1.0	0.9	0.9	1.1	1.3	1.0
Other Social Services	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.2
Economic Services	**4.1**	**4.6**	**3.8**	**4.7**	**4.5**	**5.1**	**4.6**	**4.7**	**4.5**	**3.9**	**3.9**
Agriculture & Allied Activities	1.6	1.7	1.4	1.6	1.3	1.6	1.7	1.9	1.5	1.1	1.4
Rural Development	0.9	1.0	0.8	1.3	1.1	1.4	1.0	0.9	0.9	1.0	0.7
Irrigation and Flood Control	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Energy	0.7	0.8	0.7	1.0	1.3	1.3	1.4	1.2	1.6	1.2	1.3
Industry	0.4	0.6	0.3	0.3	0.4	0.4	0.3	0.3	0.3	0.2	0.2
Transport	0.3	0.4	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Others	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Compensation to LBs	**1.0**	**1.1**	**1.0**	**0.8**	**1.0**	**1.1**	**1.0**	**0.9**	**0.7**	**0.6**	**0.5**

Source (Basic Data): Finance Accounts and State Budgets

The expenditures on wages and salary, pension payments, and interest payment taken together constitute a major portion of revenue expenditure. These spending items being committed in nature cannot be avoided or postponed during the year. The committed expenditure averaged over 2011-12 to 2018-19 constituted about 40 percent of total revenue expenditure. For the fiscal years 2017-18 and 2018-19, this has declined to 37 percent. The relative share of items of committed spending given in table 3.7 shows that salary and wages have been declining over the years. Pension has more or less remained stable over the years. In the year 2018-19, the relative share of committed spending has increased to 38.9 percent from 35.3 percent incurred in 2017-18. This was due to payment arrears of 7th pay Commission starting from 2018-19. According to the government estimates the salary payments increased by 18.53 percent in 2018-19 as compared to the previous years and this has further increased by 25.77 percent in 2019-20[24]. Despite the increase in salary payments due to arrears of pay revision, there has been a qualitative improvement in spending pattern over the years due to shrinking committed spending.

Table 3.7
Share of Committed Spending in Revenue Expenditure

	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
Interest Payment	10.1	8.9	9.1	8.6	8.1	7.9	8.5	9.0	9.4
Pension	8.3	7.9	8.5	8.3	7.8	7.6	7.1	8.5	8.0
Salaries and wages	28.6	25.8	26.3	25.8	21.9	19.8	19.7	21.5	21.9
Committed Expenditure	**47.0**	**42.5**	**43.9**	**42.7**	**37.9**	**35.3**	**35.3**	**38.9**	**39.3**

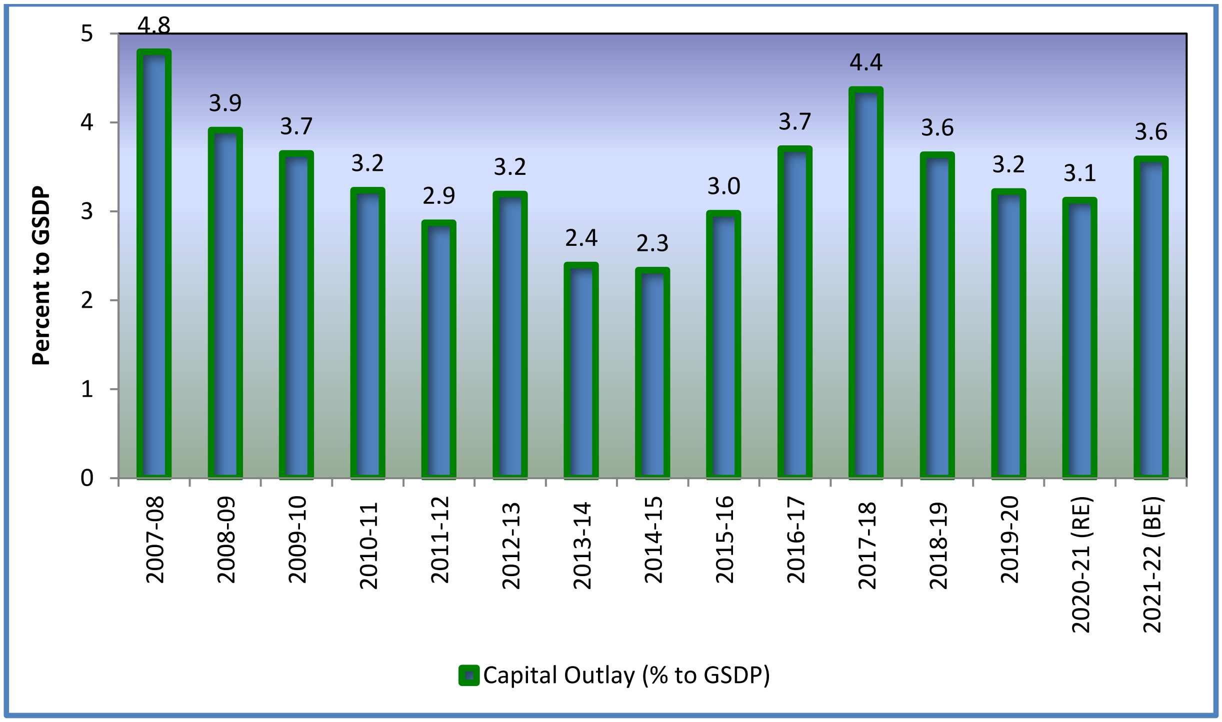
Capital Outlay

Figure 3.5 shows the capital outlay net of loans and advances given by the government as percentage to GSDP. This is actual capital spending carried out by the government in different sectors. The trend of capital outlay shows considerable revival as percentage to GSDP since 2015-16. It increased from 2.3 percent of GSDP in 2014-15 to 4.4 percent in 2017-18, however, there has been some moderation in 2018-19 to 3.6 percent. Further decline in 2019-20 and 2020-21 was due to the changes in priorities to address the demands of Covid-19 pandemic. Indeed,

[24] The FRBM documents (2019-20), Government of Madhya Pradesh

capital outlay becomes residual in the system responding to fiscal exigencies. The trend of capital outlay in recent years indicates a qualitative change in state spending pattern. While higher flow of central transfers and flexibility provided by FC-XIV to expand borrowing helped improving capital outlay, strengthening own revenue effort will provide further impetus.

Figure 3.5
The Capital Outlay (Net of Loans and Advances)



The composition of capital outlay given in Table 3.8 clearly shows that productive economic services attract about 80 percent of allocation. The capital outlay in social services has been about 18 percent and general services which includes public works and police infrastructure gets about 2 percent. In economic services the sectors like irrigation, energy, rural development, and transport are the priority sectors for capital investment. In the case of social services, water supply, sanitation and urban development, welfare services, health and education are sectors where government invested to create infrastructure. 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.

Table 3.8
Composition of Capital Outlay

Percent

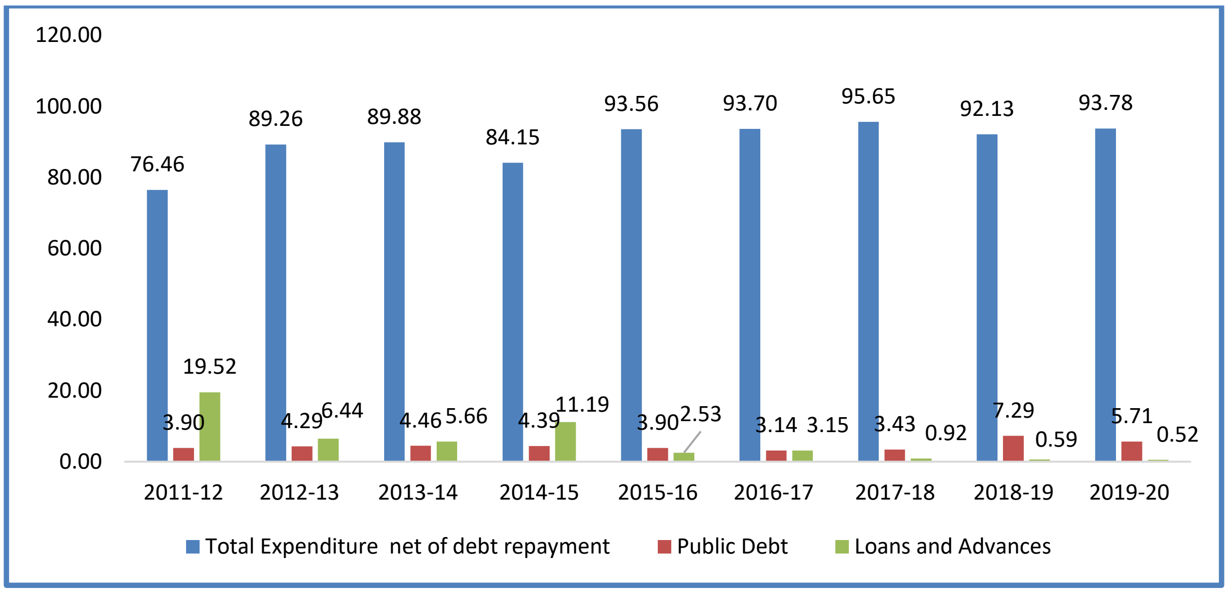
Heads	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
General Services	**1.8**	**1.8**	**1.8**	**2.2**	**3.3**	**2.9**	**2.7**	**2.5**	**3.4**
Police	0.5	0.6	0.5	0.8	1.1	1.5	1.5	1.3	1.9
Public works	1.4	1.1	1.1	1.1	2.0	1.4	1.2	1.2	1.4
Other General Services	0.0	0.1	0.2	0.2	0.2	0.0	0.0	0.0	0.1
Social Services	**17.7**	**14.0**	**17.6**	**17.4**	**18.0**	**13.8**	**19.6**	**19.4**	**23.7**
Education	1.9	1.3	1.2	2.7	4.5	3.1	2.5	3.2	5.1
Public Health	1.6	1.5	1.5	2.0	1.3	2.4	3.8	4.1	3.7
Water Supply Sanitation Housing & Urban Dev	8.2	7.2	8.6	9.2	9.1	4.7	8.6	9.3	11.1
Welfare of SC/ST/OBC	4.6	3.8	3.2	2.5	2.4	2.3	3.9	2.5	3.4
Social Welfare and Nutrition	1.2	0.1	3.0	0.9	0.3	0.9	0.4	0.2	0.2
Other Social Services	0.2	0.2	0.0	0.2	0.3	0.5	0.3	0.1	0.1
Economic Services	**80.5**	**84.2**	**80.6**	**80.4**	**78.8**	**98.2**	**90.7**	**78.1**	**73.0**
Agriculture and Allied Services	1.4	3.0	1.7	1.4	0.7	2.9	1.4	6.4	1.9
Rural Development	10.8	12.6	6.5	10.5	14.4	13.4	8.0	10.9	15.2
Irrigation and Flood Control	36.6	36.9	42.0	34.7	37.9	35.7	29.1	28.5	30.8
Energy	11.3	10.6	5.8	7.7	3.3	19.7	27.3	7.7	1.9
Industry and Minerals	0.4	1.8	1.8	1.1	1.5	6.4	0.9	0.9	1.9
Transport	19.1	18.3	22.0	24.2	20.1	19.7	23.4	23.4	21.1
Science and Environment	0.0	0.3	0.2	0.2	0.0	0.0	0.0	0.0	0.0
General Economic Services	0.8	0.8	0.5	0.5	1.1	0.5	0.4	0.2	0.2

Source (Basic Data): Finance Accounts and State Budgets

Composition of Total Expenditure and Emerging Priorities

Revenue and capital expenditure taken together show that on average, the Government of Madhya Pradesh has spent about 90 percent of aggregate expenditure on development programs, 4 percent on debt repayment and 6 percent on loans and advances (figure 3.6). Spending on government programs net of debt repayment has been increasing in the state over the years. It has increased from 76.46 percent in 2011-12 to 92.13 percent 2018-19. The loans and advances, which used to be a major spending items for the government has come down considerably from 19.52 percent to less than one percent during the same period. The relative share of debt repayment more or less remained the same during the same period except in 2018-19, where it has increased. 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.

Figure 3.6
Composition of Total Expenditure



The trends of revenue and capital expenditure show the level of government spending and broad classification of government expenditure depending upon resource availability, existing programs and new programs undertaken in the budgets. Sector wise government spending out of total expenditure can show the priorities and emerging areas of focus. The composition of total expenditure (net of debt repayment, loans, and advances) in the state given in table 3.9 gives the priority areas for government.

Education sector, which also includes art and culture, emerges to be the largest component of government spending. Relative share of education on an average during the period from 2011-

12 to 2018-19 was 16 percent. Interest payment and pensions taken together on an average during the same period constituted about 14 percent of total expenditure. In the social sector, the other major spending items are water supply, sanitation and urban development, social welfare and nutrition and health sector. The relative share of health sector in total expenditure has not changed much, despite showing some spikes in 2014-15 and 2015-16. In economic services, agriculture, rural development and irrigation as a block constituted on an average 21 percent of total expenditure. The other two big spending items in this category are energy and transport. Broadly, infrastructure development that includes water supply and urban development, human development that includes education, health and social welfare, rural sector development, agriculture and irrigation, and provision of electricity and transport services have been the priority areas for the government.

Table 3.9
Relative Share of Sectors in Total Expenditure

(Percent)

Heads	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Interest Payment	8.6	7.5	7.9	7.5	6.9	6.2	6.9	7.4	7.9
Pension	7.2	6.7	7.4	7.3	6.7	6.0	5.8	7.0	6.7
Admin. Services	5.7	5.5	6.0	5.6	5.1	4.4	4.6	4.9	4.8
Other Gen. Serv. (Rev. Exp.)	4.8	4.1	4.2	3.4	3.3	2.4	2.7	2.6	2.7
Local Bodies	5.2	5.5	5.6	4.5	5.1	4.6	4.4	4.5	3.3
Capital Outlay on Police	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.2	0.3
Capital Outlay on Public works	0.2	0.2	0.1	0.1	0.3	0.2	0.2	0.2	0.2
Other Gen. Serv. (Capital Exp.)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Education	16.2	14.8	17.1	17.6	15.3	14.9	15.1	15.9	16.8
Public Health	4.2	4.4	4.3	5.1	4.7	4.0	4.6	4.2	5.3
Water Supply Sanitation Housing & Urban Dev.	4.1	4.8	4.7	4.6	6.7	8.4	12.2	9.5	8.1
Welfare of SC/ST/OBC	3.6	3.6	3.4	2.7	2.9	2.5	2.7	2.3	2.7
Welfare and Nutrition	6.9	6.6	6.6	5.7	9.1	4.5	4.2	4.4	5.8
Other Social Services	0.5	0.6	0.6	0.7	0.6	0.6	0.6	1.4	0.8
Agriculture	8.4	8.5	7.9	9.0	6.5	7.5	7.6	10.2	7.7
Rural Development	6.3	7.0	5.1	8.3	7.3	8.2	5.6	6.2	7.1
Irrigation	6.4	6.7	6.6	5.3	6.0	6.2	5.3	5.5	5.6
Energy	5.0	5.4	4.9	6.4	6.7	11.7	10.7	7.2	8.1

Industry and Minerals	2.0	3.1	2.1	1.5	2.3	3.0	1.4	1.4	1.6
Transport	4.2	4.6	4.7	4.4	3.9	4.0	4.7	4.6	4.1
Science Tech.	0.1	0.1	0.2	0.1	0.2	0.2	0.1	0.1	0.0
General Eco. Services	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.2	0.2

3.5 Debt Management in the State

There are several features of debt management at state level that include ceilings determined by central government, FRBM Act provisions, and conditions recommended by successive central finance commissions. Annual borrowing limit for the state is fixed by the union government, which now is pegged at the fiscal deficit limit prescribed by FRBM Act. The composition of state debt has also undergone changes after the recommendation of FC-XII limiting loans from the Central Government. At the same time the recommendation of the FC-XII helped in reducing average cost of debt and debt burden of the states through debt restructuring formula. The debt restructuring formula was conditioned on states willingness to adopt fiscal rules and abide by the fiscal consolidation path suggested by the Commission. The FC-XIII recommended state wise debt-GSDP ratios, which became part of state FRBM Acts. The fiscal management principles contained in FRBM Act calls upon the state to maintain debt burden at sustainable level.

The FC-XIV in their fiscal roadmap for the states recommended anchoring the fiscal deficit at 3 percent of the GSDP. The states can avail the flexibility to increase this limit by 0.5 percentage points, 0.25 percent separately depending upon conditions prescribed. One of the major conditions was to limit the debt-GSDP ratio to 25 percent in the previous year. Thus, for all effective purposes the benchmark of debt-GSDP ratio was 25 percent. The State remained within this limit. The State availed a higher level of fiscal deficit in 2016-17 and 2017-18 based on this achievement and other prudency conditions recommended by the Commission. The award period of FC-XIV covers 2015-16 to 2019-20 and the recommendations of the FC-XV regarding fiscal consolidation path and debt burden limit is applied on the fiscal year 2020-21 and then from 2021-22 to 2025-26.

The composition of stock of public debt given in Table 3.10 reveals that the share of central government loans to the State has reduced considerably. As compared to its share of about

14.01 per cent in 2011-12, the central loan accounts for 8.95 per cent in 2018-19. In nominal terms, central loans have increased from Rs.11,359 crores in 2011-12 to Rs.17,389 crores during the same period. The internal debt that includes market loans, special securities and NSSF, and loans from financial institutions has increased in nominal terms from Rs.50,011 crores in 2011-12 to Rs. 1,40,009 crores in 2018-19. The relative share of market borrowing has increased from about 61.67 per cent in 2011-12 to 72.05 per cent in 2018-19. The overall borrowing in a year, however, remains within the limit fixed by the Central Government. 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 to 19.00 percent. As the debt-GSDP ratio has stabilized in the state during the post FRBM Act period, the compositional shift to market borrowing reflects the strength of the fiscal situation of the state. The debt-GSDP ratio, however, would change to reflect Covid-19 pandemic induced higher borrowing and the consolidation path suggested by FC-XV.

Table 3.10
Outstanding Liabilities

(Rs. Crore)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public Debt	**61370**	**66577**	**72113**	**82262**	**97386**	**122308**	**138424**	**157398**	**180829**
Internal Debt	50011	54309	59395	69008	83718	108391	123683	140009	159793
Central Govt. Loans	11359	12268	12718	13254	13668	13917	14741	17389	21036
Other Liabilities	**19725**	**22930**	**24051**	**25765**	**29096**	**32830**	**33829**	**36911**	**49743**
Small savings Provident Fund	9355	10191	11137	12098	13121	13932	14322	16577	19034
Reserve Fund	3068	5087	5751	5893	7627	7115	5409	6074	11900
Deposits	7303	7652	7163	7774	8348	11784	14099	14260	18809
Total Liabilities	**81095**	**89507**	**96826**	**108688**	**127806**	**149102**	**172363**	**194309**	**230571**
Debt-GSDP Ratio (%)	**25.7**	**24.7**	**21.3**	**21.3**	**22.5**	**23.2**	**24.4**	**24.0**	**25.4**
				% composition					
Public Debt	**75.68**	**74.38**	**74.48**	**75.69**	**76.20**	**82.03**	**80.31**	**81.00**	**78.43**
Internal Debt	61.67	60.68	61.34	63.49	65.50	72.70	71.76	72.05	69.30
Loans from Central Government	14.01	13.71	13.14	12.19	10.69	9.33	8.55	8.95	9.12
Other Liabilities	**24.32**	**25.62**	**25.52**	**24.31**	**23.28**	**22.46**	**19.69**	**19.00**	**21.57**
Small savings Provident Fund	11.54	11.39	11.50	11.13	10.27	9.34	8.31	8.53	8.26
Reserve Fund	3.78	5.68	5.94	5.42	5.97	4.77	3.14	3.13	5.16
Deposits	9.01	8.55	7.40	7.15	6.53	7.90	8.18	7.34	8.16

Source: Finance Accounts, various issues

The maturity profile of the repayment liabilities pertaining to the internal debt shows that during the period 2017-18 to 2019-20, 5.79 percent of the debt stock will be matured for repayment (Table 3.10). Thus, debt repayment is not going to increase in the short run. During the next five years, i.e., from 2020-21 to 2024-25, another 35.58 percent of the existing debt will be matured. During the next five years, another 46.15 percent of the debt stock will be matured. Beyond 2020-21, repayment liabilities will increase as large portion of loans are going to be matured by 2024-25.

Table 3.11
Maturity Profile of Internal Debt

Financial Year	Total - 6003 Internal Debt (Rs. Crore)
Maturing in and prior to 2019-20	8103.83
Maturing in 2020-21 to 2024-25	49820.5
Maturing in 2025-26 to 2029-30	64608.87
Maturing in 2030-31 to 2034-35	4939.16
Maturing in 2035-36 to 2038-39	1586.17
Details of Maturity year not available	9950.67
Others	1000.00
Total	140009.2
Composition (%)	
Maturing in 2017-18 to 2019-20	5.79
Maturing in 2020-21 to 2024-25	35.58
Maturing in 2025-26 to 2029-30	46.15
Maturing in 2030-31 to 2034-35	3.53
Maturing in 2035-36 to 2038-39	1.13
Details of Maturity year not available	7.11
Others	0.72

Source: Finance Accounts, 2018-19

Guarantees given by the State Government

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 an increase in contingent liability, care should be taken while incurring such liabilities. Justification of public purpose to be served should be the main criterion behind the sovereign commitments. The Government usually puts a limit on guarantees to be given by it as permitted under the Constitution.

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 guaranteed fees. 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. The State Government has constituted a Guarantee Redemption Fund during the year 2005-06. At the end of the year 2018-19, there was a balance of Rs. 4,08,78.50 lakh under Fund and Investment account. The entire amount has been invested in Central Government dated Securities.

Madhya Pradesh State Government Guarantee Rules, 2009 (Amended) controls the process of giving guarantees. As per the Fiscal Responsibility and Budget Management Act 2005, the State Government shall limit the annual incremental Guarantees to ensure that the total guarantees do not exceed 80 per cent of total revenue receipts in the year preceding the current year. The total outstanding guarantees during 2017-18 and 2018-19 were Rs. 30, 751.10 crore and Rs. 30,916.80 crore respectively. They were within the limit of 80 percent of revenue receipts of their respective previous years i.e., 2016-17 (25 percent of Rs. 123306.79 crore) and 2017-18 (23 percent of Rs. 134875.39 crore).

4. Compliance to the Provisions of FRBM Act

> A Act to provide for the responsibility of the State Government to ensure prudence in fiscal management and fiscal stability by progressive elimination of revenue deficit, reduction in fiscal deficit, prudent debt management consistent with fiscal sustainability, greater transparency in fiscal operations of the Government and conduct of fiscal policy in a medium term framework and for matters connected therewith or incidental thereto.
>
> ***Madhya Pradesh Rajkoshiya Uttardayitva Evam Budget Prabandhan Adhiniyam, 2005***

Budgeting in India in general and at the level of states, is rule driven process. The budgeting process involving demand for resources by ministries and departments, control and supervision of finance department, preparation of budget, legislative control over financial management, budget implementation process during the year, reporting of financial transactions, and auditing process are based on established budgeting rules and regulations. However, conventional budgeting is an open-ended process that does not restrict government incur spending based on popular demands beyond its resource capacity resulting in fiscal imbalances. The fiscal rules (in the form of FRBM Act) counters this tendency and facilitates budgeting within fixed constraints in the form of fiscal targets and commitments regarding transparency and political acceptance[25].

FRBM Act facilitates observing fiscal discipline and addresses the biases entrenched in the budgeting process leading to higher spending excess of available resources. The mandatory fiscal targets, accountability clauses, transparency measures and guiding principles for fiscal management are major elements of the Act that helps the government in self-regulation. The targets prescribed under the Act in terms of deficit and level of debt are considered major benchmarks to qualify the fiscal management in the state. The initial phase of FRBM Act focused on achieving the prescribed deficit and debt targets over period of time for which gradual reduction of deficit was targeted in the Act. As the states in India and Madhya Pradesh

[25] Schick, Allen (2003), "The Role of Fiscal Rules in Budgeting", OECD Journal of Budgeting, vol3, no.3

in particular managed to achieve the deficit targets and came out of severe fiscal imbalance, aided by higher transfer of resources, practicing prudency in spending, availing incentives from central finance commission, generating higher revenue due to tax reforms and higher growth, the focus of the Act shifted to sustaining fiscal consolidation process.

The assessment of compliance of the State Government to the FRBM Act provisions for the years 2017-18 and 2018-19 is important to evaluate state's capacity, commitment, and fiscal management practices in pre-Covid period. This is the period, when the states were facing resource problem and fiscal stress was building up. The inherent strength in state's economy, prudency in fiscal management, and commitment to fiscal rule will be crucial factors to come back to fiscal consolidation path. The assessment report in addition to fiscal targets, looks into issues like establishing fiscal transparency, medium term framework for budget management, improving budget predictability, and improving institutional measures. These are crucial features of a sound public financial management system and are part of building blocks of FRBM Act.

4.1 Major Features of the FRBM Act

The FRBM Act adopted in 2005 continues to provide the basic structure and defines the broad principles of rule based fiscal management. The State has undertaken amendments to the Act from time to time to reflect the recommendations of the central finance commissions relating to fiscal deficit and debt targets. While the initial FRBM Act contained the gradual reduction of deficit and debt conforming to FC-XII fiscal consolidation path, the government brought amendments to include the recommendations of FC-XIII to reflect the fiscal deficit and annual debt targets. The State Government amended the Act following the prescribed fiscal consolidation path of FC-XIV regarding the flexibility in fiscal deficit and associated prudency conditions. The Act was also amended in 2017 to exclude the borrowing under UDAY scheme from the normal net borrowing limit fixed for the State for FRBM compliance purpose.

The basic features of Madhya Pradesh FRBM Act are as follows:

i. Present Medium Term Fiscal Statements including the macro-economic framework statement, medium term fiscal policy statement (MTFP), and the fiscal policy strategy statement.
ii. Undertake appropriate policy measures reflecting fiscal management principles indicated in the Act to achieve the targets.
iii. Achieve fiscal targets relating to deficit, stock of debt, and guarantees given by the government.
iv. Take suitable measures to ensure greater transparency in the fiscal operation.
v. Take measures to enforce compliance.

The rules associated with the Act further detail the requirements, documents to be prepared, and the quantitative limits of the fiscal indicators. The rules provide the form in which the medium-term fiscal statements are presented to provide relevant information about Government’s activities and enhance transparency.

- **The Macro-economic Statement:** It is expected to give an overview of the state economy, analysis of GSDP growth, overview of state government finances and assessment regarding growth prospects and fiscal prospects.
- **Medium Term Fiscal Policy Statement:** The Medium-Term Fiscal Policy (MTFP) forms the core of the FRBM Act related documents. This statement gives three-year outward projection of fiscal outcomes like revenue deficit, fiscal deficit, and outstanding liabilities as percentage to the GSDP in addition to the revised estimates of current year and budget estimates of the ensuing year. The Madhya Pradesh fiscal rules differ from many other states due to a longer projection period of three years beyond the budget year. The statement is supposed to include assumptions relating to the trend of fiscal variables leading to the projection of major fiscal outcomes. The MTFP gives assessment regarding the balance between revenue receipts and revenue expenditure and use of capital receipts for generating productive assets. Thus, the MTFP contains a fiscal plan of the state government for the ensuing budget year and three outward years.

- **The Fiscal Policy Strategy Statement**:

a) The fiscal policy strategy statement contains the fiscal stance of the state government with respect to fiscal targets for the ensuing year, revenue generation efforts, expenditure plan and consequent borrowing requirements.

b) The strategic priorities of the government;

c) The reasons for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administered pricing and borrowings;

d) An evaluation of the current policies of the Government based on fiscal objectives and fiscal principles enunciated in the Act.

- **Disclosures:**

The FRBM Act stipulates the governments to provide data and information on fiscal variables and outcomes of fiscal transactions. These are called disclosure statements and rules to the Act specifies the format in which this information is to be given. The wide range data and information given in FRBM document is expected to enhance transparency in the system and help the policy makers to take informed decisions. The disclosures include the following statements;

1. A statement of select indicators of fiscal situation
2. A statement on components of State Government liabilities and interest cost of borrowings/mobilization of deposits
3. A statement on the Consolidated Sinking Fundi
4. A statement on guarantees given by the Government
5. A statement on the Guarantee Redemption Fund
6. A statement of financial assets
7. A statement on claims and commitments made by the State Government on revenue demands raised but not realized
8. A statement on the details of number of employees in the State Government, State Public Sector Undertakings and State aided institution and related salaries

- **Fiscal Targets**

The fiscal targets for the Government of Madhya Pradesh, as per the FRBM Act, are the following;

1. **Revenue Deficit:** The Act when adopted in 2005 had the target to eliminate revenue deficit by 2008-09 and generate surplus after that.

2. **Fiscal Deficit:** The initial target was to reduce the fiscal deficit to 3 percent of GSDP by 2008-09. The state amended the Act (2015) following the recommendations of FC-XIV to avail the flexibility to increase fiscal deficit to 3.5 percent.
3. **Debt-GSDP Ratio:** The State Government amended the FRBM Act in 2012 to include annual debt-GSDP as per the recommendations of the 13th FC. According to that amendment, the debt-GSDP ratio was to be limited to 35.3 percent in 2014-15, the last year of the 13th FC award period. The 14th FC, however, has not given any specific debt-GSDP ratio in their recommendations. While allowing the States the flexibility of increasing their fiscal deficit by 0.5 percent of GSDP, the Commission put a condition of achieving debt-GSDP ratio at less than or equal to 25 percent in the preceding year. The state FRBM Act amended in 2015 kept 25 percent as the limit. The assessment report takes this limit as the debt-GSDP target for the state.
4. **Guarantee limit:** The State has to limit the annual increment guarantees so as to ensure that the total guarantees do not exceed 80 percent of the total revenue receipt in the year preceding the current year.

The FRBM related documents, particularly the MTFP and the fiscal policy strategy statements, are expected to give a perspective on the impact of the policies included in the budget in the medium term. These statements satisfy the requirements of the FRBM Act and contain useful information relating to fiscal outturns. The MTFP provides a platform to articulate the fiscal policy objectives and fiscal constraints in quantitative and qualitative terms and forms the basis to assess the fiscal impact of the budget provisions. There is considerable scope to develop the MTFP into a meaningful budgeting document which will become helpful not only in disseminating government's fiscal policy stance but also become helpful in decision making process.

4.2 Compliance of the State Government to the FRBM Act Targets: 2017-18 & 2018-19

Although the revenue growth was subdued, the control overgrowth of the spending created a favorable situation for the observance of the fiscal rules. The Government of Madhya Pradesh remained within the contours of fiscal prudence as detailed by the provisions of the FRBM Act during 2017-18 and 2018-19. In addition to fiscal targets and disclosing routine information, the Act also provides overarching fiscal policy objectives and principles that the State needs to follow. Post FRBM Act, the State Government adhered to the fiscal targets and other requirements of disclosing information in specified formats. The State Government placed the statements like macroeconomic statement, medium term fiscal policy statements, fiscal strategy statement, and disclosers in specified formats along with the budget. The compliance record of the State Government to the FRBM targets is given in table 4.1 – A, B, and C.

Table 4.1 (A)
Presentation of FRBM Documents along with Budget

FRBM Documents	Compliance
The Macro-economic Framework Statement	The Macroeconomic Framework Statement as required under Section 6 in Form F-1 was presented along with FRBM documents. It contains; a) Overview of the State economy b) GSDP Growth c) Overview of State Government Finances and prospects
Medium Term Fiscal Policy Statement	The Medium Term Fiscal Policy Statement, as required under sub-section (1) of section 7 in Form F-2 was presented with five year rolling targets in respect of the following variables; a) Revenue deficit as a percentage of GSDP b) Fiscal deficit as a percentage of GSDP c) Outstanding total liabilities as a percentage of GSDP
The Fiscal Policy Strategy Statement	The Fiscal Policy Strategy Statement as required under Section 8 in Form F-3 was submitted along with FRBM documents

Table 4.1 (B)
FRBM Act Provisions and Compliance

	2017-18		2018-19	
	Target	**Achievement**	**Target**	**Achievement**
Revenue deficit(-) /surplus(+) % of GSDP	Surplus	0.65	Surplus	1.09
Fiscal deficit % of GSDP	-3.5	-3.22	-3.5	-2.93
Total debt stock % of GSDP	25	24.38	25	24.01
Total Guarantee limits (80% total revenue receipt in the year preceding current year- Crores of Rs).	98645.43	30751.1	107900.3	30916.8

Table 4.1 (C)
Disclosure of Information and Compliance – 2017-18 and 2018-19

Disclosure Statements	**Compliance**
1. A statement of select indicators of fiscal situation	Select fiscal indicators like deficit, debt stock, revenue receipts, committed liabilities were presented in Form F-4 for 2017-18 and 2018-19
2. A statement on components of State Government liabilities and interest cost of borrowings/mobilization of deposits	In Form F- 5 following information were presented for 2017-18 and 2018-19; (A) Components of liabilities for previous year, current year and ensuing budget year (B) Weighted Average Interest Rates on State Government Liabilities for previous year and current year. (C) Details of Special Ways & Means Advance / Ways & Means Advance Overdraft availed by the State Government from Reserve Bank of India
3. A statement on the Consolidated Sinking Fundi	Details of Consolidated Sinking Fund (CSF) was presented in Form F-6
4. A statement on guarantees given by the Government	Details of guarantees given by the state government was presented in form F-7
5. A statement on the Guarantee Redemption Fund	Guarantee Redemption Fund (GRF) details are provided in Form F-8
6. A statement of financial assets	Statement on financial assets was given in Form F-9.

7. A statement on claims and commitments made by the State Government on revenue demands raised but not realized	Revenue raised but not realized for principal taxes and non-taxes was presented in Form f-10.
8. A statement on the details of number of employees in the State Government, State Public Sector Undertakings and State aided institution and related salaries	Following categories of information on employment were provided in Form-11; 1. Employment in State Government 2. Employment in State Public Sector Undertaking Employment in Semi Government Bodies 3. Employment in Universities 4. Employment in Urban Local Bodies 5. Employment in Development Authorities 6. Employment in Rural Local Bodies

4.3 Fiscal Management Objectives and Principles

Madhya Pradesh FRBM Act contains broad fiscal management objectives to be pursued in policy making and taking appropriate measures to achieve the goals.

Fiscal Management Objectives

(a) The state should take appropriate measures to eliminate the revenue deficit and thereafter build up adequate revenue surplus and contain the fiscal deficit at a sustainable level and utilize such surplus for funding capital expenditure;

(b) The state should pursue policies to raise non-tax revenue with due regard to cost recovery and equity.

(c) The state should lay down norms for prioritization of capital expenditure and pursue expenditure policies that would provide impetus for economic growth, poverty reduction and improvement in human welfare.

During the post-FRBM Act period, the State was able to eliminate the revenue deficit and managed to generate surplus in revenue account. The fiscal deficit has remained below the Act stipulated limit of 3 percent and due to availing the flexibility provided by the FC-XIV the deficit exceeded 3 percent while remaining within the limit imposed by the amended Act. Thus, the State has shown commitment and ability to conform to the basic objectives of the fiscal rules. However, the Covid-19 induced fiscal stress has created disruptions since 2019-20 and the fiscal consolidation process in the coming years will depend upon growth revival and flow of central transfers.

The objective of pursuing policies to raise non-tax revenue with due regard to cost recovery and equity is a difficult task in the state finances given the fact that states have expanded public services where cost recovery is not a big factor. The state government also partners with the Union government in several central schemes relating to education, health, housing, and livelihood schemes which are heavily subsidized. Royalties from minerals, interest receipts, dividends, income from forestry, have remained major sources for non-tax revenue with some contribution from social and general services. The trend of non-tax revenue as percentage to GSDP (Table 3.1) shows that it has been declining over the years. Non-tax revenue as percent to GSDP has declined from 2.4 percent in 2011-12 to 1.3 percent in 2017-18 and marginally increased to 1.6 percent in 2018-19. The annual growth rate of non-tax revenue given in figure 3.2 show volatility with large negative growths in several years.

The FRBM Act stipulates the state to lay down norms for prioritization of capital expenditure. Prioritizing capital expenditure in state finances assumes significance due to dominance of revenue expenditure to the extent of 85 percent during 2011-12 to 2018-19. State government has made efforts to improve capital outlay in recent years. As discussed earlier capital outlay as percent to GSDP, which was declining until 2014-15, has revived (Table 3.1) and relative share of capital outlay in total expenditure has increased (Table 3.5). Rise in central transfers after the recommendations of FC-XIV and higher borrowing facilitated this trend. The composition of capital expenditure given in table 3.8 shows that government has prioritized productive economic sector, which includes sectors like irrigation, energy, rural development, and transport. In the social sector education, water supply, sanitation and urban development, and welfare services are the focus areas. The capital expenditure in the state requires an improved public investment management, which is key prerequisite to achieve and sustain growth process and achieve strategic objectives in infrastructure building. A sound public investment management includes economic analysis based on state guidelines, prioritization based on efficient projection selection criteria, costing investment projects over their life cycle, and efficient monitoring cost and physical progress.

The fiscal management objectives stipulated in the FRBM Act calls upon the state to pursue expenditure policies that would provide impetus to economic growth, poverty reduction, and improvement in human welfare. Public financial management literature underlines the fact that fiscal discipline helps government to take decisions that improves prioritization of resource allocation and service delivery. Performance indicators reflecting the achievement of results in line with fiscal management objectives should be part of the budget to establish a link between policy and achievements is challenging.

The composition of total expenditure (net of debt repayment, loans, and advances) analyzed earlier shows that state has been giving emphasis to sectors for human development, infrastructure building and social welfare. 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. While the State has adopted a fiscal policy that prioritizes human development, there is need to improve human development indicators particularly in education and health. From Table 4.2 it is evident that there are several crucial human development indicators that require immediate attention.

Table 4.2
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] (2018) (per 1000 birth)	48	32	43 (2nd highest U.P.)
Maternal Mortality Ratio (MMR) [SRS] (2015-17) *	188	122	229 (Assam)

Malnourished Children (% of underweight children under < 5 years [NFHS 4]-2015-16	42.8	35.7	47.8% (Jharkhand)
Human Development Index (HDI 2019)	0.603	0.645	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 (2017)	2.7	2.2	lowest in Sikkim (1.2)

Fiscal Management Principles and Innovations Undertaken by the State

The objective of including fiscal management principles in the FRBM Act is to influence the policy making to achieve policy majors and facilitate adherence to agreed-upon fiscal strategy The fiscal management principles reflect the necessity of strengthening public financial management system (PFM) and institutional process. The Act includes the following fiscal management principles.

1. Transparency in setting the fiscal policy objectives, the implementation of public policy and the publication of fiscal information so as to enable the public to scrutinize the conduct of fiscal policy and the state of public finances;
2. Stability and predictability in fiscal policy making process;
3. Responsibility in the management of public finances, including integrity in budget formulation;
4. Fairness to ensure that policy decisions of the State Government have due regard to their financial implications on future generations; and
5. Efficiency in the design and implementation of the fiscal policy.

Transparency in public finances leads to comprehensive budgeting and financial information prepared consistently, which is accessible to users. The crucial features of transparency in financial management are comprehensive budget classification, budget documents covering all aspects of financial transactions of the government, minimal revenue sources and spending responsibility outside the budget, less discretionary element in transfers of resources to the state, and timeliness on information on transfers. While the government prepares and maintains the information transparently, it is crucial that there is public access to all the fiscal information.

Stability and predictability in fiscal policy making can be achieved by ensuring predictability in raising revenue and utilizing them as planned in the budget implementation process. The crucial features that shape the ability of the government in achieving stability and predictability are an effective revenue administration and accounting system, meeting the spending plans approved in the budget, and effective internal control system to reduce irregularities help the authorities to achieve the program objectives.

Responsibility and integrity in budget management are broad principles that are inherent in the budgeting system of any government. The budgeting system in India both at Union and state level is based on rules, regulations and are managed through established procedures. However, a realistic budget, which shows the ability of the government to implement agreed upon plans improves trust of people in the government's policies.

Policy decisions having due regard to their financial implications on future generations is linked with the concept of intergenerational equity in public economics which explains that provision of public goods and services should not be financed through excessive borrowing putting burden of repayment on future generation. The fiscal rules give due regard to this concept by stipulating to reduce fiscal deficit and stabilize the debt burden.

Efficiency in the design and implementation of the fiscal policy can be achieved if the fiscal strategy and the budget is prepared by showing due consideration to government fiscal policies, plan and programs for the sectors, and macroeconomic projections.

Public financial management system in India including the budgeting process, accounting system, and auditing process is common to both Union and state governments. The Constitution at high level, the GFR, various statutes, legislations, guidelines, and manuals define the whole PFM process. While the state government may not have the flexibility to change the basic framework and procedural rules and regulation, there is considerable scope to improve the efficiency of PFM institutions. The state of Madhya Pradesh took several initiatives over the years to improve the efficiency of PFM system in general and budget management in particular. These include introduction of outcome budget, efforts to introduce medium term expenditure framework (MTEF) adopting cash management system, computerization of treasury activities and integrated financial management system (IFMS).

Medium term Expenditure Framework (MTEF): Madhya Pradesh is one of the few states in India, which made considerable efforts to introduce MTEF to provide a medium-term perspective to the budget system. While the FRBM Act provided an opportunity to develop medium term perspective in budget making, the projections carried out by states for outward years mostly remained confined to deficit and debt numbers. 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. While the State Government started these initiatives a few years back, it has not succeeded in optimally utilizing it in budgeting process due to uncertainties in revenue receipts. The State Government, instead of building a structured MTEF process, continues to project the expenditure impact of all the Government programs. The MTEF remains as work in progress in the state.

Outcome Budget: Outcome budget at the level of states mirrors the outcome budget adopted by the Union Government in 2005. The objective of the outcome budget is to instill performance orientation in the budgeting system and influence the resource allocation based on the utilization of the performance information of the programs. The outcome budget is a supplementary instrument, which is expected to influence the regular budget. As in the Union government, outcome budget at state level has not helped the process of utilizing the performance information in the program formulation and resource allocation decisions. However, the outcome budget provides an opportunity to improve the performance orientation in the budgeting system, which is crucial at the sub-national level.

Cash Management System: 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.

Treasury Computerization and Establishing Integrated Financial Management and Information System (IFMIS): Treasury computerization and establishing IFMIS system has provided strong basis to the government in getting financial and physical information on implementation of programs, improved payment system and reduction delays and irregularities in financial transactions. 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. The state government also has joined the broad web based PFMS platform provided by the central government to link the state financial information with CAG and RBI.

4.4 Budget Credibility

In a federal country like India, where the state governments bear major functional responsibilities following constitutional provisions spanning over social and economic sectors, a credible budget is crucial to reduce uncertainty and risks in fiscal management. The performance of sub-national governments, in terms of service delivery and achieving policy goals, depends upon the performance of their budget. The ability of the government to provide quality public services, to meet the entitlements of citizens, and to make the information accessible depends upon the implementation of the budget as planned. The FRBM Act in the state calls upon to establish stability and predictability in the fiscal management for which the budget should be formulated in an objective manner with due regard to the general economic outlook and realistic revenue prospects and minimize deviations during the year.

Comparison of actual revenue generated, and expenditure incurred with the original approved budget and the extent of deviation from the projections gives the measure of budget credibility. The deviation as percent to the budget projections over a period of three years is considered as performance indicator to measure budget credibility. The performance indicator is scored following a four-point ordinal scale, A, B, C, D. The scoring broadly follows PEFA methodology and is based on precise criteria established for the performance indicator[26]. While scoring the performance indicators in a block of three years, performance of at least two years is considered to remove any outlier year that may happen due to the influence of extraneous factors.

- As per this methodology, for the aggregate revenue good performance with score of 'A' is given if the actual revenue remains within 97 percent to 106 percent of budgeted revenue. Score 'B' is given if it remains between 94 percent to 112 percent and 'C' is given if it is within 92 percent and 116 percent and a performance less than this gets a score of 'D'. While PEFA methodology prescribes to score the composition as separate dimension of revenue receipts, we have scored all the major components of revenue receipts as broad aggregates.
- In the case of expenditure, a variance of 5 percent from the budget estimates gives a 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 variance above that gets a score of D. Debt repayment is not included in capital expenditure as this is sovereign commitment. To find deviations and scoring, we have considered major components of total expenditure like revenue expenditure and under this general, social and economic services, and capital expenditure as broad expenditure categories to score.

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

[26] PEFA: Framework for Assessing Public Financial Management, 2016, PEFA Secretariat, Washington DC

in projects and schemes that have not gone through the detailed scrutiny of the budget. Governments do adjust their budget during the course of the year by presenting supplementary budgets. However, if budget amendments change the budget projections for various programs considerably 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 influences the spending. Timeliness of reliable information on the allocation from the Central Government for the coming year helps the sub-national Government 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 environmental factors are other reasons for derailment of spending plans.

Assessment of Credibility: Revenue Receipts

Total revenue receipt of state shows low deviation from budget estimates in all three years from 2016-17 to 2018-19 (Table 4.3). It was only in 2018-19, that the actual receipts fell short of projections marginally higher than 3 percent. The score, based on the methodology discussed earlier, is highest at ‘A’ implying a good performance in revenue generation effort. Looking at the major components of total revenue receipts, while the state fared better in central transfers, the deviations from budget estimates in own tax and non-tax revenue are large.

Table 4.3
Revenue Receipts: Deviations and Scoring (Deviation as percentage to BE)

	2016-17	**2017-18**	**2018-19**	**Score**
Total Revenue Receipts	-2.21	-3.00	-3.52	**A**
Own Tax Revenue	-4.96	-10.90	-6.46	**C**
Own Non-Tax Revenue	-20.86	-22.42	21.53	**D**
Central Transfers	2.81	5.01	-4.78	**A**
Tax Devolution	5.47	-0.50	-3.59	**A**
Grants	-1.94	15.81	-7.09	**C**

The relative share of own tax revenue and non-tax revenue constitute about 40 and 10 percent of total revenue receipts respectively. The deviation from budget estimates in the case of own tax revenue was more than 10 percent in 2017-18 and more than 6 percent in 2018-19. As the budget outturn was less than 94 percent of budget estimates at least in two out of three years, the score becomes C, taking aggregate revenue scoring method. The non-tax revenue seems to be highly volatile as compared to the budget estimates. The performance of central transfers, particularly the tax devolution, was favorable to the state, as the deviation from budget estimates has remained low. Despite a higher deviation seen in the case of grants, the overall score for the central transfers was ‘A’ during this block of three years.

Assessment of Credibility: Expenditure

Expenditure outturn at aggregate level shows that the deviation from budget projections was relatively low for total expenditure excluding debt repayments in the year 2017-18 and for the years 2016-17 and 2018-19, it was more w than 5 percent. Thus, a score ‘B’ for total expenditure indicates that the deviation of aggregate expenditure outturns was not large. Following broad classification of expenditure into revenue and capital expenditures, it is evident that the performance of actual revenue expenditure was similar to total expenditure. The revenue expenditure, which constitutes about 84 percent of total expenditure, has clearly influenced the performance of total expenditure as compared to budget estimates. The performance of capital outlay in terms of conforming to budget projections has been favorable as the deviation was low in 2017-18 and 2018-19. Despite a large deviation witnessed in 2016-17, the score for the three-year block is ‘A’. The push for higher public investment gets an impetus if the Government conforms to its budget plans.

Table 4.4
Total Expenditure: Deviations and Scoring (Deviation as percentage to BE)

Deviation from Budget Estimates				
	2016-17	**2017-18**	**2018-19**	**Score**
Total Expenditure	-9.18	-2.88	-7.55	**B**
Revenue Expenditure	-5.76	-3.18	-9.03	**B**
Capital Expenditure	-22.82	-1.59	0.28	**A**

The comparison of actual expenditure with budget projections for a period of three years from 2016-17 to 2018-19 shows that deviation in aggregate revenue was small. Indeed, the better performance of revenue receipt was driven by performance of tax devolution, which remained close to budget projections. The actual total expenditure reflects the good performance of aggregate revenue, as the deviation from projections was relatively small. The performance in capital expenditure, particular in 2017-18 and 2018-19, has been favorable to the state as the deviation from budget projections was marginal. Low variation in revenue receipts and spending in these three years shows the ability of the state to implement the budget as planned.

5. Concluding Remarks

A sound public financial management (PFM) system is crucial for sustainable fiscal position, improvement of allocative efficiency and achieving operational efficiency in service delivery. Fiscal rules provide self-restraint to politicians and executives to observe fiscal discipline, which is foremost factor to improve allocative and operational efficiency in public finance. The independent review of fiscal management assessing state’s compliance to provision of fiscal rules provides an institutional framework to improve accountability and transparency. It facilitates legislative control over financial management of the state government. The State of Madhya Pradesh had adopted independent review feature in the fiscal rules before the FC-XIII recommended for this.

The COVID-19 pandemic has destabilized the public finance in the country resulting in loss of revenue and reduced fund flows to states. The states were allowed to increase borrowing and the FC-XV recommended a gradual fiscal consolidation path starting from 2021-22. Achievement of fiscal consolidation by states will depend on economic growth and availability of resources both through internal effort and central transfers. Strengthening PFM system and adherence to amended FRBM Act targets will be important. The achievements during pre-Covid period, 2017-18 and 2018-19 as covered in this review, will serve as performance indicators to judge the ability and commitment of the state to comply with FRBM Act provisions. The review report in addition to fiscal targets looks into the quality and direction of public spending, fiscal governance, and institutional development. These issues will be crucial while the state addresses the fiscal challenges brought on by the pandemic.

During 2017-18 and 2018-19, the State Government complied with the provisions of FRBM Act that include fiscal targets, presentation of FRBM related documents, and disclosure of information in specified formats. The State Government placed macroeconomic statement, medium term fiscal policy statements, fiscal strategy statement, and disclosure statements in specified formats along with the budget. While own revenue growth was not buoyant, control overgrowth of the spending, and higher tax devolution to the state created a favorable situation for the observance of fiscal rules. The state amended the FRBM Act to increase the fiscal deficit beyond 3 percent following the recommendation of FC-XIV. In 2017-18, the fiscal deficit was 3.17 percent of GSDP and in 2018-19, it declined to 2.7 percent. The Government of Madhya Pradesh remained within the requirements of FRBM Act provisions in these two years. However, outstanding debt as percentage to GSDP despite remaining within 25 percent of GSDP in 2017-18 and 2018-19 as required under the FRBM Act, the increasing trend looks ominous.

In addition to fiscal targets, the Act calls upon the government to achieve a set of fiscal objectives and for that prescribes guiding fiscal principles. These are expected to improve fiscal policy making and strengthen PFM institutions. The objectives include generating surplus in revenue account to create capital assets, raise non-tax revenue giving due regard to cost-recovery and equity, prioritize capital expenditure, and pursue expenditure policies that would provide impetus for economic growth, poverty reduction, and improvement in human welfare. Fiscal management principles encourage the state to achieve transparency, establish stability and predictability in fiscal policy to establish medium term perspective and improve efficiency in policy formulation and implementation.

Judging from the objectives and principles enshrined in the FRBM Act, it is evident that there were many successes and there exist scope to improve in others. While the state made strides over the years, complied with fiscal targets, and took several measures to strengthen institutions, 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, needs to be further improved. The fiscal policy of the state Government in the future needs to be calibrated keeping these areas in consideration.

While compliance with FRBM fiscal targets in 2017-18 and 2018-19 shows the commitment, the fiscal years starting from 2021-22 will test the ability of the Government to adhere to numerical fiscal targets and avoid fiscal stress. Indeed, there was already a pressure on revenue generation when Covid-19 pandemic created more headwinds. The state needs to create fiscal space to address the emerging situation and manage public spending requirements. The state needs to move further from high deficit and debt burden of the pandemic year to the fiscal consolidation path of by the FC-XV. The need to enhance own resource base and prioritize spending pattern to get value for money from the utilization of public resources will be crucial.

Government of Madhya Pradesh needs to strengthen the initiatives already taken over the years to improve the fiscal architecture and governance. The opportunities provided by outcome budget and medium-term expenditure framework (MTEF) should be utilized to improve performance orientation and instill medium term perspective in budgeting system. Post-pandemic fiscal management would require more attention to achieving results by utilizing public resources. The improvement in information base due to deepening of computerization, streamlining spending pattern across the year by utilizing cash management system, and better procurement system will facilitate improving efficiency in budget management and get value for money.

Given the wide-ranging functional responsibilities of the state government, improving performance orientation in budgeting system is crucial as budget is the most important fiscal instrument available to implement policies. A performing state needs its budget to perform. The outcome budget being a supplementary instrument, the outcome indicators included in this should influence the resource allocation in the administrative budget. An effective outcome budget will enhance transparency, accountability and help in taking resource allocation decisions. The commitment to fiscal discipline by complying with FRBM Act targets should lead to giving more attention to the objectives and principles of the Act and achieving results from utilization of public resources.

Madhya Pradesh was one of few states in India, which made efforts to introduce MTEF. While the Union government has introduced MTEF as part of FRBM Act and prepares three-year projection of department wise spending, it has not been pursued by states. MTEF is expected to provide a medium-term perspective of spending requirements and become instrumental in linking plans to budget. 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. The State Government should pursue this important innovation by making it part of the budget system to improve budget implementation in the medium term.

State government has the flexibility to include these budget innovations in the fiscal rules legislation. What is important in this context is to build a consensus among stakeholders and own these in policy making. The independent review of fiscal policy and FRBM Act is an excellent institutional framework within which these reform measures can be assessed. The state government can widen the ambit of the independent review to include assessment of PFM reforms and their working along with compliance to FRBM Act provision. Although it may be difficult to establish direct linkage between reforms and achievements within annual budget horizon, the review can ascertain the changes within a medium term.