Executive summary

Haryana, one of the smaller and richer among the major States of India, experienced high rates of economic growth (6 percent annual) during the period 1980–96. However, industry and services have slowed down in recent years; alongside bottlenecks have emerged in infrastructure sectors, especially in power. The Government of Haryana (GoH) has initiated a significant process of reforming and restructuring the power sector into an efficient and commercially viable sector to lay the basis for future growth and development of the economy. Having embarked upon the path of economic reform, the GoH now faces some important challenges both in the medium term (1998–2003) and in the short term (1998–2000).

KEY CHALLENGES

Medium term challenges

Two key areas, which influence the growth potential of the State economy are power and irrigation. It is imperative for the State to :

- **ensure the success of the power sector reform already initiated**;
- **address the problem of inadequate operation and maintenance in irrigation** : in spite of spending higher than average and/or normatively specified amounts on a recurring basis, the irrigation network of the State continues to be in poor repair, primarily owing to the rising staff costs crowding out allocations to material inputs.

The high growth performance of the State has not translated necessary improvements in the performance in social sectors. The need is for expenditure prioritisation in favour of

- **education and health services** : Haryana is at the bottom of the league in terms of female literacy, infant mortality, fertility, and sex ratio;
- **poverty reduction** : in spite of higher than average growth, poverty has increased in rural areas.

Moving ahead with tax reforms towards a full-fledged VAT – could be easier to implement in Haryana given that inputs are largely tax free, and therefore, there is no basis to fear any revenue loss.

Short term challenges

The upward revision of the salaries following the Fifth Central Pay Commission's recommendations, alongwith the up-front costs of the power sector reform pose a major constraint on the budget, curtailing the government's ability to address the medium term challenges outlined above. While financial commitments to the power sector reform would recede after the first two years, the need is **to find effective and non-distortionary ways to raise additional revenue** in the short run.

DISTURBING TRENDS

Interest payments have risen as a share of State income and revenue, while capital investment by the State has declined sharply. While outstanding debt (at 17 percent of GSDP) and annual fiscal deficit (3.5 percent of GSDP) in Haryana are lower than and no higher than the India average respectively, interest payments have still risen as a share of State revenue, from 10 percent to 19 percent over the past decade. This is mainly the effect of deregulation of interest rates and the consequent rise in the cost of borrowing in the Indian market. The consequence of rising interest payments has been most severe on public investment. Capital expenditures (excluding loans) have declined from over 3 percent of GSDP in 1985–86 to 1.4 percent in 1996–97.

Recurrent expenditures have risen faster than revenue receipts of the State. In the late 1980s, the revenue (or current account) balance turned from positive to negative and has remained negative in most years, since then. This means that the State is using part of its borrowed funds at the rising market driven rates on interest, to finance recurrent expenditures.

Salary and pension payments, which have absorbed about 45 percent of revenues in the recent past, are likely to rise sharply following the latest pay adjustment. This, together with the rising share of interest payment, would imply that **non-wage allocations would remain below the recommended norms.** In other words, with investments and maintenance expenditure being marginalised, the growth prospects of the State could be seriously undermined. A telling case is that of the irrigation sector in Haryana, where actual maintenance activity has suffered a setback in spite of significant levels of expenditure as a result of its neglect in the composition of expenditure.

FINANCING STRATEGY

Tax measures

It is important to avoid enhancement of revenues by further raising the tax rates. On the contrary, there is a need to reduce the rates considerably in the case of stamp and registration fees, alongwith improved administration in order to curb evasion and enhance compliance in reported property values. In the case of sales tax, there is need to immediately reduce the multiplicity of rates, as part of the preparation for moving to VAT over the medium-term. The only tax instrument where a higher rate could be justified is the motor vehicles tax, where the prevailing rate is lower than in many other States.

There is a case for levying additional one percent market fee on the sale of rice in Haryana. Given the scarcity of water in the State and the distortion in the cropping patterns in favour of water-intensive rice cultivation induced by the irrigation subsidy policy, an additional levy on the sale of rice would contribute towards correcting the distortion, alongwith rationalisation of the irrigation subsidy itself which is likely to take longer.

Other tax measures that could be considered for implementation in the short term include:

- introduction of a **profession tax** on non-agricultural workers;
- enhancing **land revenue** and combining it with an agricultural income tax; and
- expanding **entertainment tax** to include video rentals and cable operators.

USER CHARGES

Given the wide range of activities that the government needs to involve itself in, and the implied strains on the budget, as a long-term strategy, the GoH needs to tap the potential of **user fees and charges**, wherever feasible.

- In the irrigation sector, under the *Water Resources Consolidation Project*, the State has imposed upon itself some cost recovery targets. Strengthening the maintenance of the existing canal system can be crucial for achieving these targets.
- Selective cost recovery in higher education and in specialised curative health care where capacity and willingness to pay exist in Haryana. These could be used to provide an element of cross-subsidy in the provision of basic services in education and health.
- **Strengthening local bodies** could facilitate increased transparency, accountability and hence make acceptable the principle of paying for services such as urban drinking water supply and sanitation.

CONCLUSION

The initiative of the GoH in reforming the power and irrigation sectors would be crucial for the State to realise its growth potential. The fruition of these initiatives, by releasing resources, would significantly determine the ability of the State to address the inadequacies in the social sectors. In the short term, however, additional resources could be generated through further tax rationalisation, fuller utilisation of potential in taxing road users, urban property owners and video viewers. Further increase in indirect taxation, however, is not advisable given the resultant negative impact on the efficiency of the economy. Within the divergent strains in the budget, a credible plan for strengthening key social services needs to be laid out: an important step for enhancing human capital formation and hence, long-term economic growth of the State.