



## Fiscal Consolidation: Balancing the Revenue Account could be Challenging for Indian States in 2011-12

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The fiscal health of the State Governments has been placed under added scrutiny in the current fiscal year. This is primarily because the fiscal targets set by the Thirteenth Finance Commission (ThFC) require 19 of the 28 Indian States to eliminate their revenue deficits and curtail their financing gaps<sup>1</sup> to 3% of gross state domestic product (GSDP) in 2011-12.<sup>2</sup> This note discusses the emerging trends, challenges and outlook for the process of fiscal consolidation<sup>3</sup> at the State level in India, focusing on the finances<sup>4</sup> of the State Governments of Andhra Pradesh (AP), Gujarat, Karnataka, Maharashtra, Punjab and Tamil Nadu (TN)—States in which ICRA has rated the debt of a number of Government entities.<sup>5</sup>

The Budgets and Medium Term Fiscal Policy (MTFP) Statements of the States in the ICRA sample broadly indicate that the Budgets for 2011-12 have been prepared keeping in mind the recommendations of the ThFC. ICRA's expectations regarding the health of the finances<sup>6</sup> of Indian States in 2011-12 are as follows:

- Sales tax collections of the State Governments are likely to report moderate growth in 2011-12. The adverse impact of the weakening consumption demand on growth of sales tax revenues is likely to be partly offset by the prevailing elevated price levels.
- Stamps & registrations collections are expected to report tepid growth in 2011-12, particularly in the case of some States that have proposed to reduce the rate of stamp duty on immovable properties.

<sup>1</sup> ICRA defines financing gap as the revenue balance plus capital receipts less capital outlay and net lending.

<sup>2</sup> All the States covered in this note, except Punjab, are required to eliminate their revenue deficit and curtail their financing gap to 3% of GSDP by 2011-12, and maintain the same thereafter.

<sup>3</sup> Please refer ICRA's publications *Thirteenth Finance Commission: Implications of Key Recommendations for State Governments* (August 2010) and *Fiscal Consolidation: Challenges for Indian States* (December 2010) available on ICRA's website [www.icra.in](http://www.icra.in).

<sup>4</sup> For the analysis, the final accounts of the States till 2009-10, the Revised Estimates (RE) for 2010-11, and the Budget Estimates (BE) for 2011-12 as published by the States concerned have been considered.

<sup>5</sup> Refer *Annexure I*.

<sup>6</sup> ICRA adjusts the revenues and expenditures of State Governments. These adjustments include double entries of funds such as interest from departmental commercial undertakings, lottery flows and other offsetting book entries; and notional receipts not matched by cash inflows such as the transfer of funds from the public account to the consolidated fund of the State, and debt waiver on account of the write off of Central loans, etc. In addition, ICRA considers all inflows from sale of land and property as capital inflows and not revenue receipts.

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- Central tax collections are expected to display modest growth in 2011-12, reflecting the adverse impact of high inflation and interest rates on economic growth and profit margins of Corporates, as well as the reduction in the duties on crude oil and petroleum products since June 2011.<sup>7</sup>
- Salaries and pensions are likely to expand considerably following increases in the rate of dearness allowance (DA), reflecting the persistently high inflation rates.
- Interest payments are likely to rise on account of the considerable accumulation of debt in recent years and hardening interest rates.
- Power subsidies are likely to remain elevated given the rising cost of domestic and imported coal and a tight fuel availability situation.
- Food subsidies are likely to rise in some States that have recently reduced the retail price of subsidised grains.
- Given the above, the ability of the State Governments to curtail the growth of committed expenditures is likely to be limited. Accordingly, some States may find it challenging to report revenue surpluses in 2011-12.
- A number of States in the sample are likely to restrict their financing gap to below 3% of GSDP, in line with the target set by the ThFC. Some States may however need to defer or cancel discretionary capital expenditure in order to achieve this target.

## Background

The Revised Estimates (RE) for 2010-11 of all the States in the ICRA sample point to a revival in the pace of growth of revenue receipts, led by improved sales tax collections and Central tax devolution (refer *Table 1*). Four of the States in the ICRA sample (except Karnataka and Maharashtra) forecast a robust sales tax growth in excess of 31% in their RE for 2010-11. Growth of sales tax collections in 2010-11 benefited from the improved economic activity, elevated price levels across a wide range of items, and the cascading effect of the partial rollback of the excise cuts in the Union Budget for 2010-11. Following a robust 27% growth of the tax collections of Gol in 2010-11, the Central taxes devolved to the States are also estimated to have grown considerably. However, the pace of growth varied amongst States based on their *inter se* shares as set by the ThFC, relative to what was in effect previously.

**Table 1: Key Factors that Impacted State Finances in 2010-11**

Central Tax Devolution	State Tax Revenues	Expenditure
Improving economic conditions and partial rollback of excise cuts	Economic recovery and improving consumption growth	Increase in salaries and pensions, led by an increase in the rate of DA
Increase in the overall share of Indian States to 32% of the net proceeds of Central tax collections recommended by the ThFC over the period from 2010-11 to 2014-15, from 30.5% earlier	Revision in rates of value added tax (VAT) on various items	Release of arrears related to the recommendations of the Sixth Central Pay Commission (SCPC) or the State Pay Commissions
Change in <i>inter se</i> share in sharable taxes recommended by the ThFC	Higher prices, particularly of petroleum products	Higher interest burden following heavy market borrowings in 2008-10 and hardening of interest rates
	Cascading effect of rollback in excise rates	
	Improving property market scenario	Elevated power and food subsidies

**Source: Budget Documents, ICRA Research**

The RE for 2010-11 indicate a pickup in the growth of total expenditure (revenue expenditure, capital outlay and net lending) in the case of five of the States in the sample (except Maharashtra) in 2010-11. Among the key factors exerting pressure on revenue expenditure in 2010-11 were higher salary and pension payments, partly on account of a rise in DA reflecting the prevailing inflationary pressures. Rising interest payments and elevated levels of power and food subsidy also exerted pressure on overall revenue expenditure levels of the State Governments. Please see Annexure II for further details.

Three of the six States in the ICRA sample (Gujarat, Punjab and TN) have forecast a growth of capital outlay in excess of 25% in their RE for 2010-11. In contrast, the RE for 2010-11 of AP and Karnataka indicate a contraction in capital outlay relative to 2009-10, led by a decline in the estimated outlay towards irrigation in the case of AP and towards water supply and urban development in the case of Karnataka.

<sup>7</sup> Gol removed the 5% customs duty on crude oil; reduced the customs duty on all petroleum products by 5%; and reduced the excise duty on diesel to Rs. 2 per litre from Rs. 4.60 per litre.

The RE for 2010-11 indicate the following trends with regard to the likely fiscal balances for the States in the ICRA sample:

- An improvement in the revenue balance position of five of the States in the ICRA sample (except for AP). Notwithstanding the anticipated improvement, the levels of the revenue deficits of Gujarat, Maharashtra, Punjab and TN are estimated to have remained large in absolute terms in 2010-11.
- A decline in the revenue surplus of AP, following a sharp growth of revenue expenditure.
- A widening of the financing gap of five States (except for Maharashtra) at an absolute level.
- A curtailment of the financing gap as a proportion of GSDP<sup>8</sup> below 3.5% for all the States in the sample; and below 3.0% in the case of AP and Maharashtra.

**Table 2: Estimated Fiscal Balances in 2010-11, according to Revised Estimates (ICRA Sample, fiscal balances adjusted by ICRA)**

	Revenue Surplus in 2010-11	Improvement in Revenue Balance in 2010-11 relative to 2009-10	Financing Gap as a % of GSDP <sup>8</sup> in 2010-11
AP	Yes	No	2.42%
Gujarat	No	Yes	3.11%
Karnataka	Yes	Yes	3.07%
Maharashtra	No	Yes	2.43%
Punjab	No	Yes	3.14%
TN	No	Yes	3.40%

**Source: Budget Documents, ICRA Research**

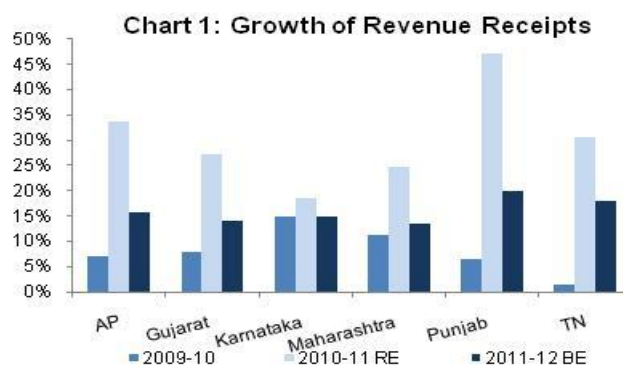
## Budget Estimates published by the States forecast an improvement in fiscal balances in 2011-12

Based on the revised roadmap for fiscal correction recommended by the ThFC, AP, Gujarat, Karnataka, Maharashtra and TN are expected to eliminate their revenue deficits and curtail their financing gap to 3% of GSDP by 2011-12, and maintain the same thereafter. Punjab is expected to eliminate its revenue deficit by 2014-15 and curtail its financing gap to 3% of GSDP by 2013-14, and maintain the same thereafter.<sup>9</sup>

The Budget Estimates (BE) for 2011-12 published by the States in the ICRA sample forecast moderating growth of both revenue expenditure and revenue receipts. Accordingly, a number of the States have forecast improving revenue balances and restriction of the financing gap below 3% of GSDP in 2011-12.

### 2011-12 BE: States forecast a moderation in the pace of growth of revenue receipts in 2011-12 relative to 2010-11

The BE for 2011-12 published by the States in the ICRA sample forecast a moderation in the pace of growth of revenue receipts in the ongoing fiscal year as compared to the RE for 2010-11 (refer *Chart 1*). This is led largely by an anticipated moderation in the growth of States' own tax collections. Additionally, the BE for 2011-12 published by the States forecast a moderation in the pace of growth of Central tax devolution too.



**Source: Budget Documents, ICRA Research**

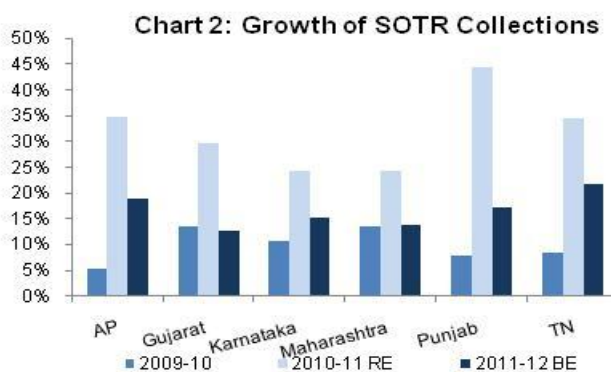
<sup>8</sup> GSDP based on respective State Government's estimate, available in Medium Term Fiscal Policy Statements or other Budget Documents

<sup>9</sup> This is in line with the recommendation made by the ThFC for General Category States that incurred revenue deficits in 2007-08. According to the ThFC, the revenue balances of only Kerala, Punjab and West Bengal reflected a deficit in 2007-08. However, ICRA makes certain adjustments to the reported financials of the State Governments, with such adjustments taking into account factors such as debt waiver received under the debt consolidation and relief facility (DCRF) facility and sale of land. In adjusted terms, the revenue balances of some more States showed a deficit in 2007-08 in ICRA's analysis. The ThFC has also remarked that several States followed the procedure of accounting for the debt write-off under the DCRF facility as non-tax revenue, thereby arriving at lower revenue and fiscal deficit figures and that such accounting policies should be discontinued in future.

**Central Tax Devolution:** Data released by the Controller General of Accounts (CGA) indicates a modest 12.5% expansion of Gol's tax revenues (net of refunds) in April-October 2011, whereas Gol's BE for 2011-12 forecast a 20% growth in Central tax devolution to the States in the current fiscal year.<sup>10</sup> The latter was based on an assumption of 9% real economic growth in fiscal 2011-12. ICRA, however, expects the economy to expand at a lower growth rate of around 7.3%-7.5% in 2011-12.<sup>11</sup> The prevailing high inflation and elevated interest rates are expected to moderate investment and consumption growth. This would reflect in a weakening demand for higher-value purchases, compression of margins of producers in certain sectors and lower growth of non-oil imports in the coming months. Accordingly, ICRA expects various tax revenue streams of the Central Government, namely corporation tax, excise duty and customs duty (as well as sales tax collections of the State Governments) to record a moderate growth in 2011-12.

Gol introduced various changes in the duty structure for crude oil and petroleum products in June 2011. These include a removal of the 5% customs duty on crude oil, a reduction in the customs duty on all petroleum products by 5% and a reduction in the excise duty on diesel to Rs. 2 per litre from Rs. 4.60 per litre in June 2011. These changes are estimated by the Central Government to entail a revenue loss of around Rs. 49,000 crore for the full year. However, the same would be partially offset on account of customs duty collections on petroleum products, which would benefit following the recent rise in international prices of petroleum products and the depreciation of the Indian rupee. Nevertheless, the changes in the duty structure for crude oil and petroleum products would reduce the pool of sharable Central taxes, which would dampen the overall tax devolution to the State Governments relative to the budgeted levels.

**Sales Tax Collections:** The weakening consumption demand is likely to have an adverse impact on the pace of growth of States' sales tax collections in 2011-12. However, this is likely to be partly offset by the increase in retail prices of petroleum products, the consumption of which is expected to be relatively inelastic. Additionally, some States have announced an increase in the rates of VAT for selected items in 2011-12. Nevertheless, in ICRA's view, sales tax collections of the State Governments are likely to expand at a moderate pace in 2011-12.



**Source: Budget Documents, ICRA Research**

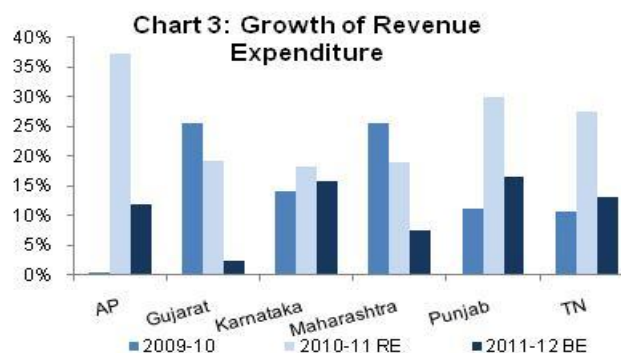
**Stamps & Registrations Collections:** Typically, stamps & registrations collections accounted for 8-18% of the States own tax collections across the States in the ICRA sample during 2007-10. ICRA expects stamps & registrations collections to record a modest growth in 2011-12. In particular, some States have proposed to reduce the rate of stamp duty on immovable properties in 2011-12. This is primarily to align the same with the norms under the Jawaharlal Nehru National Urban Renewal Mission (JNNURM), which requires States to reduce stamp duty to 5% by 2012-13. For instance, AP reduced stamp duty on immovable properties from 7% to 5% in September 2010, whereas Karnataka has proposed a reduction in stamp duty from 6% to 5% in the Budget for 2011-12.

<sup>10</sup> BE for 2011-12 prepared by the State Governments forecast varying growth rates for Central tax devolution, as several State Budgets were presented prior to Gol's Budget for 2011-12

<sup>11</sup> Please refer ICRA's publication *Outlook for the Indian Economy Worsens* (November 2011) available on ICRA's website [www.icra.in](http://www.icra.in).

## 2011-12 BE: States forecast a slower pace of growth of revenue expenditure too in 2011-12

The BE for 2011-12 published by the States in the ICRA sample indicates a slowdown in the pace of revenue expenditure growth relative to the RE for 2010-11 (refer *Chart 3*). The BE for 2011-12 of AP, Karnataka, Punjab and TN have forecast growth rates of 12-17%, while those of Maharashtra and Gujarat have forecast low growth rates of 7.6% and 2.5%, respectively. However, ICRA expects committed expenditure to continue to rise, limiting the ability of the State Governments to restrain revenue expenditure growth in 2011-12.



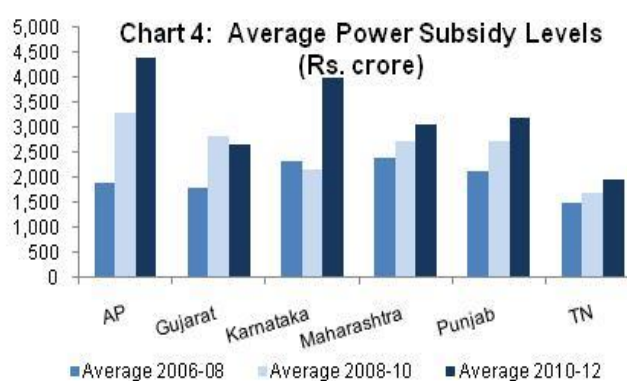
Source: Budget Documents, ICRA Research

**Salaries and Pensions:** Given the prevailing high inflation rates, ICRA expects the rate of DA to be increased, which would enlarge expenditures towards salaries and pensions in 2011-12. The inflation rates related to the Wholesale Price Index (WPI) and the Consumer Price Index (CPI) for Industrial Workers have remained above 8% since January 2010 and July 2008, respectively. Govt enhanced the DA by 6% in March 2011 (with effect from January 2011) and recently by 7% in September 2011 (with effect from July 2011). Accordingly, it is likely that several State Governments would enhance their respective rates of DA as well.

The BE for 2011-12 of AP, Punjab and Karnataka indicate a 15-28% growth of pensions in the ongoing fiscal year relative to 2010-11. However, Maharashtra and TN have forecast a low growth of pension payments for 2011-12 (0.4% and 5.2%, respectively) on account of the base effect.<sup>12</sup> ICRA expects pension payments to remain considerable in the coming years. In addition to payouts for current pensioners, States would need to make defined contributions for new employees hired since the introduction of the New Pension Scheme, which has been adopted by the States in the sample (except for Punjab).

**Interest Payments:** The States in the ICRA sample forecast a 10-25% increase in interest payments in 2011-12 (Budget Estimates) relative to the RE for 2010-11. This reflects the considerable increase in the debt burdens of the State Governments in absolute terms since 2008-09. Additionally, ICRA expects the hardening of the interest rates in India, following the increase in the headline repo rate by 175 bps since April 2011, to have an adverse impact on the interest expenditure of the State Governments.

**Power Subsidies:** Several States provide free and/or subsidised power to various categories of consumers such as agricultural consumers, weavers and domestic consumers. Broadly, the power subsidy levels have risen for the States in the ICRA sample over the recent years (refer *Chart 4*). This trend reflects a higher cost of generation, partly related to rising fuel costs. Additionally, the unit cost of power purchases made from the open market rose sharply in some periods, based on the evolving demand-supply scenario (influenced by factors such as the magnitude of hydel power generation). Nevertheless, ICRA notes that the level of subsidy released by the State Governments



Source: Budget Documents, ICRA Research

may not have been adequate to compensate the State power utilities for their losses from providing free/subsidised power, in the absence of an adequate increase in tariffs. This has resulted in arrears of power subsidy that would need to be released to the utilities. For instance, the Karnataka Electricity Regulatory Commission (KERC) has directed the State Government of Karnataka to release an additional amount of around Rs. 3,500 crore towards power subsidies for the years between 2007-10, largely on

<sup>12</sup> The RE for 2010-11 published by Maharashtra and TN indicate a sharp growth of pension payments of 64% and 40%, respectively, likely to be led by a delay in the calculation and release of arrears to pensioners in 2009-10.

account of additional subsidy allowed by the KERC related to a rise in costs. This would exert pressure on the fiscal balances of the State Government in the coming years. While similar estimates are not yet available for other States, ICRA expects that there could be considerable arrears related to power subsidies in a number of other States as well.

Some States in the ICRA sample (AP, Gujarat, Maharashtra and Punjab) have forecast a small decline in power subsidies in 2011-12 (Budget Estimates) relative to the RE for 2010-11. However, ICRA expects power subsidies to rise in the current fiscal year relative to the BE for 2011-12, given the rising cost of domestic (and imported) coal and tight fuel availability (coal and natural gas).

- **Domestic coal output** has declined by 5% in H1FY12 relative to H1FY11,<sup>13</sup> on account of issues related to regulatory and environmental clearances and heavy rainfall. This has impacted the plant load factor (PLF) for coal-based power plants, which account for nearly 55% of the current installed capacity of power generation in India.<sup>14</sup> Lower generation by the State thermal power plants boosted the demand for, and consequently, the price of power purchased from the open market in the recent months.
- **Domestic output of natural gas** has declined by 8% in H1FY12 relative to H1FY11,<sup>15</sup> largely on account of lower availability from the Krishna-Godavari Basin. This has impacted the PLF of gas-based power plants, which account for nearly 10% of the current installed capacity of power generation in India, according to data released by the CEA. A switch to naphtha to boost the PLF may however increase the cost of generation. Amongst the States in the ICRA sample, gas-based plants form a considerable portion of the installed capacities of Gujarat, AP and Maharashtra.

Overall, in the absence of a considerable policy shift regarding provision of power free or at subsidised rates to some categories of consumers, ICRA expects power subsidies to remain a burden on the fiscal health of States over the medium term. However, the burden may be partially offset in the current year as a favourable monsoon rainfall is likely to dampen power required for irrigation and also boost hydel power generation in some States. Overall, hydel generation accounts for around one-fifth of the current installed capacity of power generation in India.<sup>16</sup> Amongst the States in the ICRA sample, hydel-based plants form more than 20% of the installed capacities of AP, Karnataka and Punjab.

**Food subsidies:** Food subsidies too impose a considerable burden on the fiscal balances of some State Governments such as AP, Karnataka and TN. Expenditure made by these State Governments towards food subsidies has risen considerably since 2007-08. This was partly because of rising minimum support prices (MSP) for rice and wheat and high food inflation. Moreover, a number of State Governments lowered the prices of subsidised grains and increased the entitlements in recent years, resulting in an increase in the level of food subsidies.

States such as AP and Karnataka have estimated lower food subsidy outlay in 2011-12 relative to that in 2010-11. However, ICRA expects the food subsidy burden to increase in the near term, on account of the following factors:

- The increasing trend in the MSP of wheat and rice.
- A likely rise in the prices of pulses, which are provided by some States through the PDS network, given the recent trends in sowing of pulses.
- Further increase in the scope of coverage, or reduction in the price of subsidised items in some States. As against its previous scheme of providing rice at Re. 1 per kg, the State Government of Tamil Nadu announced a scheme in June 2011, under which rice card holders are entitled to rice free of cost through the PDS network.<sup>17</sup> The State Government of Andhra Pradesh recently announced a reduction in the price of rice provided under the subsidised rice scheme to Rs. 1 per kg from Rs. 2 per kg to certain categories of consumers from 1<sup>st</sup> November 2011.

Over the medium term, ICRA expects the food subsidy levels in the various States to rise further, in the absence of improvements in targeting or reductions in the scope of coverage. However, the nature and scope of implementation of the proposed National Food Security Act may reduce the burden of food subsidies on the States, to an extent, by shifting the same to GoI.

<sup>13</sup> According to the data released by the Central Statistics Office (CSO) on the Index of Eight Core Industries

<sup>14</sup> As on 31<sup>st</sup> October 2011, according to data released by the Central Electricity Authority (CEA)

<sup>15</sup> According to the data released by the Central Statistics Office (CSO) on the Index of Eight Core Industries

<sup>16</sup> However, the share of hydel power in total power generated is typically lower in the non-monsoon period. Moreover, the PLF of different units would vary based on the water source.

<sup>17</sup> The entitlements under this scheme are as follows: 4 kg per adult per month and 2 kg per child per month (in all districts except The Nilgris) subject to a minimum of 12 kg and a maximum of 20 kg per card per month. Families falling in the Antyodaya Anna Yojana category are entitled to 35 kg of free rice of cost per month.

While ICRA expects the States to attempt to restrain revenue expenditure in order to balance the revenue account in 2011-12 in line with the fiscal roadmap set by the ThFC, the ability to curtail committed expenditure would be limited. Accordingly, the State Governments would need to display a restraint while introducing new schemes/expanding the scope or entitlements under existing schemes. Additionally, some States may resort to deferring payments to contractors or creditors, because under the cash based accounting system followed by the State Governments, such expenditure would be accounted for in a future period when the transfer of funds takes place.

### 2011-12 BE: A sharp increase in capital outlays expected to take place in 2011-12

All the six States in the sample have forecast a healthy growth in capital outlay in 2011-12 (relative to the RE for 2010-11), led by the irrigation, transport, urban development and rural development sectors. The States of Karnataka, Maharashtra and TN have forecast growth at 15%-19%. Contrastingly, the States of AP, Punjab and Gujarat have forecast a considerably higher growth of 34%-44%, which ICRA expects to be somewhat difficult to achieve.

The capital outlay budgeted by most States in the ICRA sample for the power sector in 2011-12 is relatively low. The outlays are less than Rs. 50 crore for AP and Punjab and between Rs. 600 crore and 900 crore for Gujarat, Karnataka and TN, while Maharashtra has budgeted for an outlay of around Rs. 2,300 crore. Given the large capital expenditure plans of power utilities in several States and their weak financial health, ICRA expects the State Governments to provide continued support to the power sector through equity infusions or provision of fresh loans.

**Table 3: Capital Outlay towards Various Sectors in 2011-12 (% of Total Capital Outlay)**

	Power	Irrigation	Transport
AP	0.2%	77.0%	10.9%
Gujarat	6.2%	32.0%	16.5%
Karnataka	5.9%	41.6%	20.7%
Maharashtra	10.4%	36.8%	13.2%
Punjab	0.0%	21.1%	12.3%
TN	3.8%	11.3%	23.2%

*Source: Budget Documents, ICRA Research*

### 2011-12 BE: Revenue balances expected to improve, financing gap likely to be curtailed below 3% of GSDP for most of the States in the sample

The BE for 2011-12 published by the State Governments forecast the following trends with regard to the likely fiscal balances for the States in the ICRA sample:

- A surplus position on the revenue accounts of AP, Gujarat, Karnataka and Maharashtra in 2011-12, in line with the recommendation of the ThFC.
- A small revenue surplus in unadjusted terms in the case of TN in 2011-12. However, subsequent to the adjustments made by ICRA related to the treatment of debt waiver, the revenue account of TN reflects a small deficit, which is not in line with the recommendation of the ThFC.
- An improvement in the magnitude of the revenue deficit of Punjab in 2011-12 relative to 2010-11, although the size of the revenue deficit is expected to remain considerable at the absolute level.
- A widening of the financing gap of three States (AP, Karnataka and Punjab) at an absolute level.
- A curtailment of the financing gap as a proportion of GSDP<sup>18</sup> below 3.0% for AP, Gujarat, Karnataka, Maharashtra and TN, in line with the recommendation of the ThFC.

**Table 4: Projected Fiscal Balances in 2011-12, according to Budget Estimates (ICRA Sample, fiscal balances adjusted by ICRA)**

	Revenue Surplus in 2011-12	Improvement in Revenue Balance in 2011-12 relative to 2010-11	Financing Gap as a % of GSDP <sup>18</sup> in 2011-12
AP	Yes	Yes	2.95%
Gujarat	Yes	Yes	2.43%
Karnataka	Yes	No	2.87%
Maharashtra	Yes	Yes	1.93%
Punjab	No	Yes	3.45%
TN	No	Yes	2.94%

*Source: Budget Documents, ICRA Research*

<sup>18</sup> GSDP based on respective State Government's estimate, available in Medium Term Fiscal Policy Statements or other Budget Documents

## Outlook

The BE for 2011-12 of AP, Gujarat, Karnataka and Maharashtra broadly indicate that these States would be able to adhere to the fiscal targets of balancing the revenue account and restricting the financing gap to 3% of GSDP in 2011-12. Although some States have put in place measures to augment revenues during the last two years, the moderating macroeconomic outlook is likely to have a considerable bearing on the pace of revenue growth in the near term, while committed expenditures are likely to display a considerable expansion. Accordingly, ICRA is of the view that some States in the sample may find it challenging to report revenue surpluses in 2011-12.

Over the medium term, policy decisions regarding issues related to land acquisition and availability of a land bank, besides other pro-industry policies, would influence the relative pace of industrialisation and economic growth among States. This would largely determine their economic prospects, employment creation, income levels and tax revenues. ICRA expects the proposed switchover to the Goods and Services Tax (GST), a substantive tax reform aimed at subsuming a number of State and Central levies, to have a positive impact on the States' revenue receipts over the medium term; the tax base is expected to widen to include most services, apart from a small negative list. Moreover, losses accruing to the States because of the switch to GST, if any, are expected to be at least partly compensated by Gol in the initial years following the switch to the GST regime.

In light of the observed variability in the growth of revenue receipts in recent years, ICRA expects expenditure control to remain crucial over the medium term for a sustainable structural improvement in the financial health of Indian States and for augmenting the fiscal space available for capital expenditure and infrastructure creation. The State Governments would need to ensure that the composition of additional expenditure is judicious and focuses on restraining growth of committed expenditure. However, this is likely to be a challenging task because of several factors as discussed in this note.

ICRA is particularly concerned about the likely impact of the accumulated losses and rising debt stock of the State power utilities on the fiscal health of the State Governments. Delays in introducing power sector reforms and inadequate increases in power tariffs may necessitate significant financial support from the State Governments to address the weak financial health of the power utilities. Such support may further jeopardise the ability of the State Governments to achieve the fiscal targets of maintaining a balanced revenue account and curtailing the financing gap to 3% of GSDP, set by the ThFC.

## Annexure I

### State Entities Rated by ICRA

The following table is a list of State entities with ICRA-assigned ratings that are currently outstanding for the debt they have raised using guarantees from the State Governments concerned. The ratings reflect the credit quality of the guarantor as well as the integrity of and the extent of adherence to the structured payment mechanism stipulated by ICRA.

Entity	State	Long-Term Rating
Andhra Pradesh Power Finance Corporation Limited	AP	[ICRA]A(SO), [ICRA]A(SO)!
Andhra Pradesh Water Resources Development Corporation	AP	[ICRA]A(SO)
Transmission Corporation of Andhra Pradesh Limited	AP	[ICRA]A(SO)
Karnataka Neeravari Nigam Limited	Karnataka	[ICRA]A+(SO), [ICRA]A+(SO)!
Karnataka State Financial Corporation	Karnataka	[ICRA]A+(SO), [ICRA]A+(SO)!
Karnataka State Industrial Investment & Development Corporation	Karnataka	[ICRA]A+(SO)
Maharashtra Water Conservation Corporation	Maharashtra	[ICRA]BB(SO)
MSEB Residual Board	Maharashtra	[ICRA]B(SO)
Punjab Infrastructure Development Board	Punjab	[ICRA]BBB(SO)
Tamil Nadu Electricity Board	TN	[ICRA]A-(SO), [ICRA]A-(SO)!
Tamil Nadu Generation and Distribution Corporation Limited	TN	[ICRA]A-(SO)!

**Note:** SO: Structured Obligation; !: Conditional Rating; For complete rating definition, please refer to ICRA Website [www.icra.in](http://www.icra.in) or any of the ICRA Rating Publications

**Source:** ICRA Limited

The following table is a list of State entities with ICRA-assigned ratings that are currently outstanding for the debt that they have raised without recourse to State Government guarantees. However, given the strong linkages of these entities with the respective State Governments, the ratings assigned by ICRA to the debt of the State entities are correlated to the credit quality of the State Governments concerned.

Entity	State	Long Term Rating
Andhra Pradesh Central Power Distribution Corporation Limited	AP	[ICRA]A-
Dakshin Gujarat Vij Company Limited	Gujarat	[ICRA]A- (Stable)
Gujarat Energy Transmission Corporation Limited	Gujarat	[ICRA]A- (Stable)
Gujarat State Electricity Corporation Limited	Gujarat	[ICRA]A- (Stable)
Gujarat Urja Vikas Nigam Limited	Gujarat	[ICRA]A- (Stable)
Madhya Gujarat Vij Company Limited	Gujarat	[ICRA]A- (Stable)
Paschim Gujarat Vij Company Limited	Gujarat	[ICRA]A- (Stable)
Uttar Gujarat Vij Company Limited	Gujarat	[ICRA]A- (Stable)
Karnataka Neeravari Nigam Limited	Karnataka	[ICRA]A(SO)
Karnataka Water and Sanitation Pooled Fund	Karnataka	[ICRA]A+(SO)
Karnataka Power Corporation Limited	Karnataka	[ICRA]A- (Stable)
Tamil Nadu Electricity Board	TN	[ICRA]D

**Source:** ICRA Limited

## Annexure II

**Table 5: Proposed Timeline for Release of Pay Commission Benefits (ICRA sample)**

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Karnataka: Fifth State Pay Commission	Revision in Scales, Arrears	Arrears					
AP: Ninth Pay Revision Commission		Interim Arrears	Revision in Scales <sup>19</sup> , Interim Arrears	Revision in Scales <sup>19</sup>			
TN: Sixth Central Pay Commission		Interim Arrears	Revision in Scales, Arrears	Arrears	Arrears		
Maharashtra Sixth Central Pay Commission <sup>20</sup>		Interim Arrears	Revision in Scales, Arrears	Arrears	Arrears	Arrears	Arrears
Gujarat Sixth Central Pay Commission <sup>21</sup>			Revision in Scales, Arrears	Arrears	Arrears	Arrears	Arrears
Punjab: Fifth Punjab Pay Commission <sup>22</sup>			Revision in Scales	Arrears	Arrears	Arrears	Arrears

**Source: Government Budget Documents, ICRA Research**

**Table 6: Trend in Interest Payments (ICRA Sample)**

	Growth in Interest Payments				Percentage of Revenue Expenditure			
	08-09	09-10	RE 10-11	BE 11-12	08-09	09-10	RE 10-11	BE 11-12
AP	6%	11%	14%	12%	14%	15%	13%	13%
Gujarat	5%	9%	11%	13%	20%	18%	16%	18%
Karnataka	1%	15%	6%	25%	11%	11%	10%	11%
Maharashtra	1%	15%	10%	13%	16%	15%	14%	15%
Punjab	8%	2%	10%	19%	23%	22%	18%	19%
TN	-2%	12%	20%	10%	11%	11%	11%	10%

**Source: Government Budget Documents, ICRA Research**

**Table 7: Food Subsidies**

	Food Subsidy (Rs. crore)				Percentage of Revenue Expenditure			
	08-09	09-10	RE 10-11	BE 11-12	08-09	09-10	RE 10-11	BE 11-12
AP	2,437	2,350	3,000	2,500	4%	4%	4%	3%
Gujarat	100	99	118	130	0%	0%	0%	0%
Karnataka	726	1,164	950	850	2%	2%	2%	1%
Maharashtra	352	496	541	247	0%	1%	0%	0%
Punjab	70	0	350	350	0%	0%	1%	1%
TN	2,700	4,020	3,950	4,500	5%	7%	5%	5%

**Source: Government Budget Documents, Reports published by the Comptroller and Auditor General, ICRA Research**

<sup>19</sup> Revised scales were introduced in February 2010; accordingly, the incidence of this revision on revenue expenditure would be substantial in 2010-11

<sup>20</sup> Arrears to be credited into the provident fund accounts of employees in five equal annual instalments from 2009-10 onwards

<sup>21</sup> Arrears to be credited into the provident fund accounts of employees in five equal annual instalments from 2009-10 onwards

<sup>22</sup> Arrears to the pensioners being released in three equal instalments in November of 2010, 2011 and 2012. Arrears to employees being released in three instalments i.e. 40% in May 2011, 30% in May 2012 and 30% in May 2013 according to the Budget Speech for 2011-12

**Table 8: Power Subsidies**

	Power Subsidy (Rs. crore)				Percentage of Revenue Expenditure			
	08-09	09-10	RE 10-11	BE 11-12	08-09	09-10	RE 10-11	BE 11-12
AP	3,385	3,222	4,504	4,300	6%	5%	6%	5%
Gujarat	2,938	2,700	2,662	2,654	8%	6%	5%	4%
Karnataka	1,943	2,341	3,693	4,301	5%	5%	7%	7%
Maharashtra	2,087	3,354	3,131	3,000	3%	4%	3%	2%
Punjab	2,602	2,874	3,376	3,020	12%	12%	11%	9%
TN	1,665	1,697	1,650	2,279	3%	3%	2%	3%

**Source: Government Budget Documents, Reports published by the Comptroller and Auditor General and ICRA Research**



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