

State's Experience with Fiscal Rules – A case of Odisha

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Salient features of Fiscal Rules adopted by Odisha

Items	Type of Fiscal Rule	Odisha FRBM Act, 2005	Odisha FRBM amendment Act, 2011
Revenue Deficit	Budget Balance Rules	Revenue Balance by 2008-09	Revenue Balance to be generated in 2011-12 and to be maintained.
Fiscal Deficit		To be contained within 3% of GSDP by 2008-09	To be contained within 3% of GSDP in 2011-12 and subsequent period.
Debt/GSDP Ratio	Debt Rules		As per recommendation of 13 th FC
Debt Stock/ Total Revenue Receipt		Within 300% by 2007-08	
IP/RR Ratio		Between 18% and 25%	Within 15%
Salary Exp/ SoR Ratio	Exp Rules	Within 80%	

Compliance to FRL

- The State has achieved all the FRL targets well within the time frame
 - The State has been generating Revenue Balance since 2005-06.
 - Fiscal Deficit contained within 3% of GSDP since 2004-05.
 - Debt stock / GSDP ratio has reached 13.41% in 2013-14 from 50.73% in 2002-03
 - Debt Stock/ TRR is brought down to 79% in 2013-14 from 341% in 2001-02
 - IP/RR ratio is 5.9% in 2013-14 from 40.22% in 2001-02
 - Salary/ SoR ratio is 43.55% in 2013-14 from 160.57% in 1999-2000.
- In fact the State has achieved the FRL targets much before the timeline and is maintaining within the target.

Sectoral FRL corrections in Odisha

Item	2000-2005	2005-14	Change	2013-14
Own Revenue	6.56%	8.19%	1.63%	8.76%
Central Transfers	8.01%	8.90%	0.90%	8.21%
Total Revenue	14.56%	17.09%	2.53%	16.97%
Total Expenditure	20.27%	17.58%	-2.69%	18.78%
NPRE	15.25%	11.62%	-3.63%	10.70%
Salary Expenditure	6.57%	4.63%	-1.94%	3.82%
Plan Expenditure	4.92%	5.79%	0.87%	7.99%
Capital Outlay	1.61%	2.09%	0.48%	2.69%
Balance before T&I	-8.89%	-7.33%	1.56%	-9.02%
Revenue Deficit	-3.03%	1.89%	4.93%	1.15%
Fiscal Deficit	-5.37%	-0.21%	5.16%	-1.61%
Debt Stock	46.45%	24.59%	-21.87%	13.41%
IP/RR Ratio	33.19%	12.17%	-21.03%	5.90%
Growth of GSDP	5.73%	7.47%	1.74%	5.60%

Impact of FRL in Odisha

- Total Public Expenditure contracted
- NPRE Contracted
- Wage Bill contained
- Debt servicing cost has come down substantially
- Lower level of borrowing - Debt stock went down sharply.
- Plan expenditure increased
- Capital Outlay increased
- Developmental expenditure as % of total expenditure increased from 51% in 2004-05 to 73% in 2013-14.
- Increased share of own resource in Plan financing.
- Economic Growth – had accelerated, but has declined in recent years due to the impact of Global recession.

Contribution in Fiscal Correction

Sl. No.	Item	Correction	Contribution
1.	Total Revenue Receipt	2.53%	49.03%
1a	Own Revenue	1.63%	31.59%
1b	Central Transfers	0.90%	17.44%
2.	Total Expenditure	-2.69%	52.13%
2a	Revenue Account	-3.17%	61.43%
	i. NPRE	-3.63%	70.35%
	ii. Plan Revenue Expenditure	0.46%	-8.91%
	iii. Salary Expenditure	-1.94%	37.60%
2b	Capital Outlay	0.48%	-9.30%
3	Non-debt Capital Receipt	-0.06%	-1.16%
4 (1+2+3)	Fiscal Deficit	5.16%	100.00%

Observation on working of FRL

- Achievement of FRL targets were linked to a number of incentives/ grants recommended by Finance Commissions.
- In fact this was the motivating factor for the sub-national Governments for adopting Fiscal Rules.
- There is no doubt that the FRL has helped most of the States to achieve stability the Finances, improving quality of public expenditure, achieving debt sustainability, lesser dependence on borrowing etc.
- However, not all achievements are attributable to FRL only.

Takeouts from experience with FRL

Positives

- Has stabilized State Finances
- Has helped in containing unproductive expenditure
- Debt sustainability achieved
- Higher own resources are available for development expenditure and Capital spending.
- Quality of Public Expenditure has improved.

Need Deliberation

- Total Public expenditure contracted.
- No provision in FRL for adjustment for economic cycles
- Even if a State is much below the prescribed level of debt stock, they are not allowed to borrow beyond FRL limits.
- Larger part of the post FRL period witnessed economic boom resulting in larger resource flow. But with the existing form of FRL, it was not possible to create a reserve fund for financing higher investment for the current economic down-turn.
- Though a consolidated sinking fund is in place for amortization of public debt, it can not be utilized beyond FRBM limits.

What should be next generation Fiscal Rules

- There is need for a cyclically adjustable Fiscal Rule.
- Need for creation of a “Reserve Fund” something like “Budget Stabilization Fund” to which savings in the boom period should be transferred for utilization at the recession.
- Though transfer to the fund is a revenue expenditure, it should be allowed over and above FRL limits.
- A mechanism should be developed to reasonably estimate the output gap and output elasticity of the budget.

**NEED FOR CREATION OF STABILIZATION FUND-
A CASE OF MINING SECTOR IN ODISHA**

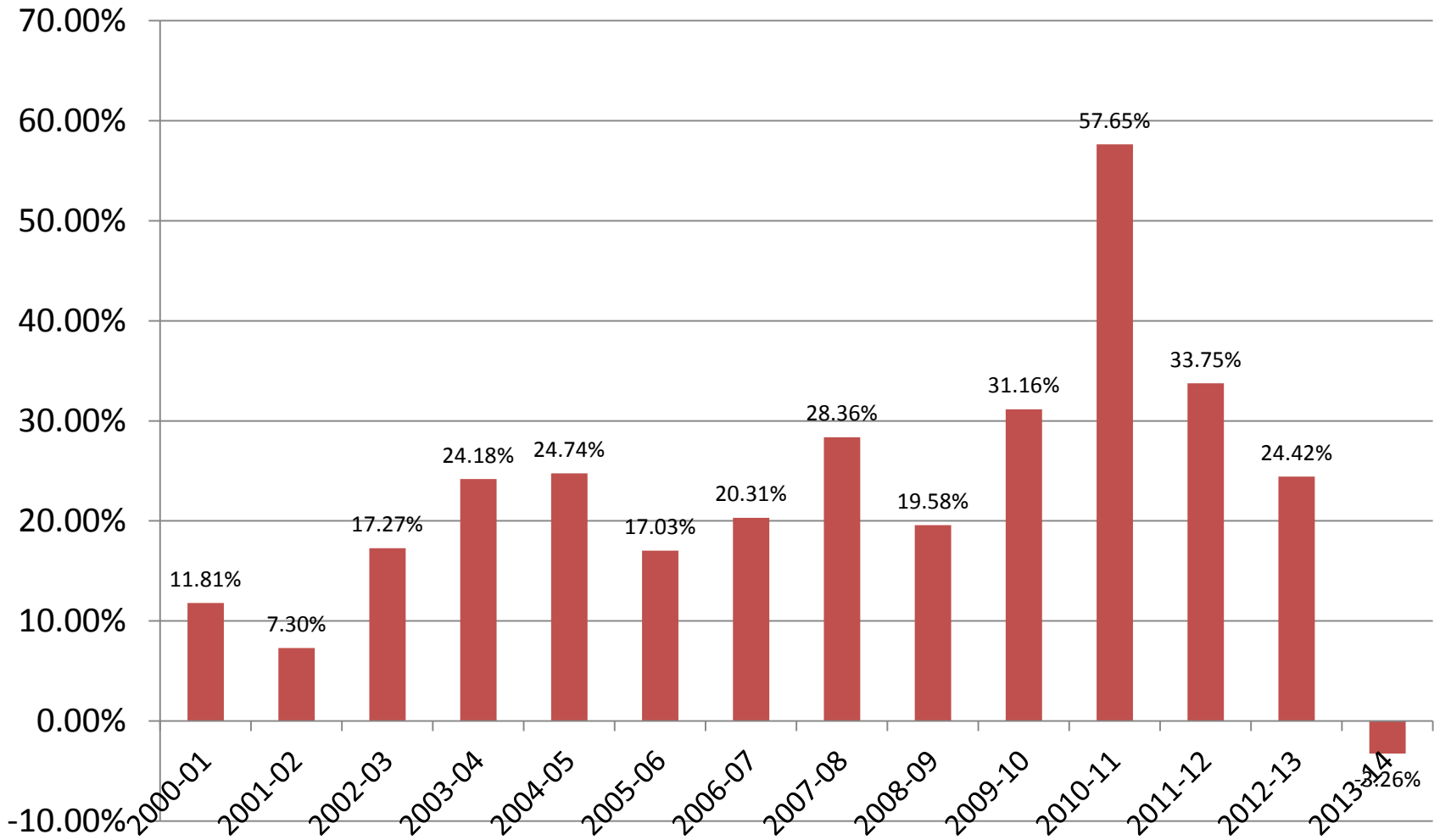
Mining sector in Odisha

- Mining & Querying plays an important role in the State's economy with contribution of about 10%.
- Revenue from the source is received in the form of Mining Royalty, VAT on Minerals and MV tax from the vehicles used for transportation of Minerals.
- During the post FRL period, mining sector has witnessed a major boom with average growth of the sector (nominal) at about 20% and revenue growing at annual rate of about 29% between 2005-06 and 2012-13.
- Higher growth in mining revenue is partly due to revision in royalty on non-ferrous ores in 2007-08 and Iron Ore in 2009-10.
- Even if its impact is taken out, the annual average growth is more than 20%.

Mining Revenue in Odisha (Rs. in crore)

Year	Mining Royalty	Commercial Taxes on Mines	MV Tax related to Mining	Total Revenue from Mining	Growth
2000-01	342.49	95.25	44.54	482.29	11.81%
2001-02	356.71	106.68	54.09	517.48	7.30%
2002-03	417.35	125.16	64.34	606.85	17.27%
2003-04	519.58	163.97	70.01	753.56	24.18%
2004-05	619.07	236.41	84.53	940.01	24.74%
2005-06	716.75	281.83	101.47	1100.04	17.03%
2006-07	836.77	380.09	106.64	1323.50	20.31%
2007-08	1126.09	457.91	114.86	1698.86	28.36%
2008-09	1380.59	519.77	131.11	2031.47	19.58%
2009-10	2020.72	491.00	152.81	2664.53	31.16%
2010-11	3330.47	688.19	181.90	4200.56	57.65%
2011-12	4571.54	849.83	197.00	5618.37	33.75%
2012-13	5695.70	1108.19	186.55	6990.43	24.42%
2013-14	5518.77	1028.97	214.75	6762.49	-3.26%

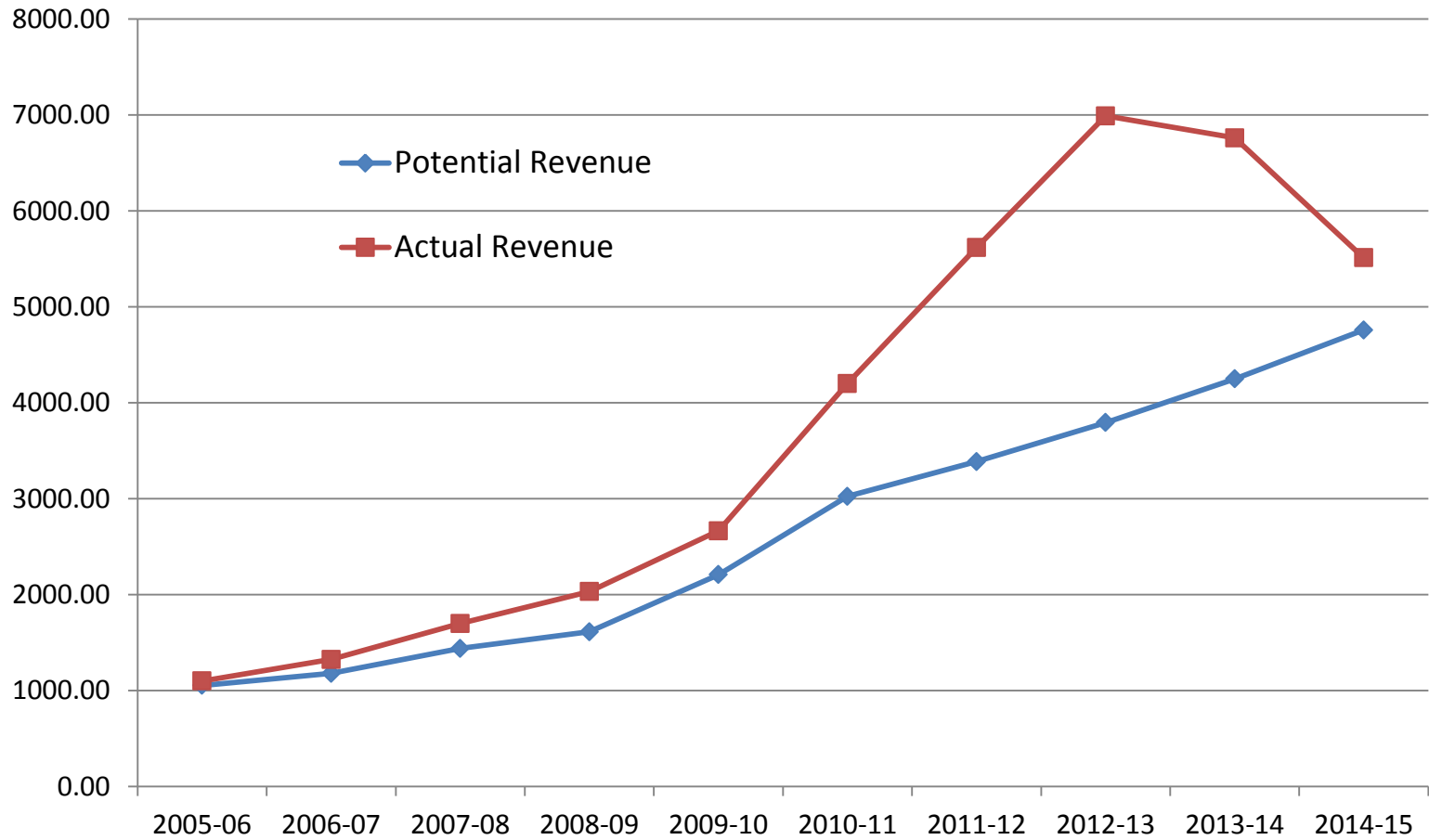
Growth in Mining Revenue



Assumptions:

- Potential nominal growth of Mining Revenue is taken at average nominal growth of GSDP (about 12%) in years not having revision of royalty.
- In years having royalty revision, impact of revision has been factored in.

Potential and Actual Mining Revenue



Likely size of Natural Resources Reserve Fund for Odisha (Rs. in crore)

Year	Actual Mining Revenue	Growth Rate	Potential Growth Rate	Potential Mining Revenue	Savings for Natural Resources Fund
2005-06	1100.04	17.03%	12.00%	1052.81	47.24
2006-07	1323.50	20.31%	12.00%	1179.14	144.35
2007-08	1698.86	28.36%	22.00%*	1438.55	260.30
2008-09	2031.47	19.58%	12.00%	1611.18	420.29
2009-10	2664.53	31.16%	37.00%**	2207.32	457.21
2010-11	4200.56	57.65%	37.00%**	3024.03	1176.53
2011-12	5618.37	33.75%	12.00%	3386.91	2231.46
2012-13	6990.43	24.42%	12.00%	3793.34	3197.10
2013-14	6762.66	-3.26%	12.00%	4248.54	2514.12
Total					10448.59

* Impact of Revision (2007-08) of Non-Ferrous Ores is factored in.

** Impact of Revision (200-10) of Iron Ores is factored in.

Impact of Adjusted Mining Revenue on other Fiscal parameters

Year	Excess/ less revenue as % of GSDP	Actual Revenue Deficit	Adjusted Revenue Deficit	Actual Fiscal Deficit	Adjusted Fiscal Deficit
2005-06	0.06%	0.57%	0.51%	-0.32%	-0.38%
2006-07	0.14%	2.22%	2.08%	0.81%	0.67%
2007-08	0.20%	3.28%	3.08%	1.02%	0.82%
2008-09	0.28%	2.30%	2.02%	-0.39%	-0.68%
2009-10	0.28%	0.70%	0.42%	-1.39%	-1.67%
2010-11	0.60%	1.98%	1.38%	-0.33%	-0.93%
2011-12	1.04%	2.61%	1.57%	0.29%	-0.75%
2012-13	1.25%	2.23%	0.98%	0.00%	-1.25%
2013-14	0.87%	1.15%	0.28%	-1.61%	-2.48%

Observations:

- Mining Revenue is showing negative trend since last year.
- Had a stabilization fund been created, the size of the fund would have been more than Rs.10,000 crore (about 3% of GSDP) only on account of surplus in mining revenue.
- It could have been created even without affecting the FRL targets of deficit indicators.
- Such reserve could have been used at present for financing the budget to make good the shortfall in mining revenue.
- States having a sizeable revenue from mineral, oil etc. which is highly volatile would definitely need such an arrangement to encounter cyclical effect.

THANK YOU